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**Does Governance Contribute
to Pro-poor Growth?
Evidence from Pakistan**

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ABSTRACT

Economic growth is a driving force in reducing poverty, but experience has shown that good governance and pro-poor choices are vitally important in the process of alleviating poverty. This paper explores linkages between governance and pro-poor growth in Pakistan for the period 1996 to 2005. The analysis indicates that governance indicators have low scores and rank at the lowest percentile as compared to other countries. The dimensions of pro-poor growth, which include poverty, inequality, and growth, demonstrate that the poor do not benefit proportionately from economic growth. It is found that poverty and inequality have worsened and the share in income and expenditure for the bottom 20 percent has also decreased, while inflation for this lowest-income group is high as compared to the highest-income group. It is also observed that approximately 25 percent households reported that their economic status was worse than in the previous year, 2004-05. The results of the study show that a strong link exists between governance indicators and pro-poor growth in the country. Econometric analysis shows that there is a strong relationship between good governance and reduction in poverty and inequality. It is concluded that greater voice and accountability, political stability, regulatory quality, and rule of law can control corruption and the pro-poor policies, which ultimately reduce poverty and inequality in the long run. To face the challenge of good governance, Pakistan needs to formulate, and implement effectively, its governance policies to improve the governance dimensions, taking account of both higher growth and the aim of achieving the Millennium Development Goals, which require halving poverty by 2015.

JEL classification: I30, I32, O10

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1. INTRODUCTION

The issue of governance has gained importance over the last two decades and became a key component of policies for economic development. Good governance acts as a positive force to influence economic growth. A growing amount of available evidence suggests that lack of quality governance hinders growth and investment, and aggravates poverty and inequality. In fact, governance problem foil every effort to improve infrastructure, attract investment, and raise educational standard. As the developing countries are characterised by weak institutions, low growth, poverty and inequality all which translate into low levels of human development. The multiplicative effects of these outcomes result in poverty traps that are extremely difficult to break out. This state of affairs has forced governments to embark on a wide range of reforms in their institutions of governance and economies with the goal of achieving economic growth.

Good governance can lead a country to achieve high and sustained economic growth by establishing conducive environment for saving and investment, risk taking, providing incentives to producers, creating certainty in markets, increasing the size of markets by removing barriers to international trade and improvements in competitiveness.

Does good governance constitute to pro-poor growth? The concept of good governance has taken central stage in development thinking and practice since the 1990s. While it has been increasingly viewed as a key ingredient for development, the decade also witnessed a renewed focus on poverty reduction as the major goal of development. Several reasons account for the increasing attention to governance and institutions by the international development community, among them research findings demonstrating the financial aid effectiveness depends on ‘a good policy environment’. The lacklustre performance of structural adjustment program initiated in 1988, political problem and institutional weakness have contributed to the new focus on governance.

The emphasis on reforming economies to achieve high rates of economic growth is largely motivated by the fact that economic growth associates with lower poverty rates and improvements in the quality of life. It is assumed that there is a strong link between economic growth and poverty reduction but this relationship does not always hold. It is observed that different episodes of growth could have substantially different impact on poverty even in the same

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country. So the key policy concern is to institute economic reforms that results in economic growth associated with substantial gains to the poor, referred as 'pro-poor growth'. Promoting pro-poor growth has now become a major goal in the strategies of international donor organisations.

Since both governance and pro-poor growth are high on the development policy agenda, the question arises as to whether and how they are related to each other. It is commonly assumed that good governance promotes pro-poor growth, this analysis empirically test this challenging assumption that links governance indicators with the joint outcomes of growth, inequality and poverty reduction which together underlie the concept of pro-poor growth. These linkages are also discussed from the available cross-country literature.

This paper is organised as follows: Section 1 is introduction providing importance and objectives of the study. Section 2 presents a literature review, while Section 3 define and measure governance dimensions and pro-poor growth. Section 4 presents empirical analysis to show linkages between governance and pro-poor growth. Concluding remarks are discussed in Section 5.

2. LITERATURE REVIEW

This section discusses the cross-country studies examining the interaction between the governance and pro-poor growth.

Mahbub ul Haq Human Development Centre (1999) illustrated that South Asia emerged by now as one of the most poorly governed regions in the world, with exclusion of the voiceless majority, unstable political regimes and poor economic management. It also analysed that the systems of governance have become unresponsive and irrelevant to the need and concerns of people.

Pasha (2000) identified nine elements of good economic governance as achievement of growth with equity, fiscal discipline, institutional capacity, credibility and consistency, protection of public interest, ability to manage crisis, effective delivery of services, integrity and sovereignty. He concluded that based on these measures of good economic governance, Pakistan's economic performance was mixed one with visible sign of deterioration in 90s. He suggested that if Pakistan's economy has to emerge once again as a relatively high growth performer the quality of economic governance will have to be of the highest level.

Ahmed (2001) analysed the political economy aspects of poverty reduction in South Asia by developing a framework for measuring governance performance and relating this performance to poverty trends. He argued that governance appears to be a significant problem in South Asia with associated adverse implication for poverty reduction.

White and Anderson (2001) examine sectoral patterns of growth. They argued that the higher the initial Gini coefficient, the less the poor benefit from growth and there are apparent trade-offs between growth and distribution. More

civil liberties tend to have a less pro-poor impact while more political freedom tends to have a more pro-poor impact while ethnic fragmentation appears to increase the poor's participation in the growth process. Agricultural growth tends to be less pro-poor while the opposite is true for growth in the service sector.

Hassan (2002) emphasised that governance is not the panacea for all evils as it is not the cause of poverty in Pakistan nor can good governance alone eliminate it. He concluded that poverty can not be eradicated without high growth rate while good governance can ensure that benefits of growth are more equitably distributed.

Dollar and Kraay (2002) found that the rule of law indicators is positively and significantly correlated with growth in per capita incomes of the poorest quintile. They concluded that greater rule of law may be associated with a greater share of growth accruing to the lowest 20 percent of the population. This is predominantly due to the indicator's influence through growth rather than through improving distribution.

Kaufmann and Aart (2002) suggested that per capita income and the quality of governance are strongly positively correlated across countries. They proposed an empirical strategy that allows separating this correlation into two parts. First, a strong positive casual effect running from better governance to higher per capita. The result confirmed existing evidence on income; the importance of good governance for economic development. Second, a weak even negative casual effect running from in the opposite direction from per capita income to governance. This resulted in the absence of "Virtuous Circles" in which higher incomes lead to further improvement in governance.

Christiansen, *et al.* (2003) found that poverty headcount decreased in countries that also experienced an improvement in their macroeconomic policy scores. They also found that poverty decreased in those countries that experienced an improvement in their political risk score. Those countries that did not experience a reduction in poverty despite improvements in governance indicators, other factors such as droughts played a role.

Chong and Gradstein (2004) discovered that the political stability and rule of law all exhibit a negative and significant relation with inequality as measured by the Gini coefficient. In other words, better governance indicators lead to a decrease in inequality. Moreover, the impact of income distribution on political institutions is greater in developing countries than in industrialised ones.

Lopez (2004) assessed whether policies that are pro growth are also pro-poor. He found that policies might not be poverty-reducing in the short run, but in the long run. However, he claimed that political economy constraints could prevent these policies from staying in place long enough to reach that poverty-reduction level.

Kraay (2004) found that 60 percent to 95 percent of poverty changes are due to growth in average income while changes in income distribution are relatively more important in the short run. He also analysed that rule of law and

accountability are both positively correlated with growth and distributional changes while openness to international trade has a positive correlation with growth and correlated with poverty-reducing shifts in incomes.

Kimnenyi (2005) presented a general theory of pro-poor growth that includes ten principles that should be incorporated in all economic reforms that seek to generate pro-poor growth. These principles highlighted the importance of understanding the poor, their economic activities, capabilities and constraints that impede their participation in markets and also an appreciation of linkages within sectors and regions. He argued that pro-poor reforms cannot have the intended impact unless there are significant changes in the institutions of governance. He concluded that these principles under score the fact that pro-poor growth policies cannot be sustained without workable partnerships between markets and states in the ever changing and complex process of social and economic development.

Chatterjee (2006) aimed to address, ‘why is economic growth in Bangladesh not pro-poor given the various shifts and changes in the economy since 1990’? They concluded that weak political institutions and the skewed distribution of economic resources as well as political capital had resulted in relatively more *de facto* political power in the hands of a few, which in turn is, hindering the process of pro-poor growth.

Resnick and Regina (2006) developed a conceptual framework that specified the linkages between different aspects of governance and pro-poor growth. Using this framework, the paper reviewed a range of quantitative cross-country studies that include measures of governance as independent variables and focuses on the dependent variable in at least two of three dimensions of pro-poor growth: poverty, inequality and growth. The review showed that governance indicators, such as political stability and rule of law are associated with growth but provide mixed results regarding poverty reduction. On the other hand, governance indicators that refer to transparent political systems, such as civil liberties and political freedom, tend to conduce for poverty reduction, but the evidence is rather mixed and the relationship of these variables with growth remains unclear.

All these studies suggest that good governance is pro-poor in terms of increasing incomes and reducing the poverty headcounts. Yet, they are less clear about what the intervention mechanism is i.e., increased growth, improved equity, or a combination of both that leads to such outcomes.

3. DEFINING AND MEASURING GOVERNANCE AND PRO-POOR GROWTH

(a) Governance

The concept of governance as referred in the development literature and discourse was originally used by specialists in Medieval English society, which was characterised by cooperation between the different sources of power, i.e.,

church, nobility, merchants, peasant, etc. The term has also been widely used in international development; there are numerous interpretations of what the term actually describes.

Governance means process of decision making and the process by which decisions are implemented. The quality of governance is determined by the impact of this exercise of power on the quality of life enjoyed by the citizens. Governance can be used as several contexts such as international governance, corporate governance, national governance and local governance. Government is one of the actors in governance.

Asian Development Bank (1995) identified four basic elements of good governance such as accountability, participation, predictability and transparency.

McCawley (2005) categorises governance issues at the macro and micro level. The macro level includes constitution, the overall rule of size and resources of the government, and relationship between legislators, the judiciary and the military, while micro issues of governance includes commercial firms, social institutions and civil society affairs.

United Nation Development Programme (1997) defines governance as the exercise of economic, political and administrative authority to manage a country's affairs at all levels. It comprises mechanisms, processes and institutions through which citizens and groups articulate their interests, exercise their legal rights, meet their obligations and mediate their differences.

International Country Risk Guide (ICRG) covering 140 countries from 1980 to the present analyses and forecast risk for international investors. It includes 22 components that are grouped into three categories of risk: political, financial and economic. The political risk assessments are made on the basis of subjective analysis of the available information, while the financial and economic risk assessments are made solely on the basis of objective data. In determining the component rating, political risk contributes 50 percent to the rating while the other two categories contribute 25 percent each.

World Bank aggregate governance indicators data set developed by Kaufmann, *et al.* (2005) hereafter called the KK Data sets, is a set of world wide measures of six composite dimensions of governance perception indicators for 105 countries. These indicators are oriented so that higher value correspond to better outcomes, on a scale refers to the point estimates range from -2.5 to 2.5. These estimates are also rescaled and ranked in percentile (0-100). The lower percentile is ranked as worse off governance indicators whereas upper percentile is ranked as best governance for any given country. These perceptions may often be more meaningful than objective data, especially when it measures public faith in institutions. These averages of governance indicators are considered to capture institutional quality. These dimensions can be classified into three clusters with two indicators in each group is given as:

The above two datasets are most commonly used datasets in the cross country research on governance. Analysis on governance dimensions encompasses positive analysis from theory as well as prepositions concerning what government ought to be doing on the achievement of development outcomes.

(b) Pro-poor Growth

A positive growth is important but it is not sufficient to assess whether the poor indeed benefit or not. Thus, in assessing the impact of growth on poor, information on the distribution of gains from growth is necessary. That is, to determine whether growth is pro-poor, it is necessary to evaluate how the benefits of growth are shared amongst the different income groups.

Pro-poor growth is variously defined as follows:

- In its simplest interpretation, the concept of “pro-poor growth” implies the type of growth that is good for the poor; a reduction in the proportion of the poor in the population.
- Pro-poor growth is also defined as growth that results in an increase in the income of the poor.
- Pro-poor growth is defined as one that associates with larger proportionate increases in income of the poor than the rest of the population.

For definition of pro-poor growth, the contribution of poverty measure, growth and inequality is important. In this context, poverty measure is based on distribution of real household incomes per capita or real household expenditure per capita, depending on which of the welfare indicator is used. Growth means an increase in the value of this welfare indicator. Inequality is taken as deviation of income from perfect equality measured by Gini coefficient. Pro-poor growth is concerned with the interrelation between the three elements, growth, poverty and inequality. The pro-poor growth literature assumes that the objective of the policy is to maximise the rate at which absolute poverty is reduced.

There are many other definitions of pro-poor growth referred by some authors; Klasen (2002) employed one approach for capturing pro-poor growth is measuring whether the per capita income growth rate of poor surpasses the average income growth rate. White and Anderson (2001) suggested that growth is pro-poor if poor’s income grows more than the incomes of the non poor. Ravallion and Chen (2003) defined it as any growth that reduces poverty is said to be pro-poor. Kakawani and Pernia (2000) and Son (2004) all suggested a measure of pro-poor growth that takes into account both reductions in poverty as well as improvement in inequality. Ravallion and Chen (2003) assumed that growth is always pro-poor unless the incomes of the poor decline or stagnate. McCulloch and Baulch (1999) used poverty bias of growth measure by

subtracting the real change in the poverty headcount between two time periods from the predicted change if there was an equitable distribution of income. If poverty bias of growth is positive, then pro-poor growth occurred. Organisation such as Organisation of Economic Co-operation and Development (2001) and the United Nations (2000) have employed a very broad definition by classifying it as growth that benefits poor. Asian Development Bank (1999) perceived the twin pillars of pro-poor, one as sustainable economic growth and other is social development which is the key elements in any framework for alleviating poverty. However that growth is always pro-poor when it is labour absorbing, and accompanied by policies and programmes that mitigate inequalities and facilitate income and employment generation for the poor, particularly women and other traditionally marginalised groups. There are many other definitions of pro-poor growth but the key elements of these definitions are that ensuing growth not only benefits the poor but they benefit disproportionately.

Finally, it is growth of the economic output that benefits the poor. If the reduction in absolute poverty is accepted as the measure of benefit for the poor, the greater the reduction in poverty incidence that growth generates, the more pro-poor it is. Since economic growth generally benefits the poor to some degree, the empirical question is not whether poor growth is or is not pro-poor, but what influences the extent to which it is pro-poor. The need is to find the kinds of economic growth for which the rate of poverty reduction is greatest, as well as to find the economic policy strategies that can produce growth of this kind.

(c) Governance in Pakistan

Our analysis is based on aggregate governance indicators developed by Kaufmann, *et al.* (2005) hereafter called the KK Data sets, which is a set of world wide measures of six composite dimensions of governance covering the period from 1996 to 2005. These indicators measure subjective perceptions regarding the quality of governance with scores lie between -2.5 and 2.5 with higher scores corresponding to better outcomes. These estimates are rescaled in percentage term. Lowest score is judged as worse off governance indicator whereas highest score is taken as the best governance indicator. For country ranking on the basis of each governance indicators, countries are ranked by their scores in ascending order and then allocated a number between 0 and 100, where 100 is associated with the highest rating and one is associated with lower rating. The Dataset attempts to capture three dimensions of governance: political, economic and institutional dimension indicators. Political governance indicator in Pakistan refers to a country's voice and accountability and political stability. If political governance deteriorates or reclaims at low level, it may be reflected in whole disruptions, a poor environment for protecting the rights and freedom of the masses, thus resulted in chaos. Table 1 reports the indices of political

Table 1

Pakistan: A Snapshot of Political Governance Indicators

Years	Voice and Accountability		Political Stability	
	Scores (%)	Percentile Rank*	Scores (%)	Percentile Rank*
1996	28.8	20.2	21.8	9.0
1998	36.4	30.4	25.8	11.8
2000	18.6	6.8	32.4	19.3
2002	27.6	17.4	19.8	11.3
2003	26.4	14.0	18.4	8.0
2004	23.8	11.6	16.6	5.7
2005	25.4	12.6	16.4	5.7

Source: Kaufmann, *et al.* (2005). *Percentile ranked (0–100).

governance from 1996 to 2005. The two indicators, voice and accountability and political stability ranked at lower percentile and portray a dismal picture. It is important to realise that in Pakistan the politics of bureaucracy dominates the politics of democracy. The very composition of Pakistan's state structure—including military and civil bureaucracy was under threat of losing all credibility and integrity during this period. This slow burn of institutional structure has successfully mutilated and molested ethical morale system. At the same time democratically elected government in power is also centralised in the hand of military dictator while local governments are weak with little administrative and financial authority. However, the economic hardships, growing corruption and the manhandling of civil society multiplies Pakistan's governance crisis. Next, the issue of growing corruption has pervaded in all three branches of government: the executive, the legislature, and the judiciary. However, in the case of Pakistan, a rising graph of corruption under both Benazir Bhutto and Nawaz Sharif regime is witnessed while under a military regime it do not make enough news due to censorship and largely stays hushed up.

The poor political governance has affected domestic resource mobilisation. Pakistan has one of the lowest tax-GDP ratio that summarises various indicators of government's ability to formulate and implement sound policies.

Economic governance refers to a country's government effectiveness and regulatory quality. The performance of economic governance is better as compared to political governance in Pakistan. The government effectiveness indicator better scores in all the years in consideration while regulatory quality indicators fluctuate in the same period. The quality of economic governance is critical to poverty reduction. Good economic governance facilitates participatory, pro-poor policies as well as sound macroeconomic management. The economic governance in case of Pakistan has performed relatively poor in 1998 as reported in Table 2.

Table 2

Pakistan: A Snapshot of Economic Governance Indicators

Years	Government Effectiveness		Regulatory Quality	
	Scores (%)	Percentile Rank*	Scores (%)	Percentile Rank*
1996	42.2	40.0	39.2	25.5
1998	35.2	22.0	46.0	37.4
2000	39.4	33.5	33.8	18.7
2002	38.6	33.0	33.4	21.2
2003	39.0	34.9	34.4	20.7
2004	39.6	37.3	32.2	18.7
2005	39.4	34.0	36.4	27.7

Source: Kaufmann, *et al.* (2005). * Percentile ranked (0–100).

The institutional dimensions of governance indicators which include rule of law and control of corruption established the primacy of institutions for well-functioning market economy for Pakistan. Table 3 summarises the low scores gained in the governance indicators hence ranked at the lowest percentile in the world. Corruption hampers achievement of the Millennium Development Goals by undermining the economic growth and sustainable development that would free millions from the poverty trap. Fighting corruption must be central plan to increase resources to achieve the goals. A Transparency International Survey of 163 countries based on perceived levels of corruption also saw Pakistan slip down two places compared to its ranking of 145 last year, suggesting a rise in corruption in 2006.

Table 3

Pakistan: A Snapshot of Institutional Dimensions of Governance Indicators

Years	Rule of Law		Control of Corruption	
	Scores (%)	Percentile Rank*	Scores (%)	Percentile Rank*
1996	40.2	35.9	29.2	12.2
1998	34.2	25.0	33.6	18.6
2000	35.0	26.4	31.2	16.2
2002	35.0	27.4	33.0	23.5
2003	36.2	28.8	34.8	27.5
2004	33.4	21.6	28.8	11.3
2005	33.8	24.2	29.8	15.8

Source: Kaufmann, *et al.* (2005). * Percentile ranked (0–100).

(d) Pro-poor Growth in Pakistan

There are three dimensions of pro-poor growth: poverty, inequality and growth in per capita incomes of the poor who are defined as the poorest 20

percent of the population (bottom quintile). The concept of ‘pro-poor growth’ very much reflects the notion of ‘redistribution with growth’.

A better quality of life for the poor calls for higher incomes. As income per capita rise, several aspects of quality of life improves in varying degrees but not all, not at the same rate and not inevitably.

Pro-poor growth occurs when economic growth disproportionately benefits the poor. One approach for capturing pro-poor growth is measuring whether the per capita income/expenditure growth rate of the poor surpasses the average income / expenditure growth rate [Klasen (2002)].

Table 4 gives the statistics of mean and growth rate of consumption expenditure by quintile in two periods, 2000-01 to 2004-05. The analysis shows that although the mean per capita consumption expenditure increased in all quintiles but the real mean expenditure growth in richest 20 percent population at 22 percent is nearly 2.5 times that of poorest 20 percent, hence show that growth is not pro-poor as the rich gets disproportionately more income share as compared to poor.

Another concept is that the growth is always pro-poor unless the incomes of the poor decline or stagnate [Ravallion and Chen (2003)]. According to this approach, growth becomes pro-poor because per adult expenditure has increased overtime.

Table 4

<i>Consumption Expenditure by Quintile at the 2001 Prices (Rs)</i>			
Quintile	PIHS 2000-01	PSLM 2004-05	Growth
Poorest 20 Percent	508	555	9.25
Second 20 Percent	690	775	12.32
Third 20 Percent	845	961	13.73
Fourth 20 Percent	1070	1238	15.70
Richest 20 Percent	1908	2327	21.96
Average	1001	1171	16.63

Source: Pakistan, 2005-06.

Table 5 compares the growth rate in per adult equivalent consumption expenditure on Commodity Groups across two points in time. The rate of growth in expenditure is greater for top 20 percent as compared to bottom 20 percent population. White and Anderson (2001) suggest that growth is pro-poor if poor’s income grows more than the incomes of the non-poor.

Table 5

Growth in Monthly Consumption Expenditure by Commodity Groups

Commodity Groups	Poorest 20 Percent (2001-02 to 2004-05)	Richest 20 Percent (2001-02 to 2004-05)
Food	11.6	19.0
Fuel and Lighting	5.7	20.0
Clothing	-2.2	8.4
Housing	9.3	16.8
Health	14.6	-6.1
Education	-13.7	11.9
Miscellaneous	15.4	54.4

Source: Computations based on [Pakistan (2005-06)].

Table 6 demonstrates the share in income and consumption expenditure and Gini coefficient over time. It is observed that both income and expenditure share for poorest 20 percent has decline while the share of richest 20 percent has increased. The ratio of highest to lowest income group has also increased between the two periods. In the same way Gini coefficient for income and expenditure also increased over time.

Table 6

Share of Income and Consumption Expenditure by Quintile

Quintile	2000-01		2004-05	
	Income [*]	Expenditure	Income	Expenditure
Poorest 20 Percent	6.3	10.1	6.2	9.5
Richest 20 Percent	49.6	38.0	50.4	39.4
Ratio of H/L	7.9	3.76	8.1	4.15
Gini Coefficient	0.41	0.27	0.42	0.29

Source: Pakistan, 2005-06. * Anwar (2005).

Dimensions of pro-poor growth in Table 7(a) indicate consistence estimates of poverty with calorie based approach for the whole country. The three estimates of poverty that is incidence, intensity and severity have increased up till 2001-02 with exception of 1996-97, where a decline has been observed. In 2004-05 a substantial decline in these poverty estimates has revealed. In Table 7(b) inequality and growth statistics are given which indicate that inequality and growth in income share of bottom 20 percent have worsened. Gross Domestic Product (GDP) at constant factor cost has shown a noteworthy increase in year 2004-05 but fruits of growth have not tickle down to the mass. The picture emerged from this table is that growth is not pro-poor during this period.

Table 7(a)

Dimensions of Pro-poor Growth

Years	Incidence of Poverty (% of Population)	Intensity of Poverty (%)	Severity of Poverty (%)
1992-93	25.46	4.27	1.10
1993-94	27.17	5.22	1.44
1996-97	25.78	4.38	1.14
1998-99	31.08	6.58	2.06
2001-02	34.46	7.03	2.13
2004-05	23.9	4.76	1.48

Source: Cheema (2005).

Table 7 (b)

Dimensions of Pro-poor Growth

Years	Inequality (Gini Coefficient)	Growth (Income Share of Bottom 20%)	Growth Rate (%) (GDP)
1992-93	0.38	6.9	2.1
1993-94	0.39	6.7	4.4
1996-97	0.40	6.6	1.7
1998-99	0.41	6.5	4.2
2001-02	0.42	6.3	3.1
2004-05	0.42	6.2	8.6

Source: Social Policy and Development Centre (2005-06), Pakistan (2005-06).

Table 8 shows inflation overtime by food /non food and by lowest and highest income groups. In recent year food and non food inflation has increased. Food inflation has increased more sharply than non food inflation and lowest income group suffer more as compare to upper income group. Household Income and Expenditure Survey data indicates that share of food expenditure of poorest 20 percent population is approximately 58 percent as compared to 40 percent of richest 20 percent population. This means inflation effects disproportionately more to poor than non-poor population.

Table 8

Inflation in Pakistan (%)

Years	Inflation	Inflation for		Inflation for	
		Food Inflation	Non Food Inflation	Lowest Income Group	Highest Income Group
2000-01	4.4	3.6	5.1	4.5	4.7
2001-02	3.5	2.5	4.3	3.0	3.6
2002-03	3.1	2.9	3.2	2.9	3.1
2003-04	4.6	6.0	3.7	5.3	4.3
2004-05	9.3	12.5	7.1	10.2	8.9

Source: Pakistan, 2005-06.

Table 9 indicates the percentage distribution of households' perception of economic situation as compared to previous year in 2004-05 by regions. It is observed that approximately 25 percent households become worse off while 51.5 percent household have no change in their economic status as compared to their previous year in Pakistan. The pattern in regions is more or less the same as observed at the national level. This scenario points out that economic growth does not benefit the mass.

Table 9

*Households Perception of the Economic Situation as
Compared to the Previous Year: 2004-05*

Economic Situation of the Households	Pakistan (%)	Urban (%)	Rural (%)
Much Worse	4.1	3.59	4.49
Worse	19.82	18.73	20.66
Same	51.51	50.51	52.27
Better	21.95	23.97	20.42
Much Better	2.20	2.71	1.81
Don't Know	0.41	0.49	0.36
Total	100	100	100

Source: Pakistan Social and Living Standards Measurement Survey, 2004-05.

Table 10 specifies the percentage distribution of households' perception of economic situation of the community where they live as compared to previous year by regions. The survey scrutinise that majority of the households perceive that economic situation of the community remain same in 2004-05. The pattern in regions is more or less the same as monitored at the national level. It is indicative that the magnitude of growth is not effective in improving the economic situation of the community as a whole.

Table 10

*Households Perception of the Economic Situation of the Community as
Compared to the Previous Year: 2004-05*

Economic Situation of the Community	Pakistan (%)	Urban (%)	Rural (%)
Much Worse	1.62	1.23	1.91
Worse	7.94	6.38	9.14
Same	59.08	57.63	60.20
Better	22.17	22.77	21.7
Much Better	3.00	3.56	2.57
Don't Know	6.19	8.92	4.49
Total	100	100	100

Source: Pakistan Social and Living Standards Measurement Survey, 2004-05.

In Pakistan it has been realised that growth alone is not sufficient for poverty reduction in development policy and practice. During the last few years pro-poor expenditures were the most important fiscal intervention to support the critical elements of the poverty reduction strategy. The percentage share of social sector and poverty related expenditure in Pakistan is reflected in Table 11. It is analysed that the percentage share of expenditure of safety nets which is to cater to the needs of the poor and vulnerable sections of the society has decreased overtime.

Table 11

<i>Governance, Social Sector, and Poverty-related Expenditure</i>			
Sectors	% Share 2001-02	% Share 2004-05	Growth (%)
Community Services	6.6	13.8	109.1
Human Development	54.2	49.2	-9.2
Rural Development	14.5	18.8	29.6
Safety Nets	4.9	2.7	-44.8
Governance	20.0	15.9	-20.5
Total (Rs Billion)	167.25	316.24	89.2

Source: Computation based on the *Pakistan Economic Survey* (2005-06).

It is concluded that in Pakistan, government knowingly or unknowingly adopt policies that are biased in favour of the rich. Consequently, the gap in well being between the have and have not tends to persist, if not widen, over time. So to foster the overall well being of the society, government needs to pursue policies that will reduce this gap.

4. ANALYSIS

This section examines the linkages between governance indicators and pro-poor growth in Pakistan by using perception based data for the period 1996 to 2005. To get consistent estimates of poverty and inequality measures, a simple interpolation technique is used to take the growth in trend between two points in time and fill the data gaps between successive observations. The analysis focuses on the empirical question: does good governance contribute to pro-poor growth? At least two of the three dimensions of pro-poor growth: poverty and inequality are taken as dependent variables to analyse this phenomenon. Aggregate governance indicators for 1996 to 2005 are shown to provide a nuanced perspective on poverty and inequality. Table 12 presents results estimated econometrically by Ordinary Least Square (OLS) technique, whether voice and accountability, political stability, regularity quality, rule of law, and control of corruption have some impact on poverty.

Table 12

Linkages between Governance and Poverty

Indicators of Governance	Standardised Coefficient(β)	<i>t</i> -statistic	R-square
Voice and Accountability	-0.488	-1.581***	0.488
Political Stability	-0.628	-2.28**	0.628
Govt. Effectiveness	0.080	0.228	0.080
Regulatory Quality	-0.649	-2.41**	0.42
Rule of Law	-0.613	-2.19**	0.376
Control of Corruption	-0.035	-0.099	0.001

Note: The *t*-values significant at 5 percent and 10 percent levels are indicated by.

The present analysis indicates that there is close link between poverty and governance indicators. The result shows that political governance which include voice and accountability and political stability are negatively and significantly correlated with poverty. This result concludes that greater accountability and political stability may be associated with reduction in poverty. In the case of Pakistan increase in the incidence of poverty is not solely attributable to slow growth as during 1990s. In addition, significant deterioration in institutions of governance is also experienced which markedly eroded State's capacity to deliver social and economic service. Political stability has also a direct effect on the continuity of policies which have a directly influence on poverty reduction strategies.

The economic governance which includes government effectiveness and regulatory quality summarise various indicators that demonstrate the government's capacity to effectively formulate and implement sound policies and quality delivery of public goods. 'Regulatory quality' governance indicator includes measures of the incidence of market unfriendly policies such as price control or inadequate bank supervision, as well as the perceptions of the burdens imposed by excessive regulation in area such as foreign trade and business development. In this analysis 'regulatory quality' has a negative and statistically significant impact on reducing the percentage of the population below the poverty line. In case of Pakistan, as far as social safety nets are concerned, there is limited involvement of the government in poverty alleviation programs directly, even though there is strong evidence that poverty is rising rapidly. Most schemes have weak institutional structure, their funding is uncertain and coverage is very limited.

The analysis of institutional dimensions of governance uncovers a negative and significant association between rule of law and incidence of poverty. In Pakistan corruption and the absence of rule of law undermine fledgling democracies hence can not tackle poverty and vulnerability directly or indirectly. Similarly, the links between poor governance, corruption, and money laundering with such security threats as organised crime and terrorism effect social sector and Poverty Reduction Strategy Programme.

Inequality refers to the deviation of income from perfect equality as measured by Gini Coefficient. It is not a final outcome of growth but plays a central role in determining the rate and pattern of growth. The results in Table 13 suggest relationship between governance indicators and inequality by applying simple OLS regression analysis. The analysis synthesises that voice and accountability and political stability exhibit a negative and significant relationship with inequality. Accountability in Pakistan has been low at all levels- state, judicial and civil society. The finding of the study shows that regularity quality has negative and significant relationship with inequality. In Pakistan, absence of regulatory control, policy announcements are likely to be seen as, more or less, temporary in character and fail to induce the desired change in behaviour of economic agents. A continuous reversal of policy decisions under pressure of interest groups erodes the administrative fiat of government and leads to effective abdication of the task of economic managements.

Table 13

Linkages between Governance and Income Inequality

Indicators of Governance	Standardised Coefficient(β)	t-statistic	R-square
Voice and Accountability	-0.550	-1.86 ^{***}	0.30
Political Stability	-0.546	-1.84 ^{***}	0.29
Govt. Effectiveness	0.114	0.324	0.013
Regulatory Quality	-0.748	-3.18 [*]	0.559
Rule of Law	-0.549	-1.86 ^{***}	0.30
Control of Corruption	0.036	-0.103	0.001

Note: The t-values significant at 1 percent, 5percent and 10 percent levels are indicated by.

Institutional dimension of governance which includes ‘rule of law’ illustrates negative and significant relation, suggests that in the absence of rule of law income inequality increases which will reduce economic growth and thereby exacerbate poverty. In Pakistan, erosion of the overall rule of law has hampered economic growth, burdens the poor disproportionately, and undermines the effectiveness of investment and aid. A key message of governance and income inequality relationship suggest that poor governance has significant distributional implications and, given its negative efficiency implications, should be considered harmful to both growth and equity.

To some up, an effective governance strategy should encourage economic liberalisation, deregulation, and tax restructuring, macroeconomic stability, administrative and civil service reform, honest commitment by the leadership to the fight against corruption and encouraging accountability.

5. CONCLUSIONS

The aim of this study is to explore linkages between governance indicators and pro-poor growth in Pakistan for the period 1996 to 2005. The analysis shows that governance indicators such as voice and accountability, political instability and violence, government effectiveness, regulatory quality, rule of law and control of corruption have low scores and ranked at the lowest percentile as compared to other countries. The dimensions of pro-poor growth which include poverty, inequality and growth indicate that poor does not benefit proportionately from the economic growth. The findings of the paper illustrate that incidence of poverty has increased, income inequality has worsened and poor's share in income and expenditure have also decreased. It is argued that majority of the households either become worse off or has no change in their economic status as compared to their previous year in Pakistan. The econometric analysis of linkages between governance and pro-poor growth suggests a significant relationship as good governance leads to reduction in poverty and inequality. Further the findings show that greater voice and accountability, political stability, regulatory quality and rule of law can control the corruption and pro-poor policies which ultimately reduce poverty and inequality in the long run.

Finally, the results on the performance of Pakistan for governance dimensions portray an unfavourable situation. Weak governance is not conducive environment for entrepreneurs for long term investment. To face challenge of good governance, Pakistan needs to formulate and effectively implement its governance policies to improve governance dimensions, taking account of higher growth and to accomplish Millennium Development Goals of halving poverty by 2015.

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