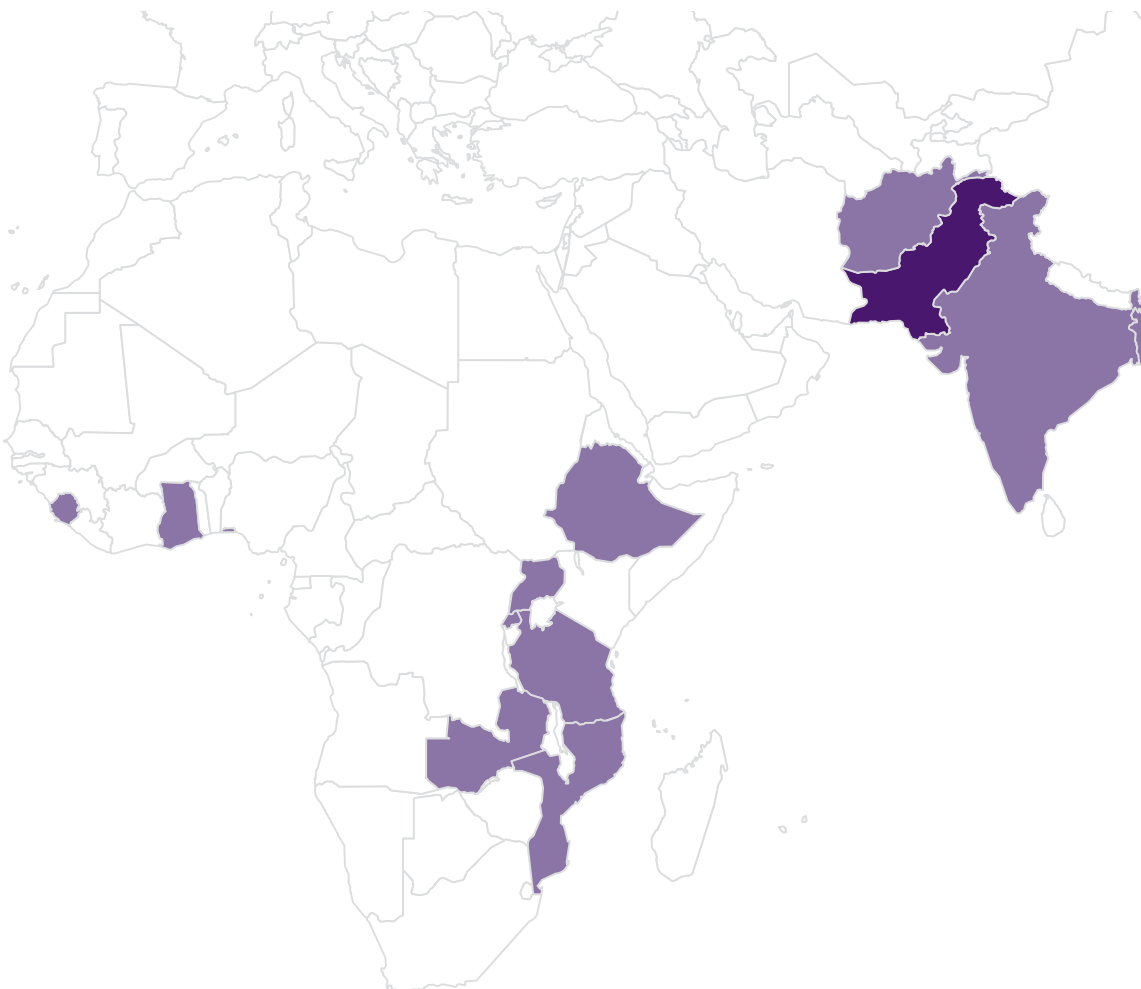


Analysis/review OF PSDP: Phase-I Report on Macro-Fiscal and Development Framework for the PSDP

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**Working
Paper 12/0062**
February 2012



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**ANALYSIS/REVIEW
OF PSDP**

**Phase-I Report
on**

**Macro-Fiscal and Development
Framework for the PSDP**

JUNE 2011

FOREWORD

We were given just over six weeks to complete Phase-I of this study on Analysis/Review of PSDP so as to contribute to the process of budget making and finalization of the PSDP for 2011-12. We are grateful to the Deputy Chairman and Members of the Planning Commission, the Secretary, Planning and Development Division and other officials for their co-operation and valuable comments on an earlier draft. We also acknowledge the support from the International Growth Centre (IGC).

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LIST OF ACRONYMS

ADB	Asian Development Bank
APCC	Annual Plan Coordination Committee
B/C	Benefit-Cost
BSP-2	Budget Strategy Paper-2
CCEA	Cabinet Committee on Economic Affairs
CCF	Concept Clearance Form
CCI	Council of Common Interests
CDWP	Central Development Working Party
DDWP	Departmental Development Working Party
DPR	Draft Project Report
EAD	Economic Affairs Division
EAS	Economic Appraisal Section
ECB	External Commercial Borrowings
ECNEC	Executive Committee of the National Economic Council
EFC	Expenditure Finance Committee
EIRR	Economic Internal Rate of Return
EPPM	Enterprise Portfolio and Project Management
FATA	Federally Administered Tribal Areas
FBR	Federal Bureau of Statistics
FDI	Foreign Direct Investment
FIRR	Financial Internal Rate of Return
FLL	Federal Legislative List
FR	Feasibility Report
GB	Gilgit-Baltistan
GDP	Gross Domestic Product
HEC	Higher Education Commission
HR	Human Resource
IGC	International Growth Centre
IMF	International Monetary Fund
IPP	Institute of Public Policy
IT	Information Technology
KPIs	Key Performance Indicators
LGO	Local Government Ordinance
LGRD	Local Government and Rural Development
LHW	Lady Health Worker
MOF	Ministry of Finance
MTBF	Medium Term Budgetary Framework

NDA	New Development Approach
NEC	National Economic Council
NFC	National Finance Commission
NGF	New Growth Framework
NHA	National Highways Authority
NIC	Newly Industrialized Countries
NPO	National Productivity Organisation
NPV	Net Present Value
OGDC	Oil and Gas Development Company
P&D	Planning and Development
P3M3	Portfolio, Programme, and Project Management Maturity Model
PAEC	Pakistan Atomic Energy Commission
PC	Planning Commission
PCSIR	Pakistan Council for Scientific and Industrial Research
PDD	Planning and Development Division
PDWP	Provincial Development Working Party
PEPCO	Pakistan Electric Power Company
PES	Pakistan Economic Survey
PIB	Public Investment Board
PIP	Public Investment Programme
PKR	Pakistani Rupee
PMC	Planning and Monitoring Cell
PNRA	Pakistan Nuclear Regulatory Authority
PPD	Provincial Planning Department/Board
PPP	Public Private Partnership
PSDP	Public Sector Development Program
PWP	Peoples Work Program
RBM	Results-Based Management
ROI	Return on Investment
S&T	Science and Technology
SBA	Stand by Arrangement
SFC	Standing Finance Committee
SMEs	Small and Medium Enterprises
TFP	Total Factor Productivity
TUF	Technology Up-gradation Fund
WAPDA	Water and Power Development Authority
WGDP	Working Group on Development Projects

Chapter 1

TRENDS IN PSDP

1.1. Introduction

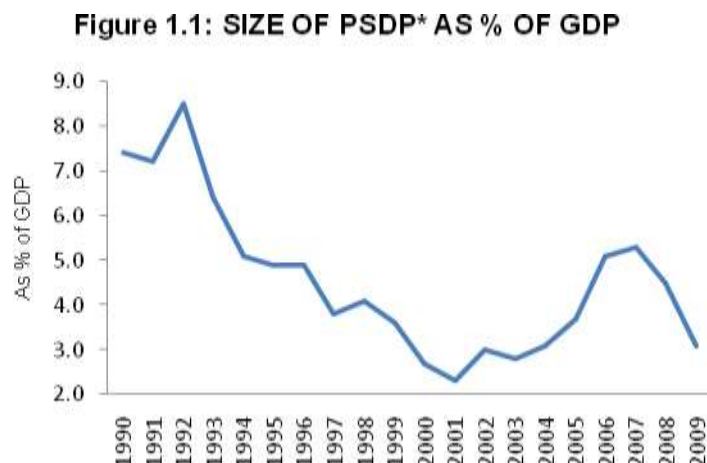
The Public Sector Development Program (PSDP) is the main instrument for providing budgetary resources for development projects and programs. According to the Planning Commission, the goals and objectives of the PSDP are as follows:

‘PSDP helps achieve the objectives and targets set by the government, to bring about a structural change towards sustainable and higher growth, achieving the MDGs and reducing poverty with measurable economic development. PSDP also helps achieve the government’s socio-economic objectives envisaged for development of the common people. The PSDP (Federal/Provincial) is the main instrument in government’s direct control to channelize funds and make developmental interventions for speedy and balanced uplift of various segments of the society. The Government provides budgetary allocations to those prioritized projects/programmes which yield maximum benefits in the shortest possible time for the society.’

The objective of this Chapter is to highlight both the long term and more recent trends in the size and composition of the PSDP.

1.2. The Level of PSDP

Analysis of data from various sources reveals that over the last two decades, the PSDP as a percentage of the GDP has shown a declining trend, from over 8.5 percent of the GDP in the early 90s to only about 3 percent of the GDP currently (see Figure 1.1). During the last decade, the PSDP had fallen to about 2.5 percent of the GDP in the earlier years of 2000 and 2001. There was subsequently a strong recovery from 2002 to 2007 when it approached 5.5 percent of the GDP, followed by a sharp decline during the last



* federal+ provincial
Source: PC, PES

2007 when it approached 5.5 percent of the GDP, followed by a sharp decline during the last

three years. It needs to be stated, however, that these trends relate only to the budgetary PSDP and not to the trend in the overall level of public investment which includes self-financing from outside the PSDP by state corporations like WAPDA, NHA, OGDC, etc.

The above mentioned trends are also revealed by the size of the PSDP in real terms (at constant prices of 1999-2000). During the last decade, the absolute size of the PSDP reached a peak in 2006-07 and has since fallen by about 13 percent by 2009-10. In fact during the current fiscal year, 2010-11, there is likely to be further decline of 25 percent. In real terms, the PSDP today is even below the level attained five years ago (see Figure 1.2).

The decline in the size of the PSDP is also reflected in the fall in its share in public expenditure, demonstrating that pressures of rising current expenditure have increasingly 'crowded out' allocations for development expenditure. Consequently, after

2006-07, in particular, the share of PSDP in public expenditure has been falling sharply from a high of almost 25 percent to a low of 12 percent projected on 2010-11 (see Figure 1.3).

A comparison of capital expenditure by the Central government in different Asian countries is given in Table 1.1. This confirms the fact that the level public investment in Pakistan is relatively low. For example, in 2009, central government capital expenditure as a percent of GDP was as high as 8.2 percent in Vietnam, 7.2 percent in Malaysia, 5.7 percent on Sri Lanka and 5.1 percent in India as compared to 2.2 percent in Pakistan. The only countries with comparable levels to

Figure 1.2: SIZE OF PSDP* AT CURRENT PRICES AND AT CONSTANT PRICES OF 1999-2000 (Rs. Billion)

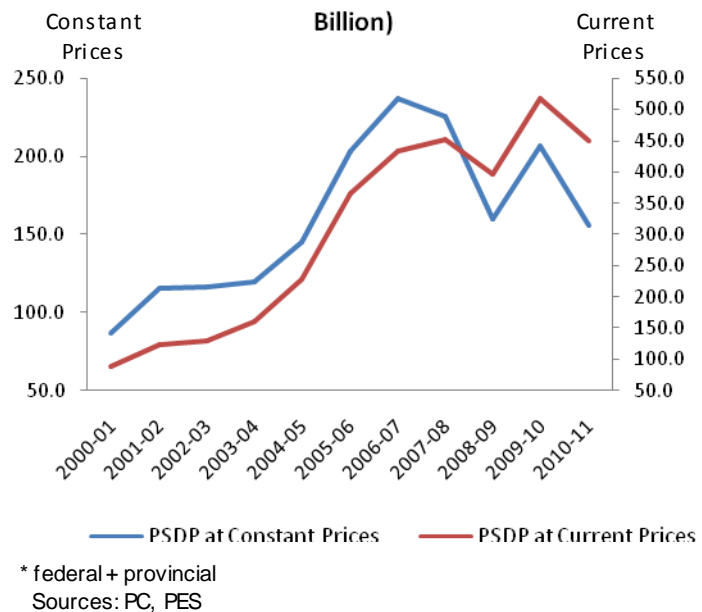
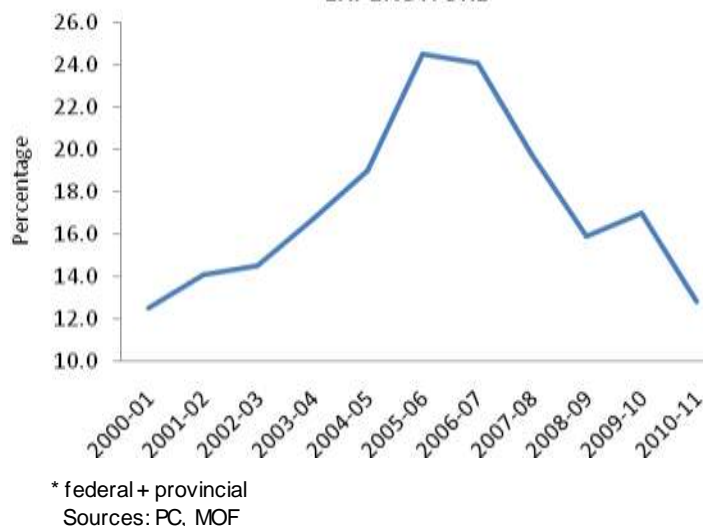


Figure 1.3: SHARE OF PSDP* IN PUBLIC EXPENDITURE



Pakistan are Thailand and Indonesia.

1.3. PSDP by Executing Agency

Historically, a large part of the PSDP has been executed by agencies of the Federal Government. In 2000-01, for example, the federal PSDP was almost 74 percent of the national PSDP, while the remainder, 26 percent, was by the four Provincial governments combined. The role of the Federal government in public investment has declined sharply since then. By 2009-10, the share of the Federal and Provincial governments respectively was almost equal. The current fiscal year is the first year after the

Table 1.1: CENTRAL GOVERNMENT CAPITAL EXPENDITURE AS % OF GDP

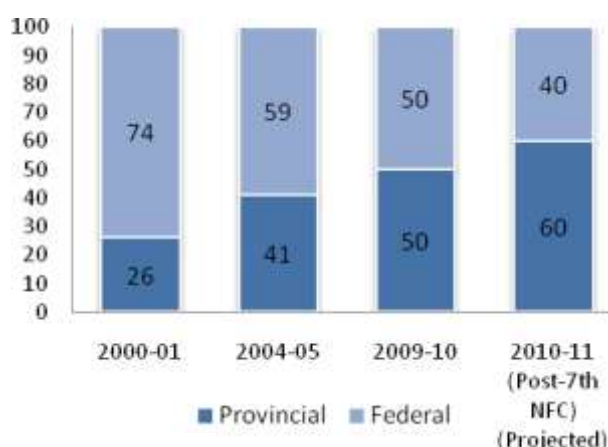
	1990	2000	2009
Bangladesh	5.7	6.9	4.4
India	4.8	2.5	5.1
Indonesia	8.6	3.1	1.3
Malaysia	6.7	7.0	7.2
Pakistan	5.2	1.9	2.2
Philippines	3.1	1.8	<i>n.a.</i>
Sri Lanka	6.1	5.3	5.7
Thailand	2.3	4.0	2.0
Vietnam	5.1	6.7	8.2

Source: ADB.

promulgation of the 7th NFC Award, which has changed the revenue-sharing formula in favour of the provinces and implied an additional transfer of almost Rs 220 billion from the Federation to the Provincial governments¹. Consequently, the combined share of the Provincial governments in the national PSDP is expected to rise to 60 percent in 2010-11 while that of the Federal government will fall to 40 percent. This has the fundamental implication that the locus of development planning in the country is shifting to the Provinces (see Figure 1.4).

The agencywise break up in terms of PSDP execution is given in Figure 1.5. Post- 7th NFC Award, the share of Federal Ministries/Divisions is projected to fall to 24 percent from 32 percent in 2009-10, prior to the Award. State corporations (National Highway Authority, Water and Power Development Authority, etc.) are expected to have a share of 10 percent while, as highlighted above, Provincial governments are likely

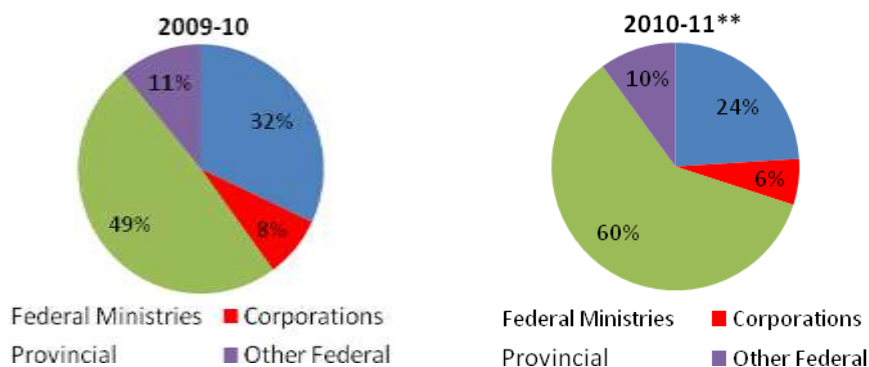
Figure 1.4: SHARE OF FEDERAL AND PROVINCIAL GOVERNMENTS IN THE PSDP



¹ According to the Institute of Public Policy (IPP) latest Annual Review on the 'State of the Economy: Devolution in Pakistan'.

to execute over 60 percent of the national PSDP. The remainder, about 6 percent, is in the form of special programs and projects in special regions (Azad Jammu and Kashmir, Gilgit-Baltistan, FATA, etc.).

Figure 1.5: AGENCYWISE BREAKUP OF EXECUTION OF PSDP*
(Pre and Post-7th NFC Award)



* federal + provincial
** original estimates
Source: PC

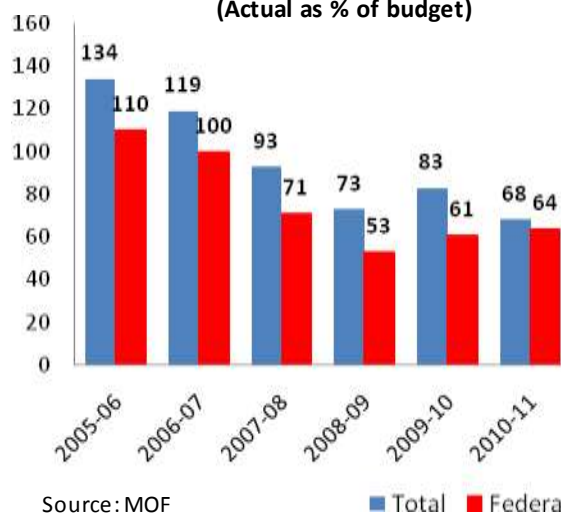
1.4. Shortfalls in PSDP

The contraction in the size of the PSDP is primarily a consequence of the efforts at controlling the fiscal deficit (especially in light of targets in the SBA with the IMF) in the presence of a low and stagnant tax-to-GDP ratio and rapid growth of current expenditure on security, subsidies, etc. As such, the initially budgeted levels of PSDP, both Federal and Provincial, have not been realized and there have been large cutbacks in the size of the PSDP from 2007-08 onwards.

According to Figure 1.6, the actual size of overall PSDP was 7 percent lower than the budgeted level in 2007-08, 27 percent lower in 2008-09 and 17 percent lower in 2009-10. The year, 2010-11, is likely to close with the largest cutback of almost 32 percent.

The figure also reveals that cutbacks in the size of the PSDP have been relatively larger for the Federal Government than in case of Provincial governments. The cutbacks in relation to budgeted size by the former are estimated at 29 percent in 2007-08, 47 percent in 2008-09, 36 percent in 2009-10

Figure 1.6: ACTUAL SIZE OF THE PSDP IN RELATION TO THE BUDGET
(Actual as % of budget)



Source: MOF

and likely 36 percent in 2010-11. A particular factor contributing to the large cut-back in 2010-11 were the devastating floods which required funds to be diverted for relief and rehabilitation.

These large reductions in allocations have inevitably disrupted the development process causing delays in payments to contractors, procurement and in the physical execution of works. It needs to be emphasized that the shortfalls are much larger than the 'operational shortfalls' normally allowed for by the Planning Commission.

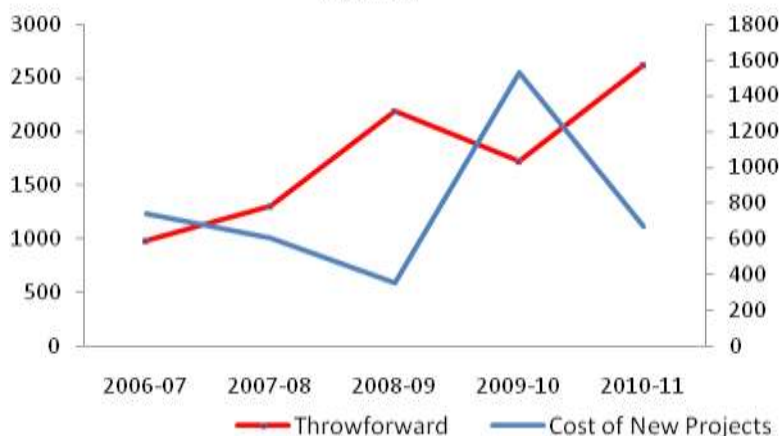
The practice of large 'ad hoc' cut backs in PSDP during a financial year, more or less, unilaterally by the MOF needs to be avoided. Now that, following the 18th Amendment, the National Economic Council (NEC) is mandated to meet at least twice a year, then any decision to cut back the PSDP should be presented to the NEC for approval.

1.5. Size of the Throwforward and New Schemes

At the start of any fiscal year, the throwforward is measured as the total estimated cost of on-going schemes in the PSDP less the cost already incurred on them. At the Federal level, the throwforward has built up rapidly due not only to the low budgetary allocations but also because of the subsequent cutbacks. During the last five years, the throwforward has increased from about Rs 1000 billion in 2006-07 to almost Rs 2600 billion at the start of 2010-11. It is likely that the next fiscal year, 2011-12, will commence with a throwforward of almost Rs 3100 billion (see Figure 1.7).

The buildup of the throwforward by is due partly to high rates of approval of new schemes, which subsequently receive allocations and become on-going schemes and partly because of the escalation in cost of on-going schemes (see Box 1.1). The cost of new schemes peaked at almost Rs 1600 billion in 2009-10 and is reported at over Rs 600 billion in 2010-11. It may be observed that there was a fall in the size of the throwforward in 2009-10 following the exercise of rationalizing the project

Figure 1.7: THROWFORWARD AND COST OF NEW SCHEMES
(Rs Billion)



Source: PC

portfolio in 2008-09 which led to an almost 20 percent reduction in the size of the throwforward.

An exercise has been carried out of quantifying some of the key indicators of the Federal PSDP over the last five years. The analysis excludes the power sector because this sector includes the Diamer-Basha dam with a cost of Rs. 894 billion, but currently only with an allocation of Rs. 15 billion in 2010-11, primarily for land acquisition. Also, there are significant allocations for projects in this sector outside the budgetary PSDP by WAPDA.

There is need to explore the possibility of taking large mega projects like Diamer-Basha Dam, Chasma Nuclear Power Projects, Neelum-Jhelum Hydropower Project, M-1 Motorway Project, etc., outside the regular PSDP in order to keep the throwforward at a manageable level. Special financing arrangements will then be needed to complete these projects.

Box 1.1

Extent of Escalation in Cost

Given below is the extent of escalation of cost in some large schemes between 2003-04 and 2010-11. There is a wide variation in the increase in costs.

Project	% Cost Escalation
1. Islamabad-Peshawar Motorway	47
2. Lowari Tunnel	193
3. Widening & Improvement of N-85	49
4. Rehabilitation, Improvement and Widening of Karakoram Highway	67
5. Railways Track Rehabilitation Plan	-14
6. Procurement of 69 D.E. Locos	0
7. PhD Fellowship for 5000 Scholars	0
8. National Program for Family Planning & Primary Health Care	415
9. Expanded Programme for immunization	392
10. Raising the Mangla Dam (including resettlement)	62
11. Mirani Dam	0
12. Greater Thal Canal (Phase-1)	0
13. Kachi Canal	0
14. Lower Indus Right Bank Irrigation & Drainage	235
15. Right Bank Out fall Drain from Sehwan to Sea	109

The escalation is higher in the case of some projects like the Lowari Tunnel and the Family Planning Program which have undergone design changes or upscaling. In other cases, costs have been adjusted for inflation. However, in some cases like the Mirani Dam no provision has been made for cost escalation.

The magnitudes of the key indicators are presented in Table 1.2. The number of schemes is large, approaching 1800. The average cost per scheme has risen from Rs 952

million in 2006-07 to Rs 1638 million in 2010-11, partly as a result of inflation. The fact that the portfolio of schemes is relatively 'young' is demonstrated by the high throwforward as a percentage of the cost of on-going schemes at almost 63 percent. The foreign loans/grants component in cost has gone up somewhat from about 18 percent in 2006-07 to almost 23 percent in 2010-11. The tendency for approval of a large number of new schemes was relatively high in 2006-07 when the cost of new schemes accounted for 43 percent of the total portfolio. This has since declined to 30 percent, but still remains high.

Evidence of the process of 'spreading thin' of allocations is given by the high ratio of the throwforward to allocation for on-going schemes. This has gone up from 4.4 in 2006-07 to 11 in 2010-11. This implies that it will take upto eleven years to complete on-going schemes. The position is even worse with regard to new schemes which can now take almost seventeen years on average to complete. The implications of this spreading this of the implementation process is that the development impact of the PSDP will be delayed due to low rates of completion of schemes as given below and most on-going schemes will be subject to substantial cost overruns.

Table 1.2: SOME KEY INDICATORS OF THE FEDERAL PSDP*

	2006-07	2008-09	2010-11
Number of Schemes	1796	1770	1779
Average Cost per Scheme (Million Rs.)	952	1257	1638
Throwforward as % of Cost of On-Going Schemes	63.6	65.9	62.7
Foreign Loans/Grants as % of Total Cost	17.5	18.1	22.7
New Schemes Cost as % of Total Portfolio	43.1	22.3	29.7
Share in PSDP of New Schemes (%)	30.0	24.7	21.0
Throwforward/Allocation for On-Going Schemes	4.4	4.4	10.8**
Cost of New Schemes/Allocation for New Schemes	7.7	3.9	17.1**

* excluding power sector.

** as per the revised allocation following cutback

Source: PC

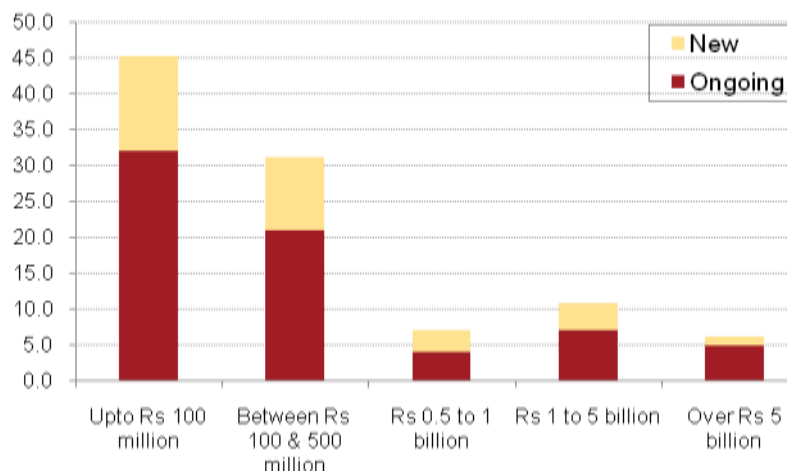
It needs to be emphasised that almost 80 percent of the throwforward is in projects related to development of infrastructure, while the remaining 20 percent is in the social sectors, special programs and areas. Therefore, any major rationalization of the throwforward will require sharp prioritisation especially in outlays on infrastructure projects.

1.6. Completion Rate of Schemes

The World Bank has undertaken a review of the portfolio of on-going schemes in the Federal PSDP. According to this review, a large part of the portfolio consists of relatively small projects as shown in Figure 1.8. Almost 45 percent of the schemes are below the size

of Rs 100 million, while another 35 percent are between Rs 100 and Rs 500 million. This implies higher than desired overhead costs on project management and problems in implementation due to lack of adequate project execution capacity, especially in some of the smaller line ministries and in the special regions.

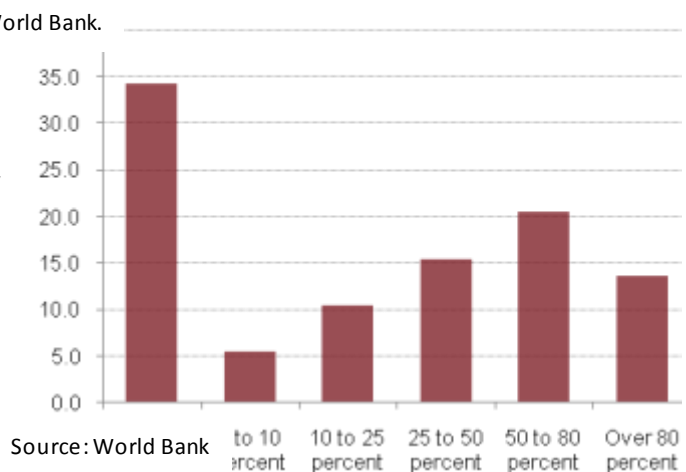
Figure 1.8: DISTRIBUTION OF SCHEMES BY SIZE



The stage of completion of on-going schemes is presented in Figure 1.9. Almost 35 percent of the schemes are virtually new. 15 percent of the schemes are less than 25 percent complete. Only 13 percent of the schemes are more than 80 percent complete.

The World Bank also estimates that projects take twice on average to complete in relation to the proposed phasing of implementation in the PC1s. The design completion period for a project/scheme is 34 months, whereas the actual time taken for completion is 68 months (see Figure 1.10). This delay in completion highlights problems in funding and also in the implementation process arising from difficulties in land acquisition, appointment of contractors, procurement, etc.

Figure 1.9: DISTRIBUTION OF SCHEMES BY EXTENT OF COMPLETION

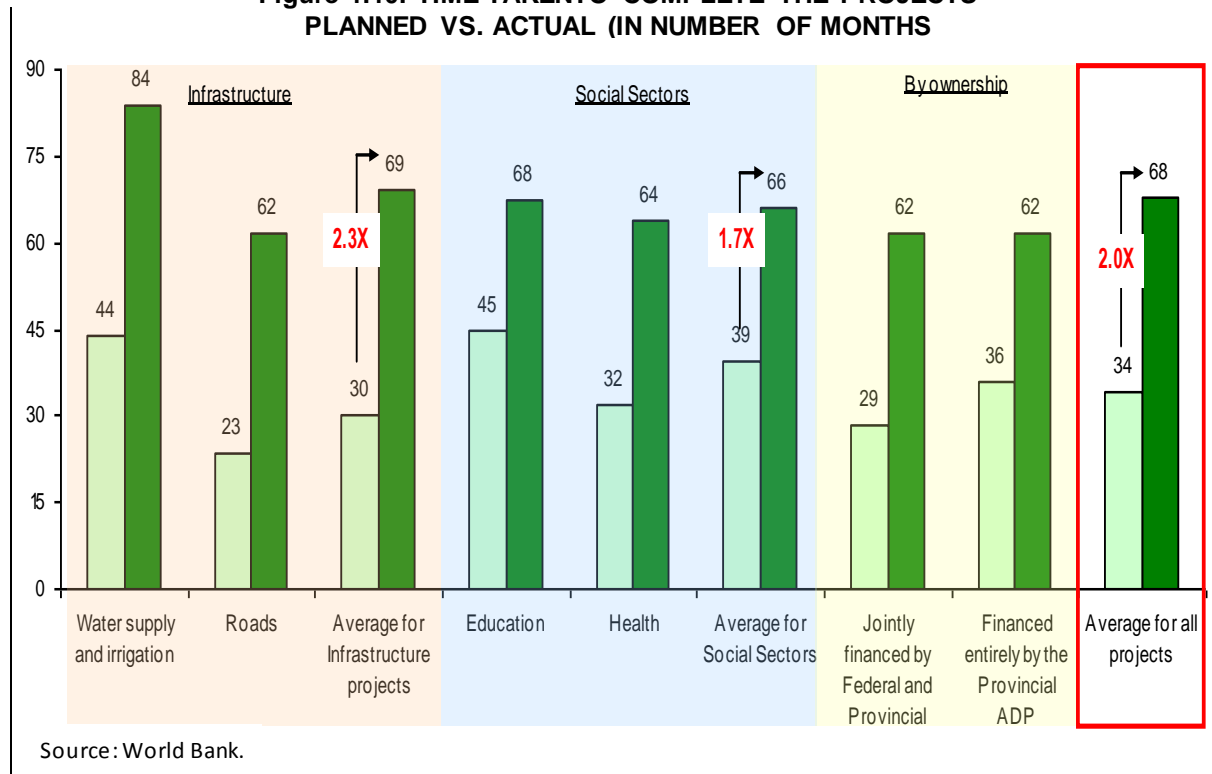


1.7. Conclusions

There appears to be a visible breakdown in the planning process as it relates to the PSDP. At the macro level, the fiscal space for financing development expenditure has become increasingly restricted. Not only have the budgetary allocations for the PSDP declined in real terms but there have also been large shortfalls in recent years. On top of this

the Planning Commission has become primarily a project approval agency. Standards of project preparation and approval have slackened considerably and far too many projects are

**Figure 1.10: TIME TAKENTO COMPLETE THE PROJECTS
PLANNED VS. ACTUAL (IN NUMBER OF MONTHS)**



being cleared through the CDWP/ECNEC process without proper fiscal assessment by the principal technical sections and overall implications of each scheme on available resources and in the absence of sectoral or national development plans. The consequence is that the throwforward of schemes has become very large and given the limited size of the PSDP has implied that allocations have been spread too thin over a large number of schemes. This is not only stretching project implementation capacity and leading to cost overruns but also more importantly, limiting the development impact of the public investment program.

Chapter 2

THE NEW GROWTH FRAMEWORK AND THE PSDP

2.1. Introduction

Pakistan's growth performance over the past sixty years has been characterized by boom-bust cycles, with the typical growth episode lasting not more than 4 to 5 years. This is unlike the experience of many of the successful fast-growth emerging economies such as China, India and Vietnam, and the NICs previously, where high rates of growth have been sustained for several decades.

The country's relatively lacklustre growth performance has come despite considerable investment in physical infrastructure over the past decades. In fact, a comparison of global "competitiveness indicators" suggests that physical infrastructure in itself is not a binding constraint in Pakistan's below-par economic performance, except for access to power (see Box 2.1).

Box 2.1

Pakistan's Ranking in Global Competitiveness Index

Pakistan's ranking in the overall Global Competitiveness Index is low at 123 out of 139 countries in 2010. The index is comprised of 111 indicators in twelve pillars. Given below are the 10 indicators in which Pakistan does the best and 10 indicators in which it does poorly.

10 Best		10 Worst	
Indicator	Ranking	Indicator	Ranking
Domestic Market Size Index	26	Business Cost of Terrorism	138
Strength of Investor Protection	27	Inflation	137
Total Tax Rate	37	Female Participation in Labor Force	137
Ease of Access to Loans	40	Trade Tariffs	133
Financing through Local Equity Market	43	Primary Education Enrollment Rate	132
Extent and Effect of Taxation	46	Quality of Electricity Supply	128
State of Cluster Development	46	Organized Crime	127
Available Airline Seat Kms	48	Business Cost of Crime & Violence	126
Hiring and Firing Practices	51	Country Credit Rating	125

It can be seen that while Pakistan does well in infrastructure (airline seats), strength of investor protection, financing of firms, etc., it does poorly in business costs due to terrorism, quality of electricity supply and education.

Despite the fact that the fiscal multiplier associated with PSDP spending is estimated to be significant (at over 2 times)* , its impact on growth does not appear to be sustained and long run in character. This can perhaps partly be explained by the *quality* of the projects portfolio (i.e. too many projects in the overall portfolio with low development impact and long implementation lags) and/or the quality of execution (with cost and time overruns diluting the spill-over effects).

An important lesson is that the scale and ambition of the public investment program should be in greater alignment with both the level of planned domestic fiscal resource generation as well as the “absorptive” capacity of executing agencies. In the absence of this alignment, the ramping up of the process of approval of new projects has created a massive throwforward of projects that is likely to cross Rs 3 trillion by the end of 2010-11.

In any case, at less than 3% of GDP currently, the PSDP accounts for only 20 percent of total fixed investment, making it one element of the investment mix, but not the most important one. Private investment, and in particular foreign direct investment (FDI), account for the bulk of the capital formation each year.

Hence, while the PSDP may be important in kick-starting the economy under recessionary conditions, it is not sufficient to sustain the required rates of overall investment in the economy. To “crowd in” sustained private investment requires more than just a high level of public investment in physical infrastructure and development of human capital, it requires the government to play its role as an “enabler” (or facilitator) in the economy, by providing the appropriate institutional framework, including laws and regulations, such as guaranteeing property rights, providing for contract enforcement and dispute resolution mechanisms, for example. In addition, improvements in security and law and order need to be focused on as Pakistan does extremely poorly in indicators of business cost of terrorism, crime and violence (see Box 2.1).

2.2. The New Growth Framework

Given the limitations of the public investment approach as a prime instrument of public policy to spur growth, the Planning Commission is formulating the Tenth Five Year Plan in the context of a “Framework for Economic Growth” that will place greater emphasis on *incentives, institutions, markets, communities, and governance* with the prime objective of raising Total Factor Productivity (TFP). (See Box 2.2) The new approach aims to develop the “software” of economic growth, increase competitiveness, redefine the government’s role in markets, promote investments on the basis of higher productivity, innovation and

* See Chapter 3 for the estimate.

entrepreneurship, exploit the immense potential of a large domestic market, make cities and regional clusters engines of growth, improve governance and public service delivery and enhance productivity.¹

Box 2.2

Determinants of Long Term Growth in Total Factor Productivity

Qazi Masood and Kalim Hyder (2007) have quantified the contribution of TFP to GDP growth on the basis of the standard application of the growth accounting approach of Solow (1956) in Pakistan over the period, 1973 to 2006 as follows:

Average GDP growth rate= 5.2%; Average Contribution of TFP to GDP growth = 1.9%, implying TFC contribution = 36%

This compares with an estimate of 26 percent for, more or less, the same period by the World Bank (2006).

Determinants of TFP Growth have been quantified as follows:

	Contribution to TFP Growth (%)
Cotton Output	12
Manufactured Exports	32
Human Capital Index	27
Development Expenditure	14
Credit to Private Sector	8
Others	7
Total	100

Therefore, opening up of the economy to international competition for manufactured exports has made the biggest contribution of 32 percent to TFP growth followed by the human capital index (measured as the years of schooling of the employed labour force). It also appears that public sector development expenditure makes a significant contribution to the improvement in TFP.

The new framework differs from the previous public investment-driven approach in at least six areas:

- A greater emphasis on “software” versus “hardware” of economic growth, i.e. an approach that will focus on enhancement of productive capacity, for example, rather than pure brick-and-mortar investment;
- A more dominant role for *Markets*;
- *Endogenous* versus *Exogenous* competitiveness;
- *Entrepreneurship* instead of *Government concessions*;

¹ Adapted from *Pakistan: New Growth Framework*, Planning Commission, 2011 (draft)

- A new role for *Cities*;
- *Quality* versus *quantity* of Service delivery

However, perhaps not emphasised is being placed on export promotion, which as shown by Masood and Hyder in Box 2.2 above is a major source of increasing TFP through greater international competition and technology transfer.

A new approach to spurring sustainable growth and development is appropriate for the constrained fiscal environment that Pakistan is facing, and is likely to continue experiencing for the next several years. With a major breakthrough in domestic resource mobilisation proving elusive for the time being, rigid expenditure demands on account of security spending and rising debt servicing, and the provision of subsidies to cushion the impact of rising commodity prices, the fiscal space for expanding development spending is limited.

In fact, the Report of the Working Group on Development Projects (WGDP) of the PC recommends as follows:

‘The FYPs should not be a fixed but flexible document representing a continuously evolving process and be adaptable to changing circumstances and requirements. Besides other things it should be able to identify the priority areas in each sector for public and private investment, which are likely to yield best results for the sector as well as the national economy, and with reference to which the new development projects are identified and the on-going projects are reviewed and amended in scope and design.’

Under such circumstances, it is appropriate for public policy to emphasise enhancing *productivity* of government expenditure, rather than look to increase its volume substantially. Two areas where interventions to improve “software” can lead to large pay-offs in productivity-enhancement can serve as examples of the proposed new approach: better operation of urban land markets and enhancement of agricultural yields through research and extension.

Currently, government and quasi-public sector entities such as the armed forces, Pakistan Railways, Steel Mills, and Karachi Port Trust, to name a few, own a disproportionately large portion of real estate in the major urban centres of the country. In Karachi, for example, it is estimated that up to 94% of available land is under the administrative or legal control of the above entities. As a result, with only a small fraction available for commercial use, the price of land is bid up to the point where development becomes commercially infeasible.

Mechanisms to make large swathes of prime urban land available for commercial use, such as through long term leases, outright sale and better zoning laws, can be undertaken at

virtually no recourse to the budget. In fact, done in a transparent manner, the process can yield substantial revenues for the entities involved. At the same time, it can unleash investment in real estate development and commercial activity on a large scale.

Similarly, despite being an agrarian economy, Pakistan’s yields for major crops are well below international, or even regional, averages. Closing the “yield-gap” in cotton, rice and wheat, for example, can usher in a second green revolution in the country. This requires improving *productivity*, not greater inputs. The required productivity-enhancement, in turn, requires minimal fiscal resources to improve existing on-field practices via improved research and extension services.

Ijaz Nabi (2010) highlights the fact that yields in crops like wheat, rice, sugarcane and cotton are below those of the Indian Punjab. Also, biotechnology offers the greatest potential for quick gains, especially in cotton output. He also emphasises on the need for fixing the policy framework for achieving competitiveness in manufacturing by removal of the overvaluation of the exchange rate, improved access to credit of SMEs, elimination of distortions in energy pricing and so on.

As both the foregoing examples illustrate, re-igniting economic growth does not necessarily require expending large fiscal resources in brick-and-mortar investment. A better prioritisation of expenditures, and an improved spending framework, can deliver very large pay-offs with perhaps only moderately enhanced level of development outlays.

2.3. Aligning the PSDP with the “New” Growth Drivers

A look at the current composition of the PSDP allocation, in Table 2.1, will make abundantly clear the magnitude of the shift in priorities that the New Growth Framework will entail. Based on original budgetary allocations for 2010-11, the largest share in the PSDP

was for *physical infrastructure* projects (32.8 percent), followed by projects in the *social development* domain (18.9 percent). *Special programmes*, bulk of which are discretionary in nature (such as the Peoples Works programme),

constitute 15 percent of the total budgeted allocation for PSDP, while *Others* constitute 14.6 percent. Allocations for “*special areas*” (Azad Kashmir, FATA, Gilgit-Baltistan, etc) account

Table 2.1: SECTORAL PRIORITIES IN FEDERAL PSDP*

Sector	2004-05	2006-07	2008-09	2010-11**
Social Development	14.4	14.2	16.4	18.9
Infrastructure	50.8	46.9	37.5	32.8
Productive Activities	6.2	5.5	7.6	4.6
Special Areas	7.8	6.2	11.3	13.8
Special Programmes	6.4	14.1	12.3	15.3
Others	14.5	13.1	14.9	14.6
Total	100.0	100.0	100.0	100.0

** federal, as per original allocations.
* original
Source: PC

for 13.8 percent of total, with *productive activities* getting the balance allocation amounting to only 4.6 percent (see following Table).

A broad classification of Ministries/Divisions within these categories is given in Chart 2.1. The current practice in the PSDP is to classify Divisions into three categories – infrastructure, social development, and others. Accordingly, the share in original PSDP allocations in 2010-11 was 49 percent to infrastructure, 47 percent to social development and the rest, 4 percent, to others. The alternative classification system suggested here is more disaggregated and perhaps more revealing in nature.

Chart 2.1	
A SUGGESTED RECLASSIFICATION OF DIVISIONS IN PSDP	
SOCIAL DEVELOPMENT	Culture, Education, Environment, Health, HEC, Local Government and Rural Development, Population Welfare, Social Welfare and Special Education, Women Development, Youth, Labor & Manpower, Sports.
SPECIAL AREAS	Kashmir Affairs and Gilgit-Baltistan, States and Frontier Regions.
SPECIAL PROGRAMMES	Special Programmes (PWP), Special Initiatives.
INFRASTRUCTURE DEVELOPMENT	PAEC, Communications, IT & Telecomm, Postal Services, PNRA, Ports & Shipping, Railways, Water, Power.
PRODUCTIVE ACTIVITIES	Defence Production, Food and Agriculture, Industries and Production, Livestock & Dairy Development, Petroleum and Natural Resources, Textile Industry, Tourism, Science & technology.
OTHERS	Cabinet, Commerce, Defence, Economic Affairs, Finance, Establishment, Information & Broadcasting, interior, Law, etc, Foreign Affairs, Narcotics Control, Planning & Development, Revenue, Housing & Works, Statistics.

As described above, the principal growth drivers envisaged in the proposed New Growth Framework are as follows:

- *Addressing the energy constraint*
- *Innovation (science and technology) (see Box 2.3)*
- *Urban development*
- *Human capital development (including investing in youth)*
- *Agricultural productivity*

Box 2.3

India's emphasis on S&T (Science and Technology)

Since independence, India has progressively allocated greater attention and resources to the development of Science and Technology (S&T). While in the initial decades, the rationale for policy emphasis on S&T appears to be more security-related, since India's adoption of market reforms over two decades ago, S&T has been viewed as a growth driver in its own right.

The greater emphasis and role of S&T in India's economic development is captured in the relative allocation in the Union and state budgets and proposed spending in the Five Year Plans. For India's Eleventh Plan (2007-2012), the total outlay projected for S&T amounts to INR 150,000 crores (Pak Rupees 2.9 trillion, or US\$ 34 billion at current exchange rates).** This is approximately equal to 1% of India's GDP. By comparison, Pakistan's actual spending on S&T as a percentage of GDP amounts to less than one fourth.

Within the S&T domain at the Union level, the bulk of the projected outlay in the Eleventh Plan is for India's space research program (41% of total), followed by programs of the department of science and technology (15%), for research and development in atomic energy (15%), and for scientific and industrial research (12%). The projected outlay for biotechnology programs is US\$ 1.4 billion (8% of total projected Plan outlay on S&T).

The emphasis on S&T has produced growth payoffs for the Indian economy across a broad spectrum of sectors and activities, ranging from agriculture to ICT, from the medical industry to pharmaceutical exports, from the automobile sector to the space and defence-related sectors. India's world ranking in the "Innovation" pillar in the global competitiveness indicators produced by the World Economic Forum has climbed to 39, significantly higher than its overall global rank of 51.

** Statement of India's Science & Technology minister, April 28, 2011. According to India's eleventh Plan, 75,304 crores (Pak Rupees 1.4 trillion, or US\$ 17 billion at current exchange rates) is the projected outlay for Central Scientific Departments.

Casting budgetary allocations in the PSDP both of the Federal and Provincial governments around the new growth drivers would imply changes in sectoral priorities of the type given in Chart 2.2.

Chart 2.2
RECOMMENDED CHANGES IN PRIORITIES
IN LINE WITH THE NEW GROWTH FRAMEWORK

	Implications of NGF	Following Depoliticisation of PSDP	Overall
Social Development	↗		↗
Special Areas			→
Special Programmes		↘	↘
Infrastructure Development	↗		↗
Productive Activities	↗		↗
Others		↘	↘

Hence, as seen from the Table, the proposed PSDP allocations would be skewed heavily towards three broad categories, namely *Physical Infrastructure*, *Social Development*,

and *Productive Activities*. By implication, it is being proposed that to rationalise the allocations and align scarce resources towards larger, 'strategic' development priorities, the current practice of sequestering fairly significant allocations within the PSDP for discretionary and directed programs and schemes is largely restricted on the basis of assessment of likely outcomes.

2.4. Strategic Interventions through PSDP

It is important to link the new growth drivers and changed sectoral priorities with specific interventions in the PSDP, both Federal and Provincial. Examples of such interventions for the principal growth drivers are given below. Many of these could be based on Public-Private Partnerships (PPP)⁴ or other arrangements:

Innovation, Entrepreneurship and Competitiveness (mostly Federal initiatives):

- Creation of a *Technology Up-gradation Fund* (TUF) to finance initially technology upgrades in the export sector. As additional fiscal resources become available, the ambit should be increased to all eligible firms;
- Creation of *Business Incubation Centres* in partnership with industry;
- The re-invigoration of *Pakistan Council for Scientific and Industrial Research* (PCSIR);
- Funding *Centers of excellence* in science and technology (S&T) in public as well as private universities (in PPP-mode);
- The creation of an *Industrial Standards and Certification Authority* ;
- The re-invigoration of the *National Productivity Organisation* (NPO) under PPP-mode to work with industry;
- Re-energising the *Energy Conservation* (Enercon) agency to conduct energy audits in industrial units;

Agriculture (mostly provincial initiatives):

- The funding of existing / setting up of new *world class research facilities* for improving yields in major crops (cotton, wheat, rice);
- Financing the training of an *extension services* corps to provide farmers with timely advice and best-practice knowledge;
- The re-invigoration of *water resource conservation and management* through appropriate levels of financing, including collaboration with private sector;

⁴ Phase 2 of the Report will discuss in detail PPPs and BOT projects in infrastructure and social services.

- Community based initiatives for livestock/dairy development

Urban Development (mostly provincial and local initiatives):

- Investments in efficient mass transit systems and urban transport for the large urban centers (initially, Karachi and Lahore);
- Water desalination and recycling plants;
- Solid waste management/effluent treatment plants;
- Development of satellite towns to the major urban centres, with land connectivity to the principal “downtown” areas via transport corridors;

Connectivity (mostly federal initiatives):

- Improving IT connectivity by investment in “back-bone” / broadband infrastructure and setting up of IT parks
- Investing in Railways as a matter of priority, especially to facilitate upcountry movement of freight cargo from Karachi and Gwadar;

Human Capital Development (mostly joint federal and provincial initiatives):

- Finance capacity-building of universities in faculty upgradation, curriculum building, improvements in facilities, scholarship programs, and creation of world class research facilities
- Finance programs of existing institutions such as Navtech, Tevta and the Punjab Skills Development Fund for skills development and provision of vocation-based technical training;

Youth Engagement (both federal and provincial):

- Launch special program of employment guarantee for youth as part of a public works program
- Special skills learning for youth
- Infrastructure like community centers and sports facilities

Creating space within the PSDP for implementation of the above initiatives while require a truncation of the existing throwforward (discussed in detail in Chapter 4) and a policy that new projects are largely undertaken in the above areas. This will greatly facilitate operationalization of the new Growth Framework.

Chaudhary and Khalid (2011) quantify the impact of the New Growth Framework on the future rate of growth of TFP in Pakistan. According to the Macroeconomic Framework developed by them, growth in TFP could make a contribution of 1.25 percentage points to the GDP growth rate in 2011-12, rising to 2.0 percentage points by 2015-16. Subject to a significant jump in the rate of investment (including public investment) of 4.5 percent of the GDP, the growth rate of the economy could approach 7.75 percent by 2015-16.

2.5. Social Versus Physical Infrastructure

The issue here is whether investments in social sectors and physical infrastructure complement or compete with each other. In a simple accounting sense, especially given the limited resources available for the PSDP in recent years, there is competition among sectors for PSDP allocations. But, as Table 2.1, shows, the share of the PSDP going to schemes for social development has increased somewhat from 14 percent in 2004-05 to 19 percent in 2010-11. There has simultaneously been a sharp fall in the share of investments in infrastructure from almost 51 percent to under 33 percent. However, this decline has not come due to large-scale diversion of resources to the social sectors but because of increases in the shares of special areas, special programs and others, some of which are politically driven, while others contribute to the development of the relatively backward areas of the country and focus on removal of service gaps at the individual constituency level.

The new Growth Framework actually emphasises the 'synergy' and complementarity between the social sector and physical infrastructure investments. On the one hand, social development alongwith civil service reform which leads to the development of human capital in the public sector not only has the direct impact of improving the managerial and technical capacity for more effective execution of complex infrastructure undertakings but also in a broader sense of increasing the development impact of infrastructure investments by enabling a larger 'crowding in' of private investment in response to the expansion of productive capacity through the availability of more entrepreneurship and skills in the population. Cost effective public/private initiatives in the areas of education and energy could lift Pakistan in two competitiveness indicators in which it performs poorly (see Box 2.1).

On the other hand, the presence of more infrastructure like roads, electricity, etc. also makes for greater efficiency in the utilisation of and in the quality of delivery from existing social services facilities. Therefore, the new Growth Framework focuses on the complementarity between social services and physical infrastructure. As such, in the context of the national PSDP of the Federal and Provincial governments combined there is a need to

increase the share in allocations of both sectors by a cut back in special programs and allocations to other sectors.

Beyond the period of transition after the 18th Amendment, it needs to be recognised that following the completion of on-going schemes, the Federal government will largely move out of the social sectors and the prime responsibility for social development will fall on the Provincial governments. As such, the former will face no real trade off between allocations to social sectors and physical infrastructure. However, Provincial governments will have to focus on the complementarity between social and economic infrastructure.

2.6. The New Institutional Architecture for Economic Planning

Following the implementation of the 18th Constitutional Amendment, the planning function will, *de facto* if not *de jure*, also “devolve” to the provinces in that sub-national governments will be the final arbiters of their respective priorities, rather than merely implementing national, vertical and top-down driven policies and targets. Hence, the planning function will become more ‘spatial’ (bottom-up) with provinces at the centre of the formulation of sub-national policies and the determination of objectives and goals. Within provinces, the ‘bottom-up’ approach could start from the district level.

The Planning Commission’s role will change in three ways. First, with a large part of the public sector development spending being devolved to the provinces, its role will diminish in overall terms in administering the PSDP. This function is likely to be taken over by provincial planning and development (P&D) departments. Second, the Planning Commission’s role as a coordinator of national policies and objectives will enhance. It will henceforth need to formulate its plan with much greater provincial input and say than has been the case thus far. Third, the Planning Commission will have to play a more active role in capacity building of P&D departments in the provinces.

To reflect the changed reality post 18th amendment, the composition of the Planning Commission may need to evolve with representation from each province at the Member-level. Hence, a senior nominee of each province should be inducted as a Member of the Planning Commission with a clear identification of his/her role and functions, consequent to the 18th Amendment. In addition, the process of formulation of the Annual or Five-Year Plans should be undertaken with greater provincial involvement and influence from the beginning of the process (also see chapter 6).

With a lumbering federal structure where the states are not only numerous but also powerful and “autonomous”; India offers an example of planning under devolved conditions.

There too, the planning model has evolved into one that is 'spatial' in nature, in that states formulate their own priorities, but coordinate via the Planning Commission on federally-run programs or programs of national importance and ensuring a consistency between spatial and sectoral plans.

In addition to the evolved role and function of planning as a result of the passage of the 18th amendment, the Planning Commission needs to be strengthened in other ways. An important step in terms of institutional architecture would be to reverse the move to coalesce Planning with the Ministry of Finance in 2009 and transform this into a more horizontal relationship. Around the world, the planning function is performed independently of other ministries, and where a formal Planning Commission or its equivalent exist, it is headed by the Prime Minister as in Pakistan.

Chapter 3

MACRO-FISCAL FRAMEWORK FOR PSDP

3.1. Introduction

We have highlighted in the previous Chapter that allocations for the PSDP in Federal and Provincial budgets have increasingly been constrained by the lack of fiscal space in the respective budgets. The objectives of this chapter are, first, to highlight the extent to which fiscal adjustment in the event of divergence from budgetary targets has fallen on the PSDP in the form of large cutbacks. Second, the implications of the size of the PSDP on the GDP are quantified through the 'fiscal multiplier'.⁵ Third, the key magnitudes in the Medium Term Fiscal/Budgetary Framework of the Government of Pakistan are presented, including the projected size of the national PSDP. The extent to which the framework has to be revised in light of developments during 2010-11 is indicated and revised projections made of the size of the PSDP over the next two years.

3.2. Fiscal Adjustment and the PSDP

Table 3.1: EXTENT OF CUTS IN PSDP AS PART OF THE FISCAL ADJUSTMENT

	2008-09	2009-10	2010-11 (Est)
(Rs. in Billion)			
In relation to Budget Estimates*:			
• Shortfall in Revenue	-42 ^a	77	225
• Rise in Current Expenditure	259	218	233
• Increase in Revenue Deficit	217	295	458
Adjustment:			
• Cut in PSDP	119	88	203
% Adjustment	55	30	44

⁵ This is estimated by the use of the Macroeconomic Model of the Institute of Public Policy (IPP), Lahore. Simultaneously, a neo-classical Growth Model has been developed by Ehsan Chaudary and Ahmed Khalid with endogenous change in TFP. The IPP Model is described in Appendix 3.1.

During the last two years, and already in

* federal and provincial governments combined
 a negative indicates actual is higher than budget estimate
 Source: MOF

2010-11, large fiscal adjustments have become essential because, first, the tax revenue targets of FBR have not been achieved and current expenditure has been higher than anticipated due to unforeseen overshooting of expenditures on security, subsidies, debt servicing, etc. Second, the pressure to contain the size of the fiscal deficit has been greater because Pakistan has been operating within a macro-fiscal framework agreed with the IMF as part of the SBA.

Table 3.1 quantifies the slippages in the revenue budget of the Federal and Provincial governments combined in 2008-09 and 2009-10, and projected for 2010-11. The major contribution to the increase in the revenue deficit in the first two years is due to unanticipated increases in current expenditure. However, in 2010-11, the shortfall in revenue is likely to be almost as large as the spillover in current expenditure in relation to budget estimates.

The table also indicates the extent to which the combined PSDP of the Federal and Provincial governments has had to be curtailed to limit the increase in the fiscal deficit over the target. The cut back was Rs 119 billion in 2008-09, equivalent to 55 percent of the increase in the revenue deficit. In 2009-10, the cut back in PSDP was smaller at Rs 88 billion, equivalent to 30 percent of the increase in revenue deficit. In 2010-11 the magnitude of the downward adjustment in the size of the national PSDP is expected to be substantially larger at over Rs 200 billion. This is almost 44 percent of the increase in revenue deficit. The remainder will be reflected in a larger fiscal deficit in relation to the level budgeted at the start of the year. Overall, it is clear that much of the burden of fiscal deficit reduction has fallen on the PSDP rather than either in the form of cuts in current expenditure or in efforts to mobilize more revenues. Clearly, the discretionary component in public spending has been easier to sacrifice. This problem has been magnified by the uneven distribution of releases during a fiscal year which have contributed further to disturbing the process of implementation (see Box 3.1).

Box 3.1

POLICY FOR RELEASE OF PSDP FUNDS

The historical quarterly shares of PSDP releases by the Ministry of Finance are given below:

	(%)			
	1 st Qr	2 nd Qr	3 rd Qr	4 th Qr
2009-10	18	22	26	34
2008-09	18	19	17	46
2007-08	21	28	31	20
2006-07	17	20	22	41

2005-06	15	23	20	42
2004-05	16	22	24	38
2003-04	14	20	19	47
2002-03	17	23	24	36
2001-02	11	30	29	30
Average	16	23	24	37

Releases have been on average only 16 percent in the 1st Qr and very high in the 4th Qr at 37 percent. This has affected the execution of schemes and there is a need to make the flow of funds more even across quarters.

On 4th August 2010, a new mechanism for release of PSDP funds has been announced whereby **maximum** quarterly ceilings would be 20 percent each for 1st and 2nd Qrs, 25% for 3rd Qr and 35% for 4th Qr. There is need, however, for raising the 1st and 2nd Qr ceilings combined to 45% and reducing that for the 4th Qr to 30%. Also, some built-in flexibility has been introduced whereby the executing agency may ask for more releases in respect of fast track on-going projects while remaining within the quarterly ceiling of the Ministry as a whole.

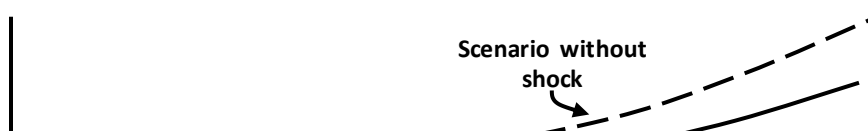
3.3. The Fiscal Multiplier of PSDP

While the preference has been to cut back the size of the PSDP in the event of fiscal pressures, the consequences has been a fall in the growth rate of the economy in the short run and some reduction in the productive capacity of the economy in the medium to long run. The 2008 report of the Commission on Growth and Development, Arslanalp, Bornhurst and Gupta (2011); Heston, Summers and Aten (2006) and World Bank (2007) demonstrate that public spending on infrastructure, education and health yield positive short and long term effects on growth. In addition, the presence of the fiscal multiplier of public investment on the GDP implies consequential effects on the level of employment and poverty.

The short term effects of public investment are best determined by quantifying the 'fiscal multiplier'. For Pakistan this has been done with the help of the Macroeconometric Model of the Institute of Public Policy. This model has 44 equations, including both behavioral equations and accounting identities (see Appendix 3.1). The model is Keynesian in character with the level of aggregate demand determining the GDP in the short run.

A simulation of the model is run with a shock in 2010-11 of a cut in the national PSDP equivalent to about 1 percent of the GDP. The consequences on the GDP during the year and the next year are derived. It appears that a Rs 57 billion cut (at constant prices of 1999-2000) in the PSDP leads to a lower GDP of Rs 114 billion in the same year. Therefore, the magnitude of the fiscal multiplier of public investment in Pakistan is two. This

Figure 3.1
Impact of a Cut in PSDP of 1% of GDP
on the GDP
 (Rs in Billion at 1999-2000 prices)



is large Source: IPP Macroeconomic Model

	2010-11	2011-12
Impact on the aggregate level of demand in the economy, and is essentially in the nature of a temporary effect. The magnitude of the multiplier has been enhanced by the fact that public investment 'crowds in' some private investment in Pakistan. Also, lasting effects are observed on the GDP because of the lagged response of private consumption to the fall in income. The impact on the GDP a year later in 2012-13 is about one thirds of the impact in 2010-11. The estimated 'fiscal multiplier' of PSDP of two corresponds, more or less, to the estimate by Hopkin and Godley (1956), Surrey (1971), Thirlwall (1974) and Blinder and Solow (1974).		

Turning to the impact on the price level, the initial impact in 2010-11 is limited because monetary expansion appears to have a somewhat lagged effect on inflation. A near 1 percent of the GDP cut in the PSDP consequently has a significant impact of reducing inflation by 1.5 percentage points a year later. This also affects inflationary expectations in a more dynamic sense.

As far as the magnitude of fiscal deficit reduction is concerned, the Model reveals that 1 percent of the GDP cut in the PSDP leads to a 0.8 percent of the GDP reduction in the size of the deficit. The relationship is not one-to-one because a fall in the GDP leads to a fall in tax revenues, although there is some decline also in debt servicing.

Overall, it appears that a cut in the PSDP equivalent to 1 percent of the GDP has the following effects:

- 2 percentage points decline in GDP growth in same year
- 1.5 percentage point decline in rate of inflation a year later
- 0.8 percent of GDP decline in the fiscal deficit in same year

The basic conclusion is that cut backs in the PSDP have significant negative effect on the short run growth process in the economy and on the rate of inflation. It appears that the process of fiscal adjustment via curtailment in the size of the PSDP in recent years is one of the key factors behind the sharp fall in GDP growth rate to only about 3 percent. The numbers below tend to substantiate this conclusion.

Period	Average Growth Rate of Public Investment (at constant price of 1999-2000) %	Average GDP Growth Rate (%)
1999-2000 to 2002-03	-6.8	3.3
2002-03 to 2006-07	11.3	7.3
2006-07 to 2009-10	-1.5	3.0

It is clear, therefore, that a key element of any strategy for early revival of the economy will have to be a jump in the size of the PSDP. However, the issue of the long term growth impact hinges also on the quality of the public investment portfolio.

3.4. Targets in the Medium Term Budgetary Framework

We turn now to the Medium Term Budgetary Framework (MTBF) of the Government of Pakistan which are presented in the Budget Strategy Paper (BSP-2). The period covered is 2010-11 to 2012-13. According to this framework, the economy was projected to grow at 4.5 percent in 2010-11, 5 percent in 2011-12 and 5.5 percent in 2012-13, with the rate of inflation at 9.5 percent in 2010-11, 8 percent in 2011-12 and 7 percent in 2012-13 (see Table 3.2). Primarily due to the devastating floods, the growth rate of the economy is now projected at about 2.5 percent in 2010-11, with a significantly higher rate of inflation, approaching 15 percent.

Simultaneously, the original fiscal framework for 2010-11 is unlikely to be adhered to. As highlighted earlier, there is likely to be a shortfall in tax revenue of almost 1 percent of GDP and in non-tax revenues of 0.5 percent of the GDP. Current expenditures are expected to be higher by over 1 percent of the GDP. Development expenditure is likely to be cutback by about 1 percent of GDP. Consequently, the fiscal deficit is projected to increase from 4 to 5.5 percent of the GDP in 2010-11. Therefore, given the large divergence from the targets during the current fiscal year it is clear that the original targets in BSP-2 for 2011-12 and 2012-13 have already become unrealistic.

Table 3.2: TARGETS IN THE BUDGET STRATEGY PAPER-2^a

	2010-11 Target	2010-11 Projected**	2011-12 Target	2012-13 Target
Macroeconomic Targets				

GDP Growth Rate (%)	4.5	2.5	5.0	5.5
Rate of Inflation (%)	9.5	15.0	8.0	7.0
Fiscal Framework (% of GDP)				
Tax Revenues	10.3	9.3	11.0	11.7
Non Tax Revenues	4.9	4.4	4.5	4.2
Total Revenues	15.2	13.7	15.5	15.9
Current Expenditure*	15.5	16.6	15.0	14.0
Development Expenditure	3.7	2.6	4.2	5.1
Total Expenditure	19.2	19.2	19.2	19.1
Fiscal Deficit	-4.0	-5.5	-3.7	-3.2

^a largely consistent with the MTBF given in Budget-in-Brief, 2010-11

* including other development expenditure

** by MOF as of April 2011.

Source: BSP-2, MOF.

**Table 3.3 REVISED MACRO AND FISCAL PROJECTIONS
2010-11 TO 2012-13**

	2010-11 projected	2011-12 projected	2012-13 projected
Macro Framework			
GDP Growth Rate (%)	2.5	4.5	5.0
Rate of Inflation (%)	15.0	12.5	10.0

We have developed an alternative set of macro and fiscal projections for 2011-12 and 2012-13 in light of the developments in 2010-11. The GDP is now projected to grow at 4.5 percent in 2011-12 and by 5 percent in 2012-13, with the inflation rate at 12.5 percent and 10 percent respectively in the two years.

Fiscal Framework (% of GDP)			
Tax Revenues	9.3	10.0	10.7
Non Tax Revenues	4.4	4.2	4.0
Total Revenues	13.7	14.2	14.7
Current Expenditure	16.6	16.1	15.6
Development Expenditure	2.6	3.1	3.6
Total Expenditure	19.2	19.2	19.2
Fiscal Deficit	-5.5	-5.0	-4.5
GDP (mp) (Rs in Billion)	17290	20326	23477

Total revenues are projected to increase by 0.5 percent of the GDP annually. The resource mobilization strategy at the federal level will consist of removal of remaining exemptions from the GDT regime on goods, making a transition from presumptive to withholding levies indirect taxes, adopting measures for greater documentation of the economy and implementing a strong drive against tax evasion and avoidance. Since much of the growth potential in revenue has shifted to the provincial governments following the 18th Amendment, they will need to concentrate on development of the agricultural income tax, removal of exemptions in the provincial sales tax on services and effective levy of taxes on property.

Simultaneously, current expenditure is expected to fall by 0.5 percent of the GDP annually. The scope for significant reduction in current expenditure lies in better targeting of subsidies, reduction in the large losses of state enterprises, economy in expenditure by ministries and rationalisation of debt servicing through better public debt management.

The above improvements will enlarge the fiscal space for the larger outlays on development while simultaneously leading to some deficit reduction. As such, development expenditure (the national PSDP) is projected to increase from 2.6 percent of the GDP in 2010-11 to 3.1 percent in 2011-12 and to 3.6 percent of the GDP in 2012-13. The fiscal deficit is estimated at 5 percent of the GDP in 2011-12 and 4.5 percent in 2012-13. Based on the experience of the last two years, a larger downward adjustment in the size of the fiscal deficit appears unlikely.

3.5 Projections of Size of PSDP

Based on the revised Macro-Fiscal Framework, projections of the Federal, Provincial and combined PSDPs are made in Table 3.4. The national PSDP is estimated at Rs 630 billion in 2011-12, with the Federal PSDP at Rs 284 billion and Provincial PSDPs collectively

at Rs 346 billion.⁶ This implies a growth rate of 40 percent in the total PSDP and 58 percent in the federal PSDP in relation to the very depressed level this year. For 2012-13, the Federal PSDP is projected at Rs 350 billion and the Provincial PSDP at Rs 495 billion.

Table 3.4: PROJECTIONS OF SIZE OF PSDP

(Rs in Billion)

	2010-11		2011-12		2012-13	
	BSP-2	Projected	BSP-2	Projected ^a	BSP-2	Projected
Federal PSDP	270	180	375	284	470	350
Provincial PSDP	350	270	450	346	680	495
Total PSDP	620	450	825	630	1150	845

^a Federal Share as projected in BSP-2.

3.6. Conclusions

During the last few years and in 2010-11 much of the fiscal adjustment has come in the form of large cutbacks in the PSDP. Given the relatively large fiscal multiplier of close to two, this has implied a significant loss of growth momentum in the short run. Therefore, any strategy for early revival of the economy will have to include a jump in the size of the PSDP. According to a revised Macro-Fiscal Framework developed by us, the projected size of the Federal PSDP is Rs 284 billion in 2011-12 and Rs 350 billion in 2012-13.

⁶ In the recent meeting of the National Economic Council (NEC) the national PSDP has been fixed at Rs 730 billion, with the federal PSDP at Rs 300 billion and the combined provincial PSDPs at Rs 430 billion. The big difference of Rs 84 billion is with our projections of the size of the total provincial PSDP. We believe that our projections are more consistent with the target of reduction in the consolidated fiscal deficit.

Chapter 4

RATIONALIZING AND FINANCING THE THROWFORWARD

4.1. Introduction

The build-up of a large number of on-going schemes with substantial portion of the costs still to be covered has not only put severe pressure on the relatively meager financial allocations in the PSDP but has also stretched the project execution capacity of the Ministries/Division to the limit. Clearly, a policy of rationalization of the huge throwforward has become necessary not only for ensuring timely completion of priority projects through enhancements in allocations but also to release resources for the pursuit of initiatives which are more consistent with the New Development Approach (as highlighted in chapter 2). Therefore, the objective of the Chapter is to develop a policy for rationalizing the throwforward and then suggesting ways and means for financing the truncated portfolio.

4.2. Size and Composition of Throwforward

According to the data made available by the Planning Commission, the total throwforward of on-going Federal schemes as of July 1, 2010 is Rs 2631 billion (see Table 4.1). The cost of new schemes included in the PSDP of 2010-11 is Rs 668 billion. Therefore, the total size of the portfolio is Rs 3299 billion. The original size of the Federal PSDP in 2010-11 was Rs 280 billion. This implies that current level of financing it will take up to 11 years to complete the projects/schemes in the portfolio. However, following the cutback of the PSDP at the Federal level from Rs 280 billion to 180 billion, the ratio between the size of the portfolio and annual financing has risen to almost 18. This ratio has risen to unsustainably high levels and it has become inevitable that the throwforward be rationalized.⁷

**Table 4.1 PROJECTED THROWFORWARD
AS OF JULY 1, 2011**

	Throwforward as of July 1, 2010	Cost of New Projects	Size of Portfolio	Allocation 2010-11*	Throwforward as of July 1, 2011	(Rs in Billion) Size of Portfolio/All ocation
All Schemes (including Schemes in Power Sector)	2631	668	3299	180	3119	18
All Schemes (excluding Schemes in Power Sector) ^a	1461	611	2072	174	1898	12

⁷ If there is no rationalization of the throwforward and the cost of new projects approved annually is over Rs 600 billion then the throwforward (excluding the power sector) could approach Rs 5.5 trillion by 2016-17. The size of the portfolio would approach 14 times the likely size of the PSDP in that year.

^a The Diamer Basha Dam alone has a cost of Rs 894 billion.

Source: PC

The distribution of the throwforward by Ministry/Division is given in Table 4.2. Divisions with schemes which collectively account for a throwforward in excess of Rs 100 billion include Water and Power (Rs 1365 billion), Communications (Rs 269 billion), Railways (Rs 217 billion), Pakistan Atomic Energy Commission (Rs 186 billion) and Health (Rs 130 billion). These Divisions and Agencies account for 82 percent of the throwforward as of July 1, 2010.

Table 4.2: THROWFORWARD BY DIVISION AS OF JULY 1 2010

(Rs in Billion)

Division	Throw-forward	Division	Throw-forward
SOCIAL DEVELOPMENT	264.1	PRODUCTIVE ACTIVITIES	80.6
1. Culture	1.6	27. Defence Production	1.5
2. Education	16.7	28. Food & Agriculture	56.4
3. Environment	6.7	29. Industries & Production	2.6
4. Health	130.0	30. Livestock & Dairy Development	11.7
5. Higher Education Commission	72.6	31. Textile Industry	0.5
6. Local Govt & Rural Development	0.9	32. Tourism	0.1
7. Population Welfare	32.1	33. Science & Technological Research	7.7
8. Social Welfare & Special Education	0.4	OTHERS	191.6
9. Women Development	0.6	34. Cabinet	1.8
10. Youth Affairs	0.1	35. Commerce	1.4
11. Labour & Manpower	0.5	36. Defence	18.6
12. Sports	2.0	37. Economic Affairs	0.0
SPECIAL AREAS	34.1	38. Finance	90.9
13. Kashmir Affairs & Gilgit-Baltistan	34.1	39. Establishment	0.8
14. States & Frontier Regions	0.0	40. Information & Broadcasting	1.5
SPECIAL PROGRAMMES	11.1	41. Interior	19.8
15. Special Programmes (PWP)	0.0	42. Law, Justice & Human Rights	6.2
16. Special Initiatives	11.1	43. Foreign Affairs	0.4
INFRASTRUCTURE DEVELOPMENT	2049.8	44. Narcotic Controls	1.9
17. Pakistan Atomic Energy Commission	185.6	45. Planning & Development	29.8
18. Communications (including NHA)	269.5	46. Revenue	4.5
19. Information Technology & Telecommunications	3.8	47. Housing & Works	13.3
20. Postal Services	1.0	48. Statistics	0.7
21. Pakistan Nuclear Regulatory Authority	0.6		
22. Ports & Shipping	6.6		
23. Railways	216.9		
24. Water	194.8		
25. Power	1170.6		
26. Petroleum & Natural Resources	0.4		

A list of mega projects is given in Table 4.3. By far the largest mega project is the Diamer-Basha Dam with the cost of Rs 894 billion. Other mega projects include the three Chashma Nuclear Projects with throwforward of Rs 241 billion. Overall, the eight mega projects have a combined throwforward of Rs 1525 billion, equivalent to 58 percent of the total throwforward.

The largest Diamer-Basha Dam with a capital cost over \$10.5 billion remains to be financed under special arrangements. Other projects within the

Power Sector are also financed by WAPDA outside the budgetary PSDP. The allocation to this sector from the budgetary PSDP is only Rs 12 billion in the presence of a large throw forward of Rs 1171 billion. Bulk of the allocations are made outside the budgetary PSDP by WAPDA/PEPCO on the basis of domestic capital market borrowings and loans especially from the ADB. In 2010-11, for example, the development outlay in the power sector is Rs 118.3 billion, out of which financing from the PSDP is over Rs 106 billion (see Table 4.4).

In view of this, the subsequent analysis of rationalization and financing of the throwforward excludes the power sector. As shown in Table 4.1, this brings down the throwforward to Rs 1461 billion as of July 1, 2010. With new projects of Rs 611 billion (excluding Power) the size of the portfolio is Rs 2072 billion, and given the level of financing of Rs 174 billion (excluding Power) it will take 12 years on average to complete the schemes in the portfolio. Therefore, despite the exclusion of the Power sector, the

Table 4.3: On-Going Mega Projects

(Above Rs. 50 billion in Size)

(Rs. in Billion)

1.	Raising of Mangla Dam	62.6
2.	CRBC First Lift cum gravity project	61.1
3.	Neelum Jhelum Hydro-power Project AJK	84.5
4.	Daimier Basha Dam	894.2
5.	Chashma Nuclear Project C-2	51.0
6.	Chashma Nuclear Project C-3 & C-4	189.9
7.	Revival of Karachi Circular Railway	128.6
8.	National Program for Family Planning and Family Health Care	53.4
Sum		1525.3

Source: PC

Table 4.4: Financing of Public Investment in Power Sector

(Rs Billion)

Year	Total Investment	Budgetary PSDP Allocation	Non-Budgetary Financing
2010-11	118.3	12.0	106.3
2009-10	139.3	20.3	119.0
2008-09	67.7	14.2	53.5
2007-08	93.4	20.6	72.8
2006-07	52.2	22.9	29.3
Cumulative	470.9	90.0	380.9 (81%)

Source: PC.

throwforward remains unacceptably large.

4.3. Rationalizing the Throwforward

An earlier exercise was undertaken by the Planning Commission in 2008-09 to rationalize the size of the throwforward by about 20 percent. The criteria used were as follows:

- Projects of high priority to be fully protected
- Projects located in Balochistan and Khyber-Pakhtunkhwa to be protected
- Exclusion of Projects implementation of which could be delayed by 1-2 years
- Exclusion of Projects which could be shifted to PPP mode

The resulting percentage reductions in number of schemes were as follows: infrastructure (46 percent), social sectors (39 percent) and production sectors (15 percent).

In 2009-10, the criteria used for revising allocations following cutbacks were as follows:

- Projects nearing end to be fully protected
- Protect projects with contractual bindings in projects with foreign assistance
- Maximum possible protection to projects under development packages
- Maximum possible protection to Balochistan based projects
- Slow moving projects be deferred
- Bricks and mortar projects to be delayed unless very critical
- New projects not yet started to be deferred until next year

[The resulting percentage reductions were as follows: infrastructure (27%), social sectors (28%) and production sectors (49%)]

The BSP-2 states that in a period of fiscal stringency the Federal PSDP will need to adhere to the following criteria for allocation of development funds:

1. Priority to projects nearing completion⁸
2. Priority to projects with small gestation period that directly impact on output and employment in the medium run.
3. Projects that boost production in agriculture and manufacturing
4. Projects that overcome critical energy and water shortages
5. Projects that raise quality of higher education and increase productivity through science and technology.
6. Projects that create employment and reduce poverty especially in less developed regions.

An exercise was also undertaken in Planning Commission to rationalise the PSDP throwforward in compliance with the decision of the NEC of 28 May 2011. Accordingly, the whole PSDP portfolio was classified into different categories in terms of expenditure incurred. However, the exercise has not been completed.

An indication of the priority in allocations is given by the extent of cut backs in 2010-11 in different Division following the scaling down of the PSDP from Rs 280 to Rs 180 billion (see Box 4.1). The above guidelines provide the basis for the criteria to be used for the next round of rationalization of schemes in the throwforward and of new schemes.

Box 4.1
PRIORITY IN REVISED ALLOCATIONS

There has been a substantial downward revision in the size of the Federal PSDP from Rs 280 billion to Rs 180 billion. The ratio of revised to original allocations is given below for Divisions with large and small proportionate cuts respectively. It appears that schemes in Special Areas and Special Programs

Rupee PSDP, 2010-11			
	Original	Revised	(Rs Bllion) Ratio
Divisions with High Ratios			
Higher Education Commission	15.7	15.0	0.954
Kashmir & Gilgit-Baltistan	14.9	13.6	0.913
States and Frontier Regions	7.5	7.1	0.947
Special Programmes	30.0	22.8	0.759
Ports & Shipping	0.5	0.5	1.000

⁸ These projects effectively yield high returns on completion, given the sunk costs.

Power	5.9	5.7	0.954
Other (Selected) with Low Ratios			
Water	28.3	17.0	0.602
Communications	37.6	18.6	0.494
Health	13.8	8.0	0.579
Education	5.1	2.7	0.523
Food & Agriculture	9.0	3.8	0.421
Overall	242.4	150.0	0.618

have been largely protected, along with allocations to high priority sectors like HEC and Power. However, high priority sectors like Health and Water have received cuts of almost 40 percent. By and large, greater importance appears to be attached to political programs.

4.4. Criteria for Rationalizing the Throwforward

The criteria suggested for rationalizing the throwforward prior to the commencement of the next fiscal year⁹ are highlighted in chart 4.1. The key recommendation is that there is need to adopt the concept of a 'core' PSDP. This will include schemes which will remain protected from any reduction in allocations in the event of any future cutbacks in the size of the PSDP. Also, in the budgetary process, an attempt will be made to adhere to the allocations proposed in the PC1s and ensure early completion of these schemes. If resources are available beyond the CORE PSDP then allocations could be made to other schemes.

Chart 4.1
CRITERIA FOR PRIORITIZATION OF SCHEMES

	SCHEMES IN	
	Core PSDP ^a	Implementation Temporarily Postponed ^b
CRITERIA 1		
in Priority Sectors	✓	
not in Priority Sectors		✓
CRITERIA 2		
Foreign Aided	✓	
Not Foreign Aided		✓
CRITERIA 3		
Completion Rate:		
< 75%		✓
> 75%	✓	

⁹ This will include review of new schemes in the 2010-11 PSDP

CRITERIA 4

Location in Balochistan

✓

Location Elsewhere

✓

^a A scheme may meet one or more criteria . To be in the 'Core' PSDP at least one criterion must be met.

^b Schemes dropped from the PSDP portfolio (and from the throwforward) will be schemes which have the following characteristics – not in priority sectors, not foreign aided, with completion rate less than 75% and not in Balochistan.

The proposed criteria for inclusion of on-going schemes (as of July 1, 2011) in the CORE PSDP are as follows:

- Schemes in priority sectors
- Schemes with part financing by foreign grants/loans (especially those which are consistent with the New Growth Framework)
- Schemes with a completion rate of 75 percent or more
- Schemes located in Balochistan

Any scheme which meets one or more of the above four criteria will qualify for inclusion in the CORE PSDP.¹⁰

Priority sectors could include investments in sectors like water, power, PAEC, health and education and sectors which are identified in Chapter 2 as being important from the viewpoint of implementation of the New Development Approach like directly productive activities, skill development and science and technology. The motivation behind inclusion of foreign-aided projects in the CORE PSDP is that given the severe constraints of financing the PSDP, project aid will partly alleviate these constraints. Also, the inflow of foreign assistance for projects will improve the financial account of the balance of payments.

Similarly, the WGDP has emphasized that the PSDP should also to conform to the concept of the “national growth strategy” and only those projects are included which trigger higher growth rates, ensure better returns, make room for the private sector involvement and bring inter sector harmony (complementarities) and balance.

The case for inclusion of ‘mature’ projects, with completion rates in excess of 75 percent, will ensure the maximization of development impact of the PSDP through the flow of benefits arising from the earlier completion of projects. It is also suggested that all on-going projects in Balochistan be protected in view of the fact that this is the most underdeveloped

¹⁰ In addition, if the practice of undertaking economic cost-benefit analysis becomes more widespread than the operative criterion should be for a project to yield a sufficiently high EIRR.

province of Pakistan and an effort to remove perceptions about relative deprivation of the people of this province the Federal Government has launched the 'Aghaz-e-Huqooq Balochistan Package'.

Beyond the CORE PSDP, schemes will be dropped either temporarily or permanently from the PSDP. It is also recommended that the above criteria also be applied to all schemes which are implemented under directives. As far as the PWP-1 and 2 is concerned the share of these special programs may be restricted to a maximum share of 6 percent in the PSDP, which was the share of such programs earlier (see Table 2.1).

Results of application of the above criteria to schemes in Ministries/Divisions with relatively large throwforward as of July 1 2010, is given in Table 4.5. It appears that the application of the above criteria will lead to the dropping of schemes equivalent to 25 percent of the throw forward. The focus will then be implementation of schemes in the CORE PSDP.

**Table 4.5 : RATIONALIZATION OF ON-GOING SCHEMES
IN DIFFERENT DIVISIONS AND AGENCIES**

(as of July 1 2010)

Division/Agency	Throwforward (as of July 1 2010)	% of Throwforward in		
		CORE PSDP	Schemes Dropped Temporarily or Permanently	Total
PRIORITY SECTORS	599.7	100.0	0.0	100.0
Pakistan Atomic Energy Commission	185.6	100.0	0.0	100.0
Water	194.8	100.0	0.0	100.0
Health	130.0	100.0	0.0	100.0
Education (including HEC)	89.3	100.0	0.0	100.0
OTHERS	861.3			
Communications	269.5	56.7	43.3	100.0
Railways	216.9	98.4	1.6	100.0
Finance	90.9	47.5	52.5	100.0
Planning & Development	29.8	9.7	90.3	100.0
Others	254.2	32.2	67.8	100.0
TOTAL	1461.0	1091.0	370.0	1461.0
%	100	75	25	

As far as the approvals of new projects hence forth is concerned, it is essential that the CDWP/ECNES adopt the policy that only those projects or schemes be approved which qualify to be part of the CORE PSDP, that is, either they are in priority sectors or are foreign aided or are located in Balochistan.

4.5. Financing the Throwforward

The current ratio of the size of the portfolio (excluding the Power sector) to annual PSDP allocation at the federal level is 11. The proposed objective is to bring down this ratio sharply, so that there are no inordinate delays in the financing and implementation of projects. Projections of this ratio have been made on the assumption, first, that on-going schemes as of July 1 2010 will be rationalized to the extent of 25 percent and, second, that new schemes in the current PSDP which will also not qualify for inclusion in next year PSDP will account for 70 percent of the cost of new schemes being implemented this year. This implies that the throwforward at the start of the next fiscal year will be approximately Rs 1250 billion, including an allowance for cost escalation of 12 percent.

The projections of throwforward over the next four years are given in Table 4.6 under the assumption that the rate of approval of new schemes, which satisfy the above mentioned criteria, will build up gradually as existing schemes are completed. The projected size of the PSDP for the next two years is derived from the revised Macro-Fiscal Framework in Chapter 3. Beyond this, up to 2015-16, projection is made of the likely size of the PSDP on the basis of an annual growth rate of 20%.

Table 4.6 demonstrates that the ratio of the size of the portfolio to the size of the PSDP falls sharply from about 12 in 2010-11 to 5 in 2011-12 after the rationalization of the throwforward before the commencement of the next fiscal year. This is, of course, conditional on a low rate of approval of new schemes in 2011-12, which satisfy the criteria for being part of the CORE PSDP.

Table 4.6 : PROJECTIONS OF THE THROWFORWARD AND RATIO OF SIZE OF PORTFOLIO TO ANNUAL PSDP^f

	Throw forward	Cost of New Schemes ^c	Size of PSDP	Size of Portfolio	Portfolio/ PSDP
2010-11	1461	611	174	2072	11.9
2011-12	1250 ^d	100	270 ^a	1350	5.0
2012-13	1188 ^e	200	330 ^a	1388	4.2
2013-14	1163 ^e	300	396 ^{a,b}	1468	3.7
2014-15	1174 ^e	400	475 ^{a,b}	1574	3.3
2015-16	1209 ^e	500	570 ^{a,b}	1709	3.0

(Rs in Billion)

^a excluding allocations to the Power Sector

^b annual growth rate of 20% after 2012-13

^c the rate of new schemes is assumed to increase in light of completion of new schemes

^d with annual inflation of 12% in throwforward

^e with annual inflation of 10%

^f innovative means of financing like PPPs to raise the availability of funds are discussed in the Phase 2 report.

4.6. Conclusions

Consequences of implementation of the above recommendations are that the ratio of the size of portfolio to the size of the PSDP will continue to fall and approach 3 by 2015-16. This will lead to adequate allocations annually for on-going schemes and avoid situations of

'spreading thin' and cost overruns. It will also enable launching of new schemes which are consistent with the new Growth Framework.

Chapter 5

THE 7TH NFC AWARD, 18TH AMENDMENT AND THE PSDP

5.1. Introduction

In the context of federalism, Pakistan has witnessed two major developments in the last two years. The first of these developments was the signing of the 7th National Finance Commission (NFC) Award on the 30th of December 2009. The award came into force on 1st July 2010, which resulted in significant changes in revenue sharing arrangements between the federal and provincial governments. The 7th NFC Award significantly enhances the share of the provinces in the federal divisible pool (federal tax revenues shared with the provinces). (See Appendix 5.1)

The other major development is the passage and signing into law on 9th April 2010 of the 18th Amendment to the Constitution by the President of Pakistan. With this Amendment the Concurrent List of functions in the Constitution stands abolished, devolving the functions contained in this list to the provincial governments. This significantly enhances the range of functional responsibilities of provincial governments.

The objective of this chapter is to highlight the implications of these developments on the financing and composition of the PSDPs of the federal and provincial governments respectively.

5.2 Size of Provincial Development Programs

Based on the large anticipated increase in transfers the provincial governments had budgeted for a big increase in their ADP/PSDP as shown in Table 5.1. With a combined development program of Rs 405 billion, showing a growth of 56.4 percent, the provinces are expected to have a larger development outlay for the first time than the federal government of Rs 280 billion. However, due to revenue shortfalls and higher current expenditure, the latter has

Table 5.1: Size of the Annual Development Program of the Provincial Governments

	(Rs in Billion)		
	2009-10 (Actual)	2010-11 (Budgeted)	Increase (%)
Punjab	132	194	47.0
Sindh	67	115	71.6
Khyber Pakhtunkhwa	40	69	72.5
Balochistan	20	27	35
Total	259	405	56.4

Source: MOF, Provincial Budget Documents

been cutback to Rs 180 billion. Similarly, faced with a consequential shortfall in transfers, the provincial governments are expected to cut back their combined development program in 2010-11 to Rs 270 billion or so.

5.3. Transfer of Functions under 18th Amendment

Following the 18th Amendment the resulting distribution of functional responsibilities between the three tiers of government is presented in Appendix 5.2, which gives the allocation of functional responsibility before and after the 18th Amendment, 2010 and the Devolution Plan 2001 (which allocated functions to local governments). The following fifteen ministries (equivalent to eighteen divisions) stand devolved to the provinces¹¹:

1. Culture	9. Social Welfare and Special Education
2. Education	10. Special Initiatives
3. Food and Agriculture	11. Sports
4. Health	12. Tourism
5. Labour and Manpower	13. Woman Development
6. Livestock and Dairy Development	14. Youth Affairs
7. Local Government and Rural Development	15. Zakat and Ushr
8. Population Welfare	

Devolution under the 18th Amendment has been planned in three phases. Phase I was completed in December 2010; Phase II was completed in April 2011. Phase III is underway and is due to be completed by June 2011. In the first phase, five ministries/divisions were devolved, in the second phase another five were devolved, while the remaining eight divisions are expected to be devolved in the third phase as indicated in Table 5.2.

Table 5.2: Phasing of Devolution under 18th Amendment

Phase I	Phase II	Phase III
1. Ministry of Special Initiatives	6. Education	11. Food and Agriculture
2. Zakat and Ushr	7. Social Welfare and Special Education	12. Health
3. Youth Affairs	8. Livestock and Dairy Development	13. Labour and Manpower
4. Population Welfare	9. Culture	14. Woman Development
5. Local Government and Rural Development	10. Tourism	15. Sports

¹¹ It is important to note that all the functions of these ministries have not been devolved. Some functions in many of the devolved ministries will continue at the federal level.

16. Statistics Division

17. Environment

18. Minorities Affairs

5.4. Federal PSDP in Devolved Functions

The original size of federal PSDP 2010-11 is Rs 265 billion (excluding the power sector). Throwforward of all the projects as on July 1, 2010 is close to Rs 1.5 trillion (excluding new schemes of 2010-11). Initial estimates provided by the Planning Commission (Table 5.3) show that total throwforward of projects transferred to the provinces, including new schemes, is Rs 317 billion.

Table 5.3: Federal PSDP Transferred to Provinces
(Initial estimates by Planning Commission)
(Rs Billion)

	Throwforward (July 1, 2010)	Total Allocation for 2010-11
Excluding HEC	269	33
HEC	48	8
Total	317	41

Source: PC

However, due to lack of availability of detailed information about the projects/schemes included or excluded in the Planning Commission's estimates, a scheme-wise analysis of PSDP 2010-11 for all devolved divisions has been conducted to estimate the total cost and throw-forward of devolved projects/schemes. As shown in Table 5.4, throwforward of the schemes in devolved divisions is Rs 344 billion. In addition, total cost of new schemes (2010-11) in devolved divisions is Rs 117 billion, implying a potential transferable liability of Rs 461 billion.

Table 5.4: Federal PSDP 2010-11* Transferred to Provinces

	Throwforward (July 1, 2010)	Allocation for 2010-11
Federal	1,117	208
Transferred to Provinces	344	57
Total	1,461	265

Source: PC
* Excluding power sector.

5.5. Issues in Transition Management

As mentioned above the total throwforward of PSDP schemes being executed under the devolved divisions (including new schemes) is Rs 461 billion. Total size of the original provincial PSDPs for 2010-11 is Rs 341 billion with throwforward of Rs 776 billion as on July 1, 2010. Adding the throwforward of devolved divisions to the provincial PSDP liability would imply that the provinces' development outlays have been pre-empted for over three years.

The basic issue relates to the financing of the schemes in the devolved functions. The provincial governments are of the view that the 7th NFC Award preceded the 18th Constitutional amendment. Therefore, the additional liabilities transferred to the provinces were not coupled with the transfer of additional resources. Hence, it is difficult for the provinces to continue execution of these projects without a meaningful transfer of additional resources at least till the currency of 7th NFC Award. Moreover, provinces will have to devote more resources to the social sectors particularly for education sector since education has been declared a right under the 18th Amendment.

As opposed to this, the federal government has argued that the provinces are already enjoying enhanced fiscal space under the 7th NFC Award. Therefore, they should be able to finance the additional responsibilities, which have been constitutionally transferred to them.

These issues have been addressed in the meeting on April 28, 2011 of the Council of the Common Interests (CCI), chaired by Prime Minister and attended by the four Chief Ministers. The following decisions were made in the CCI:

1. Federal government will continue to fund higher education till the next National Finance Commission (NFC) award due in 2014-15. This implies that the devolution of the Higher Education Commission (HEC) has effectively been put on hold.
2. The federal government will provide financing for vertical programs of the health and population sectors (see Table 5.5).
3. All projects located in the provinces except those being carried out under presidential and prime minister's directives would be financed by the provinces.

Table 5.5: Major* Vertical Programs in Health and Population Welfare Sectors

(Rs million)

Sector	Cost	Expenditure up to June 2010	Throw-forward (July 1, 2010)	Total Allocation 2010-11
National TB Control Programme	1,184	472	713	123
National Programme for Prevention and Control of Blindness	2,775	1,092	1,683	247
National Maternal, Neonatal and child Health Programme	19,995	5,594	14,401	2,281
National Program for Family Planning & Primary Health Care	53,406	5,316	48,090	5,762
Prime Minister's Program for Prevention & Control of Hepatitis	13,904	1,898	12,006	600
Population Welfare Program Punjab (2003-08)	18,826	7,791	11,035	1,549
Population Welfare Program Sindh (2003-08)	12,759	4,531	8,228	885
Population Welfare Program Khyber Pakhtukhwa (2003-08)	6,080	2,432	3,648	477
Population Welfare Program Balochistan (2003-08)	5,330	1,695	3,635	391

* Above Rs 1 billion size.

Source: PC

The decisions listed above clearly indicate the responsibility of respective governments for funding of HEC, vertical programs and provincial projects. However, it is not clear that what will be the mechanism of funding of those projects which are neither location specific (to be categorized as provincial projects) nor vertical programs. Some examples of such projects are given in Box 5.1. It is suggested that these projects/schemes be funded on a matching finance basis i.e. federal government provide 50 percent of the funding for completion of the projects while 50 percent is to be financed by the provinces.

Box 5.1
Some Examples of the Projects with Unclear Responsibility of Funding

Sector	Project
Education	Establishment & Operation of Basic Education Community Schools in the Country
Environment	Conversion and Rehabilitation of Indus Delta Mangroves for Sustainable Management
Environment	Establishment of Environmental Monitoring System in Pakistan
Health	National Plan for Disease Surveillance
Health	Health System Strengthening and Policy Programme
LGRD	Model Village Development in Pakistan
Food and Agriculture	National Program for Improvement of Watercourses in Pakistan
Food and Agriculture	Water Conservation & Productivity Enhancement through High Efficiency Irrigation System
Food and Agriculture	National Project for Enhancing Existing Capacity of Grain Storage
Special Initiatives	Clean Drinking Water for All

Source: PC

5.6. Financial Implications of Devolution

Considering the decisions of CCI and our recommendation of matching finance, Table 5.6 presents the resulting liabilities of federal and provincial governments for devolved federal PSDP schemes/projects. The estimates of liabilities are derived as follows:

- The schemes that are location specific and fall clearly in federal territories are classified as federal schemes. Execution of these schemes is the sole responsibility of federal government
- All schemes of HEC and vertical programs of health/population sectors have been included in federal government's responsibility
- The schemes that are location specific and fall in provincial boundaries are shown as provincial responsibility

- The schemes in the residual category are categorized as shared schemes.

Table 5.6: Sharing of the Throwforward and Allocations*

(Rs in Billion)

	Federal Liability						Provincial Liability			
	Throw-forward	New Schemes	Throwforward**			Allocation 2010-11	Throwforward**			Allocation 2010-11
			Federal Schemes	Shared Schemes	Total		Provincial Schemes	Shared Schemes	Total	
Culture	1.6	0.0	0.2	0.0	0.2	0.1	1.4	0.0	1.4	0.3
Education	16.7	4.3	4.0	1.7	5.7	1.2	13.6	1.7	15.2	3.9
Environment	6.7	0.0	0.6	2.9	3.5	0.6	0.3	2.9	3.2	0.4
Food and Agriculture	56.4	37.4	2.1	43.7	45.8	5.1	4.3	43.7	48.0	5.7
Health	130.0	20.0	109.6	3.4	112.9	13.4	33.8	3.4	37.1	3.5
HEC	72.6	21.4	94.0	0.0	94.0	15.8	0.0	0.0	0.0	0.0
Labour	0.5	0.0	0.4	0.0	0.5	0.1	0.0	0.0	0.1	0.0
LGRD	0.9	32.3	0.9	16.1	17.1	0.0	0.0	16.1	16.1	0.0
Livestock and Dairy	11.7	0.0	0.0	5.6	5.6	0.4	0.5	5.6	6.1	0.5
Population	32.1	0.0	31.7	0.0	31.7	4.1	0.3	0.0	0.3	0.0
Social Welfare	0.4	0.0	0.2	0.0	0.2	0.0	0.3	0.0	0.3	0.1
Special Initiatives	11.1	0.0	0.0	5.5	5.5	0.5	0.0	5.5	5.5	0.5
Sports	2.0	0.4	0.1	0.0	0.1	0.1	2.3	0.0	2.3	0.2
Statistics	0.7	0.0	0.7	0.0	0.7	0.1	0.0	0.0	0.0	0.0
Tourism	0.1	0.2	0.1	0.0	0.1	0.0	0.3	0.0	0.3	0.1
Women Development	0.6	0.5	0.2	0.0	0.3	0.1	0.8	0.0	0.8	0.1
Youth	0.1	0.0	0.1	0.0	0.1	0.0	0.1	0.0	0.1	0.0
Total	344	117	245	79	324	42	58	79	137	15

* After 2010-11

** Including new schemes

Source: PC

As shown in Table 5.7, out of throwforward (including new schemes) of Rs 461 billion, federal government will have to finance schemes of Rs 324 billion, including Rs 245 billion of schemes allocated to it and Rs. 79 billion of schemes with shared financing. Liability of Rs. 137 billion will be transferred to the provinces.

In summary, during the transition period, most of the burden of liability (over 70 percent) will have to be borne by the federal government. Total annual allocation of the devolved divisions for 2010-11 is Rs 57 billion. Considering the current level of allocation,

devolution of PSDP will create an annual fiscal space of Rs 15 billion for federal government. This potential saving in development expenditure may be used to allocate more resources to the priority sectors. As opposed to this, the four provincial governments will have to take on an additional liability of Rs 15 billion in their development programs, alongwith the recurring expenditure on devolved functions.

There is a possibility that the federal government may attempt to reduce its contingent liabilities on allocations to schemes it is required to complete following the CCI decisions, either by dropping or underfunding some vertical programs and HEC schemes. There needs, therefore, to be an understanding that any such rationalization will take place after consultation with the provincial governments. It would indeed be unfortunate if in the process of implementation of the 18th Amendment some valuable programs are dropped or underfunded which are conferring significant benefits to the people. For example, there are ten vertical programs in the health sector currently being funded by the federal PSDP. Information provided by the Planning Commission indicates that the current allocation of Rs 8 billion for National Program of Family Planning Primary Health is insufficient because after the enhancement of salaries of LHWs as per the decision of Supreme Court of Pakistan, the estimated requirement for salaries alone is Rs 8.5 billion whereas Rs 2.5 billion would be required for logistic support including medicine. Therefore, the program may not perform at the desired level due to insufficient funding. Moreover, there is also a need to identify sustainable exit strategies for these vertical programs well before the next NFC award.

Beyond this, the devolution presents an opportunity to the provinces to rationalize the throwforward of location-specific projects according to their own priorities. It is important for the provinces to demonstrate the sense of ownership for the transferred projects, which are expected to contribute to the development goals of the country. Some guiding principles for rationalisation in this regard are suggested below for the following projects:

- projects which are evidently politically driven, do not provide adequate economic justification and have not been through the due process of project appraisal/approval
- projects which represent a duplication of existing provincial development activities
- new projects and the ongoing projects for which expenditure incurred up to June 2010 is less than 25 percent of the total cost.

5.7. Conclusions

The 7th NFC Award has increased substantially the transfers to the provinces. It now appears that provincial governments will be the major players in the development process as

compared to the federal government. More functions have also been devolved to the provinces after the 18th Amendment. Based on the recent decisions by the CCI, the federal government will have to continue allocating annually over Rs 42 billion from the PSDP for completion of schemes in the devolved areas, while the additional liability on the provincial governments is about Rs 15 billion. Therefore, the saving annually to the federal government is Rs 15 billion which it can allocate to other high priority sectors.

Chapter 6

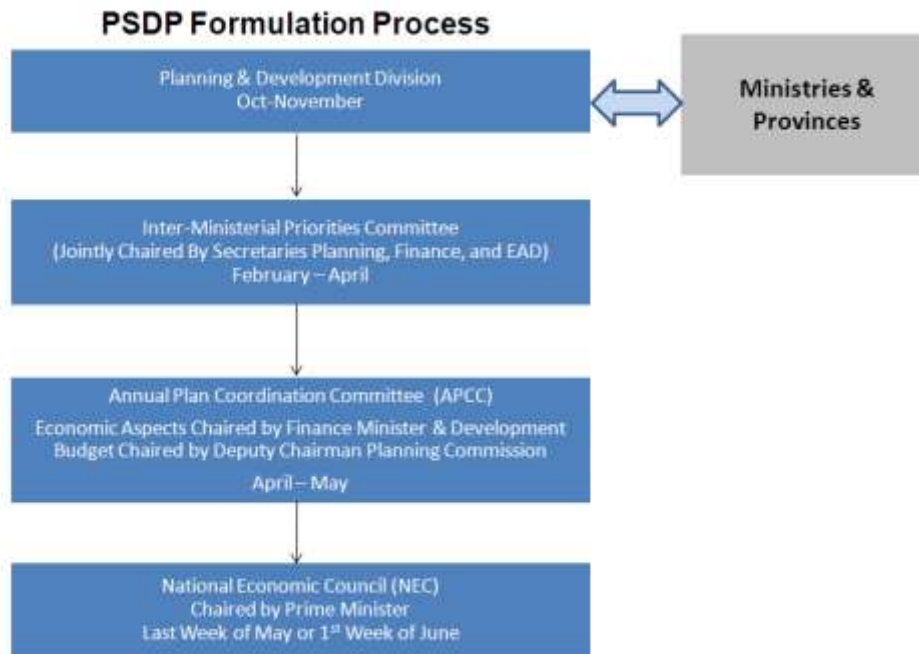
PSDP FORMULATION WITH FOCUS ON RESULTS-BASED MANAGEMENT (RBM)

6.1. Introduction

This chapter reviews the current mechanism of Public Sector Development Programme (PSDP) formulation, investment programming and portfolio management followed by the Planning Commission, Government of Pakistan. The objective of this Chapter is to improve this process by linking it more effectively to the MTBF and focusing on outcomes.

6.2. Process of PSDP Formulation

The PSDP is formulated by the Planning and Development Division in consultation with all the Ministries. Once the budget allocation requests have been received by the Planning Commission from ministries, a meeting of Inter-Ministerial Priorities Committee is convened. The Priorities Committee is jointly chaired by Secretaries Planning and Development, Finance and Economic Affairs Division (EAD). The mandate of the Priorities Committee is to review both the current and development expenditures. Sectoral and program priorities are also reviewed by the Priorities Committee. After review of sectoral and program priorities with the ministries, a working paper is prepared with recommendations on proposed level of allocations and forwarded to the Annual Plan Coordination Committee (APCC). The PSDP formulation process along with annual timeline is shown below.



The APCC is bifurcated into recurring expenditures and development budget. The APCC meeting to review current budget is chaired by the Finance Minister and the APCC meeting to review the development budget is chaired by the Deputy Chairman, Planning Commission. The mandate of the APCC is to review the recommendations of the Priorities Committee, and ensure that they are in line with overall investment goals and objectives of the country. The APCC can override the recommendations of the Priorities Committee before forwarding them to the National Economic Council (NEC) for final approval of the PSDP / Annual Development Plan. The NEC is chaired by the Prime Minister of Pakistan and following the 18th Amendment is expected to meet twice a year.

The size of the PSDP is determined based upon the priorities set by the political government, need for strategic program, regional development priorities, and overall economic outlook of the country. Funds for PSDP program/projects are allocated based on on-going and new schemes for Ministries, Corporations/Autonomous Bodies, Special Development Programs/Projects and Special Regions including Federally Administered Tribal Areas (FATA), Azad Kashmir, Gilgit-Baltistan, etc.

While the fund allocation procedures are laid out in the Manual for Development Projects of the Planning Commission, some funds are allocated on the basis of political considerations and government directives as shown in Box 6.2. The absence of a MTFD makes it difficult to prioritise allocations on the basis of important outcomes.

An analysis of the determinants of allocations to Divisions is undertaken in Box 6.1. It appears that the allocations primarily depend upon the size of the portfolio (throwforward + cost of new schemes) in each Division. Therefore, the problem does not lie so much in the process of allocation of funds but more to the process of preparation and approval of scheme. Once a scheme gets approved it acquires certain 'entitlement' rights to receiving allocations. Therefore, the latter process has to be made much more strategic and rigorous in character.

Box 6.1
Determinants of Allocations to Ministries/Divisions

The issue here is what determines the allocation of funds within the PSDP to individual Ministries and Divisions as mediated through negotiations by the Priorities Committee. Do these allocations clearly reflect inter-sectoral priorities or are they the outcome of a, more or less, 'neutral' process whereby allocations are largely linked to the size of the throwforward and the cost of new projects? Are there other considerations like the need to provide rupee counterpart funds for foreign aided projects or larger allocations to complete 'mature' projects?

We attempt to answer these questions by undertaking simple cross-sectional econometric analysis of the determinants of original allocations at the level of the 45 Divisions for 2010-11. At this stage, we specify the following variables

- A = Allocation to a Division in the PSDP
- T = Size of the Throwforward
- N = Cost of New Projects
- P = Size of Portfolio (= T + N)
- F = Foreign Aid Component in Costs of Projects
- DI = Dummy Variable for a Division executing infrastructure projects, with DI = 1; otherwise 0

Political programs, like the PWP, have been excluded from the analysis because these programs do not have any throwforward.

Results of OLS regression are as follows:

$$A = 265 + 0.073P - 592 \left(\frac{N}{P} \right) - 0.035DI \cdot P + 0.024 \left(\frac{F}{P} \right) + 0.229A_{-1}$$

(0.26) (7.66)* (-0.93) (-5.05)* (3.05)* (6.77)*

Adj. $R^2 = 0.98$, $F = 433$, $SEE = 1060$

Figures in brackets are *t*-ratios. * Significant at 5% level.

(Autocorrelation is not a problem given that the OLS regression is cross-sectional.)

Over 98 percent of variation in allocations is explained by the equation. There is a very strong link between allocations and the size of the portfolio. Foreign aided projects get favourable allocations while infrastructural projects get relatively lower allocations due to longer gestation periods. Also, current year allocations bear some link with previous year allocations. There is, of course, a need for research of the above type for earlier years also.

6.3. Selection of Programs/Projects and Fund Allocations within Ministries

Programs and projects are supposed to be created and prioritized based upon the criteria that includes ,as mentioned earlier, on-going projects at a fairly advanced stage of implementation; foreign-aided projects with high national priority and projects dealing with emergencies such as flood relief. However, this criteria is quite often ignored while allocating funds to programs and projects.

Well thought-out and carefully planned programs/ projects are essential for public sector development. Programs/ projects provide an important means by which investment and other development expenditures foreseen in the MTBF are incurred. Proper planning, feasibility studies, clear definition of scope, and economic viability of projects are key ingredients for effective program/ project creation and public sector development. Once projects supported by proper feasibility studies and clear scope have been conceived and aligned with overall development and investment strategy, they need to be planned, monitored, implemented by following a proper project management methodology such as Results-Based Management (RBM).

While political considerations also weigh-in on creation of new program/ projects, but they must be aligned with the overall public sector investment goals and objectives (see Box 6.2), Medium Term Development Framework (MTDF) and MTBF 2010-13. Therefore, sponsoring ministries/agencies must keep in mind the overall goals and objectives of the Five-Year or Annual Plan, MTDF, and MTBF 2010-13 while creating new program/projects that are financially and economically viable.

Box 6.2 Examples of Political Programs

Examples of political programs are given below. These include allocations for schemes chosen by MNAs/Senators for execution by line Ministries in PWP-1 and on the basis of directives by the Prime Minister in PWP-2. There are also packages in different cities announced by the President or the

Allocations 2010-11 (Rs
in Billions)

PWP-1 PWP-2	30,000
Packages for Different Cities/Regions (through Finance Division)	13181
Unfunded Important Projects (through Planning & Development Division)	6856
Total	50037
Total PSDP	242415
Share (%)	21%

Prime Minister. On top of this, there is the somewhat surprising inclusion of a provision of almost Rs 7 billion for Unfunded Important Projects by PDD, presumably in anticipation of directives. Overall, over Rs 50 billion, equivalent to 21% of the original Federal PSDP for 2010-11, has been allocated for political programs. Considering the tight fiscal space the urge to adopt politically motivated projects needs to be curtailed. Therefore, it is recommended to follow the same PSDP and project appraisal process for politically motivated projects as outlined in Box 6.4.

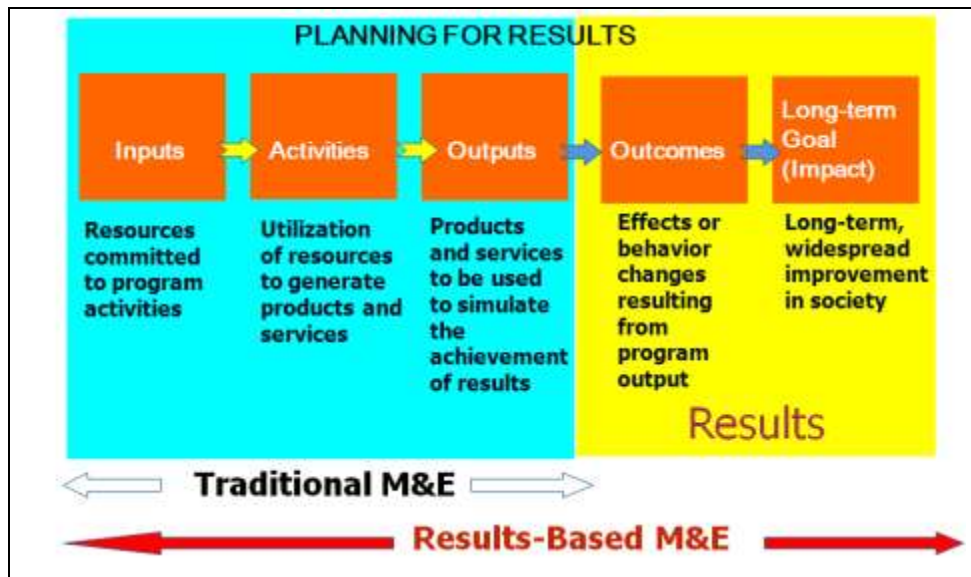
6.4. Results Based Management (RBM)

Within the framework of a portfolio, program and project model (see Appendix D) we discuss management results-based management (RBM). RBM can mean different things to different people/organizations. A simple explanation is that RBM is a broad management strategy aimed at changing the way institutions operate, by improving performance, programmatic focus and delivery. It reflects the way a ministry or agency applies processes and resources to achieve interventions targeted at commonly agreed results.

Results-based management is a participatory and team-based approach to program planning and focuses on achieving defined and measurable results and impact. It is designed to improve program delivery and strengthen management effectiveness, efficiency and accountability.

RBM can be a useful methodology and tool for conceiving, planning, implementation, monitoring, and evaluation of public sector programs and projects. A summary of RBM methodology is shown in Box 6.3.

<p>Box 6.3 Results-Based Management Methodology</p>

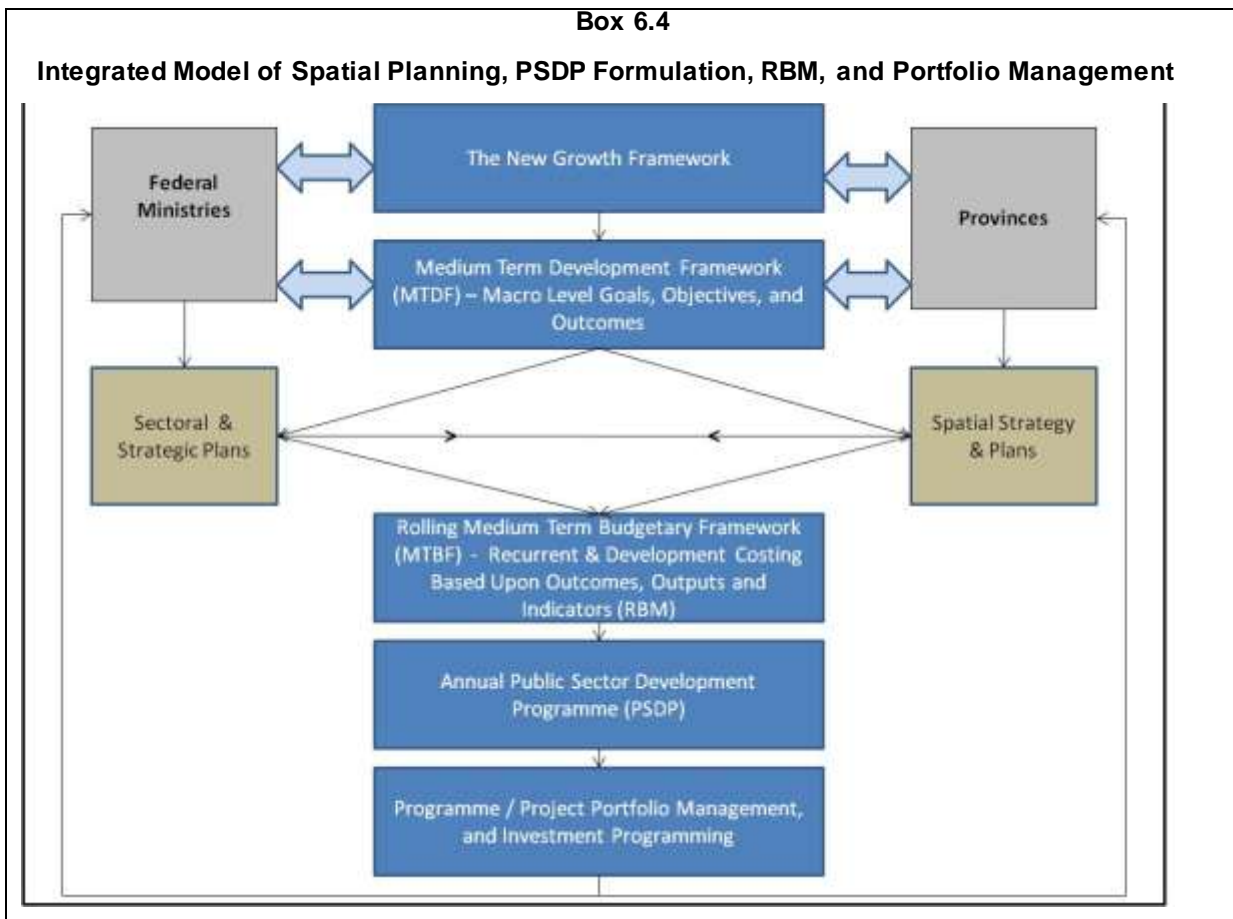


The Medium Term Budgetary Framework (MTBF) 2011-14 describes outcomes, outputs, and indicators for programs and projects that are expected to be implemented by ministries⁵. However, the ministries, corporations, departments, and sponsoring agencies need to ensure that the program/ project outcomes, outputs, and indicators are incorporated into the respective PC-I and PC-II documents. The link between PSDP 2011-12 and MTBF 2010-13 seems to be missing. The budgeted figures in MTBF 2011-14 are based upon outcomes and outputs. On the other hand, the allocations in PSDP 2011-12 are based upon schemes/programs/projects. Synchronization of PSDP, MTDF, and MTBF 2011-14 is critical to ensure that programs and projects are conceived, planned, monitored, and implemented properly.

RBM focuses on both the inputs as well as outputs. Before feeding inputs into activities and turning them into outputs, RBM requires project planners to think through outcomes and long-term impact that need to be created in communities. Quality of deliverables and projects can be enhanced through proper monitoring and evaluation. The monitoring and evaluation includes definition of key performance indicators (KPIs), physical inspections, and project evaluation reports with key stakeholder input. International benchmarks on quality standards can be incorporated into the key performance indicators and measured as per the requirements of the project and the community. For example, one of the KPIs for a clean drinking water project could involve testing the quality of water by reputable environmental laboratory before call the project success. Similarly, surveys can be conducted on the quality of students graduating from a primary or high school.

Recommendations for effective use of RBM are as follows:

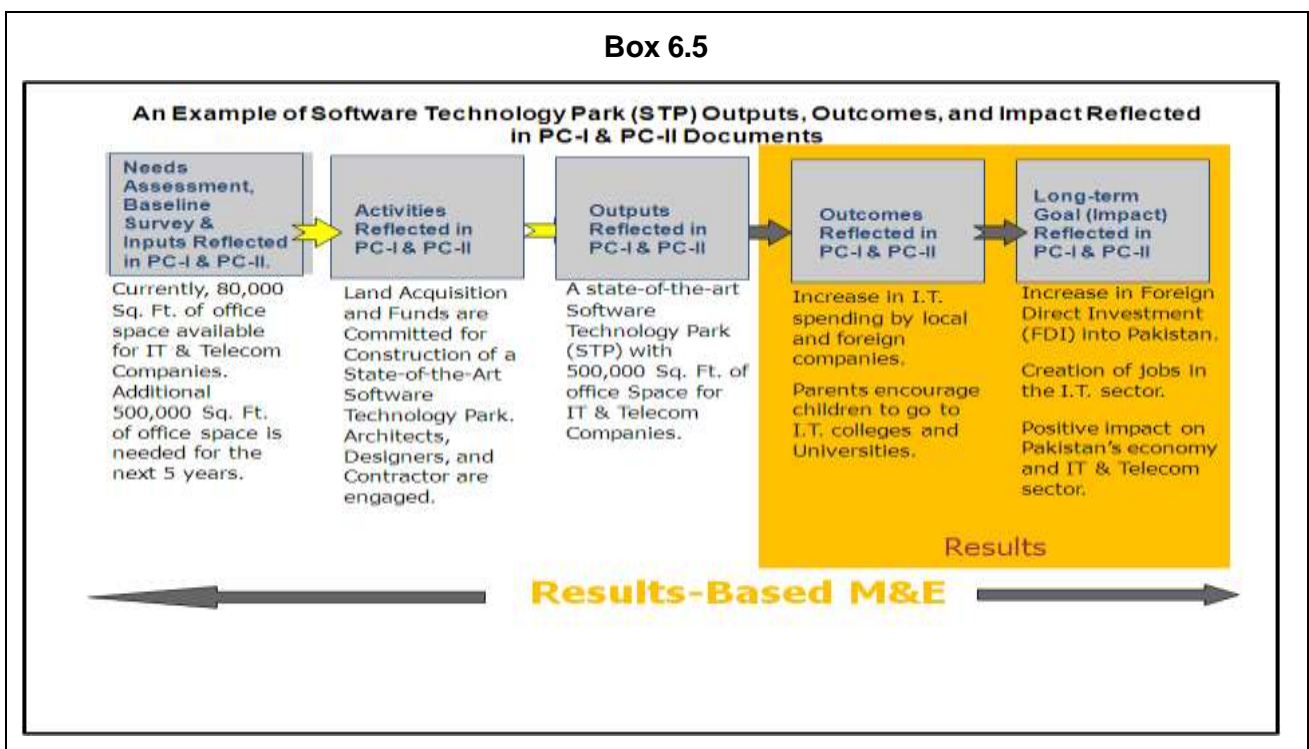
- (i) Integrated spatial planning, investment programming, and portfolio management along with e-Governance and an integrated monitoring & evaluation system are critical for public sector development in Pakistan. Therefore, an “**Integrated Model for Spatial Planning, PSDP Formulation, RBM, and Portfolio Management**” is recommended. The model is shown in Box 6.4.
- (ii) Bottom-up and top-down approach of spatial planning, investment programming, and portfolio management needs to be followed for robust and fruitful planning, monitoring, and implementation of programs and projects. This would be an iterative process that should be coordinated between federal ministries and provinces. This process is also depicted in Box 6.4, while an example of application of this methodology is given in Box 6.5.



- (iii) The Medium Term Development Framework (MTDF) is a key ingredient to PSDP formulation. The MTDF should be prepared in consultation with the federal ministries and provinces, which should result in comprehensive and robust sector

plans, strategy, and priorities. It should also provide macro level outcomes and development goals and objectives. Advantages of the MTFD are as follows:

- a. The MTFD can help the government in deciding sectoral and program priorities and it should be approved by National Economic Council (NEC). Therefore, preparation of MTFD is critical.
- b. MTFD can also provide a rational method of program/project selection and prioritization across ministries and sectors. It can help the government in making decisions regarding sectors and programs with competing priorities.



- c. Sectors and programs that are strategic in nature and create a wider and long-term impact need to get a higher priority. For example, water and power sector investments must get a higher priority as they are related to removing constraints of growth. Disaster stricken areas and regions should also be a priority.

- d. MTBF preparation, investment programming, aggregate planning, and portfolio management must be carried out based upon the investment goals and sector priorities that are defined in the MTDF. The basic purpose of the MTBF must be to cost out both recurring and development expenditure for the achievement of different outcomes.

The WGDP has noted with satisfaction the restructured budgeting procedure under the Medium Term Budgetary Framework (MTBF) which has tied budgetary allocations for the development projects to their results, performance and outcomes. The bad projects would then be deferred. The PSDP will have better linkages with the resource situation and improve quality of decision making.

- (iv) In light of the recent developments and adjustments made to PSDP 2011-12, the MTBF 2010-13 needs to be reviewed and updated. Apparently, this exercise is being finalised by Ministry of Finance.
- (v) The outcomes, outputs and indicators mentioned in the MTBF 2011-14 must be incorporated into PC-I and PC-II documents for a clear definition of scope, monitoring, and evaluation of programs/projects. In addition, baseline surveys must be carried out before the preparation of PC-I documents to enable progress monitoring and impact evaluation of programs and projects.
- (vi) RBM needs to be adopted by all ministries, corporations, departments, and executing agencies in order to take the planning, monitoring, and implementation of the development process forward. However, some of the ministries and programs still need indicators to monitor and evaluate the progress of their programs/ projects. In addition, quarterly and yearly monitoring and project progress reports must be submitted to the Planning Commission so that decisions can be made regarding further funds disbursements to ministries, corporations, and executing agencies. This can also allow planning commission and finance ministry to manage the cash flows and throwforwards more effectively and efficiently.
 - a. Some of the outcomes and outputs in the MTBF 2010-13 seem to be mere statements or activities as opposed to well-thought outcomes and outputs. Ministries and agencies need to review and improve the definitions of outcomes and output.

- b. All ministries, departments, and corporations need to review and understand the MTBF 2011 – 14 document before creating the programs and projects. As such, workshops and seminars on integration of MTBF 2011-14, RBM, and program/project PC-Is should be held for ministries, corporations, and agencies

(vii) The Planning Commission has already compiled an inventory of projects (PC-Is). However, there is a need for an executive dashboard by which the senior management at the planning commission and provinces can quickly review and analyze the entire development program and project portfolio. The executive dashboard can be provided through tools like Enterprise Portfolio and Project Management (EPPM). Senior management at the planning commission, ministries, corporations, agencies, and departments must have access and visibility to the overall portfolio of programs and projects.

- a. The EPPM can allow visibility across federal PSDP and provide linkages and connectivity to all provinces. All federal and provincial ministries can be linked and interconnected, which will allow better planning, monitoring, control, transparency, and governance.
- b. The use of proper project management methodologies and tools along with implementation of best practices for public sector development can also give confidence to donor agencies in government's ability to plan, program, monitor, and implement programs / projects.

(viii) E-Governance and an integrated monitoring and evaluation system need to be put in place in order to link all ministries, agencies, corporations, and provinces. It will ensure better planning, investment programming, cash flow and throwforward management, transparency, and program/ project governance.

(ix) Human resource (HR) development is critical to public sector development. The management and officers at ministries, corporations, agencies, and provinces must be trained on project management tools and techniques including project management methodology, RBM, aggregate planning, EPPM, P3M3, MTBF, and portfolio management.

- (x) 'The WGDP observed that project management is now a specialized discipline and the projects are managed through a well integrated network of processes e.g., planning, executing, monitoring and closing. It was therefore, recommended that training in project management be focused to produce certified leaders for project governance. It was felt that redundant processes and procedures also need to be improved in the light of new body of project management knowledge so as to control delays & wastages in the development projects.'

Chapter 7

PROJECT FEASIBILITY APPRAISAL AND APPROVAL: SYSTEMS, PROCEDURES AND MECHANISMS

7.1. Introduction

One of the principal mandates of the Planning Commission in the development arena is to plan, appraise, approve and monitor all development schemes. To ensure quality and consistency in project preparation the PC has introduced a number of processes and formats. These range from the clearance of a project's or programme's concept, preparation of the feasibility study, appraisal and approval in designated fora. This is followed by the approval and release of funds and the physical implementation of the project. Concurrent monitoring during the physical implementation stage is undertaken by the relevant Planning departments/divisions.

7.2 Institutional Framework: Appraisal to Ex-Post Evaluation

Mandate, Composition and Powers of the Agencies

Appraisal and approval of schemes is undertaken at both the Provincial and Federal levels by sponsoring agencies. At both levels, initiation of and preparation of projects is the responsibility of sponsoring agencies. Pre-approval appraisal of all proposed schemes is the domain of the Planning and Development Departments/Board (PPD) or the Planning and Development Division (PDD). The institutional framework and the approval ceilings for each tier are shown in Table 7.1.

7.3 The Planning Mechanism: Identification to Monitoring

Identification: Donor Assisted Programmes/Projects

The mechanism for foreign aided projects is shown in Appendix 7.1. Thereafter the process remains the same both Provincial and Federal Government and the Public Sector at large. All schemes require that an application be submitted accompanied by the Concept Clearance Form (CCF). Invariably no feasibility report is attached to these forms¹². It is recommended that such applications should be returned even if funding arrangements have been made *a priori*.

¹² Of the five CCFs placed before the CDWP/CCC for approval in the joint meeting on 7th of April 2011 not one was accompanied by a feasibility report.

Table 7.1: Sanctioning Authorities by Size of Project

	Composition		Limitation	Ceiling (PKR Mln)
	Chair	Members		
Provincial Departmental Development Working Party (P-DDWP)	Secretary of Department Head of Agency	Representative of Finance Department Chief of concerned Section PPD	Projects Foreign Funded or requiring Foreign Exchange to be referred onwards	40 ¹
Provincial Development Working Party (PDWP)	Additional Chief Secretary (P&D)/Chairman P&D Board, Punjab	Secretary Finance + Secretaries of line departments	Projects Foreign Funded or requiring Foreign Exchange to be referred onwards	5,000
Federal Departmental Working Party (DDWP)	Secretary of Ministry/Division Head of Agency	Representative of Finance Division Chief of concerned Section PPD	Projects Foreign Funded or requiring Foreign Exchange to be referred onwards	60
Central Development Working Party (CDWP)*	Deputy Chairman Planning Commission	Secretary Planning; ACS (P&D) of the Provinces, the Chairman of the Punjab P&D Board	Federal and Special Area Projects	1,000
Concept Clearance Committee		By invitation: Heads of Planning in AJ&K, FATA & GB	Provincial Projects	5,000
Economic Committee of the National Economic Council (ECNEC) ¹³	Finance Minister	Deputy Chairman Planning Commission	Provincial and Special Area Projects	≥1,000
		All Federal Ministers	Provincial Projects	>5000

Notes: * All Projects with an FEC ≥ 25%
Source : Planning and Development Division; Government of Pakistan
¹ In Punjab this is Rs. 200 million

Preparation and Approval

The preparation of the project or programme is the domain of the sponsoring agencies and must complete a PC-I, in to and submit this along with a feasibility study^{14, 15}. Generally the PC-Is are incomplete. Requests for approval for appointing consultants and seeking funding for this are submitted on the PC-II. These are appraised, approved or sanctioned at different levels. The process flow leading to approval and sanction is shown in Appendix 7.1.

¹³ By special invitation: Finance & Planning Minister; Additional Chief Secretary (P&D), AJ&K; Dy. Chief Executive and Chief Secretary, FATA, and by Chief Executive and Chief Secretary, Gilgit-Baltistan.

¹⁴ Government of Pakistan, Planning Commission; April 2000; Guidelines Part I, p3 para iii); and Secretary's letter of 14th January.2011

¹⁵ All proposals beyond a threshold level of investment (Rs. 300 million), or those with a sizable share of investment requiring foreign exchange (25 percent plus) or are complex in character (cutting edge technology, span across sectors or inter-provincial boundaries) must be accompanied by a professionally prepared feasibility report. In other instance a departmentally prepared report is acceptable.

The WGDP felt that the pre-requisite of a feasibility study should be made mandatory for all kind of development projects i.e., major and minor and relating to all sectors. This would ensure better quality of project formulation and make appraisal and selection process quicker and easier. Only sound projects and of a right priority for funding out of the public sector, would then find entry into the PSDP. A quality feasibility report would also explore the possibility of private sector investment in the project.

The documents must be signed by the Head of the sponsor's controlling authority. It is expected that all necessary information requested for in the requisite¹⁶ application forms are complete in all respects. In most instances the forms are completed without critical information. For instance, the response to relevance of the proposal to Plans is "not applicable" in the absence of FYPs and a similar response is also given for social and economic benefits from the proposed scheme. The information on the current situation justifying the project is not based on field surveys. Discussions with the Chiefs of the Technical sections lends credence to the impression that the capacity to prepare the PC-Is within the sponsoring agencies is deficient largely because of both the absence of the mandated Planning and Monitoring Cell (PMC) in the controlling authorities' offices and the absence of skilled and trained manpower to man them in most instances. It is recommended that the PMCs mandated by the ECNEC be established and manned by requisite staff, all existing staff be trained and mandatorily attend refresher courses. Further, since proposals valued at ≤PKR 300 million should include a departmentally prepared feasibility report, staff should also be trained in preparing these reports.

After the 18th Amendment, 18 Divisions of the Federal Government have been devolved to the Provinces rendering the staff surplus. Following training, some of these employees could be transferred to the PMCs in various Divisions. The level of effort in training these staff members would be minimal as most were, in one way or another, involved in monitoring the development work of the devolved Ministries / Divisions.

There are mechanisms for circumventing standard procedures of approval of schemes (see Box 7.1). It is recommended that these should be discouraged and should only be

¹⁶Available from

<http://www.pc.gov.pk/downloads/pc-I%20forms/PDF/PC-I%20Production%20Sectors.pdf>,
<http://www.pc.gov.pk/downloads/pc-I%20forms/PDF/PC-I%20Infrastructure%20Sectors.pdf>, and
<http://www.pc.gov.pk/downloads/pc-I%20forms/PDF/PC-I%20Social%20Sectors.pdf>

allowed after following due process of preparation. This will ensure value for money and the efficient use of scarce resources.

Box 7.1

By-passing Standard Operating Procedures

In some instances, sponsoring agencies by-pass established procedures through what is euphemistically referred to as “anticipatory approval”. The PC itself encourages this mechanism¹, and has formalised the process through a Proforma for such requests for both new and on-going projects. This contravenes principles of fiscal responsibility and good governance. The approval is not limited to concept clearance, but also authorises expenditures which have not been budgeted for, thus skewing the allocations for development. Moreover, such approvals subsequently create “de facto” situations when the formal request for approval is submitted. This practice needs to be curtailed for all projects other than those which are being funded by bi- or multi-lateral aid agencies and development partners. In such instances the CCF should be approved ‘in principle’ to initiate negotiations and once these have been finalized, the normal process of approval should be followed.

Yet another method for sanctioning projects is the “special directives from Government” or those nominated by legislators. Both types circumvent stated procedures. Politically motivated projects can be justified as long as they are well thought-out, aligned with the MTDf and MTBF, planned and monitored properly, and executed under a robust project governance model. These projects must create value for citizens, provide necessary public services, and have a long-term positive outcome.

Monitoring of Implementation

Project approval is followed by administrative approval and sanction for incurring expenditure. Administrative approval is issued by the Federal Ministry in respect of federally sponsored projects, while for the Provincial projects the approval is issued by the Provincial Department concerned. Once these implementation steps have been completed and the scheme has crossed the start-up stage, the process of monitoring kicks-in.

This is the prime responsibility of the controlling authority of the executing agency. The PPD/PDD’s responsibility is limited to third party validation. Each of the Ministries are

required to have a Planning and Monitoring cell mandated to undertake both concurrent monitoring and ex-post evaluation and submit the periodical relevant reporting formats – PC-III for each month, the PC-IV on completion and the PC-V annually for five years after completion. The PPDs and the PDD each have a specialised Monitoring Cell/Wing devoted to validating this information through both desk-review of the information provided and a physical verification of a sample of these, but are understaffed and under-resourced¹⁷. It is recommended that monthly reports (PC-III) should be abandoned in favour of quarterly reporting. The former frequently show little change from one report to the other. Moreover, the monitoring reports should also comment (at least every six months) on the efficacy of the project intervention, perception of stakeholders, highlight constraints and bottlenecks and suggest remedies and also the follow-up action taken on such suggestions.

A review of the monitoring activity within the PDD reveals that after approval of the proposal to set up the Project Monitoring Wing with sufficient funding for 8 years (starting in 1996/97) periodic concurrent monitoring of some 500 projects is undertaken annually. For instance, in the current fiscal year the target is to monitor one-thirds of the projects. Achievement to the end of March 2011 was 422. These were in addition to ex-post evaluations of 11 projects to date during the current year and 116 cumulatively since the Wing was established. The target for ex-post evaluation is 20 annually.

To improve monitoring within the controlling authority offices of projects and programmes it is recommended that the mandated Planning and Monitoring Cells should be operationalised and staffed and resourced adequately. To ensure that there is no complicity between the PMC and the executing agency staff, the PMC head should report (at the provincial level) to the Secretary of the controlling Department and not the executing agency. At the Federal level the reporting should be to the Secretary of the Division. Sequentially the monitoring reports should be referred to the PPDs'/PDD's Monitoring Units for undertaking the monitoring of on-going projects as a Third Party.

Contents of Applications

The content of these forms are fairly comprehensive and range from defining the purpose and objectives of the proposal, the inputs required, the time frame for completion,

¹⁷ In most instances conspicuously absent and where these have been established are moribund. Other than the PDD which has an eight-year project funded through the PSDP for Monitoring and Evaluation

the methodology for implementation, the short- to medium-term results to be achieved and the long-term impact of the proposal on the socio-economic fabric of the country.

a. *Concept Clearance Form*

The form is divided into two parts: the first to be completed by the sponsoring agency, and the second by the Planning Commission/PDD contains the comments of the concerned Technical Sections. Missing from the Form is information regarding the perceived benefits. It is recommended that these should be listed and quantified as a mandatory requirement.

b. *PC-II Form (Surveys, Feasibility Studies, Design)*

The Form requires that five major aspects of the project be covered as follows:

- i. General description and justification
- ii. Expected outcome
- iii. Implementation period, and
- iv. Year-wise estimated cost and its Financing plan
- v. Manpower requirements

A comprehensive guideline for completing the Form is attached with it.

c. *PC-I Form (Production, Infrastructure and Social Sectors)*

This form was revised in 2005. The set now consists of one each for the Production, Infrastructure and Social Sectors (see Box 7.2).

An examination of the PC-I formats reveals that these are not MTBF compliant (as highlighted in Chapter 6).

d. *Anticipatory Approval*

This process circumvents the approval and sanctioning process. As such it is recommended that this process be discarded for all projects other than those which are foreign aided. Therefore, the forms will no longer be required and may be abandoned.

e. Feasibility Study

The PC has set out the requirements of a feasibility study and states that this is basically an in-depth three-in-one study of a project which gives its technical, financial and economic viability and arrives at definitive conclusions on all the basic issues of the project after consideration of various alternatives. It also accepts that the nature of a feasibility

study differs by sector and project. This can be completed departmentally for projects costing upto Rs. 300 million. If departmental capacity does not exist then, during the period that internal capacity is not enhanced through training of existing staff the feasibility may be prepared by professionals hired for the purpose.

f. Quarterly Performance Report

The PC-III Form is actually a set of three forms. It contains the Activity Chart/Work Plan for the fiscal year and required to be submitted before the start of the year along with the budgetary request for the forthcoming year. This is used as a benchmark to measure performance during the year.

<p>Box 7.2</p> <p>The set of PC-Is and their Content</p> <ul style="list-style-type: none"> • Production Sectors (Agriculture Production, Agriculture Extension and Industries, Commerce and Minerals), • Infrastructure Sectors, and • Social Sectors (Education, Training, Manpower, Health, Nutrition, Family Planning, Social Welfare, Science, Technology, Water Supply, Sewerage, Culture, Sports, Tourism, Youth, Mass Media, Governance and Research). <p>These forms are designed to provide, for both new and on-going projects, information on physical aspects (location, hinterland, scope, objectives, inputs), social benefits (outputs, outcomes and impacts), economic benefits (what, how much, EIRR, B:C Ratio), environment and gender impacts, and financial implications (development cost and ex-post recurring expenditure of downstream activities, rates of return). The specified content meets the sum of the requirements for a pre-implementation appraisal, but does not meet the full requirements for the MTBF.</p> <p>The additional information for on-going projects is the to-date year-wise funds allocation, release and utilisation statement, the year-wise statement of completion of activities, the justification for the revision, a comparative statement of original and revised cost and completion schedules, and the statement of variances with justification.</p>
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The PC-III (B) is a summarised statement of funds received and spent, the physical throughput of each activity and the outputs during the month. These reports were used in the past to control release of funds. Since the practice is now to release funds to the Ministry rather than the project the practice of monthly reporting to the PPD/PDD is now not in vogue by most projects. It is recommended that the form should now be submitted quarterly to the Ministry who should collate this as an annex to their quarterly requests for release of funds. The Ministry's monthly release of funds should be deferred if the PC-III (B) of 25% of the on-going projects/programmes is not annexed to the report. Along with the availability of data needed for concurrent monitoring by the Finance Division/Department and the PPD/PDD, this has the added advantage of forcing monitoring by the Ministry/Department to ensure their release of funds on time.

The PC-III (B) is the Annual Progress Report. Its non-submission is no longer a hindrance to release of funds. A similar condition for the second and third quarters' withholding of the release will ensure compliance.

g. Completion Report

The PC-IV Form is the Project Completion Report. It is rare to see this being submitted other than by the most conscientious Project/Programme Directors/Managers. This is a necessary and sufficient requirement for post-completion evaluation. It is recommended that the Project Directors/Managers be trained in preparing these reports to include lessons learnt for the future. These reports should be approved by the Ministry and forwarded to the PPD/PDD for their reference and uploading on the relevant websites.

h. Post-completion Annual Performance Report

The PC-V Form reports the annual performance of the project after its completion and is essentially a report on the variance between the actual and planned recurring costs and outputs and an explanation of the variance. This can also be used to measure the outcomes (medium-term benefits – 3-5 years after completion) from the third year onwards. This should be included and has been incorporated in the revised form shown as PC-V.3+ in Appendix 7.2. The responsibility for preparing these should be that of the PMC's and TPV should be the responsibility of the PPD/PDD. Impact Evaluation (five or more years after the completion) should be mandatorily undertaken for projects/programmes costing Rs. 5 billion or more by the

PPD/PDD itself or contracted out to consultants. The results of all evaluation should be uploaded on the PPDs/PPD's websites.

All projects mandatorily have submitted PC-Is as without this the Project cannot be funded even though anticipatory approval may have been awarded. The PC-II is required only where sponsoring entities require funding for hiring the services of professionals for surveys, conducting feasibility studies or preparing complex designs. The PC-III has been submitted mandatorily until the recent change in the financing mechanism – from direct releases to projects to bulk releases on a monthly basis to Ministries/Divisions. The completion of the PC-IV (Project Completion Report) has been a rare occurrence in the past and continues to be so in the present. Discussions with Section Heads in the PDD lends credence to the foregoing statement as most deny having seen this over their career. The PC-V is even more conspicuous by its absence. Unfortunately, there is no record maintained of the frequency of submission of the PC-III to PC-V Forms and reliance on the historical frequency of submission is based on recall and anecdotal evidence. Discussions with the M&E section of the Implementation Wing also confirms this situation.

The WGDP has recommended that 'in order to ensure that various sections of the PC conform to the prescribed procedures and processes prescribed for project appraisal, approval and M&E, the PC may consider itself for ISO 9001 certification.'

Also, the WGDP considers that since 'consultations with stake holders through all stages of the project cycle would be of immense value and should be encouraged. It shall lend authenticity, help monitoring the implementation (especially the work of contractors) and in creating public trust and faith in the government initiatives.'

Further the WGDP 'recommends that post completion evaluation is often weak. Important analysis such as restraints & limitations, success & failings and impact on growth should be made part of post completion reports and the findings are utilized for better designing of the projects in future.'

Since such monitoring will help in improving the implementation of projects through the "lessons learnt" sections of the monitoring reports, it is recommended that both concurrent

monitoring and post-completion evaluation should be built into the MTBF as a mandatory requirement.

South Asia started off with similar procedures for project formulation to approval. However, each country has evolved its practices and implemented divergent procedures depending on the state of governance. For example, the Indian experience provides a useful guide (see Box 7.3)

Box 7.3

The Indian Process – Formulation to Approval of Public Sector Projects

Realising the need for improving the project cycle, the Government of India set up a Committee to study the procedures and suggest changes. The Report on the process from Formulation to Approval was completed in 2003 and the revised system was notified on 7th May 2003 to take effect from 1st July 2003.

The project cycle would commence with the submission of the Feasibility Report (**FR**) to the Planning Commission by the Administrative Ministry/Department. The stages and timelines following this are given in the following Table:

(i)	Decision on "in principle" approval based on FR	4 weeks
(ii)	Preparation of Draft Project Report (DPR) by Administrative Ministry/Dept and circulating the same along with draft Expenditure Finance Committee (EFC)/Public Investment Board (PIB) Memo.	The time limit will vary from project to project. The time limit for preparation of the DPR should be stipulated by the competent authority while according approval for preparation of
(iii)	Comments to be offered on DPR and draft EFC/PIB memo by Planning Commission and concerned	6 weeks
(iv)	Preparation of final EFC/PIB Memo based on DPR and comments received, and circulating the same to Planning Commission, Department of Expenditure and other concerned Ministries/Agencies	1 week
(v)	Convening EFC/PIB meeting after receiving final EFC/PIB Memo	4 weeks
(vi)	Issue of minutes of EFC/PIB	1 week
(vii)	Submission for Approval of Administrative Minister and Finance Minister (for projects of Rs. 500 million and above but less than Rs. 1,000 million)	2 weeks
(viii)	Submission for Approval of Cabinet/Cabinet Committee on Economic Affairs (CCEA) (for projects of Rs. 1,000 million and above)	4 weeks

The Planning Commission requires that the ECB/SFC/PIB Memorandum in addition to the description and viability of the project should also provide a statement (a) of the reliability of the cost estimates and the rigour with which these have been prepared, (b) where land acquisition the extent to which the land has been encroached upon and what arrangements have been made to recover the land, and (c) the funding sources and the extent to which these are reliable. Very detailed guidelines have also been prepared for the preparation of the DPR.

The appraisal of these documents is rigorous and incomplete or insufficiently detailed responses to the Memorandum items results in returning these for corrections. Rigorous approval procedures to curtail the proliferation of schemes have been ensured which require a multi-layered approval where the rigour of scrutiny increases by stage. One major requirement is that the funding for the proposal should be assured ex-ante without which the proposal will not be considered.

7.4. Mechanism for Appraisal and Approval of Applications

Brief description of the Mechanism

People Work Program-I, People Work Program-II and proposals below the sanctioning levels of the DDWPs are not appraised. Beyond these they are appraised by the relevant sections of the PPDs/PDD. The Chiefs of the relevant sections undertake a rapid appraisal of the technical and environmental components of the scheme. A detailed appraisal is undertaken by the specialist concerned. Simultaneously an appraisal of the economic and social aspects of the scheme is undertaken¹⁸.

These are then put together and a Working Paper is prepared by the concerned Technical Section for the PDWP/CDWP meeting.

Critique on Systems and Procedures

Appraisal requires time, capacity and capability. According to instructions issued by the ECNEC the time has been reduced, for instance within the PDD from three months to only three weeks currently. Staff availability is another major issue. Each section within both the PPDs and the PDD is under strength caused by the lid on recruitment and the exit of staff owing to superannuation. Staff exit is also caused by the attraction of higher salaries offered by the private and international agencies for the more competent and efficient officers. At the PDD most sections are working at half-strength or less.

The systems and procedures are enshrined in the Manual of Development Projects (twice revised), Guidelines, Handbook, Notifications and Circulars of the Secretary PDD. An examination reveals that these are adequate and if implemented in letter and spirit meet the requirements of current day practice and are also compliant with the requirements of the MTBF.

The appraisal of any scheme delves into six aspects the last two of which are required by international agreement: one, technical; two, financial; three, economic; four, social; five, environmental; and six, gender. 1, 4, 5 and 6 are dealt with by the relevant technical sections of PPD/PDD and 2 and 3 are the domain of Economic Appraisal Section (EAS) in the PDD and its counterparts within the PPDs.

Discussions with officials of both the technical and economic appraisal sections of the PDD and an examination of a sample of project documents establish that a consolidated appraisal report is not prepared. Working papers, embodying the appraisal prepared by the technical section for the PDWP/CDWP meetings, are largely a repeat of the information provided in the PC-I. The mandatory requirement of a feasibility study is overlooked,

¹⁸ Economic Appraisal Section (EAS) in the PDD; the Economic Policy and Research Section (EPRS) in Sindh's PPD; and by similar sections in the other PDDs

technical designs are accepted based in line drawings, cost estimates based on Schedule of Rates and rule of thumb Bills of Quantities are accepted with a caveat that these would be revised and submitted subsequently. Very rarely are the requirements of financial analysis and economic analysis fulfilled. Risk analysis, shadow pricing and estimation of rates of return are unknown to most staff. The discount rate, to be notified by the Finance Division, has not been changed over the last several years. Changes in the discount rate could be used for undertaking the Risk Analysis of Projects and thereby establish the robustness or otherwise of the project's concept, objectives, outcomes and design.

The pressures faced by the staff can be gauged from the fact that only over the last 6 months, a total of 216 proposals were processed and the EAS has a complement of only one Deputy Chief and three Assistant Chiefs. Of the 216 proposals "appraised", 60 were submitted within the week preceding the meetings of the CDWP.

CDWP and ECNEC meetings

Over the last 6 month period, mid-October 2010 to mid-April 2011, four CDWP meetings have been held on 3 November 2010, 21 January 2011, a Special meeting on 16 March 2011 and the last one on 7 April 2011. The last meeting of the ECNEC was held on 9 December 2010.

An examination of the Minutes of the last four meetings of the CDWP, November 2010 to April 2011, held during this fiscal year shows that the Agenda itself states that the working papers for a not insignificant number of schemes "will follow". These are, however, submitted piecemeal over the course of the week. The output of the last four meetings, one of which was called specially to discuss projects relating to rehabilitation of the 2010 flood affected infrastructure, is shown in Table 7.2.

The Table shows that of the 216 proposals valued at Rs. 1.085 trillion considered by it, CDWP sanctioned 192 projects worth more than Rs. 985 billion, an approval rate of nearly 91 percent. Adding this to the current throw-forward and given an expected annual PSDP of around Rs. 150 billion, CDWP has effectively pre-empted development expenditure spending for 18 years. The Manual, Handbook, Guidelines, Notifications and the Advisory Memoranda all stipulate that major considerations for approval should be available resources, ability to implement the schemes and perhaps, most importantly, the benefits that will accrue. Sanctioning projects without proper appraisal, quantification of benefits and assessment of absorptive capacity represents a major breakdown of the approval process.

TABLE 7.2 ANALYSIS OF CDWP DECISIONS FOR THE SIX MONTH PERIOD NOVEMBER 2010 TO APRIL 2011

Sector	SUBMITTED FOR DECISIONS									DECISIONS OF THE CDWP						
	Pre- Agenda #	Final Agenda		Special Area Packages		Government Directives		Foreign Aided		Deferred		Not Approved		Approved Projects		
		#	PKR Mln	#	PKR Mln	#	PKR Mln	#	PKR Mln	#	PKR Mln	#	PKR Mln	#	PKR Mln	
Agriculture & Food		11	148,215	7	4,490			1	796	1	13,321			10	134,894	
Forestry & Wildlife		1	23	1	23									1	23	
Industries and Commerce		15	27,467	8	1,992	1	2,40	5	22,519					15	27,467	
Water Resources		24	179,484	9	17,321			4	73,530	1				23	179,227	
Energy		16	80,742					13	77,556	1	340			15	80,402	
Education		4	5,673					3	5,223					4	5,673	
Information Technology		6	33,845					2	15,272	1	12,908			5	20,937	
Governance		5	11,656					3	26,178	1	9,602	2	243	3	2,003	
Science and Technology		3	9,703											3	9,703	
Higher Education		12	10,858	5	6,114			4	3,015	2	1,413	1	473	9	8,971	
Physical Planning & Housing		24	9,679	5	2,832					1	762	4	1,161	19	7,756	
Environment		1	193.00	1	193									1	193	
Transport and Communications		40	232,027	15	23,547			7	80,148	3	14,671	2	21,785	35	195,570	
Devolution & Area Development		6	25,295					1	14,694					6	25,295	
Health		3	25,128					1	24,983					3	25,128	
Gender Development		1	167					1	167					1	167	
Manpower		5	8,308			1	80	3	7,726					5	8,308	
Mass Media, Culture & Sports		7	2,977			1	423	4	831					7	2,977	
Population Welfare		32	273,539	1	1,471			11	76,560	1	300	3	21,836	28	251,402	
TOTAL		156	216	1,084,9780	54	57,924	3	2,908	63	429,199	12	53,318	12	45,499	192	985,905

An analysis of the decisions taken by ECNEC in its last meeting shows that a total of 43 projects were discussed, of which 12 (27.9%) provided no details of costs and yet were either approved with the caveat that costs would be provided later or were deferred to the next meeting as not only costs but other details were also missing. The value of those providing estimated costs was over Rs. 1.6 trillion (see Table in Appendix 7.1). The decisions of the ECNEC appear to follow the same principles of decision-making as in the CDWP.

7.5. Recommendations

Based on the above evaluation of the feasibility preparation, appraisal and approval process the following summary recommendations are made:

1. A moratorium should be declared for approval of new projects other than those which qualify to be in the CORE PSDP as defined in Chapter 4,
2. Following the 18th Amendment, the provinces may not refer any projects to the CDWP for approval, other than those involving foreign assistance or those that have an impact on more than one province, such as projects in the water sector,
3. Approval of projects, irrespective of their originating office or organisation, should be based on the results of a rigorous appraisal which should include:
 - a. Appraisal of all technical aspects undertaken by specialists. In the event that such specialists are not available, the PDD should select a specialist from a list of approved consultants available within PDD, until capacity has been developed in-house through training and recruitment. The specialist may undertake the technical appraisal, such as: appropriate design, energy efficiency, veracity of costs, unit rate analysis, accuracy in estimates of quantity, environmental impact assessment, etc.
 - b. Financial appraisal of all projects to determine FIRR, ROI, pay-back period, break-even analysis, risk analysis,
 - c. Social analysis which should reflect the impact on the beneficiary population, dislocation, resettlement, livelihoods, security and other benefits,

- d. Economic analysis which should contain a clear identification of benefits with cost-benefit analysis leading to estimation of EIRR, B/C Ratio, NPV, and Domestic Resource Cost, and
- e. Risk analysis should be undertaken with respect to time delays, cost variations, design and content modifications, political and security environment.
- f. Consistency of a scheme with the MTDF and the MTBF should be clearly indicated.
- g. All proposals not accompanied by a feasibility which responds to the content and rigour required by the layout specified by the Planning Commission should not be entertained.

Chapter 8

RECOMMENDATIONS FOR THE BUDGET

Based on the findings and recommendations in the previous Chapters the following paragraphs are suggested for inclusion in the 2011-12 Budget Speech* of the Finance Minister:

‘ The Government proposes to expand rapidly the PSDP in 2011-12 in order to promote the process of early revival of the economy. The total PSDP is being set at Rs 730 billion, with a growth rate of 62 percent in relation to the level likely to be attained this year. The Federal PSDP will be Rs 300 billion, while the four Provincial governments will execute a combined PSDP of Rs 430 billion. We have also finalised the policy of timely releases of funds to development projects during the financial year.

The government proposes to give priority to the implementation of projects which have an early development impact and provide for a balanced uplift of various segments of society, while bringing about the structural changes necessary for achieving higher and sustainable growth.

In this connection, the Planning Commission has finalised a Growth Framework which focuses on enhancing productivity by addressing the energy constraint, raising agricultural productivity, promoting innovation (especially science and technology), facilitating human capital development (including investing in youth) and urban development. The PSDP will be aligned with the ‘new’ growth drivers in this Framework.

The on-going portfolio of projects is being rationalised in order to ensure adequate funds for projects in priority sectors and which are near completion. All projects in Balochistan, especially those which are being implemented as part of the **Aghaz-e-Huqooq Balochistan Package**, will be fully protected in the allocations.

* This is, of course, subject to approval of the Planning Commission.

The Government will adhere to the June 30 deadline for implementation of the transfer of functions to the Provincial governments as per the 18th Amendment. 18 Divisions are being devolved to Provinces. Although there has been a substantial additional transfer of resources to the Provincial governments following the 7th NFC Award, the Federal government is keen to ensure that enough funds are available to ensure an orderly transition without any disruption in the access to basic services.

Therefore, the Council of Common Interests, chaired by the honorable Prime Minister, has decided to continue to fund higher education till the next NFC Award in 2014-15 and all key national programs of the health and population welfare sectors. We will ensure that these pledges are honored in the interests of the Federation.

Following the 18th Amendment and in recognition of the greater Provincial autonomy, the planning process is being fundamentally altered. Henceforth, no Provincial projects, except those which are foreign aided, will have to come to CDWP and ECNEC in Islamabad for approval. The emphasis will now be on bottom-up rather than top-down planning as was the case in the past. National plans and strategies will be formed only after extensive consultations with the Provincial governments, private sector and civil society. The Planning Commission has decided that there will be one Member of the Commission from each Province.

I am pleased to report that the Medium Term Budgetary Framework has been updated for the period, 2011-12 to 2013-14. The MTBF focuses on achievement of outcomes and represents a fundamental transition to Results Based Management (RBM). Projects will henceforth be approved depending upon the extent to which they contribute to the achievement of different outcomes. In addition, the Planning Commission is taking a number of important steps to improve the process of project preparation, approval, monitoring and evaluation.

APPENDICES

Appendix – A: FEATURES OF THE IPP MACROECONOMIC MODEL

- Short-Run/Medium-Run-Keynesian
- Long-Run – Harrod - Domar
- 44 Equation Model
- Based on Consistent National Income Accounts from 1980-81 to 2009-10
- Models Consequences of
 - Fiscal Policy
 - Monetary Policy
 - Trade Policy
- On Macroeconomic Imbalances, Inflation, Growth, Employment and Poverty
- Models Impact of Changes in World Economy
- Handy Tool for Policy Analysis and Scenario Building

What Drives Growth in the Model?

- 1) Increased resource mobilisation and current expenditure containment enable an improvement in the fiscal situation; public investment grows. With improved macroeconomic indicators, private investment responds. Overall growth rate rises.
- 2) Implementation of strong reform agenda brings forth more support from the international community (including the IMF); helps in BOP financing and sustains a higher level of imports and FE reserves, which contributes to raising private investment and growth.
- 3) Other variables which impact on growth are real interest rate, relative export and import prices, remittances, etc.

The model has high ex-post forecasting capability. A comparison of the ex-post forecast by the model and the actual magnitude of endogenous variables reveals high correlation ranging from 0.910 to 0.999.

Details of variables in the model are given below:

Number of Endogenous and Exogenous Variables in the IPP Macroeconomic Model

Including endogenous and exogenous variables, there are a total of 56 variables in the model (40 endogenous and 16 exogenous). Total number of equations in the model is 44: 16 behavioural equations and 28 accounting identities. The lists of endogenous and exogenous variables are given below:

List of Endogenous Variables

Real Sector Block

Private Consumption Expenditure, Private Investment, Expenditure on Exports of Goods and Services (in Rupee and US Dollars), Expenditure on Imports of Goods and Services (in Rupee and US Dollars) and Gross Domestic Product

Government Finances Block

Government Total Revenue, Government Tax Revenue, Government Total Expenditure, Development Expenditure, Defence Expenditure, Subsidies, General Administration Expenditure, Other Expenditure and Fiscal Deficit

Debt Block

Interest Payment on Domestic Debt, Interest Payment on External Debt, Inflation Rate, External Debt without IMF, Domestic Debt, Total Debt without IMF, External Debt with IMF and Total Debt with IMF

Monetary and Price Level Block

Domestic Price Level, Food Price Level, GDP Deflator, Money Supply, Exchange Rate (Average and at end of the period), Unit Value Index of Exports and Unit Value Index of Imports

Balance of Payments Block

Current Account Deficit (in Rupee and US Dollars), Foreign Exchange Reserves and Foreign Exchange Reserves (Months of Imports)

Social Sector Block

Level of Employment and Level of Poverty.

List of Exogenous Variables

Policy Variables

Public Consumption Expenditure, Public Investment, Real Interest Rate, World Demand, Real Wage Rate and Level of Direct Taxation.

Other Exogenous Variables

Change in Stocks, Non-Tax Revenue, Net Factor Income from Abroad, Foreign Direct Investment, Net Foreign Assistances, Repayment of IMF Loan and Population.

Appendix – B: The 7th NFC Award

Intergovernmental fiscal transfers have historically taken three forms: divisible pool transfers, straight transfers and grants & subventions. Prior to 7th NFC Award, the divisible pool included Income Tax, Sales Tax, Excise Duties, Export Duties and Capital Value Tax on immovable properties. Straight transfers include surcharge on gas, excise duty on gas and crude oil, net hydel profits and royalty on gas and crude oil. In addition, provinces also used to receive grants and subventions. In 2009-10, the share of divisible pool transfers, straight transfers and grant in total transfers was 80 percent, 12 percent and 8 percent respectively.

Major features of the 7th NFC Award are as follows:

- The share of provinces in federal divisible pool has been enhanced from 50 percent (including grants) to 56-57.5 percent.
- Earlier, horizontal distribution of divisible taxes among the provinces was based on population shares only. It will now be based on multiple criteria that include population (82%), poverty (10.3%), revenue (5%) and inverse population density (2.7%).
- Basis of calculating the straight transfers has been altered resulting in enhancement of straight transfers to the provinces.
- Use of grants/subventions as a mechanism of transfer has been discontinued. Only Sindh will get a Rs 6 billion grant in lieu of abolition of octroi/zila tax grant.

As a consequence of 7th NFC Award, budgeted increase in revenue transfer to provinces is presented in Table A-5-I. As compared to the previous revenue sharing arrangement, budgeted transfers to provinces are expected to be over 27 percent higher, that is, Rs 1033 billion as compared to Rs 812 billion. However, the revenue gains presented are those

Table B-I: Budgeted Increase in Revenue Transfer to the Provinces under 7th NFC Award (2010-11)

	Rs billion
Under previous revenue sharing arrangements	812
Under 7 th NFC Award	1034
Increase	222
Percent increase (%)	27.3
Source: IPP	

budgeted at the start of fiscal year 2010-11. Realization of actual gains after the first eight months in the current fiscal year indicates a shortfall of about Rs 75 billion.

The substantial enhancement in the transfers to the provinces under 7th NFC Award is bound to have a significant effect on both provincial and federal government finances. Some of the consequences have become visible during the current fiscal year 2010-11. Federal government has already recorded a fiscal deficit of 5.5 percent of GDP in the first nine months. As opposed to this, the provinces have not been able to absorb the large post-NFC transfers in the short run, which has led to a large build up in cash balances of about 0.7 percent of GDP. However, these cash balances are likely to decline by the end of the year in view of the expected shortfall in transfers, unanticipated expenditures on flood relief and rehabilitation and the impact of the 50 percent hike in salaries and allowances.

Appendix – C: Transfer of Functions under 18th Amendment

Allocation of functions among different tiers of government is defined in the Fourth schedule of the Constitution of Pakistan. Prior to the 18th Amendment, the Fourth Schedule contained the Federal Legislative List (FLL) (Part I and Part II) and the Concurrent Legislative List. The functions performed by the federal government were included in the

Table C-I
Changes in the Allocation of Functions among Different Levels of Government*

Service	According to 1973 and 2001 Devolution Plan	After 18 th Amendment 2010 and 2001 Devolution
Defence	F	F
International Trade	F	F
External Affairs	F	F
Census	F	F/P
Nationality, Citizenship	F	F
Posts and Telegrams	F	F
Currency Foreign Exchange	F	F
Public Debt	F	F/P
Telecommunications	F	F
Railways	F	F/P
National Highways	F	F
Major Ports	F	F/P
Electricity	F	F/P
Irrigation	P	P
Distribution of Inputs	P	P
Agriculture Extension	P/L	P/L
Higher Education (University)	F	F/P
Higher Education (Colleges)	P/L	P/L
School Education (Secondary)	L	L
School Education (Primary)	L	L
Preventive Health	L	L
Curative Health	L	L
Farm-to-Market Roads	L	L
Water Supply	L	L
Sanitation	L	L
Drainage	L	L
Solid Waste Management	L	L
Fire Fighting	L	L
Parks and Playgrounds	L	L

* F = Federal, P = Provincial, L = Local
Source: Constitution of Pakistan LGO 2001

Federal Legislative List while the Concurrent Legislative List listed functions that could be performed by either level of government. In practice, most of the functions were performed by the federal government. Functions not mentioned in either list are the responsibility of sub-national governments.

The 18th Amendment has abolished the Concurrent Legislative List of the Constitution and has made changes in the Federal Legislative List, Parts I and II. Consequently, the structure of government has changed quite substantively. The only exception is electricity, which now falls into Part II of the Federal Legislative List.

Appendix – D: PROJECT, PROGRAM, AND PORTFOLIO MANAGEMENT CONCEPTS

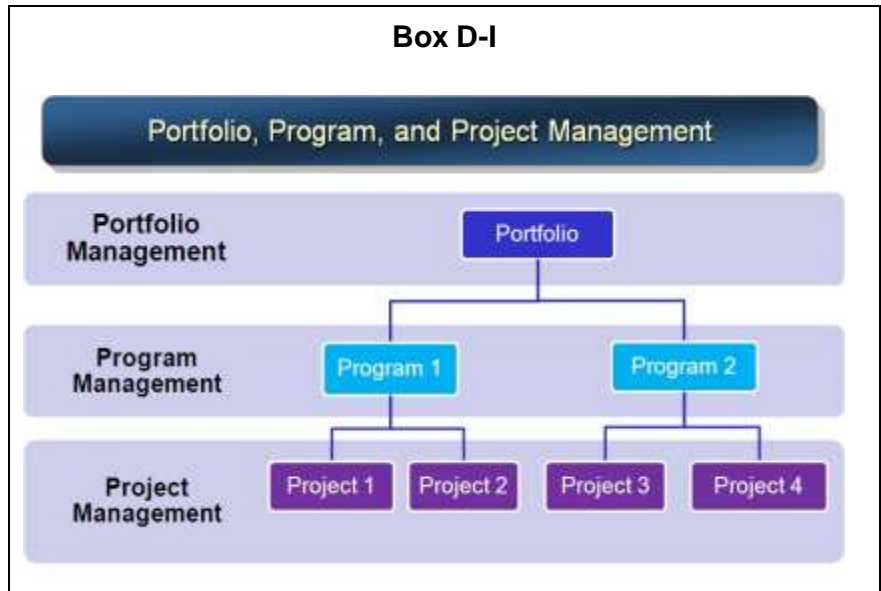
A **portfolio** refers to a collection of projects, program and other work that are grouped together to facilitate effective management to meet strategic public sector investment objectives. The projects or programs in the portfolio may not necessarily be interdependent or directly related. For example, Water and Power ministry can have a portfolio containing program and projects for dams, power generation, power distribution, and others.

From the mix of a project portfolio, the ministry or corporation may choose to manage related projects as one **program**. For example, all power generation projects may be grouped together and called a “Power Generation Program”. Similarly, all telecom related projects may be grouped together and called the “Telecom Programme”. A program can be created through a PC-I that is reviewed and subject to the normal approval process.

Portfolio management refers to the centralized management of one or more program/project portfolios. It includes identifying, prioritizing, authorizing, managing, and controlling projects, programs, and other related work to achieve specific strategic public sector investment objectives. Portfolio management focuses on ensuring that projects and programs are reviewed to prioritize resource allocation, and that the management of portfolio is consistent with and aligned to overall public sector investment goals and objectives. Some of the key benefits of portfolio management include:

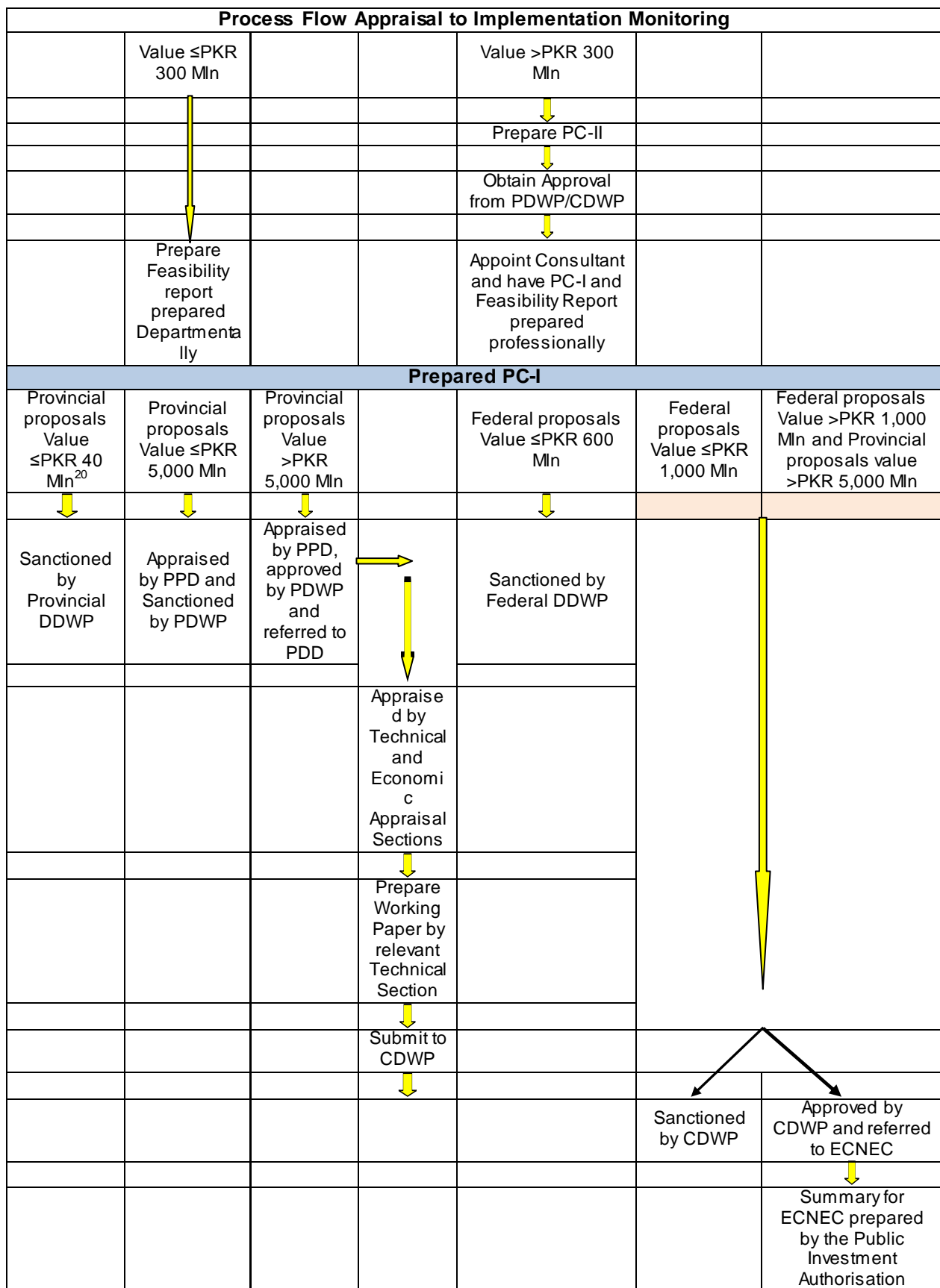
- Building discipline into program / project selection process.
- Linking program / project selection to strategic metrics such as MTDF and MTBF.
- Prioritization of program / project proposals across a common set of criteria.
- Allocation of resources to programs / projects that align with strategic objectives and direction of the country.
- Balancing of risk across all program / projects.
- Justifying rationalization of program/ projects that do not support goals and objectives of the development plan.
- Improving communication across ministries, agencies, corporations, and key stakeholders.

The concept of portfolio, program, and project management is summarized in Box A-6-I. The discipline of Enterprise Portfolio and Project Management (EPPM) is a portfolio management and governance technique that can provide decision support data to ministries, planners, and decision-makers in order to make timely and effective decisions regarding public sector investments. EPPM is vital to enabling large and complex ministries, corporations, and departments to achieve efficiency, transparency, and good governance.



Appendix – E

Flow Chart - Foreign Funded Projects Process of Initiation				
Process Flow			Remarks	Responsibility
Value ≤ PKR 10 Mln		Value > PKR 10 Mln		
Prepare CCF		Prepare CCF + departmentally prepared Feasibility Report		Federal & Provincial Governmental and Public Sector Agencies
	Obtain Secretary's Approval		For Provincial Projects obtain approval of PDWP	
	Appraised Coordinated by Public Investment Programme (PIP) Section and Appraised by the relevant Technical Section PDD			Planning Commission
	Approved by CCC			
	Obtain foreign assistance through EAD			EAD
	Prepare PC-I + Project Document(s)			As at top



						Section of the PDD
						↓
						Submitted to Cabinet Division for ECNEC meeting
						↓
						Sanctioned by ECNEC

Tabulated Decisions of ECNEC on Development Projects 9 December 2010

Sector	Project	Amount (PKR Mln)	Sector Total	Decision
Education	Promotion of Primary Education for Girls in selected Districts of Khyber Pukhtunkhwa Province (WFP assisted)	2,115		
Education	Basic education Improvement Programme Phase-II, Khyber Pukhtunkhwa Province (Norway Assisted)	2,915	5,030	
Energy	Power Distribution Enhancement Project (Phase II) IESCO	2,718		
Energy	Power Distribution Enhancement Project (Phase II) FESCO	2,530		
Energy	Power Distribution Enhancement Project (Phase II) GEPCO	5,200		
Energy	Power Distribution Enhancement Project (Phase II) PESCO	2,888		
Energy	Power Distribution Enhancement Project (Phase II) MEPCO	3,737		
Energy	Power Distribution Enhancement Project (Phase II) HESCO	3,628		
Energy	Power Distribution Enhancement Project (Phase II) LESCO	3,274		
Energy	Power Distribution Enhancement Project (Phase II) QESCO	2,494		
Energy	Addition of 500 & 220 KV Substations and transmission Lines for strengthening of NTDC System	24,528		
Energy	Combined Cycle Power Plant By installation of 320 MW UAE gifted Gas Turbines and 120 MW Steam Units at GTPS Faisalabad			Cost to be determined
Energy	Rehabilitation of Jabban Hydro-Electric Power Station	3,754		
Energy	2x50 MW Power Plant from SYNGAS (IGCC-2009)	8,899	63,642	
Food & Agriculture	National project for enhancing the existing storage capacity of grain storage			Deferred
Food & Agriculture	Pilot Project for Sustainable Agriculture through water reservoirs in tail-end areas of non-perennial canals in Sindh			Approved. Rationalise cost, particularly of vehicles
Food and Agriculture	Pak China National Project for Controlled Atmosphere and Advanced Ventilated Cold Storage	2,230	2,229	
Governance	Establishment of National Forensic Science Agency (NFSA) in Pakistan (Revised)	3,488	3,488	
Health	Prime Minister's Programme for Prevention and Control of Hepatitis (Prime Minister's Emergency Action on Hepatitis)			Cost to be worked out
Health	Expanded Programme on Immunisation (EPI) (Revised)			Cost to be worked out
Health	National Programme for Family Planning and Primary Health Care (NP-FP & PHC) "The Lady Health Workers (LHWP) (Phase II)			Cost to be worked out
Higher Education	Fulbright Scholarships Support Programme (Revised) (USAID funded)	9,568		

Tabulated Decisions of ECNEC on Development Projects 9 December 2010

Sector	Project	Amount (PKR MIn)	Sector Total	Decision
Higher Education	Establishment of NUST Teaching Hospital and School of Health Sciences at sector H-12, Islamabad			Approved. Rationalise cost. Establish fee structure
Higher Education	Establishment of Shaheed Benazir Bhutto University, Benazirabad (President's Directive)	1,557	11,125	
Industries & Commerce	REKO DIQ Gold/Copper Project	8,812	8,812	
Information Technology	National Electronics Complex of Pakistan (NECOP) (Phase-I)			Deferred
Manpower	Punjab Economic Opportunities Programme	7,500	7,500	
Physical Planning & Housing	Multi-Sector Rehabilitation Project in A&JK			Initiate enquiry report
Physical Planning & Housing	Agroville Town in Deh Akro, Taluka Daur, District Shaheed Benazirabad			
Physical Planning & Housing	Emergency response and Social Administration Information System on Turnkey project basis			Deferred
Physical Planning and Housing	Improvement of Water Supply System in Faisalabad	6,433		
Physical Planning and Housing	National Compact Fluorescent Lamp (CFLs) Project (Compliance Report on ECNEC decision dated 21.01.2010)	7,198	13,631	
Population Welfare	Population Welfare Programmes 2010-15 (Federal Activity, Punjab, Sindh, Khyber Pukhtunkhwa, Balochistan and A&JK)			Approved to Jun 2011. Devolved. Unused amount to be devolved as per share
Transport & Communications	Procurement of (US origin) Diesel Electric Locomotives	55,488		
Transport & Communications	Improvement, Widening and Construction of Kohlu-Sibi Road Project Length 162.5 Km (Re-Revised)	4,752		
Transport & Communications	Construction of Cross-Border Optical Fibre Cable (OFC) system between China and Pakistan for international connectivity of Voice/Data Traffic			
Transport & Communications	PAKSAT Projects (Phase-I Extension) (Revised)	1,420		
Transport & Communications	Improvement and Widening of Jagloat-Skardu Road (S-1) (167 Km)			Subject to cost estimates revision
Transport & Communications	Extension of Motorway (M-4) from Khanewal to Multan 57 Km (Revised)	14,495	1,494,735	
Water Sector	Construction of 100 Delay Action Dams in Balochistan (USAID funded)	4,647		
Water Sector	Six (06) Dispersal Structures on nari River, Construction of Ghazi, Tuk, Khokhar, Erri, Haji Shaheer, and remodelling/rehabilitation of Mithri Weir and Canal System	2,000		
Water Sector	Punjab Barrages Improvement Phase-II (PBIP-II)	12,678		
Water Sector	Water Conservation and Productivity Enhancement through High Efficiency Irrigation Systems (HEIS) (Revised PC-I)		19,326	Deferred
Total		1,629,518	1,629,518	

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