

### III CAUSES OF POVERTY

*Poor governance is the key underlying cause of poverty in Pakistan. However, economic and social factors such as the slowdown in GDP growth in the last decade, and the persistence of a regressive social structure, stemming from the highly unequal distribution of land, have also contributed to the increase in poverty witnessed in the 1990s.*

Poverty is impacted by a number of factors. Some of these may be general in that they may serve to create or intensify privation across all sectors of the economy, and across different population groups. Other causes of poverty may be more specific or localized, and their effects may be more apparent in particular population groups, or in populations associated with specific sectors of the economy. The factors or causes of poverty can, furthermore, be grouped into categories based on the channels through which they affect poverty levels. Thus, for example, they may originate from issues of governance and the structure of institutions or be economic or social in nature. In most cases, however, poverty is likely to be the result of several mutually reinforcing factors that together define its scope and pervasiveness. The prime causes of

poverty in Pakistan are detailed in this chapter.

#### A. POOR GOVERNANCE

Governance is defined as the manner in which power is exercised in the management of a country's social and economic resources for development<sup>1</sup>. Good governance implies a capacity to turn public income into human development outcomes. Good governance is an essential pre-condition for pro-poor growth as it establishes the enabling regulatory and legal framework essential for the sound functioning of land, labor, capital and other factor markets.

By the end of the 1990s, governance had clearly emerged as Pakistan's foremost development concern. Corruption and political instability resulted in waning business confidence, deteriorating

economic growth, declining public expenditure on basic entitlements, low efficiency in delivery of public services as discussed in the earlier section on human development, and a serious undermining of state institutions and the rule of law. The lack of public confidence in state institutions, including the police and judiciary, eroded their legitimacy and directly contributed to worsening conditions of public security and law and order. The present Government has committed to thorough reforms to restore the legitimacy and performance of all institutions, political, administrative, and judicial.

#### 1. Governance, Political Instability and Poverty

Political stability is fundamental to the creation of an enabling environment for growth and development. Economic agents, particularly investors, must be reassured with regard to the continuation of policies, should have confidence in the government's credibility in order to operate effectively, and in the case of investors, be induced to take risks. The perceived security threat on its eastern border which has dominated Pakistan's political culture has resulted in the domination of the military in politics, excessive public

1. Asian Development Bank, 1995: *Governance: Sound Development Management Policy*.

*Three of the last four civilian governments that were in power in the 1990s were dismissed prematurely by successive presidents on charges of corruption.*

spending on defense at the expense of social sectors, and erosion of the rule of law. Politically, Pakistan has alternated with regularity between democratic and military governments. Between 1947 and 1988, military governments were in power for 24 out of the 41 years. During the period of parliamentary democracy between 1988 and 1999, there were four national elections and nine changes of government. In addition, Pakistan's involvement in the war during the 1980s and 1990s in Afghanistan was responsible for the growth of extremist groups, spread of weapons, and frequent breakdowns of internal security. The uncertainty created by these frequent changes of government, the associated economic policies and lapses in internal security has had a negative impact on private investment and growth.

Three of the last four civilian governments that were in power in the 1990s were dismissed prematurely by successive presidents on charges of corruption<sup>2</sup>. Although the accountability drives that followed each change of government were flawed in many respects, there is little doubt that corruption was pervasive through much of the last decade<sup>3</sup>. The incidence of corrupt practices, as well as the atmosphere of uncertainty that followed the fall of each successive government, were not conducive to the growth or use of sound business practices. These and other factors not only discouraged private investment, but prompted capital flight, as businessmen either migrated in large numbers (most notably to Canada), or shifted assets to more favorable locations (such as the United Arab Emirates).

The change of governments in the 1990s was also characterized by extreme policy reversals as well as one sided and non-

transparent accountability drives that have sapped the morale of public servants and private entrepreneurs alike. The most relevant example of the effects of reversal of policy is the renegotiation of agreements with independent power producers IPPs which started in 1997. The resulting disputes took four years to resolve, and had extremely adverse impacts on foreign investment inflows into the country. Other examples of policy inconsistency in the 1990s include the reversal of decisions on withdrawal of tariff concessions and incentives for certain industry groups in at least one case, an industrial zone, the Gadoon Amazai project. All these factors have in turn affected growth, and subsequently poverty levels in the country. In general, political instability and macro-economic imbalances have been reflected in poor creditworthiness ratings, even compared to other countries of similar income levels, with resulting capital flight and lower foreign direct investment inflows<sup>3</sup>.

## **2. Non Transparency in Resource Allocation**

The lack of transparency in public sector planning, budgeting and allocation of resources in Pakistan has ensured that those who do not constitute the political elite are unable to make political leaders and the Government responsive to their needs or accountable to promises. This has led to a supply driven approach to service provision, with development priorities being determined not by potential beneficiaries but by the bureaucracy and a political elite which may or may not be in touch with the needs of the citizens. The results manifest themselves in, for example, the existence of "ghost schools" (which

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2. While the immediate causes of the dismissals in each case may have been tensions in the centers of power, the reasons for dismissal cited in each case were the prevalence of corrupt practices in government.
  3. Pakistan was ranked the second most corrupt country in the world by Transparency International in 1996. Its ranking had improved to 12th most corrupt by 2001.

exist only on paper), absenteeism of health and education staff in rural areas (who are not held accountable by the authorities, and are often political appointees rather than public functionaries appointed on merit)<sup>4</sup> and deterioration in the quality of services wherever they do exist. Poor service delivery and the restriction of access of the poor to services are key determinants of long term poverty and serve to exacerbate the vulnerability of the lowest income groups in recessionary periods. In addition, the absence of a public debate on resource allocation, and allocation within the social sectors has resulted in distortions such as the emphasis on provision of tertiary services in urban areas rather than primary services in rural areas.

On a larger scale, non-transparency in the management of public accounts has led to a distortion of development priorities and a tendency to safeguard the interests of specific groups at the expense of the larger public interest. Examples include the government's hesitance to impose agricultural income tax; the tendency to frequently grant concessions or exemptions on taxes and tariffs, which often benefit powerful pressure groups; and ad hoc decision making on imports and exports as well as pricing in the agricultural sector, which can favor hoarding and speculation.

### 3. Weak Public Sector Capacity

Public sector capacity in Pakistan, considered in the 1960s to be in league with that of the top performing Asian countries, has eroded significantly for several reasons. This is despite the massive growth in the numbers of staff employed by the public sector over these years. The first and foremost reason for this decline in capacity

has been the inability of the public sector to remain competitive in attracting better qualified and competent people owing to the dismal financial and career incentives offered. Secondly, there has been a steady weakening of meritocratic selection procedures in recruitment of staff as a consequence of rampant systemic corruption and nepotism. This has worsened in the last decade, during periods of elected civilian governments, when recourse to political interference and influence became common and, in fact, almost a pre-condition in getting public sector jobs. As a consequence, the autonomy and objectivity of institutions such as the Federal and Provincial Public Service Commissions charged with carrying out recruitment for a major proportion of public sector jobs has been affected, and confidence of citizens in these institutions has weakened. Finally, training, capacity development, and skills enhancement opportunities across the board have historically been very limited due to which there is no serious and systematic effort at capacity upgrading of in-service employees in most public sector departments. Somewhat ironically, however, together with this declining capacity to deliver, the State assumed added functions in a number of different areas and sectors that were perhaps best left to the private sector. This has led to an unsustainable and unnecessary over-extension of the public sector with the result that whatever internal capacity there was had to be more thinly spread over in diverse sectors rather than being concentrated in a few key ones such as regulation and law and order. The result of this development has been the realization of diseconomies of scale in the public sector (as is evidenced from the many examples of loss-making state-owned

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4. During a recent monitoring exercise for the SAP, some 19 percent of primary school teachers were not present at school and only 38 percent of schools could be classified as 'functional' according to a minimal criteria. Research also revealed that 21 percent of health staff are absent from basic health facilities. See Rimmer, M. 2000: *Reducing Poverty in Pakistan: Priorities for the Asian Development Bank*, Working Papers, Poverty Assessment. Unpublished report, p. 47.

enterprises), and an accompanying disenfranchisement of the private sector that has given rise, as mentioned earlier, to the flight of capital and of entrepreneurship from the country.

Finally, over-centralization in the public sector has led to inefficient delivery of social sector related and other services with the resulting disenchantment of the citizenry in the ability of the State to provide effective and accessible services. At the same time, the role of the private and civil society sector has not been systematically encouraged to build synergistic public-private partnerships to achieve greater scale and coverage in the delivery of these services.

#### 4. Inadequate Access to Justice

Inadequate access to justice is widely perceived in Pakistan to be a key governance issue that directly contributes to the powerlessness of the poor and reinforces social and economic inequities widely prevalent in the institutional fabric of society. With the general deterioration of public sector institutions in the country, and their uncontrolled politicization, those providing judicial services could not have been expected to remain insulated from this trend. Consequently, the state and level of public confidence in the ability of these institutions to administer justice in a fair and equitable manner has been compromised. One important result of the weakening of judicial institutions has been a general decline in the vitality and effectiveness of regulatory frameworks in the country on account of which the enforcement and protection of property rights, especially those of the poor, has suffered. Side by side, ineffective regulation and lack of timely

judicial arbitration on matters of conflict has eroded confidence of investors and contributed to the observed stagnation in business activity in the country.

The constraints to effective dispensation of justice in the country are well known, and summarized recently in an ADB project document<sup>5</sup>. These include the weak governance and administration of the judicial system; lack of professional management; inadequate budgetary resources and basic infrastructure; long delays in court case decisions; absence of client focus; absence of grievance redressal procedures; and gender imbalances and under-representation of women in the judiciary. In addition, the access to justice of the citizenry at large is severely restricted by an inefficient and corrupt police system that is often accused of playing in the hands of the influentials and victimizing the poor and the underprivileged. In this regard, harassment by the police and its indiscriminate and exploitative abuse of power has been repeatedly reported by the poor to be a major source of insecurity and vulnerability for their lives and livelihoods.

#### B. ECONOMIC DETERMINANTS

The slowdown in economic growth in Pakistan during the 1990s was a key factor in rising poverty during the period. Growth declined in all sectors in the 1990s and there was also much greater volatility in the growth rate, particularly in agriculture. In addition, growth was slower than the average in labor intensive sectors, such as construction and wholesale and retail trade, and faster than the average in capital intensive sectors, such as electricity and gas distribution. Thus not only was growth slow, but was also not pro-poor<sup>6</sup>.

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5. Asian Development Bank: *Report and Recommendation of the President to the Board of Directors on Proposed Loans and Technical Assistance Grant to the Islamic Republic of Pakistan for the Access to Justice Program*, November 2001.

6. The increasing inequality of incomes in the 1990s also points to the non-pro-poor nature of growth during this period.

The causes of the slowdown in growth may be divided into two categories, i.e. structural and others. Among the structural causes, the burgeoning debt burden and declining competitiveness of the Pakistan economy in the increasingly skill-based global economy are the most important. While the former occurred due to economic mismanagement, the latter was because of Pakistan's low level of human capital development.

Increasing debt service requirements resulted in a growing fiscal squeeze, which in turn led to a declining proportion of GDP being spent on development and social sectors in the 1990s. Falling public investment, together with unsuccessful attempts at macroeconomic stabilization also adversely affected private investment. At the same time, reduction in tariffs, exhaustion of simple import substitution opportunities, and elimination of export subsidies in the 1990s meant that international competitiveness became an increasingly important determinant of investment opportunities in Pakistan. Because of the low level of human development and poor state of physical

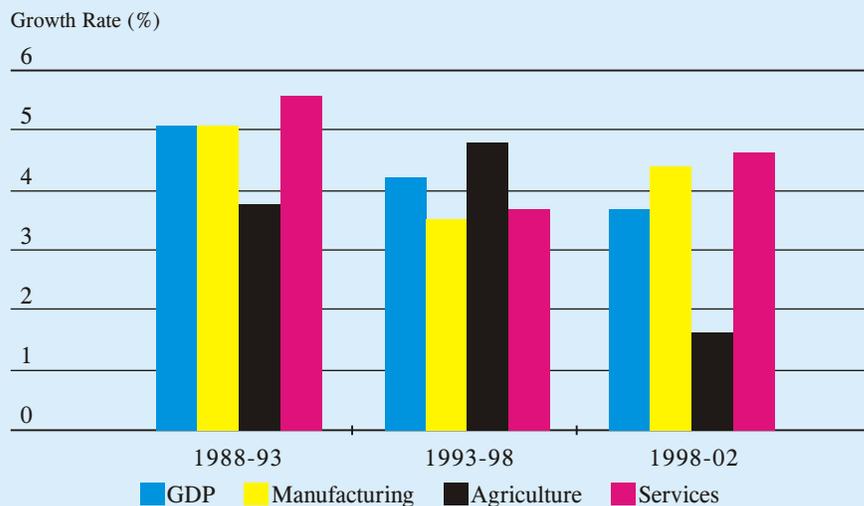
infrastructure, areas where Pakistan was competitive were not many. As a result, total fixed investment declined significantly, bringing about a fall in the economic growth rate.

The adverse impact of structural factors was reinforced by other problems such as ethnic and sectarian violence, poor state of law and order, and a high degree of economic and political uncertainty because of the many changes in government. Throughout the 1990s, the Government was implementing a series of medium term structural adjustment programs under the aegis of the International Monetary Fund (IMF). However, because of frequent changes in government, adherence to the adjustment program was unsatisfactory, and as a result, the 1990s can be characterized as a decade of stop-go stabilization policies, with the attendant negative impact on growth, but without the desired improvement of macroeconomic fundamentals.

As shown in Figure 3.1, annual compound growth rates of GDP in Pakistan have declined from 5 percent for the first period of adjustment, to 3.6 percent for the

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Figure 3.1 Sectoral Growth Rates in the 1990s



Source: Government of Pakistan, *Economic Survey*, Various Issues.

most recent period. Manufacturing growth has been adversely affected by deficiencies in infrastructure, as well as by sluggish domestic demand. In the most recent period of our analysis, agricultural growth rates have been particularly low at just 1.6 percent. This sharp decline has been mainly due to the unprecedented drought, precipitated by inadequate rainfall, that the country experienced from 1999 to 2001.

The present Government, soon after coming into power, initiated an ambitious program of reforms to address outstanding macroeconomic, structural and governance problems. In October 2000, Pakistan began implementing a far-reaching macroeconomic stabilization and restructuring program under an IMF standby arrangement (SBA) which was successfully completed in September 2001. Following the successful implementation of the SBA, the IMF approved in December 2001 a \$1.3 billion Poverty Reduction Growth Facility to be implemented during 2002-2004. Also in December 2001, the Government of Pakistan successfully negotiated a debt restructuring agreement with the Paris Club which is expected to reduce the net present value of total debt by at least 30 percent. While the above developments have made it possible for Pakistan to achieve sustained, high growth in a much shorter period than earlier thought possible, the experience of the last decade suggests that reviving growth and reducing poverty is strongly dependent on the Government's ability to stay the course of macroeconomic and structural reform.

Trends in the key economic variables that have an impact on poverty are discussed in more detail as follows.

### 3. Investment

Investment is a key driving force for GDP growth, and declining investment levels point to low GDP growth rates. The

early 1990s were characterized by the intensification of deregulation and privatization policies. Foreign resources in terms of loans, investment and foreign currency accounts supplemented domestic savings, which are typically low at an average of 14 percent of GDP, and helped in enhancing investible resources and reducing investment risks. Resultantly, private investment during this period increased from 7.4 percent of GDP in FY1988 to 10 percent by FY1993 (Table 3.1). Public investment averaged just over 8.4 percent of GDP in this period, and total investment increased from 17.3 to 19.9 percent.

The period from FY1993 to FY1998 was characterized by a lack of continuity in economic policy and political uncertainty. Fiscal deficits averaged 6.7 percent of GDP in this period and further constrained public finances (see Table 3.3). This was reflected in investment trends, as the adjustment burden fell on public investment, which fell drastically from 9 percent of GDP in FY1993 to just 4.9 percent in FY1998 because of inadequate resource mobilization efforts. Private investment fluctuated around an average of 9.3 percent in this period, after having reached a peak of 10 percent of GDP in FY1993. Total investment declined from 20.6 percent to 17.1 percent of GDP.

In subsequent years, the investment climate deteriorated even more significantly as a result of the imposition of sanctions on the country after the nuclear tests of 1998, and related policy decisions such as the freezing of foreign currency accounts. Total investment declined from 17.1 percent of GDP in FY1998 to just 14.7 percent in FY2001. This decline was entirely due to a sharp fall in private investment, which declined from 9.6 percent of GDP in FY1998 to 7.5 percent in FY2001. Initial estimates suggest that total investment further declined in FY2002, to 13.9 percent of GDP, primarily due to the post 11

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Table 3.1 Trends in Investment - 1988 to 2001

Years	Total Investment	Fixed Investment	Public Investment	Private Investment	Share of Private Sector in Fixed Investment
	% of GDP	% of GDP	% of GDP	% of GDP	%
FY1988	17.3	15.8	8.5	7.4	46.5
FY1989	18.3	16.7	8.7	8.0	48.2
FY1990	18.2	16.6	8.0	8.6	51.7
FY1991	18.5	17.0	8.3	8.7	51.3
FY1992	19.9	18.4	8.7	9.7	52.7
FY1993	20.6	19.0	9.0	10.0	52.5
FY1994	19.4	17.8	8.3	9.5	53.6
FY1995	18.3	16.8	8.2	8.6	51.3
FY1996	18.7	17.1	8.1	9.0	52.5
FY1997	17.7	16.2	6.8	9.4	58.0
FY1998	17.1	14.5	4.9	9.6	66.2
FY1999	15.0	13.3	5.3	8.0	60.2
FY2000	15.0	13.4	5.3	8.1	60.4
FY2001	14.7	13.1	5.6	7.5	57.3

Source: Government of Pakistan, *Economic Survey*, Various Issues.

September regional conflict, the military standoff with India and a further deterioration in internal security.

Growth depends not only on the level of investment, but also the pattern. Trends in

the pattern of investment, as given in Table 3.2, show that investment in agriculture has consistently declined over the period under review, from an average of 1.8 percent of GDP in FY1988 to just 0.9 percent in FY2002. Investment in manufacturing has

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Table 3.2 Pattern of Investment in the 1990s

Sector	Investment (% of GDP)			
	1987-88	1992-93	1997-98	2000-01
Agriculture	1.8	1.5	1.3	0.9
Manufacturing	2.9	4.7	2.1	2.5
Power	2.0	2.5	2.7	1.4
Total Fixed Investment	16.5	19.1	14.5	13.0

Source: Government of Pakistan, *Economic Survey*, Various Issues.

fluctuated, and reached a peak of 4.7 percent of GDP in FY1993 because of the implementation of deregulation policies and privatization. However, by FY1998 it had declined to 2.1 percent of GDP. In the last period of our analysis, there was a modest improvement in investment in the sector largely as a result of balancing and modernization in the textile sector, which was preparing for the removal of restrictions on international trade in textiles by 2005 under the World Trade Organization.

Investment in the power sector increased from 2 percent of GDP in FY1988 to 2.7 percent in FY1998, as a policy geared towards attracting foreign investors as IPPs was implemented, and attracted significant amounts of foreign direct investment. However, investment in the sector declined to 1.4 percent of GDP by FY2002 as a result of the emergence of excess capacity in the power sector as well as disputes on tariffs between the Government and the IPPs.

The patterns of investment indicate that investment in agriculture, which employs 47% of the labor force, has been low and falling in the last decade, while investment in industry has fluctuated sharply. Total investment in the power sector has, however, been quite high, even surpassing investment in manufacturing in FY1998. Foreign direct investment, in particular, has been concentrated largely in this sector, which is highly capital intensive. Thus not only has investment in the last decade generally been low and declining, but has also been concentrated in capital intensive rather than labor-intensive sectors. The growth witnessed since the early 90s has not, therefore, been "pro-poor", and has not served to alleviate poverty to a significant extent.

#### 4. Fiscal Policy

Pakistan's increasing debt servicing requirements in the 1990s exerted

considerable pressure on the fiscal account and budget deficits averaged over 7 percent for the decade. As Pakistan was required to reduce the size of the budget deficit to less than 5 percent in this period under the IMF's structural adjustment program, the requirements of public debt servicing placed serious constraints on the government's budget allocation priorities, leaving very limited resources available for development projects. As revenue generation efforts remained largely unsuccessful, successive governments attempted to reduce the deficit by controlling development expenditure, which led to a declining proportion of GDP being spent on development and social sectors in the 1990s.

The pattern of public expenditure in the 1990s is shown in Table 3.3. The tradeoff between development expenditure and expenditure on interest payments becomes apparent as development expenditure declined from 6.4 percent of GDP in FY1991 to 3.9 percent in FY1998 and further to 2.8 percent in the last fiscal year. Interest payments have however increased from 5.5 percent of GDP in FY1991 to 8.2 percent in FY1998 as the Government increasingly resorted to short term commercial borrowing, and have fluctuated around 8 percent since then. In constant terms, development expenditure in the country has declined almost continuously from FY1992 to FY2001, with the exception of one year, FY1998, when expenditures registered a significant increase. Development expenditure has fallen in real terms from Rs. 65.3 billion in FY1991 to Rs. 47.6 billion in FY2001, crowded out by expenditure on interest payments and defense. Although expenditure levels have fluctuated, the annual compound growth rate of development expenditure in real terms averages 3.1 percent for the last decade.

The Government's fiscal options have, in the last decade in particular, been significantly constrained because of the

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need to meet debt obligations, and the policy of sustaining expenditure on defense. Expenditure on defense and interest payments together accounted for 88 percent of total tax revenue in FY1991. From FY1998 to FY2000 expenditure on these two heads has remained at over 90 percent of tax revenue. In the absence of a political settlement with India, the government has little flexibility in reducing expenditures on defense<sup>7</sup>. Furthermore, defense expenditure has the potential to rise sharply if tensions between the two countries are exacerbated. In FY2002, for example, defense spending was higher than anticipated (Rs. 151.6 billion as against the targeted Rs. 131.6 billion) as a result of the military standoff with India. The successful negotiation of

terms for debt rescheduling with the Paris Club has, however, created some fiscal space for the Government, with estimated cash flow savings of \$2.7 billion until FY2004.

While rigidity in expenditure is one constraint on the Government's resource allocation policy, the failure to mobilize additional revenue is the other side of the coin which has had equally damaging effects. Pakistan's tax-GDP ratio has remained more or less stagnant at low levels over the past decade. It was recorded at 11 percent in FY1991, rose marginally to 13 percent in FY1996, and was estimated at 10.9 percent in FY2002. The Government is committed to major reform and restructuring of the Central Board of

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Table 3.3 Revenue and Expenditure Trends - 1998 to 2001

Years	Total Revenues	Tax Revenues	Total Expenditure	Development Expenditure	Interest Payments	Fiscal Deficit
	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
FY88	17.3	13.8	26.7	6.9	6.9	8.5
FY89	18.0	14.3	26.1	6.2	5.0	7.4
FY90	18.6	14.0	25.7	6.5	6.9	6.5
FY91	16.9	12.7	25.7	6.4	5.5	8.8
FY92	19.2	13.7	26.7	7.6	5.8	7.5
FY93	18.1	13.4	26.2	5.7	6.6	8.1
FY94	17.5	13.4	23.4	4.6	6.4	5.9
FY95	17.3	13.8	22.9	4.4	5.8	5.6
FY96	17.9	14.4	24.4	4.4	6.8	6.5
FY97	15.8	13.4	22.3	3.5	7.1	6.4
FY98	16.0	13.2	23.7	3.9	8.2	7.7
FY99	15.9	13.3	22.0	3.4	8.0	6.1
FY00	16.9	12.8	23.4	3.2	9.0	6.5
FY01	16.4	13.6	21.8	2.8	8.0	5.3

Source: Government of Pakistan, *Economic Survey*, Various Issues

7. Figures from the Economic Survey 2000-01 show that expenditure on defense has remained more or less stagnant in real terms since FY1997. However, independent analysts surmise that this may be partially because salaries and pensions of defense personnel were grouped under General Administration in the budget for FY2001.

Revenue to make it more efficient, more responsive to taxpayers and more transparent in its operations, but progress on this issue has been slow. The Government has initiated a series of fiscal reforms, however, including effecting the separation of the audit and accounts functions, the reestablishment of Public Accounts Committees, and, from FY2003, the introduction of a self-assessment scheme for income tax. The effects of these reforms on revenue collection and expenditure management will be closely monitored over the medium term.

### 5. Subsidies

In FY1991, federal and provincial government subsidies amounted to Rs. 10.7 billion and constituted 4.1 percent of total expenditure. Thereafter, subsidies fell significantly in terms of constant 1990 rupees until FY1994, when expenditure on subsidies was just 1.4 percent of total expenditure. Subsequently, subsidies followed a fluctuating trend, rising to 3.8 percent of total expenditure in FY2000, and estimated at 3.0 percent of total expenditure in FY2002.

From a poverty assessment perspective, it is more revealing to look at the breakdown of subsidies. Subsidies in Pakistan are generally divided into two heads, current subsidies and development subsidies. Current subsidies include subsidies on wheat, sugar and edible oil as well as payments made by the government to bodies such as the Cotton Export Corporation and the Pakistan Steel Mill. Development subsidies consist of subsidies given to the fertilizer industry, primarily in the form of reduced prices for the use of natural gas as feedstock. Subsidies on wheat, sugar and edible oil are considered as poverty related subsidies, as expenditures on these items are

estimated to constitute over a third of total household expenditure for the lowest income brackets.

Expenditure on these subsidies fell steadily from FY1991 to FY1995, but then increased in subsequent years as wheat imports rose from 1.97 million metric tons in FY1996 to 4.1 million metric tons in FY1998. In July 1997, the government launched an Atta Subsidy Scheme for families living on incomes of less than Rs. 1500 per month<sup>8</sup>. In FY2001, expenditure on poverty related subsidies was 21 percent lower in real terms as compared with FY1991.

### 6. Employment

Pakistan's labor force is expanding at an annual rate of 2.4 percent, and the average annual GDP growth rate of 4.5 percent during the 1990s was insufficient to generate the necessary additional employment. The average employment elasticity in Pakistan is estimated to be 0.4, which means additional jobs created in the 1990s would have provided employment to only about two-thirds of the new entrants into the labor force. It is estimated that about 0.6 million people are being added to the ranks of the unemployed every year. In the absence of a formal social security system, this does not fully translate into an increase in the unemployment rate, but adds to the large number of under-employed workers in the informal sector, and a growing number of working poor.

The official unemployment rate had increased to 7.8 percent by 2000 - 6.1 percent for men and 17.3 percent for women (see Box 3.1)<sup>9</sup>. However, unemployment statistics in Pakistan are generally unreliable because of the relatively high incidence of disguised unemployment, and the fact that a

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8 Government of Pakistan 1999: *Economic Survey, 1998-99*. Economic Adviser's Wing, Finance Division.

9. Federal Bureau of Statistics, 2001: *Labour Force Survey, 1999-2000*.

### Box 3.1 Women in the Labour Force

The majority of women in the formal sector of the economy are concentrated in low paid jobs with limited opportunities for upward mobility. Thus 56 percent of female workers are concentrated in the category of "skilled agricultural and fishery workers" compared to 37 percent of male workers, while 22 percent are classified as unskilled workers compared to 18 percent of male workers. Female labor force participation rates in the informal sector, which offers more flexible work conditions, are estimated to be higher, but once again they tend to be heavily concentrated in low wage earning categories, operate primarily from their homes, and have limited access to the market as they rely on middlemen and contractors to procure work. While research on women's employment is limited, there are indications that with the increase in the number of women acquiring high school and college level education, there is a steady increase in the number of women entering the labor force. This trend has been accentuated by the slow growth in the economy, increase in unemployment of males and decline in real wages, all of which have prompted more and more women to look for employment in both the formal and informal sectors.

The disparity in male-female unemployment rates could be attributed to a number of factors, including the fact that more women may have entered the labor force in recent years due to increasing levels of education amongst urban women in particular, and the fact that the downturn in the economy has necessitated the entry of more members of a typical household into the labor force. Unemployment amongst women may also be higher because women tend to be concentrated in lower level positions, and are thus more susceptible to retrenchment. In general, the increased participation of women in the labor force not only has positive effects on household incomes, but can also serve as a safety net, preventing the household from falling into poverty.

significant proportion of total employment even outside agriculture is generated in the informal sector. In general, the capacity to absorb labor in the economy is expected to have declined over time, given declining GDP growth, and increasing capital intensity in the commodity producing sectors.

## 7. Inflation

High inflation acts as a regressive tax on household incomes by eroding purchasing power, and has particularly adverse impacts on households dependent on fixed salaries, as well as low-income households in general. Pakistan experienced double digit inflation from FY1991 to FY1997<sup>10</sup> a period when the size of the fiscal deficit averaged 7 percent of GDP and rate of growth of money supply averaged over 17.5 percent<sup>11</sup>. As is

clear from Figure 3.2, however, there has been a declining trend in inflation since FY1997, which is obviously beneficial to the low-income groups.

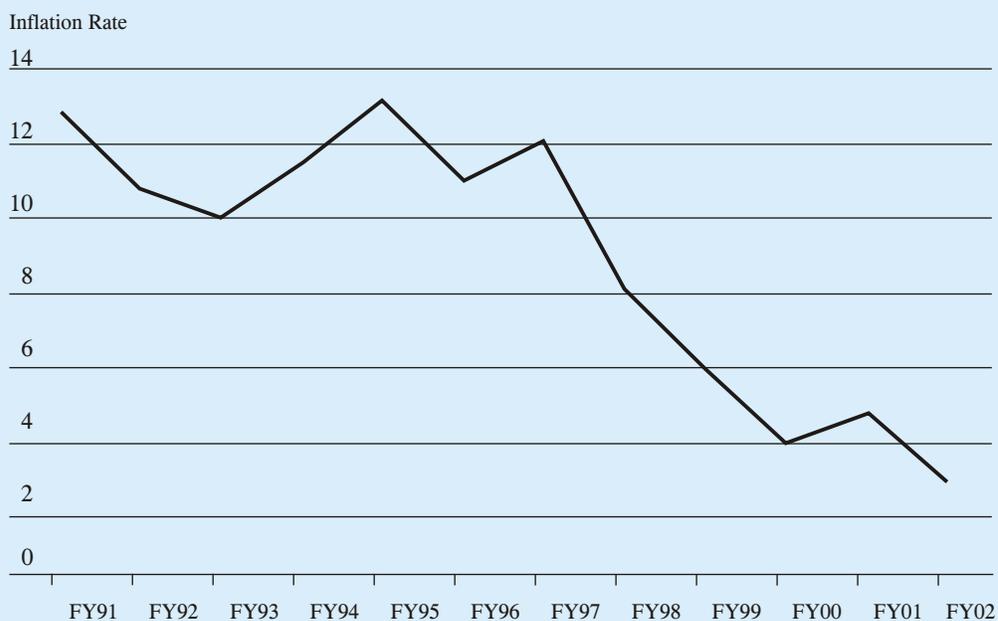
Inflation fell significantly, to 7.8 percent in FY1998, and has continued to decline thereafter, largely because of macroeconomic management in the form of reduction in the budget deficit and a reduction in the average rate of increase of money supply to 9 percent between FY1998 and FY2001. In FY2002, inflation was estimated at 2.6 percent for the first ten months of the year, with food price inflation estimated at 1.4 percent. Inflation has also been controlled because of low average international prices of key commodities like petroleum and petroleum products, and because of improved supply of food items in markets all over the country.

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10 The inflation rate here refers to the Consumer Price Index.

11. Borrowing from the banking sector has been the government's preferred method of financing the fiscal deficit in Pakistan, a policy that limits the government's option of using monetary policy as a tool to lower inflation or encourage investment.

Figure 3.2 Inflation Rate in the 1990s



Source: Government of Pakistan, Economic Survey, Various Issues.

## 8. Remittances

Remittances from overseas, particularly from the Middle East, played a key role in poverty alleviation through most of the 1980s. The migration to the Middle East was unique in a number of ways. Firstly, rather than whole families migrating (as happened in the case of migration to the United Kingdom in the 1960s for example), the principal migrants in this case were young males, the primary breadwinners in households, who subsequently sent a bulk of their earnings to their families in Pakistan. Secondly, the bulk of the migrants were unskilled workers from low-income households, for whom the remittances were a windfall, enabling their families to set up small businesses, acquire real estate and make substantial improvements in their standard of living.

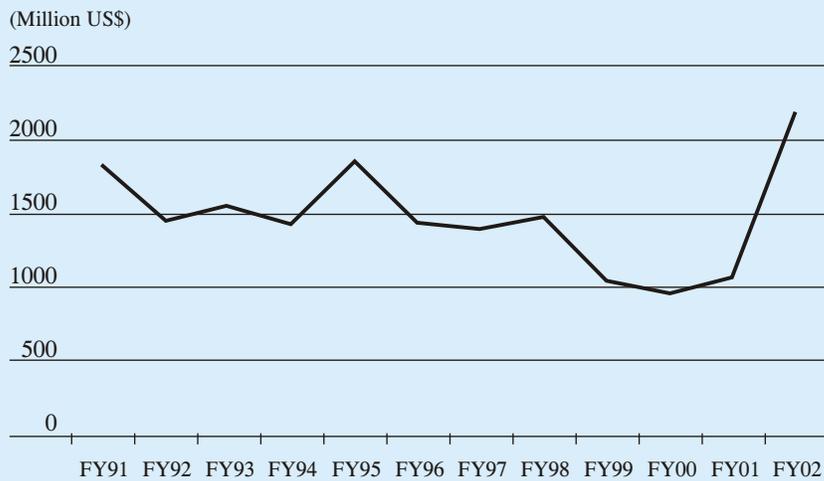
As such the migration to the Middle East served to protect the lower income groups from the vicissitudes of the Pakistani

economy to some extent. No such opportunities presented themselves to the unskilled labor force of Pakistan in the 1990s. The construction boom in the Middle East, which had fueled the migration slowed down in the early 1990s. The decrease in employment opportunities overseas for unskilled workers was thus a factor in the increase in poverty particularly in parts of NWFP and Punjab in the 1990s.

Remittances peaked in the mid 1980s, and thereafter fluctuated, averaging just over US \$1.4 billion through the 1990s. Figure 3.3 shows the trend in official remittances in the last decade. Actual remittances were larger, however, because a substantial portion came into the country through informal money markets (the *hundi* system). In the post 11 September period, however, when controls on informal money markets have been tightened, the inflow of remittances through banks has increased significantly to \$2.2 billion in FY2002 compared to \$1.09 billion in FY2001.

*In the post 11 September period, however, when controls on informal money markets have been tightened, the inflow of remittances through banks has increased significantly to \$2.2 billion in FY2002.*

Figure 3.3 Trend in Worker Remittances



Source: Government of Pakistan, *Economic Survey*, Various Issues.

### C. SOCIAL DETERMINANTS

The economic determinants of poverty are key to understanding the circumstances that can intensify poverty, or increase the proportion of people falling below the poverty line. The existence of pervasive poverty, wherein a significant proportion of the population remains poor over an extended period of time, is attributable more to social than to economic factors. The impacts of economic causes of poverty tend to be accentuated under a regressive social structure, and rigid societal mores can act as impediments to the equitable distribution of the benefits of growth. Some of the social determinants of poverty are discussed as follows.

#### 1. Land Tenure Systems

Access to land, which is the basic factor of production, is crucial to reduce poverty in rural areas. Data from the Agricultural Census of Pakistan conducted in 1990 shows that cultivated land is highly unequally distributed in Pakistan. About 47

percent of the farms are smaller than 2 hectares, accounting for only 12 percent of the total cultivated area. Approximately 19 percent of farms are of 5 hectares or more and account for 61 percent of the total cultivable land. Table 3.4 details the data. The disaggregated data by province shows that NWFP has a predominance of small farms, with almost 70 percent of farms having an area of less than two hectares. In Balochistan, a province characterized by vast expanses of land and strong tribal society, the proportion of small farms is less than a quarter of the total. In Sindh, a province where the rural society is dominated by a feudal elite, the proportion of small farms is just above a third.

The data indicates that in 1990, 73 percent of farms were owner operated, while the remaining operated under tenancy agreements. Where farms are tenant operated, sharecropping, an arrangement in which the cultivator and the owner divide the responsibility for provision of inputs, and then allocate output accordingly, is the

*The impacts of economic causes of poverty tend to be accentuated under a regressive social structure, and rigid societal mores can act as impediments to the equitable distribution of the benefits of growth.*

Table 3.4 Farm Classification by Size of Farm

Province	Less than 2 Hectares		Greater than 2 and Less than 5 Hectares		5 Hectares and Above	
	Farms(%)	Area (%)	Farms(%)	Area (%)	Farms(%)	Area (%)
Punjab	45	12	34	29	21	61
Sindh	34	9	47	34	19	58
NWFP	69	24	21	29	9	47
Balochistan	23	3	35	12	43	86
Pakistan	47	12	34	27	19	61

Source: Agricultural Census Organization (1994). *Census of Agriculture, 1990*. Ministry of Food, Agriculture and Livestock.

*In general, areas with a high degree of absentee landlordism, or feudalism, tend to have high levels of rural poverty.*

most commonly observed tenurial arrangement as detailed in Table 3.5. However, the form of the contract between the owner and the cultivator can vary considerably and is an indicator of how equitable the agricultural production systems are. In general, areas with a high degree of absentee landlordism, or feudalism, where sharecropping arrangements are structured to favor the landowner, tend to have high levels of rural poverty. Examples include southern

Punjab, southern NWFP and the bulk of rural Sindh, the province that also has the lowest proportion of owner operated farms<sup>12</sup>.

Ownership of even small landholdings can significantly increase the owner's capacity to absorb economic shocks, and ensure food security for the household. Land ownership is also the key factor determining access to credit from the formal banking sector, thereby decreasing the

Table 3.5 Tenure Classification of Farms

Province	Total Farm	Owner Operated	Tenant Operated			
	Area in Million Acres	% of Total Area	Area in Million Acres	Sharecropped %	Leased %	Other %
NWFP	5.83	80	1.15	77	21	3
Punjab	27.11	72	7.57	69	29	2
Sindh	8.60	65	3.00	76	23	2
Balochistan	5.78	86	0.81	89	7	2
Pakistan	47.32	73	12.54	72	26	2

Source: Agricultural Census Organization (1994). *Census of Agriculture, 1990*. Ministry of Food, Agriculture and Livestock.

12. Disaggregated data on incidence of poverty is limited, but studies in this area (quoted in Naqvi: 2000) show that northern Punjab, where rainfed agriculture is prevalent, is the most prosperous region of Pakistan. This seems to indicate that access to non-agriculture income earning opportunities is a key determinant of poverty.

dependence of the poorest sections of society on informal credit markets, which can be singularly exploitative. Unequal land tenure patterns do not just have implications for income distribution, but can also have adverse impacts on agricultural productivity. The prevalence of an unequal land distribution system is thus a major cause of poverty.

## 2. The Structure of Society

Pervasive inequality in land ownership intensifies the degree of vulnerability of the poorest sections of rural society, because the effects of an unequal land distribution are not limited to control over assets. The structure of rural society, in areas where land ownership is highly unequal, tends to be strongly hierarchical, with large landowners or tribal chiefs exercising considerable control over the decisions, personal and otherwise, of people living in their area, as well as over their access to social infrastructure facilities<sup>13</sup>.

The system of intermediation is also likely to persist in cases where the private

sector or development agencies attempt to make inroads into a particular area. For example, implementation of infrastructure and development projects in areas where feudal domination is strong, only proceeds after local landowners and tribal chiefs have given their full concurrence to the activity. Very often, they are asked to nominate people for employment opportunities generated by the project.

The feudal elite has also been courted by all mainstream political parties in the country, and has invariably constituted the bulk of the strength of the elected legislatures, both national and provincial<sup>14</sup>. The composition of the legislature may have been the major factor in each successive elected government's inability to design and implement land reforms or even institute a tax on income from agricultural holdings. Analysts confirm that the predominance of the feudal elite has persisted in the recently held local bodies elections. The structure of society in Pakistan thus contributes significantly to perpetuating poverty in rural areas, through a combination of social, political and economic factors.

*The composition of the legislature may have been the major factor in each successive elected government's inability to design and implement land reforms or even institute a tax on income from agricultural holdings.*

### Box 3.2 Power Patronage in Rural Pakistan

The system of patronage is deeply entrenched in rural Pakistan, and encourages the concentration of power. Wherever this concentration of power exists, it has had serious implications for the vulnerability of the rural population, and particularly their ability to exploit whatever limited economic opportunities are available to them. Local influentials tend to act as intermediaries between the poor and the public functionaries assigned to their area, and limit direct contacts between the public and the systems of governance. There have also been significant instances of resistance on the part of the local elite to organizations/individuals working to bring about social development in such areas. Public functionaries are often beholden to the power elite, who have been known to exert considerable pressure on them, and in extreme cases, effect transfers for officials who are not responsive to their demands. As a result, the lower bureaucracy and service provision network is highly politicized, with decisions on the location of facilities, staffing and recruitment etc. being taken not on the basis of financial considerations or merit, but to oblige local influentials and key government functionaries.

13. A recent study on rural primary schools shows a significant association between the existence of a highly differentiated social system and participation in schooling. Gazdar 2000: *State, Community and Universal Education: A Political Economy of Public Schooling in Rural Pakistan*. Asia Research Center, London School of Economics.

14. This has been true even for the populist government of Zulfikar Ali Bhutto (1972-1977) which was elected to implement a socialist agenda.

### 3. Low Level of Human Development

A country's future growth potential and ability to reduce poverty is strongly dependent on its stock of social capital, and investments made to increase that stock. The level of human development in Pakistan is currently very low, and little improvement has taken place during the 1990s. As detailed in Chapter II, Pakistan lags behind other South Asian countries with respect to its social indicators. The social sectors have been consistently neglected in Pakistan, with the bulk of budgetary expenditure being concentrated in defense and debt servicing. The limited resources allocated to the social sectors also tend to be used ineffectively, and social service delivery is largely inefficient and substandard. The quality of service provision has declined sharply over the last decade, and served to enhance the vulnerability of the users of public facilities who have had to contend with inadequate services, and have had no recourse for redress of their grievances.

*The limited resources allocated to the social sectors also tend to be used ineffectively, and social service delivery is largely inefficient and substandard.*

The persistent neglect of the social sectors has effectively translated into the disempowerment of a vast section of society. To the extent that poverty is defined as a limitation on the right to make decisions to improve one's quality of life, and an inability to take advantage of opportunities, this in itself is a manifestation of poverty. Since the poor are strongly reliant on public social services, the lack of attention to provision of widespread, quality social services has particularly adverse impacts on the poor.

It has been convincingly argued that the critical constraint to growth in Pakistan is not the financing gap (i.e. the fiscal deficit

and deficit on the balance of payments account) but the "social gap", where the latter is defined as the gap between social indicators of developed and developing countries<sup>16</sup>. In Pakistan's context, the social gap can also be defined as the difference in social indicators across income classes, urban and rural areas, and the sexes. The current slowdown in growth, which has persisted for much of the last decade, and has exposed precipitous state of the country's public finances, has also served to highlight the critical role that investment in health, education and social infrastructure can play in sustaining long term economic growth. The consistent neglect of the social sectors has resulted in a lack of productive potential in the economy. That this lack of productive potential exists in spite of years of relatively high economic growth in the 1960s and 1980s in particular is an indicator of the skewed priorities of policy makers in the past.

Growth in the last decade has been disappointing, and Pakistan's long term growth potential is being seriously undermined by its poor social indicators. Low levels of education ensure that the bulk of the labor force is unskilled, thus placing limitations on the structure of the economy, which rests on low value production in agriculture and agro-based industry. In a rapidly integrating global economy, countries need to diversify their export base, and encourage low cost production of more value added high technology products to stay competitive. This in turn requires the mobilization of a highly skilled and specialized labor force. If this key resource has not been developed, as is the case in Pakistan, the economy tends to be mired in a low value production mode.

16 Easterly, W., 2001: *Pakistan's Critical Constraint: Not the Financing Gap but the Social Gap*. Background Paper for Pakistan Poverty Assessment 2000-01. Development Research Group. World Bank. Unpublished.

A high population growth rate, which in turn is fuelled by the lack of access to educational facilities, and health and population planning services, effectively erodes gains in GDP growth. The population growth rate has also served to magnify inadequate social sector service provision, as limited resources tend to be spread more thinly to accommodate ever-increasing demand. The relatively high dependency ratio (43 percent of the population was below the age of 15 according to the 1998 census) in turn places additional pressure on the working population, and effectively serves to keep average household incomes at subsistence levels.

The data also points to persistent gender discrimination in the country. The proportion of elementary school age girls enrolled in a primary school was 40 percentage points lower in Pakistan than in other comparable countries in 2000. The gender differential persists in all social indicators, and ensures that women face a disproportionately high share of the poverty burden. The low level of female education, in particular, has manifold implications. There is a high degree of correlation between adult female literacy and lower infant mortality, higher primary school enrolment and lower dropout rates, and higher contraceptive prevalence rates. Female literacy may thus be the single most important determinant of the state of human development in a society, and significant improvements in this one indicator can lead to an across the board improvement in human development in the long term.

Societal gender inequality has also succeeded in keeping female labor force participation rates in the formal sectors low, as women are typically not qualified, or not

allowed to participate in the formal labor market. As mentioned earlier, overall female labor participation for the country is estimated at barely 14 percent<sup>17</sup>. However, this understates female participation in the agriculture sector and in the informal economy in urban areas where women often do home based contract work. Some studies indicate that in urban areas, female labor force participation rates in the market for professional labor have increased to 20 percent<sup>18</sup>. Nevertheless, participation rates, particularly in the formal sector, remain low compared to other South Asian countries. This in turn serves to keep dependency ratios high and average household incomes low. It also translates into labor costs that are higher than the average in low-income countries, which have higher female labor participation rates, thus reducing Pakistan's international competitiveness.

#### 4. Ethnic and Sectarian Conflicts

The increasingly strong nexus between economic and social factors, and the importance of the latter as determinants of growth was apparent in Pakistan for the period from 1985 onwards, when Pakistan's largest city and industrial center, Karachi, intermittently remained in the grip of civil strife. The continued unrest in the city, which is the country's financial capital, only seaport, and houses the bulk of Pakistan's manufacturing capacity, has been cited as at least one of the factors prompting the average annual growth rate of large scale manufacturing to slump to 3.5 percent in the 1990s, from an average of over 6 percent in the previous decade.

In general, ethnic and sectarian divisions have been exploited for political purposes over the last twenty years, which has led to an increase in ethnic and sectarian

*The proportion of elementary school age girls enrolled in a primary school was 40 percentage points lower in Pakistan than in other comparable countries in 2000.*

17 Federal Bureau of Statistics (2001): *Labour Force Survey 1999-2000*, Islamabad.

18 Naqvi, Zareen F. (2000). *Poverty in Pakistan: Review of Recent Literature*. South Asia Poverty Reduction and Economic Management Unit, The World Bank, Islamabad.

**Box 3.3 Trends in Growth and Human Development in Pakistan**

Pakistan has experienced a marked lopsidedness in its development history, that is, good growth in the 1960s and 1980s, but weak progress in human development. The 1990s, however, have been characterized by slow GDP growth as well as slow progress in human development. The causes of the economic downturn have been discussed in detail earlier in this section. However, the low level of human development may, in the long run, prove to be of far more consequence for both macro-economic outcomes and poverty than the fiscal and current account deficits and the low investment levels that have characterized the economy. Indeed, it has been convincingly argued that the growth slowdown is related to insufficient investment in education, health, and other social services, and in improving the governance systems necessary to convert increased resources into human assets<sup>1</sup>.

1. Easterly, W. (2001). *Pakistan's Critical Constraint: Not the Financing Gap but the Social Gap*. Background Paper for Pakistan Poverty Assessment 2000-01. Development Research Group. World Bank, Washington D.C. Unpublished.

tensions, and recurring episodes of violence. Of late, the violence has extended to sections of society who have not traditionally been targeted in such conflicts. Thus the city of Karachi, for example, has witnessed the targeted killings of over 200 doctors belonging to the Shia community in the last two to three years, prompting many members of the medical community to migrate either to other cities, or out of the country altogether. Similarly, incidents of random attacks on church congregations and worshippers in mosques, shootings of prominent (and often apolitical) members of society and bomb blasts etc. have occurred all over the country. Such incidents are a major symptom of the deteriorating law and order situation in the country, and heighten the sense of uncertainty and lack of security that pervades big cities. This uncertainty is an important factor in the declining private investment and economic growth rates witnessed in the last decade. Ethnic and sectarian conflicts have thus served to stifle growth and employment opportunities and may have significantly contributed to poverty, particularly in urban areas. The law and order situation has also precluded the development of industries such as tourism which is a potentially high foreign

exchange earning sector, and can generate considerable employment opportunities in remote areas.

#### **D. ENVIRONMENTAL DEGRADATION AND POVERTY**

A two-way causality exists between environmental degradation and poverty, and the two states reinforce each other as well. These linkages are further explored as follows.

##### **1. Impacts on Health and Linkages with Poverty**

The most commonly cited indicators of environmental degradation in Pakistan are increasing air pollution and contamination of ground and surface water. Empirical work on the measurement of air and water pollutants is limited in the country, but recent studies suggest that emissions of particulate matter in Pakistan exceed WHO recommended standards. Emissions of pollutants like nitrogen oxides, carbon monoxide and lead, from both stationary and mobile sources are on the increase, and according to some estimates may be costing

*Ethnic and sectarian conflicts have thus served to stifle growth and employment opportunities and may have significantly contributed to poverty, particularly in urban areas.*

Rs. 25 billion in health costs in urban areas<sup>19</sup>.

In Pakistan, the environment-poverty nexus manifests itself most particularly in health effects. For example, water borne diseases are widespread because 17 percent of the urban and 47 percent of the rural population do not have access to clean drinking water. Such diseases may in fact contribute to 30 percent of hospital cases, and 60 percent of the recorded infant deaths<sup>20</sup>. The prevalence of diseases like cholera and typhoid can also be linked to solid waste management being minimal, with only a quarter of estimated waste generated actually being collected for disposal.

The poor also tend to be more vulnerable to the effects of air and water pollution, both in rural and urban areas, given their limited access to quality health care. Extended exposure to such pollutants is likely to have significant impacts on health in the form of skin and respiratory diseases, eye infections and in extreme cases, disorders of the central nervous system. The prevalence of disease exacerbates poverty firstly by compelling the poor to devote ever increasing proportions of a limited income to health costs, and secondly by reducing productivity and working days.

## 2. Effects of Degradation of Natural Resources

The degradation of natural resources can have a devastating impact on the poor,

given that they tend to be strongly dependent on the exploitation of such resources. The rural economy in particular is built around the sustainable use of natural resources, particularly water and cultivable land. In Pakistan, the effects of land degradation have been apparent for the last few decades, and may have been intensified by the increased use of fertilizers and pesticides following the green revolution of the late 1960s. Unsustainable exploitation of groundwater has led to serious drawdown in the level of aquifers in areas such as Balochistan. Similarly, high rates of siltation in denuded watersheds and the degraded state of the irrigation system have led to inefficiencies in water use and wastage of freshwater resources. Around 25 million acre feet of water is lost every year due to low water management efficiency<sup>21</sup>. The rural poor are particularly vulnerable to collusion between rent-seeking Irrigation Department bureaucrats and powerful local feudal elements, and even illegal diversion is resorted to in ensuring this<sup>22</sup>.

The rural population, particularly small landholders bear a disproportionate part of the costs of environmental degradation in the form of lower crop yields and reduced productivity of agricultural land. The poor also bear the brunt of the degradation of rangelands, which increasingly support smaller herds, and of forest lands from which they meet their fuelwood needs. The high rate of deforestation in the country has endangered biodiversity and may have devastating effects on the livelihoods of communities in mountain areas, who are

*The rural population, particularly small landholders bear a disproportionate part of the costs of environmental degradation in the form of lower crop yields and reduced productivity of agricultural land.*

19 Federal Environmental Protection Agency, 2000: *Pakistan Country Report to Male Declaration on Control and Prevention of Air Pollution and its Likely Transboundary Effects for South Asia* and Government of Pakistan, 2001: *Economic Survey 2000-01*. Economic Adviser's Wing, Finance Division, Islamabad.

20 Government of Pakistan, 2001: *Economic Survey, 2000-01*.

21 Government of Pakistan, 2001: *Three Year Poverty Reduction Program, 2001-2004*, Planning Commission, Islamabad.

22 Dinar, A, et al, (2001): *Political Economy and Political Risks of Institutional Reforms in the Water Sector, Rural Development Department*, World Bank, Washington DC.

dependent on forests for their energy and fodder needs, in addition to putting medicinal plants and herbs found in forests to a variety of uses.

The poor are also more vulnerable to the effects of climate change, which in the short term may manifest itself in the form of increased incidence of floods, droughts, cyclones and other natural disasters and in the long term could have potentially serious

effects on water resources and cropping patterns. The effects of climate change can thus cause widespread loss of the assets of poor communities in the short run, which tend to be more vulnerable to natural disasters. In the longer term, climate change can potentially have negative effects on the yields of crops such as cotton which are grown in areas where heat stress is high, and rice which requires the regular provision of adequate water supplies.

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33. Government of Pakistan, 2001: *Economic Survey, 2000-01*. Economic Adviser's Wing, Finance Division Islamabad. Cultivable waste is defined as land available for cultivation, but not cropped in the last two years.