



REFORMS FOR
A BRIGHTER
FUTURE
TIME TO DECIDE

REFORMS FOR A
BRIGHTER FUTURE:

OVERVIEW AND SUMMARY

Policy Notes: Fundamental Policy Shifts for
Pakistan's Sustainable Economic Development



TIME TO DECIDE:

Pakistan is at a critical decision point. “Muddling through” the current economic crisis, and continuing to avoid urgent, fundamental, and long overdue policy shifts will bring major costs and risks. If the political will for once-in-a-generation changes does not materialize, this crisis could “go to waste”, as many have before. The same old pattern of slow development and recurrent crises would be repeated, as climate and other shocks mount in severity and frequency.

Alternatively, the current crisis could be a turning point, if it leads stakeholders and decision makers to realize that the current model of development has failed, leaving a large proportion of the population behind.

At this critical juncture, and as a long-standing partner of Pakistan, the World Bank has a responsibility to recommend a set of fundamental policy shifts that we believe are required to durably change Pakistan’s development course. These policy notes outline required policy shifts and are intended to steer debate and build consensus around the urgent adoption of a new development framework. Recommended policy shifts would require those who have gained from the status quo to give up undue benefits, through eliminating distortions that favor a minority while muting broad-based growth, and mobilizing resources from the wealthy to finance much needed expansions of basic services for those most deprived (including education, health, and access to water). These changes would ultimately benefit all, leading to faster and more sustainable and inclusive growth and development, and allowing Pakistan to realize its potential to reach upper-middle income status by its centennial in 2047.

The World Bank, December 2023.

Background

Pakistan is at a critical decision point. While there have been recent important examples of reform progress, economic policies over past years and decades have had overall negative impacts on sustainability, productivity, and investment. As Pakistan has fallen behind its peers, progress with poverty reduction has ceased. Human development outcomes remain dire, while the benefits of growth have accrued disproportionately to a narrow elite. Amid continued rapid population growth and a youth bulge, a growing number of young Pakistanis are frustrated by the lack of opportunities, with prospects for young women especially bleak. Pakistan is among the countries most impacted by climate change, and recent events, including the 2022 floods, have highlighted the urgent need for investment in climate resilience. The economy is now, again, sustained by a short-term IMF program, inflation is at record highs, the rupee has depreciated sharply, while foreign exchange reserves remain at uncomfortably low levels. Recent policy measures (including the restoration of exchange rate flexibility, subsidy reforms, and movements towards fiscal constraint) have supported economic stabilization, but the underpinning drivers of Pakistan's economic fragility remain to be addressed.

Many countries, including Indonesia, India, and Vietnam, have taken the opportunities presented by crisis to pursue deep economic reforms, driving step changes in growth and substantial and sustainable improvements in living standards. It is now time for Pakistan to decide whether to maintain the patterns of the past or boldly move towards strong, sustainable, and inclusive growth.

This note presents critical policy shifts required to move beyond the current low equilibrium towards sustainable and inclusive economic development and poverty reduction. As outlined in the table below, Pakistan must move:

1. **From** underfunded, inefficient, and fragmented service delivery and social protection systems **towards** coordinated, efficient, and adequately financed service delivery, targeting the most vulnerable.
2. **From** wasteful and rigid expenditure financed by high levels of debt and a narrow, distortive, and inequitable tax system towards prioritized public investments that support growth and development, financed by a broad-based, efficient, and equitable tax system.
3. **From** a protected, stagnant, and unproductive economy with a large state presence **towards** a dynamic open economy driven by private investment and exports.
4. **From** agriculture sector policy settings that lock farmers into a low-value, low-productivity farming system **towards** a market-driven, productive agricultural system that is resilient to climate change impacts.
5. **From** energy sector policies that drive high energy costs, environmental harms, and unsustainable accumulation of debt **towards** efficient, sustainable, and resilient generation and distribution, based on accurate price signals and strengthened private participation.
6. **From** a public sector that is inefficient, often ineffective, and vulnerable to capture by vested interests **towards** accountable, efficient, and transparent government.

This note summarizes the accompanying series of policy notes. It i) outlines Pakistan's current development challenge; ii) identifies the critical constraints to faster development progress; iii) describes the major policy shifts that would be required to address current constraints; and iv) proposes broad principles to guide implementation of required reforms. These policy shifts, what they should entail, and the potential benefits they would provide are summarized in the following table.

Table 1: Required Policy Shifts

From	To	Through	Potential Gains
Underfunded and inefficient service delivery and social protection systems with fragmented and unclear accountabilities.	Coordinated, efficient, and adequately financed service delivery, targeting the most vulnerable.	Developing and implementing a national strategy for coordinated action to address stunting; progressively increasing budgetary allocations to stunting, health, education, and social protection, as fiscal space becomes available; strengthening support to family planning; increasing the number of schools and quality of teaching; enhancing the efficiency of social protection spending.	<ul style="list-style-type: none"> • 32 percent increase in GDP per capita by 2047 from closing human capital gaps with peers
Wasteful and rigid expenditure financed by high levels of debt and a narrow, distortive, and inequitable tax system.	Prioritized investments that support growth and development financed by a broad-based, efficient, and equitable tax system.	Reducing subsidy spending; realigning federal spending with constitutional mandates; divesting or reforming SOEs; reducing tax expenditures; introducing new excises on harmful products; introducing new taxes on property and agriculture.	<ul style="list-style-type: none"> • 2.1 percent of GDP in savings from expenditure measures • 2 percent of GDP increase in revenues from closing tax expenditures, new excises, and reforms to income tax • 3 percent of GDP increase in revenues from new taxes on land and agriculture
A heavily regulated, protected, stagnant, and unproductive economy with a large state presence.	A dynamic open economy driven by private investment and exports.	Maintaining a flexible, market-based exchange rate; reducing fiscal deficits to increase availability of credit to the private sector; pursuing business regulatory simplification through coordinated federal and provincial processes; reducing the presence of the state in the economy; eliminating the anti-export bias of trade policy through major tariff reform.	<ul style="list-style-type: none"> • US\$88 billion export potential • US\$2.8 billion FDI potential • 7-8% GDP growth by raising investment to 25% of GDP
Agriculture sector policy settings that lock farmers into a low-value, low-productivity farming system.	A market-driven agricultural system supported by public interventions that enable productivity and resilience.	Repurposing public spending from inefficient and inequitable subsidies (including for fertilizer and tube-wells) and price support measures towards investments in core public goods, including agronomic research, animal health, food safety, sanitary and phytosanitary standards, early warning and monitoring systems, and rural infrastructure.	<ul style="list-style-type: none"> • Up to US\$4.9 billion savings from reducing subsidy support to agriculture (Punjab and Sindh)
Energy sector policy settings that drive high energy costs, environmental harms, and unsustainable accumulation of debt.	Efficient, sustainable, and resilient generation and distribution, based on accurate price signals and strengthened private participation.	Maintaining progress with reducing energy subsidies; implementing measures to improve the efficiency of distribution companies and transmission, including through the introduction of private sector participation; moving towards increased use of renewable energy sources over time to reduce generation costs.	<ul style="list-style-type: none"> • 6.5 percent of GDP in avoided economic losses from unreliable electricity • Around US\$2 billion in avoided interest costs from eliminating circular debt
A public sector that is inefficient, often ineffective, and vulnerable to capture by vested interests.	Open, accountable, efficient, and transparent government.	Strengthening institutions for coordination between different levels of government; progressing digitization and e-government; increasing transparency, including through performance standards; reforming public sector recruitment, training, and performance; and progressing the devolution agenda.	

Recurrent macroeconomic instability reflects the unsustainability of the current growth model.

Pakistan's economic growth has not only been slow, but also volatile, with Pakistan experiencing periodic macroeconomic crises. Periods of rapid growth have been driven by high government spending, fueling consumption and imports rather than investment. Private consumption has accounted for around 71 percent of total aggregate demand over the past two decades and most GDP growth. Private investment has averaged only around 11 percent of GDP and been steadily declining (compared to 20-25 percent in India and Bangladesh). Exports have fallen as a share of GDP, from around 16 percent of GDP during the 1990s, to around nine percent today. Periodic balance of payments crises driven by unsustainable fiscal and current account deficits have necessitated subsequent painful contractionary adjustments, slowing growth, reducing certainty, and undermining investment.

Pakistan's current growth model is both harmful to the environment and leaves Pakistanis vulnerable to climate and other shocks.

Pakistan is one of the countries most exposed to the impacts of climate change. Alongside increasing temperatures, Pakistan is experiencing increased climate variability and extreme weather events, including flooding, drought, cyclones, and landslides. The current model of economic development leads to overuse of key natural resources, especially water, while production practices impose major environmental damage including through pollution. Air pollution already shortens the average Pakistani's life expectancy by 4.3 years. The combined risks from the intensification of climate change and environmental degradation, unless addressed, will further aggravate Pakistan's economic fragility and could ultimately reduce annual GDP by 18 to 20 percent per year by 2050. Poor and marginalized communities are likely to bear a disproportionate burden, as they are more heavily exposed to climate risks and have fewer resources with which to mitigate impacts of adapt.

Key constraints

Several interrelated factors underpin Pakistan's inadequate development progress.

First, and above all, Pakistan faces a human capital crisis. Low human capital and weak utilization of available human capital heavily constrains productivity, growth, and development.

Pakistan's human development outcomes lag well behind the rest of South Asia and are roughly equivalent to those in many Sub-Saharan African countries, with the costs disproportionately borne by girls and women. Close to 40 percent of children under the age of five are stunted. Pakistan has the largest number of out-of-school children in the world (20.3 million), including 37 percent of girls and 27 percent of boys, with boys expected to receive 1.4 years more education than girls on average. 79 percent of ten-year-old children are unable to read and understand a short age-appropriate text. Nearly seven percent of children do not survive until their fifth birthday, compared to 0.7 percent in Sri Lanka. Weaknesses in human capital reflect constraints to access and poor quality of services, arising from a range of policy and institutional dysfunctions. Public investment of about 2.5 percent of GDP in education and 0.9 percent on health is much lower than the global average and the average for similar economies. High fertility rates and rapid population growth place additional pressure on services. Along with the obvious human costs, poor human development outcomes impose large economic costs. If Pakistan's human capital outcomes and utilization improved to the level of its peers, per capita GDP growth could almost double (from a projected 18 percent to 32 percent) over the next 25 years.

Second, Pakistan faces large and unsustainable fiscal deficits. Pakistan's fiscal deficit has been persistently large and growing, driving debt to unsustainable levels. High government consumption, often driven by the political cycle, has increased demand for imports, contributing to current account deficits and periodic balance of payments crises. Post-2010 annual average deficits have been significantly larger than the pre-2010 average, and the general government deficit reached a 22-year high at 7.9 percent of GDP at end-FY22. Debt reached 78.0 percent of GDP in FY22, in breach of the fiscal rules stipulated by the Fiscal Responsibility and Debt Limitation Act (FRDLA). While external debt is not high by international standards, upcoming external debt amortizations contribute to current high external financing needs and associated risks, in the context of low exports and depleted foreign exchange reserves. Large domestic financing

financing needs are crowding out private sector lending, with the government absorbing most available credit from the banking sector, leading to high banking sector exposure to the government and associated increases in financial sector risks. Large fiscal deficits reflect weaknesses in expenditure and revenue policies. Expenditures are rigid, with 80 percent of federal expenditure allocated to interest payments, transfers and subsidies, and payments to civil servants, contributing little to equity or growth. Revenues remain low by international standards, with a regressive tax system dependent on indirect taxes and substantial exemptions disproportionately benefiting the better-off.

Third, market distortions deter investment and exports. Pakistan suffers from low productivity and investment because policies distort markets, preventing resources from being allocated to their most efficient use. Inefficiency in social resource allocation is reflected in Pakistan's labor productivity increasing by just 40 percent over the past three decades, compared to 170 percent in Bangladesh, and 330 percent in Vietnam. Critical policy distortions include i) periodic overvaluation of the exchange rate, imposing an implicit tax on exporters while subsidizing imports; ii) protectionist trade policies that increase the relative profitability of selling in the domestic market and discourage exports; iii) tax policies (such as under-taxation of land and agriculture) that encourage investment in low-productivity sectors of the economy; iv) a business regulatory environment that imposes substantial transaction costs on domestic investment and curtails foreign direct investment; v) a large state presence in the economy, with unproductive State-Owned Enterprises (SOEs) operating in commercial sectors and crowding out private activity (federal commercial SOEs had a combined output of 12 percent of GDP and combined assets valued at 48 percent of GDP in fiscal year FY2020); vi) limited capacity of the financial sector to effectively channel savings into private sector investment, due to limited access to finance (only around 21 percent of Pakistanis have a bank account) and high-levels of government borrowing from domestic banks crowding out private borrowing (around 70 percent of total bank lending is to the public sector). Low female labor force participation represents an additional major misallocation of social resources, with fewer than one in four (23 percent) women participating in the labor force (compared with four in five men), with many educated women excluded from employment opportunities.

Fourth, the agriculture sector is unproductive and stagnant. The agri-food sector is critical to the Pakistan economy and employs many of the poor. It accounts for around 23 percent of GDP and employs around 40 percent of the labor force. Government interventions in the agri-food sector include input subsidies (including for water, fertilizer, and electricity), minimum guaranteed prices, and import and export restrictions. These interventions, intended to stimulate staple production and stabilize prices, have proven extremely costly¹ and ineffective while imposing important perverse impacts. They have locked smallholder farmers into a low-value farming system; encouraged resource-intensive and environmentally damaging production practices; and weakened innovation, diversification, and productivity. As a result, agricultural output per worker in Pakistan has grown at around a quarter of the pace of the average for South Asia between 1991 and 2019. Water productivity in Pakistan stands at 130 grams of crop output per cubic meter of water, as compared to 390 grams in India, 800 grams in China and 1,560 in the USA.

Fifth, energy is expensive and unreliable, while mounting energy sector debt contributes to fiscal challenges. In the energy sector, current policies have generated large fiscal and economic costs. Major weaknesses in the current policy framework include continued price subsidies that impose fiscal costs, create economic distortions, and disincentivize energy efficiency; high costs of generation, including due to poor choice of power generation technology, and expensive power purchase contracts signed when risks were very high and needs acute; increasing costs of imported fuels, exacerbated by the depreciation of the Rupee; and large distribution losses, including technical and collection losses of up to 30 percent, arising from inefficiency and mismanagement of state-owned distribution companies. Persistent gaps between the costs of providing power and tariffs charged to consumers continue to impose large fiscal costs, while starving the

¹ Direct and indirect subsidy support to agriculture and irrigation in Punjab and Sindh has accounted for about US\$2.2 and US\$2.7 billion of public spending per year, including tax relief for inputs, import and export subsidies and revenue gap financing

sector of revenues required for maintenance and new investment and fueling the accumulation of arrears and debt (total power sector circular debt is currently estimated at US\$8.95 billion, or four percent of GDP). Economic losses arising from lack of access to reliably electricity for firms and households were estimated at US\$15 billion in 2015.

Finally, Pakistan's public sector is inefficient, often ineffective, and vulnerable to elite capture due to important institutional and governance deficits. Policy decisions are heavily influenced by strong vested interests, including those of military, political, and business leaders (Kaplan, 2013; Husain, 2018; Hasnain 2008; Ahmad 2010). The devolution agenda remains incomplete, posing challenges to efficiency and accountability. The 18th Constitutional Amendment saw a major devolution of service delivery responsibilities to provinces, presenting opportunities for stronger accountability, but federal government continues to deliver many devolved functions, creating overlaps in service delivery, increasing fiscal costs, and blurring accountabilities. Local government appointments and budgets remain controlled by the provincial governments, leaving decision-making centralized in provincial capitals and Islamabad. The structure of government is extremely complex and unwieldy, while the performance of public sector staff is undermined by inadequate recruitment of staff with key skills, weak performance incentives, and the short tenure of staff in many important decision-making roles.

Time to Decide – a Framework for Reform

Pakistan has enormous untapped development potential which must now be realized. Constraints to growth described above can be resolved through bold and decisive policy reform. Previous World Bank analysis has shown that, with the right policies in place, Pakistan could leverage its young and fast-growing working age population, natural resource endowments, and geographical location in a fast-growing region to achieve upper-middle income status by 2047 (after one hundred years of independence). Many other countries have taken the opportunity presented by economic crisis to implement major reforms to successfully drive step-changes in growth. These countries include India and Indonesia in the 1990s and Vietnam in the 1980s. As it faces yet another macroeconomic emergency, it is time for Pakistan to decide between two paths: reform and inclusive growth, or stagnation and recurrent crisis.

Achieving Pakistan's development potential will require major and wide-ranging policy shifts across six key policy areas. Major policy shifts are required to 1) address the human capital crisis; 2) achieve sustainability in public finances; 3) build a competitive and outward-oriented private sector; 4) realize Pakistan's agri-food potential; 5) achieve sustainability in the energy sector; and 6) strengthen institutions for effective reform implementation. The table below outlines the key constraints to Pakistan's development; required policy shifts; and potential gains. The table lists the relevant World Bank discussion notes and additional analytical work providing detailed reform recommendations within each area. The following sections provide a summary of required reorientations in policy.

Table 2: Policy Shift Framework

Constraints	From	To	Potential Gains	Relevant Analytics
An ongoing human capital crisis	Underfunded and inefficient service delivery and social protection systems with fragmented and unclear accountabilities.	Coordinated, efficient, and adequately financed service delivery, targeting the most vulnerable.	<ul style="list-style-type: none"> 32 percent increase in GDP per capital by 2047 from closing human capital gaps with peers 	<ul style="list-style-type: none"> Policy Note: Reducing Child Stunting Policy Note: Improving Learning Outcomes Human Capital Review
Large and unsustainable fiscal deficits	Wasteful and rigid expenditure financed by high levels of debt and a narrow, distortive, and inequitable tax system.	Prioritized investments that support growth and development financed by a broad-based, efficient, and equitable tax system.	<ul style="list-style-type: none"> 2.1 percent of GDP in savings from expenditure measures 2 percent of GDP in revenues from closing tax expenditures, new excises, and reforms to income tax 3 percent of GDP in revenues from new taxes on land and agriculture 	<ul style="list-style-type: none"> Policy Note: Rationalizing Government Expenditures Policy Note: Strengthening Government Revenues Federal Public Expenditure Review
Insufficient productivity, investment, and exports	A heavily regulated, protected, stagnant, and unproductive economy with a large state presence.	A dynamic open economy driven by private investment and exports.	<ul style="list-style-type: none"> US\$88 billion export potential US\$2.8 billion FDI potential 7-8% GDP growth by raising investment to 25% of GDP 	<ul style="list-style-type: none"> Discussion Note: Transforming the Private Sector Country Economic Memorandum Public Expenditure Review Pakistan@100
An unproductive and stagnant agricultural sector	Agriculture sector policy settings that lock farmers into a low-value, low-productivity farming system	A market-driven agricultural system supported by public interventions that enable productivity and resilience	<ul style="list-style-type: none"> Up to US\$4.9 billion savings from reducing subsidy support to agriculture (Punjab and Sindh) 	<ul style="list-style-type: none"> Discussion Note: Unleashing the Agri-Food Sector Country Climate and Development Report Pakistan@100
Unreliable and high-cost energy, with mounting energy sector debt	Energy sector policy settings that drive high energy costs, environmental harms, and unsustainable accumulation of debt	Efficient, sustainable, and resilient generation and distribution, based on accurate price signals and strengthened private participation.	<ul style="list-style-type: none"> 13 percent reduction in generation costs from renewable energy US\$2 billion in savings from energy efficiency US\$13 billion in potential avoided imports 	<ul style="list-style-type: none"> Discussion Note: Achieving Energy Sustainability Country Climate and Development Report
Weaknesses in institutions and governance	A public sector that is inefficient, often ineffective, and vulnerable to capture by vested interests.	Open, accountable, efficient, and transparent government.		<ul style="list-style-type: none"> Discussion Note: Strengthening Institutions for Effective Implementation Pakistan@100

Policy Shift #1: Addressing the human capital crisis

To move from underfunded and inefficient service delivery and social protection systems with fragmented and unclear accountabilities towards coordinated, efficient, and adequately financed service delivery, targeting the most vulnerable, Pakistan must: i) develop and implement a national strategy for coordinated action to address child stunting (Policy Note #1); ii) progressively increase budgetary allocations to health, education, and social protection, as fiscal space becomes available; iii) strengthen support to family planning, including through awareness and education campaigns; iv) increase the number of schools (especially for girls) and female teachers (Policy Note #2); v) ensure teachers have the rights skills and use effective teaching practices (Policy Note #2); vi) enhance the efficiency of social protection spending, enhance coordination between social protection programs, and ensure benefits reach the intended population.

Policy Shift #2: Achieving sustainability in public finances

To move from wasteful and rigid public expenditures towards tightly prioritized public spending that supports growth and development, Pakistan must immediately: i) reduce energy and commodity subsidies (these cost around 1.8 percent of GDP in FY22 for federal government alone and primarily benefited those in the top three deciles of the income distribution); ii) fully implement the Treasury Single Account to reduce the carrying costs of large cash balances in government accounts; iii) impose temporary austerity measures, including through a stringent review of operational costs, development projects, a government-wide hiring freeze (and wage freeze for upper echelons), a halt to vehicle purchases, and limiting allowances for representation, travel, and petrol. Over the medium-term, reforms should be introduced to: i) realign federal recurrent and development spending with constitutional mandates, reducing federal spending on provincial mandates through ministries, agencies, and vertical programs; ii) reduce the fiscal drain of SOEs through discontinuing subsidies, imposing restrictions on SOE loans, selective divestment, increased private participation, and improved governance; and iii) reform pensions including through indexation to inflation subject to a cap, instituting a minimum retirement age to receive benefits and circumscribing dependents eligible for survivorship benefits.

To move from a narrow, distortive, and inequitable tax system towards a system that is broad-based, efficient, and equitable, Pakistan must i) reduce or eliminate costly and often regressive duty and sales tax exemptions; ii) increase excises on socially harmful goods, including tobacco; iii) expand the base for personal income tax by simplifying the structure, merging the schedules for salaried and non-salaried workers, and lowering the tax-free threshold; iv) increase, improve, or implement progressive taxation on property, retail, and agriculture income, particularly at the provincial level; and v) introduce new environmental taxes and user charges, including on carbon emissions or other pollutants.

Policy Shift #3: Building a competitive and outward-oriented private sector

To move from a protected, stagnant, and unproductive economy with a large state presence towards a dynamic open economy driven by private investment and exports, Pakistan must:

- Maintain a market-based exchange rate, aligned with fundamentals.
- Improve firms' access to finance, including through i) reducing the fiscal deficit and reversing government's increasing monopolization of domestic financial sector resources; ii) strengthening insolvency and creditor rights; iii) reforming development finance; and iv) developing capital markets.
- Pursue business regulatory simplification and digitalization through coordinated provincial and federal processes, beginning with revisions to the Investment Act to facilitate new foreign investment.
- Reduce the presence of the state in the economy by i) divesting SOEs operating in purely commercial sectors; ii) improving the governance and financial management of retained SOEs; and iii) divesting other state property and assets that could be effectively managed by the private sector.

- Eliminate the anti-export bias in trade policy by i) developing and implement a long-term tariff rationalization strategy; ii) phasing out regulatory and additional customs duties; and iii) reforming export support schemes to benefit a broader range of new exporting firms.

Policy Shift #4: Realizing Pakistan's agri-food potential

To move from agriculture sector policy settings that lock farmers into a low-value, low-productivity farming system towards a market-driven agricultural system supported by public interventions that enable productivity and resilience, Pakistan must: i) repurpose public spending from inefficient and inequitable subsidies (including for fertilizer and tube-wells) and price support measures towards investments in core public goods, including agronomic research, animal health, food safety, sanitary and phytosanitary standards, early warning and monitoring systems, and rural infrastructure; ii) simplify the policy and regulatory framework at both the federal and provincial government levels to facilitate private investment; iii) support small farmers by facilitating adoption of climate-smart and regenerative agriculture practices, facilitating access to input and output markets, reducing information asymmetries, and rebalancing bargaining power along agri-food value chains; and iv) reform the wheat sector by reallocating resources from the wheat purchase program towards improving seed quality and improving storage and marketing through farmers' organizations.

Policy Shift #5: Achieving sustainability in energy

To move from energy sector policy settings that drive high energy costs, environmental harms, and unsustainable accumulation of debt towards efficient, sustainable, and resilient generation and distribution, based on accurate price signals and strengthened private participation, Pakistan must: i) maintain progress with reducing electricity subsidies including through rapid implementation of required tariff adjustments and avoidance of new subsidy measures and elimination of tube-well subsidies; ii) implement end-user gas tariff reforms to align tariffs with the cost of supply to constrain unsustainable gas demand and reduce mounting gas sector circular debt; iii) implement measures to improve the efficiency of distribution companies, including through the introduction of private sector participation; iv) move towards increased use of renewable energy sources over time, reducing generation costs; and v) support improvements in energy efficiency including through information campaigns and building and product standards.

Policy Shift #6: Strengthening institutions for effective implementation

To move from a public sector that is inefficient, often ineffective, and vulnerable to capture by vested interests towards open, accountable, efficient, and transparent government, Pakistan must: i) revive and strengthen institutions for effective national policy coordination between federal and provincial governments (including the Council of Common Interest and National Economic Council) to ensure policy coherence and effective policy implementation; ii) improve processes for public sector appointment, performance management, and tenure to enhance incentives for delivery; iii) enhance digitalization and e-government to improve efficiency and reduce opportunities for corruption; and iv) increase government transparency through improved availability of information and the establishment of performance targets for key government entities. In parallel, the incomplete devolution agenda should be further progressed to strengthen local-level accountability. A clear vision for effective devolution should be developed and implemented, including through reforms to government financing and structure.

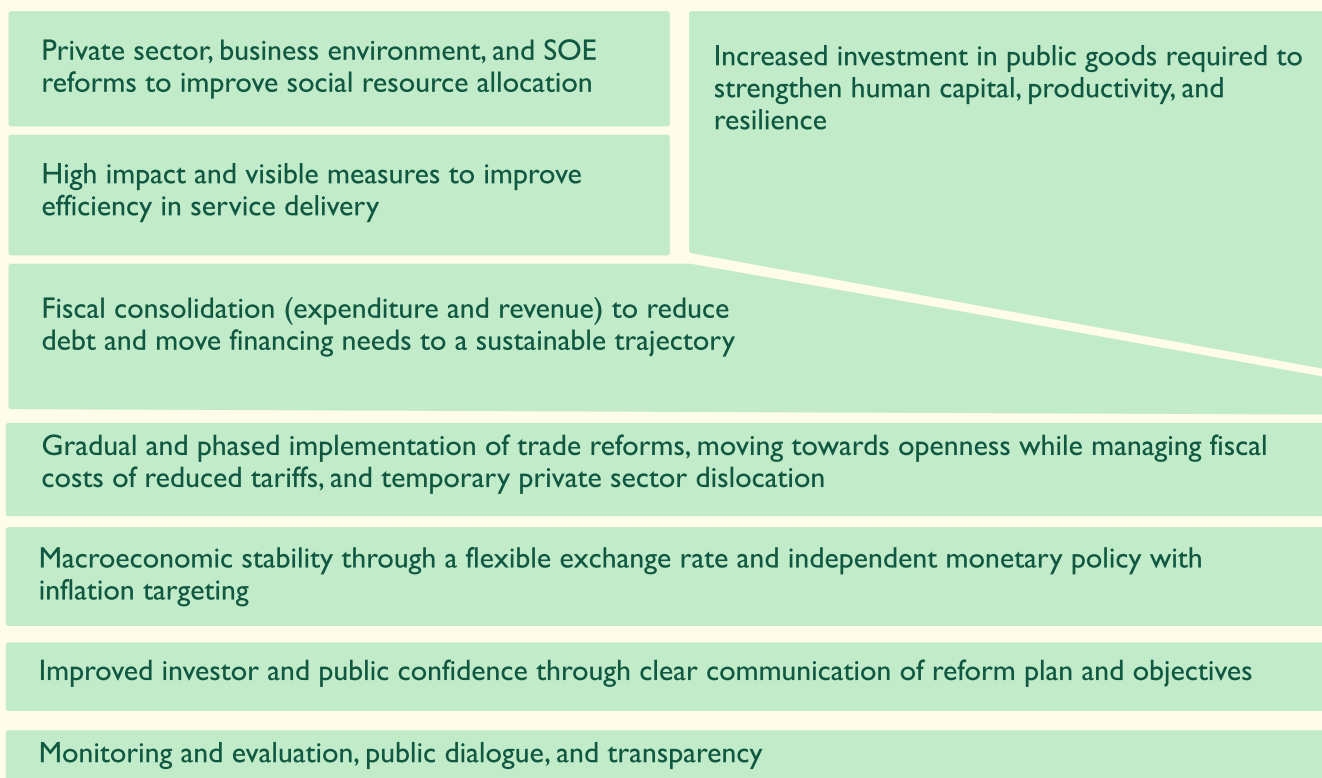
Implementation, Tradeoffs, and Sequencing

Implementation of the reform priorities identified above will present important challenges. The proposed reform agenda is expansive, and full implementation may not be immediately feasible with available administrative capacity and fiscal space. Some proposed reforms involve short-term costs for longer-term benefit, and would therefore be likely to encounter political opposition, including from the public or special interests. Several key issues will need to be taken into account for effective reform implementation.

Phasing and Prioritization

The above reforms would not all need to be implemented immediately. Fiscal pressures and implementation constraints could be managed through a sequenced approach. In the current fiscal context, immediate priorities would include i) maintenance of a sound macroeconomic framework including a flexible exchange rate and maintenance of tight monetary policy; ii) measures to consolidate government spending, including subsidy reforms, austerity measures, and a program for SOE divestment or private participation (including for DISCOs); iii) reforms to improve revenue collections, including closing exemptions and simplifying tax schedules; iv) reforms to restore business confidence, including through immediate steps to ease the business regulatory environment and ease foreign investment; v) decisive but gradual measures to reduce import duties and encourage exports; and vi) increased allocations to the BISP program, along with a cost-sharing plan with the provinces, to support the poor during a period of economic adjustment. With progress towards economic stabilization, debt on a sustainable trajectory, and some recovery of fiscal space, subsequent priorities could include: i) broader increases in allocations to critical social services and for public interventions to enhance female labor force participation; ii) expanded provision of public goods to support key productive sectors, including agriculture, including for enhanced climate resilience; and iii) fiscal and structural reform measures to progress the devolution agenda.

Figure 3: A Framework For Reform Sequencing



Increasing confidence and investment, growth recovery, restoration of fiscal space

Box: Top reforms for the first year of a new government

A new government could immediately progress the following reforms to stabilize the economy, restore confidence, and establish the foundations for improvements in service delivery and governance:

1. Develop and implement a national strategy for coordinated action to address child stunting.
2. Reduce energy and commodity subsidies in the budget (including for fertilizer and tube-wells) and reallocate spending towards critical public goods and increased social protection spending to shield the poor from any negative short-term reform impacts.
3. Impose temporary austerity measures, including through a stringent review of operational costs and development projects, and a government-wide hiring freeze.
4. Divest, restructure, or introduce private participation in the operation of several large SOEs (including energy sector distribution companies) in accordance with the recommendations of recent government analysis.
5. Implement an ambitious package of tax reforms including, reductions in duty and sales tax exemptions, increased excises on socially harmful goods, including tobacco, and new taxes on land and agriculture.
6. Initiate a coordinated federal-provincial process for business regulatory simplification and digitalization with clear targets, beginning with revisions to the Investment Act to facilitate new foreign investment.
7. Develop, publicize, and implement a long-term trade tariff rationalization strategy, including immediate reductions in protectionist tariffs.
8. Implement end-user gas tariff reforms to align tariffs with the cost of supply to constrain unsustainable gas demand and reduce mounting gas sector circular debt.
9. Through a consultative nationwide process led by the Council of Common Interest, develop a clear vision for effective devolution and a roadmap for implementation through reforms to government financing and structure.

Consensus and Communication

Sustaining political momentum will require clear communication regarding the scope, nature, and medium-term objectives of reform. A clear medium-term implementation strategy for economic reform and recovery should be developed and publicly disseminated, ideally with broad political support. This strategy should i) clearly articulate the inevitability of major reforms to escape the current equilibrium of low growth and periodic crisis; ii) explain how short-term economic costs are expected to translate into longer-term economic benefits for much of the population; and iii) bundle reforms that are likely to impose economic hardship on segments of the population with mitigation measures, especially focused on protection of the poor or those vulnerable to falling into poverty. Public engagement sessions should be undertaken to discuss the distributional impacts of reforms, and how the poor will be protected from negative impacts, including through enhanced access to social protection.

Accountability and Transparency

A clear monitoring and evaluation framework should be established against which to measure and monitor the impact of the reform program. This will allow the gains from economic reforms to be measured and communicated. It will also allow for course adjustments in the case of unexpected outcomes or slower-than-expected progress. This should be accompanied by broader measures to improve public sector governance, accountability, and transparency, to build public confidence and ensure responsiveness of policy to public preferences (see Discussion Note 7: Strengthening Institutions for Effective

Implementation). This should include improvements in ex ante assessment of new public expenditure programs and PSDP projects, further improvements in budget and fiscal transparency, and improved public reporting against policy agendas and objectives, supported by enhanced use of digital technologies (including implementation of e-Procurement systems, Citizen Portals, e-Khidmat centers, and similar innovations).

ABOUT THE “REFORMS FOR A BRIGHTER FUTURE” POLICY NOTES:

“Reforms for a Brighter Future” is an initiative of the World Bank, aimed at fostering debate and dialogue on critical economic development policy issues facing Pakistan. Further information is available from the World Bank Pakistan website at <https://www.worldbank.org/en/country/pakistan/brief/reforms-for-a-brighter-future-time-to-decide>. This note was prepared by Tobias Haque (Lead Economist), drawing on inputs from Derek Chen (Senior Economist), Lucy Pan (Senior Economist), Irum Touqeer (Public Sector Specialist), Gonzalo Varela (Lead Economist), Fahad Hasan (Financial Sector Specialist), Amjad Bashir (Senior Operations Officer), Qurat ul Ain Hadi (Financial Management Specialist), Teuta Kacaniku (Senior Energy Sector Specialist), Olivier Durand (Lead Agriculture Specialist), Basharat Saeed (Water Resources Specialist), Ghazala Mansuri (Lead Economist), Izza Farrakh (Senior Education Specialist), Toby Linden (Lead Economist), Jon Jellema (Senior Economist), Christina Wieser (Senior Economist), Moritz Meyer (Senior Economist), Akmal Minallah (Senior Financial Management Specialist), Rafay Khan (Senior Financial Sector Specialist), Ziauddin Hyder, (Senior Health Specialist), Naz Khan, (Principal Country Officer), Puteri Watson (Senior Operations Officer) and Ishrat Husain (Consultant).