

Pakistan
Country Strategy Paper
(2002-2006)

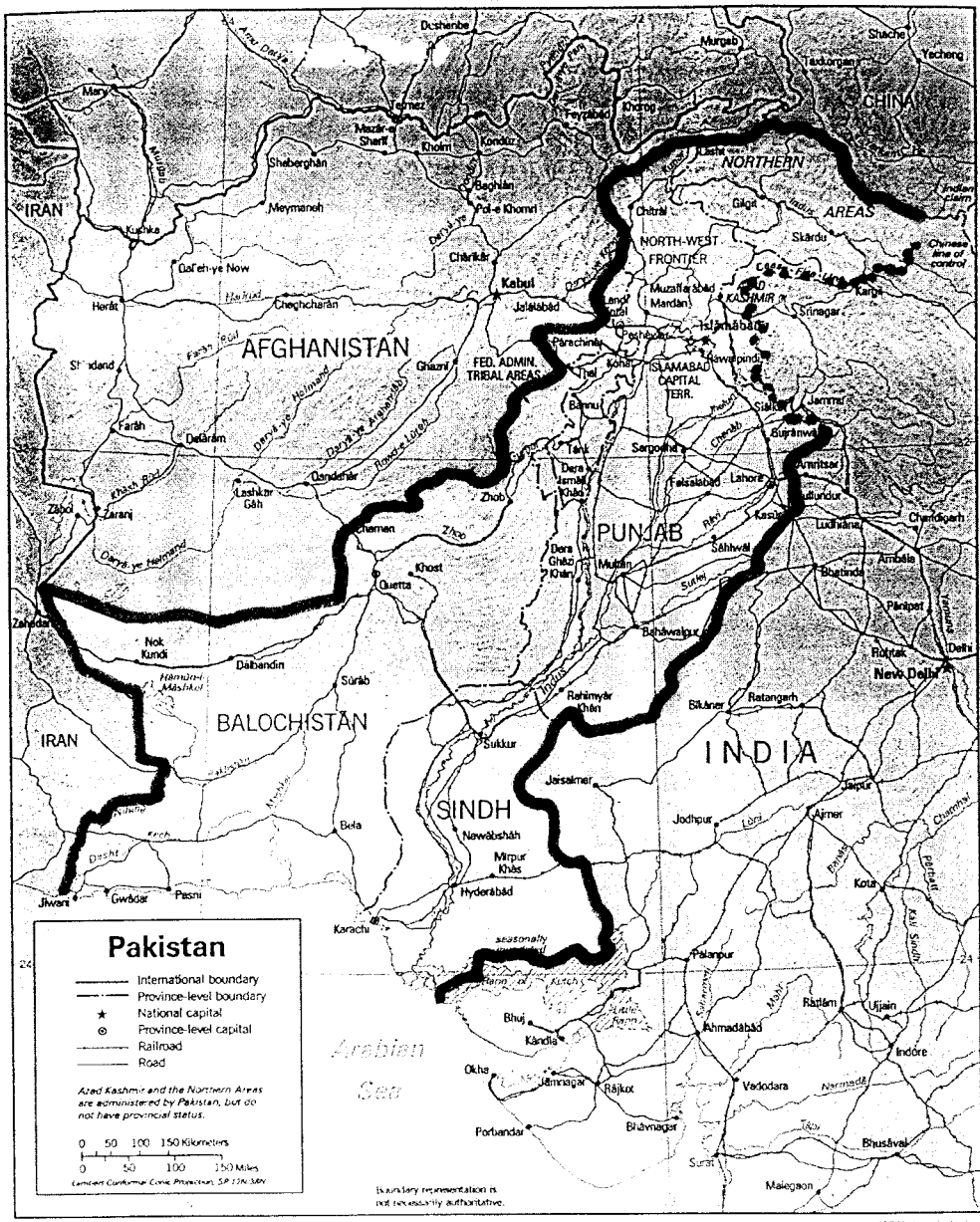


TABLE OF CONTENT

1	Summary	4
2	Description of EC Co-operation Objectives.....	8
3	Pakistan’s Policy Agenda.....	9
	3.1 Internal	9
	3.1.1 Economic Reforms.....	9
	3.1.2 Political Reforms.....	9
	3.1.3 Human Rights and Governance.....	10
	3.1.4 Development Policy	12
	3.2 External	13
4	An Analysis of the Political Situation, the Economic and Social Situation, Including the Sustainability of Current Policies and Medium Term Challenges.	14
	4.1 An Analysis of the Political Situation.....	14
	4.2 An Analysis of the Economic and Social Situation, including the Sustainability of Current Policies and Medium-Term Challenges.....	16
	4.2.1 Economic situation, structure and performance.....	17
	4.2.2 The Social Situation	18
	4.2.3 The Public Sector	19
	4.2.4 Assessment of the Reform Process	19
	4.2.5 External Aspects.....	21
	4.3 Sustainability of Current Policies.....	22
	4.4 Medium-term Challenges.....	23
5	Overview of Past and Ongoing EC Cooperation (lessons & experience), Information on Programmes of EU Member States and other Donors.	24
	5.1 Overview of Past and Ongoing EC Co-operation (lessons and experience).....	24
	5.2 Information on EU Member States Programmes and other Donors	25
6	The EC Response Strategy, Coherence with EU Policies, Complementarity within the EU and with other Donors.....	26
	6.1 The EC Response Strategy	26
	6.1.1 Human development in the education sector with focus on poverty reduction ...	27
	6.1.2 Trade development and promotion of business and institutional links.....	28
	6.1.3 Other areas of co-operation	30
	6.1.4 EC response to the crisis in the region surrounding Afghanistan	31
	6.2 Coherence with EU Policies and Complementarity within the EU and as well as with other Donors.....	33
7	A Tentative Work Programme	34
	Economic Co-operation.....	34

1 SUMMARY

Given Pakistan's location in a volatile region, with widespread incidence of drugs and arms trafficking as well as illegal migration, it is important for the EU to engage the country for geo-political reasons. Above all, the EU has an interest in fostering peace and stability in South Asia. The constructive behaviour of Pakistan's government during the American intervention in neighbouring Afghanistan made a sustained contribution towards stabilising the entire region and thus contributed decisively to the fight against international terrorism. The European Commission as a donor should aim to assist in this ongoing process and contribute towards Pakistan's engagement with the international community.

This Country Strategy Paper for Pakistan for the period 2002-2006 takes EC co-operation objectives and Pakistan's policy agenda into account. Given the uncertain outcome of the current crisis, this CSP will need to be reviewed in 2002/2003.

In more general developmental terms, the preparation of a Poverty Reduction Strategy Paper offers a comprehensive approach directed at poverty alleviation, based on economic growth, delivery of social services and improved governance. The policy framework that is being worked out offers the opportunity for EC co-operation programmes to reinforce Pakistan's own efforts towards overcoming its poverty problems.

The implementation of this CSP needs to take the following constraints into account, analysed in more detail in the paper :

- Political instabilities, regional conflicts and lack of sound economic management have, during the last decade, resulted in slow growth, a worsening fiscal deficit and a precarious balance of payments situation. An ambitious reform programme has been launched to address this state of affairs.
- Poverty in Pakistan is generally believed to be on the rise. Available data imply that approximately one third of the population is affected, with an over-proportional increase of poverty in urban areas. Poor access to social services, inappropriate economic policies and lack of good governance are underlying reasons for this development. The recent crisis has already put a severe budgetary squeeze on government spending, which is likely to further increase this unfortunate trend.
- While Pakistan's social welfare indicators have seen some improvements over the past two decades, progress remains too slow, and the challenges daunting. Population growth is at a high 2.4% (alternative estimates rate it at up to 3%), and low levels of education and poor health constrain productivity growth throughout the economy. Pakistan's social indicators, particularly for women, compare unfavourably with those of other countries at a comparable stage of development. Illiteracy is at 55 % and infant mortality per 1.000 live births is 91.

- On the more positive side, an assessment of the reform process arrives at the conclusion that the reform programme is sufficiently comprehensive and that the current administration has been consistent in implementing reform measures. This has been recently confirmed by key WB and IMF officials when speaking to a visiting Commission delegation. Areas remain where more needs to be done (expanding the tax base, clarify administrative and financial responsibilities envisioned in the devolution plan, social service delivery, speeding up privatisation).
- Obviously, significant risks remain and may even rise, as the economy is vulnerable to shocks and external finance is in short supply. For example, the proposed privatisation of the banking sector had to be postponed in light of the current crisis, since investor confidence, already low under normal circumstances, has sunk to zero. This has further aggravated an already precarious balance of payments situation.
- Medium-term challenges include the need to continue with a high economic growth strategy in a stable macroeconomic environment, the return to democratic rule and genuine political participation, expanding expenditures for social services while ensuring their quality, and improving governance.
- Lessons from past and ongoing EC co-operation with Pakistan (since 1976 the EC has committed more than € 300 Mio) indicate that in practically all projects there have been unacceptable delays in execution. Lately the Commission has oriented its activities away from infrastructure projects towards support to policy-based sector investment programmes, with emphasis on human development, the gender dimension and community participation. This is expected to result in a better impact of interventions.
- The Community has to build up more expertise in dealing with sectoral programmes in Pakistan (emphasis on social sector reform). The Social Action Programme (SAP), currently the largest EC intervention in Pakistan, faced a management and governance problem, as necessary improvements in the effectiveness of delivery systems did not materialise. As EC aid is in the form of grant aid and not loans, particular attention needs to be given to performance and transparency issues, in order to assure proper accountability. The Community must adapt to a role in which it will have a greater input into sectoral policy discussions.
- The donor community has in the past taken a more reserved approach towards Pakistan for various reasons: the nuclear tests, questions about democracy and human rights, the presence of corruption, the stop-go pattern of implementing reforms by the Government, high military spending and its still limited absorption capacity. More recently, there has been a major re-orientation by the donor community towards Pakistan in view of its support to the coalition against terrorism.

EC Medium – term response

Against the background of these rather ambiguous developmental parameters, poverty reduction and eradication as well as linking trade with development through furthering Pakistan's integration in the world economy are key objectives of the EC medium term response strategy. More specifically, the EC proposes two priority areas for co-operation with Pakistan during the reference period, which together would account for close to 90 % of the freely programmable resources (namely the € 15 M per year available for Pakistan under the multi-annual Asia budget allocation):

- 1) Human development in the education sector with focus on poverty reduction, since education plays a strategic role in poverty alleviation and economic development (80 %). A sector programme (which would also place great emphasis on improving good governance and accountability in the provision of educational services) would be considered as the cornerstone for the EC's interventions in this area.
- 2) Trade development and promotion of business and institutional links (8 %). The key objective here is to enhance co-operation in the economic field, which should contribute to the creation of income and employment as well as poverty alleviation.

While the proposed allocation to the above sectors reflects the Community's efforts to streamline its operations (characterised in the past by a very un-homogenous portfolio of projects), the CSP proposes to reserve about 12 % of total resources to a number of other areas, felt to be important in the current context of the country. This includes activities suitable to contribute towards the eradication of child labour, projects with direct impact on poverty alleviation, for instance in rural development, measures with focus on good governance, the fight against drug abuse, and measures of conflict prevention.

In addition to funds available under the Asia budget allocation, the Community intends to make systematic use of specialised budget lines in order to reinforce its co-operation with Pakistan. Other budget lines will address the promotion of democracy and human rights, NGO co-financing, HIV and population-related operations, aid to uprooted people (Afghan refugees) and curbing illegal migration.

Particular emphasis will also be placed on addressing gender issues and co-operation with non-governmental organisations and community-based organisations. This will include assistance to strengthen the legal framework for civil society operations.

EC response to the crisis in the region surrounding Afghanistan

Exceptional circumstances following the 11 September attacks called for a community response commensurate with the stakes and which would make a significant and visible engagement with Pakistan, both in political and economic terms. A number of measures were taken as part of a concerted Community response to the crisis, including signature of the third generation Co-operation Agreement, additional measures in development co-operation and a preferential trade package. A € 50 M programme in support of financial sector reforms to strengthen micro financing institutions will be committed in early 2002.

The following indicative figures (covering the six year period from 2002-2006)¹ are retained for the different areas of intervention described in this document, taking into account the relative level of priority and the type of activities envisaged. They are subject to further refinement during programming of a National Indicative Programme for the years 2002-2004 (initially foreseen concomitantly to the CSP, but delayed because of security and other crisis-related considerations.)

EC co-operation priority areas and interventions	Budget line	Million €
Multi-annual Asia Budget Allocation		
Human Development in the Education Sector with Focus on Poverty Reduction	B7-300	59
Trade Development and Promotion of Business and Institutional Links	B7-301	6
Other areas (child labour, good governance, drugs, rural development)	B7-300	10
Aid to Uprooted People ^a	B7-302	15
Total		90
Crisis-related additional interventions		
Quick-disbursing programme (financial sector reform) ^b	B7-300	50
Other budget lines ^c		
European Initiative for Democracy and Human Rights ^d	B7-700	6
NGO co-financing ^e	B7-600	10
HIV and population related operations ^f	B7-6211, B7-6312	4
Co-operation with Third Countries in the Area of Migration ^g	B7-667	5
Grand total		165

^a Estimate 2002-2004

^b Part of the EC response to the current crisis and in addition to regular proposed multinational budget allocation.

^c Humanitarian aid (Afghan refugees) and electoral assistance/observation to be determined according to needs.

^d The allocation is for the period 2002-2004, and the situation will be assessed for the following years. € 2 M have been allocated for 2002, further annual allocations to be reviewed.

^e Programmed yearly with basis of calls for proposals, therefore not reflected in detail in this CSP

^f Estimate

^g Estimate

¹ Programme on veterinary services with 6-year duration to the value of € 22,9 M to be committed in December 2001 not included.

2 DESCRIPTION OF EC CO-OPERATION OBJECTIVES

The objectives of the EC-Pakistan co-operation are governed by Article 177 of the EU Treaty which sets out the three broad overarching Treaty objectives for Community co-operation with developing countries, which are: fostering of sustainable economic and social development, the smooth and gradual integration of developing countries into the world economy and the campaign against poverty.

More specific guidance is derived from the terms of Council Regulation 443/92 of 25 February 1992 on financial and technical assistance and economic co-operation with the developing countries of Asia and Latin America, which identifies human development, targeted primarily towards the poorest sections of the populations, developing the rural sector, protection of the environment and natural resources, sustainable development, measures to increase participation of women, child protection, population growth, good governance and human rights as well as measures to combat drugs as priorities.

Following conclusion of a Commercial Co-operation Agreement in 1976 a 2nd generation EC-Pakistan Co-operation Agreement came into force in 1986, emphasising the desire to deepen and diversify commercial exchanges, to foster economic co-operation in fields of mutual interest and support to development programmes. A new 3rd generation Co-operation Agreement between the European Community and the Islamic Republic of Pakistan on Partnership and Development was signed on 24 November 2001 in Islamabad. As a major difference with the previous ones, it defines respect for human rights and democratic principles as its basis under Article 1. A joint statement was issued on the occasion of signature in which Pakistan reiterates its commitment to return to a democratic government in accordance with the roadmap announced on 14 August 2001.

Activities in the field of development co-operation have traditionally occupied a central place in the EC-Pakistan relationship. The European Community's Development Policy of 24 April 2000 is based on the principle of sustainable, equitable and participatory human and social development, with poverty reduction and eventually eradication as its central aim. Key priority areas are defined as promoting the link between trade and development, regional integration and co-operation, equitable access to social services and support for macroeconomic policies, transport networks, food security and rural development strategies, and institutional capacity building.

Economic co-operation, which by definition should serve the mutual interest of the Community and its partner countries, is still of limited relevance in the case of Pakistan, mainly because the country was not ready to engage in this type of activities and due to insufficient interest by EU economic operators. The focus here is to build an environment more favourable to international trade and investment.

Following the 11 September 2001 terrorist attacks against the United States and Pakistan's decision to side with the international coalition the Council (GAC conclusions of 8 October 2001) called on the Commission to examine ways to reinforce Community Assistance to Pakistan. Apart from signature of the 3rd generation Co-operation Agreement, this led to the proposal of additional trade and development measures in response to the crisis.

3 PAKISTAN'S POLICY AGENDA

3.1 Internal

The policy agenda of the present military-led Government is based on the 17 October 1999 policy speech by Chief Executive (since 20 June 2001 President) General Musharraf, wherein he outlined a “seven-point agenda” for national renewal: rebuilding national confidence and morale; removing inter-provincial disharmony; reviving the economy through deregulatory reform and restoring investor confidence; ensuring law and order; the de-politicisation of state institutions; the devolution of state power; and the even-handed pursuit of political accountability. In addition, measures against terrorism, sectarianism and extremism, and improving the country’s human rights record were identified as priorities.

The Supreme Court of Pakistan on 12 May 2000, gave a deadline of three years, starting from the date of the coup, for return to democracy. The Court also bestowed on the Government the legal right to amend the Constitution, as and when required, for the introduction of reforms.

3.1.1 Economic Reforms

The military government placed immediate precedence on stabilising the economy. On 15 December 1999 General Musharraf unveiled a set of guidelines to stabilise and reinvigorate the economy described as the “Economic Revival Plan (ERP)”. It contained three major objectives: to restore investor confidence; to make the country self-reliant in the medium term; and to ensure that the benefits of development are felt widely. Concrete reform measures which have been launched include:

- Expanding the tax base through imposition of a general sales tax at retail level, an unprecedented tax on agricultural income, implementation of tax surveys as well as reform of the tax authorities.
- A rise in development expenditures, with emphasis on poverty reduction schemes.
- Sector policies focusing on agriculture (pricing, abolition of export restrictions), SMEs (credit availability), gas and petroleum (pricing, encouraging exploration and foreign investment), information technology (upgrading professional education).
- Reactivation of the privatisation programme.
- Plans to diversify the export base away from textiles.
- Tariff reduction to 25% maximum in 2003 and enhanced autonomy for Tariff Commission.

3.1.2 Political Reforms

Democracy in Pakistan has been weak in the past. Turn-outs in recent parliamentary elections have been low, and those elected have been described as not truly representing the Pakistani population, as they predominantly originate from wealthy or land-owning families.

On 14 August 2000 the military government unveiled a far-reaching devolution plan aiming to strengthen grass-roots democracy by creating accountable elected local governments and to decentralise provision of government services. The local government design is based on five fundamentals: devolution of political power, de-centralisation of administrative authority, de-concentration of management functions, diffusion of the power-authority nexus, and distribution of resources to the district level. The military government termed the plan as the first step towards returning the country to a rebuilt democracy.

The process was initiated with local body elections based on new electoral rolls held on a non-party basis between December 2000 and May 2001, followed by elections to district assemblies and the installation of district governments in July and August 2001. Elections to Provincial and National Assemblies and the Senate are to be held between 1 and 11 October 2002 according to an announcement made by President Musharraf on 14 August 2001, who personally reaffirmed this commitment to high-level EU visitors (ministerial Troika on 25 September 2001, Belgian PM Verhofstadt and Commission President Prodi on 24 November).

3.1.3 Human Rights and Governance

Pakistan has ratified three international human rights instruments: the Convention on the Elimination of All Forms of Racial Discrimination (CERD) in September 1966, the Convention on the Elimination of All Forms of Discrimination against Women (CEDAW) in March 1996 and the Convention on the Rights of the Child (CRC) in November 1990.

Following suspension of the Constitution legislation in Pakistan is based on Provisional Constitutional Order No. 1 (PCO) issued in October 1999. According to the PCO basic human rights mentioned in the Constitution will be respected. Senior judges were asked to swear an oath of allegiance on the PCO, and actions of the military administration were placed outside judicial review.

The military government presented its policy framework on human rights in a Human Rights National Convention on 21-22 April 2000. Elimination of injustice and poverty, the safeguarding of human dignity, promotion of women's rights and establishment of the rule of law were identified as basic elements.

Pakistan has maintained a relatively free and independent press. The government has not applied any restricting measures towards NGOs and human rights groups are free to raise issues of concern publicly. The government promulgated a Juvenile Justice System Ordinance protecting children's rights and established a National Commission on the Status of Women. The government formulated an action plan and policy to eradicate the worst forms of child labour and is in the process of formulating an action plan against bonded labour.

Despite these positive steps numerous concerns remain. Democratically elected institutions have been dissolved and basic political rights are restrained, in particular through a ban on public political rallies. Discrimination against religious minorities continues and there is lack of respect for the rule of the law, as finds expression in allegations on use of torture, lack of fair trials and arbitrary detention. The death penalty is still practised in Pakistan. Incidence of child labour (estimated at 3.3 million children aged between 5 and 14) and bonded labour remains high.

Pakistan has still not signed or ratified the two UN Covenants on Economic, Social and Cultural Rights and on Civic and Political Rights. Accession to these instruments would imply some willingness to demonstrate commitment to the promotion and protection of human rights.

In an effort to fight corruption the military government is committed to an accountability drive directed mainly at politicians, business leaders and civil servants to recover monies illegally obtained. The National Accountability Bureau (NAB) and special accountability courts have been set up to oversee this process. A number of prominent individuals have been tried and sentenced and large number of civil servants has been dismissed.

Governance is not a new theme in the Pakistani context, as a number of committees have made recommendations on the issue over the years. In October 1999 General Musharraf, in his speech to the nation, identified governance as the greatest development challenge facing Pakistan. The devolution plan, if implemented successfully, would have far-reaching consequences on de-centralisation of administrative authority and management functions through a revised approach on sharing resources between federal, provincial and local levels. The National Reconstruction Bureau (NRB) was set up as an institution with think tank character to oversee the reforms, supported by the good governance group project.

3.1.4 Development Policy

Accelerating development by reducing poverty is an important part of the military government's reform agenda. An Interim Poverty Reduction Strategy Paper was presented at the Pakistan Development Forum in March 2001 and updated in November 2001, defining goals, targets and instruments to achieve equitable growth and social development for poverty reduction. The IPRSP process will be concluded after October 2002 as a full PRSP by the elected government following provincial and district level consultations. It represents the overarching framework for developmental activities of the Government of Pakistan and multilateral and bilateral donor agencies. The major components of the strategy are:

- Macroeconomic reforms: Ensuring broad-based economic growth that generates income-generating opportunities for the poor;
- Governance reforms: Improving the efficiency of the government to develop and deliver services to the poor;
- Physical and social assets creation: Enhancing the human capital of the poor by improving access to physical assets, education, vocational skills training, primary health care, nutrition and other social services;
- Provision of social safety nets for the most vulnerable groups.

Plans for implementing Pakistan's poverty reduction strategy focus on (a) directing a public policy debate on the needs of the poor, (b) forging broad-based alliances with civil society and the private sector to bring about an effective transformation of society, (c) understanding the nature of poverty and (d) empowering people, especially the most deprived, by increasing access to factors of production, particularly land and credit.

Concrete initiatives on social development and poverty reduction include:

- launching the Integrated Rural and Urban Development Programme (IRUDP) to stimulate economic activity and to generate employment in the poorest districts of the country,
- increasing social and poverty related budgetary expenditures by 29% for the 2000/01 fiscal year, equivalent to 0.4% of GDP, and by 18.5 % in 2001-2002.
- establishing credit facilities to small and medium-sized enterprises (SMEs) and self-employed micro enterprises.

The administration is planning to reduce the interest bill and to contain defence expenditures, as debt repayment and military spending remain the two largest items in the budget. It further hopes to enhance the development impact of the budget through improved expenditure management.

3.2 External

The military government stated initially that there will be no change in external policy and that international obligations and commitments would continue to be honoured. The main pillars of Pakistan's foreign policy are the strengthening of ties with Muslim countries, the wish for a stable Afghanistan, reinforcing the traditionally close links with China, and maintaining a friendly relationship with major powers, especially the United States. Relations with neighbouring India are dominated by the Kashmir issue and have been notoriously difficult.

Following the May 1998 nuclear tests by India and Pakistan, concerns on stability and non-proliferation in the region remain. President Musharraf has affirmed that Pakistan is sensitive to the concerns of the international community, and while preserving its vital security interests, the country would continue to pursue a policy of nuclear and missile restraint and sensitivity to global non-proliferation and disarmament objectives. Pakistan stated that it would not conduct further nuclear tests and that it was working towards a national consensus on the issue of signing the CTBT.

The military government maintains a firm stand on the Kashmir dispute, insisting on an "end to Indian repression". Nevertheless, President Musharraf expressed willingness to resume negotiations with India on Kashmir at any time. Major international players have repeatedly urged both countries to re-launch the dialogue under the Lahore process. In May 2001 Indian Prime Minister Vajpayee invited President Musharraf to visit India for talks. The meeting took place in Agra from 14-16 July 2001 but did not result in a joint declaration. Given the onset of renewed tension along the line of control and the international border it is currently not certain whether the dialogue will be continued. SAARC has become largely inoperative due to differences between the two countries.

The continuing dispute over Kashmir has over decades prevented the improvement of bilateral relations with India, thus constituting a major root cause for conflict in the region. These circumstances have further contributed to Pakistan attaching great importance towards allocating a major proportion of its limited resources for defence purposes. A strengthened regional security system has become highly desirable.

After the 11 September events Pakistan made a U-turn on its Afghan policy, revising its earlier position of long-standing support to the Taliban. Pakistan is now in favour of a broad-based multi-ethnic political dispensation and UN involvement, and has welcomed the Bonn agreement on an interim administration.

4 AN ANALYSIS OF THE POLITICAL SITUATION, THE ECONOMIC AND SOCIAL SITUATION, INCLUDING THE SUSTAINABILITY OF CURRENT POLICIES AND MEDIUM TERM CHALLENGES.

4.1 An Analysis of the Political Situation

Pakistan has been under military rule since 12 October 1999 when the Chief of Army Staff, General Musharraf, ousted the democratically elected government of Prime Minister Nawaz Sharif in a bloodless coup. National and provincial assemblies were initially suspended, later dissolved, and the constitution placed in abeyance, although the press remains free.

General Musharraf initially took on the title of Chief Executive, on 20 June 2001 he was sworn in as President of Pakistan by the Chief Justice in what was effectively a self-appointment. He is ruling with a National Security Council and a Cabinet. The government has been described as one of technocrats. The military take-over has been validated by the Supreme Court on the basis of the ‘doctrine of necessity’ with the important limitation that democracy should be restored within a time limit of 3 years, i.e. by October 2002.

On 30 April 2002 President Musharraf held a referendum, asking the electorate whether it favoured continuation of reforms initiated by him combined with electing him as President for a further five years. According to the Election Commission of Pakistan 99,47% of votes supported the referendum. However, large parts of the press carried allegations of widespread irregularities and the turnout was widely contested between government and opposition (ranging between 56 and 5%). It is to be expected that the referendum will result in a polarisation of the political debate in the run-up to the October elections.

President Musharraf heads the 4th military government since Pakistan’s independence in 1947. The armed forces have been in power for about half of Pakistan’s history. The present government maintains that Pakistan’s experience of democracy hitherto has been unsatisfactory (President Musharraf has referred to the period under Nawaz Sharif as a “sham democracy”) and that major reforms are necessary to the country’s political system. On the other hand, political observers argue that democracy in Pakistan has never been given a proper chance to grow roots and develop. The country has a long-standing feudalistic tradition, with power concentrated in the hands of a few wealthy families. One consequence has been the lack of social and economic reforms, including land and taxation reform.

The army is aiming to develop a new political class untainted by corruption, which has become endemic among Pakistan’s elite. Leading politicians have been discredited. Deposed Prime Minister Nawaz Sharif, leader of the Pakistan Muslim League (PML), was jailed for hijacking but has been released into exile in Saudi Arabia in December 2000 on condition that he would refrain from politics. Leader of the Pakistan People’s Party (PPP) and former Prime Minister Benazir Bhutto has been convicted, still under Nawaz Sharif, on charges of corruption and is living in exile in London and Dubai. In April 2001 the Supreme Court set aside the earlier conviction and ordered a retrial. Since then however, she has been convicted again in absence on new corruption charges, making a possible return from exile unlikely. Other politicians have been prosecuted under the NAB ordinance, whereby convictions on account of corrupt practices can result, in addition to sentencing, in disqualification from political or public office for an extended period.

Although the military take-over met with wide-spread international disapproval, the reaction of society at large has been one of accommodation. Initially there seemed to be a high level of public acceptance of the army's self-imposed role as Pakistan's ultimate political arbiter. By mid-2000 voices among sidelined political parties calling for restoration of democracy grew stronger, which culminated in the PML joining a group of other parties including arch-rivals PPP in the Alliance for Restoration of Democracy (ARD) in November 2000. This in turn led to the split of the PML into a pro-Sharif, pro-ARD group on the one hand, and a faction of dissidents (called the "like-minded" group) said to be favoured by the army on the other hand. The ARD was dealt a setback when Nawaz Sharif accepted the army's offer to leave for exile. General Musharraf ended speculation that the assemblies could be restored before the end of the 3-year term fixed by the Supreme Court by dissolving them at the time of ascending to the Presidency, but confirmed that political parties would be allowed to contest provincial and national elections. However, parties appear to lack clearly-defined political and economic agendas, and are not actively involved in shaping the reform process.

Political devolution through empowering local district councils is the centrepiece of the army's reform plans. By holding local body elections on a non-party basis in four phases the army is trying to bypass the traditional power bases of political parties in the national assembly and provincial assemblies. The voting age was reduced from 21 to 18 years, adding approximately 10 million new voters. The number of elected local officials in the country rose dramatically. In view of the non-party formula there is uncertainty as to the political value of these elections. Most political parties are critical of the devolution plan, which they argue will erode provincial autonomy, as provinces had been lobbying for certain powers which will now be transferred to local bodies.

The EU did not observe the local body elections in view of their non-party nature, however the Commonwealth and some international NGOs sent observers. Results from the local body elections show a higher than expected turnout (45% or higher according to government claims), but do not appear to have resulted in a challenge to the old political elite. Reportedly the majority of those elected are linked to major political parties, as party members were not prevented from contesting elections on an individual basis. Minorities have largely boycotted the local body elections in protest against the separate electorate which is applied.

Following the military take-over the EU issued a declaration calling for speedy return to democracy. The EU intends to assess in early 2002 whether an EU observation of elections to the National Assembly, to be held in October 2002, could be carried out.

In recent years Pakistan has given the impression of rising pressures of religious fundamentalism, and there have been frequent incidents of sectarian violence. Religious schools run by fundamentalist organisations are offering free education and have become ever more popular for lack of a public alternative. However, the large majority of the population is committed to a tolerant Islamic society and fundamentalists have never featured prominently in elections. The army has shown some determination to confront religious and sectarian extremism more decisively by prohibiting the public display of weapons by militant organisations.

Asymmetry between Punjab and other provinces have persistently influenced domestic politics, with ethnic political consciousness a prominent phenomenon. Tension over access to water between Punjab and Sind could intensify in future. Within Sind there is historic friction between Urdu-speaking migrants who settled in Pakistan at the time of independence and rural Sindhis.

Major questions remain as to how the present government can succeed in its declared political reform endeavours. President Musharraf intends to put in place constitutional changes resulting in a system of “checks and balances”. The National Security Council is widely expected to secure a certain influence for the army beyond October 2002 with the aim to ensure that political and economic reforms will not be easily reversible.

Given Pakistan’s support to the international coalition against terrorism and in view of exceptional circumstances resulting from the crisis, the European Union intends to intensify its relations with Pakistan in order to contribute to the stability of the region. As a result it was proposed that Pakistan should be encouraged by political measures (signature of 3rd Generation Co-operation Agreement, upgrading of political dialogue) as well as reinforced co-operation in the development, trade and economic fields.

4.2 An Analysis of the Economic and Social Situation, including the Sustainability of Current Policies and Medium-Term Challenges

With 138.1 million inhabitants in 2000 Pakistan is the world’s 7th largest country in terms of population. Pakistan’s land area is 803,943 square kilometres, out of which 25% is cultivated. A further 83,900 square kilometres is taken up by the Northern Areas and Azad Jammu & Kashmir, those parts of the old state of Jammu & Kashmir administered by Pakistan under the terms of the 1949 ceasefire with India.

Population, mid year (millions)	138.1
GNP per capita (Atlas method, US \$)	490
Population growth (1% of annual average, 94-00)	2.4
Poverty (% of populations below national poverty line)	33
Life expectancy at birth (years)	63
Infant mortality (per 1000 live births)	90
Illiteracy (% of population age 15+)	54

All date for 2000, or most recent estimates

Pakistan managed until the late 80s to achieve reasonable economic progress since independence. Over the last decade, lack of sound economic management, regional conflicts and political instabilities have resulted in slow growth, a worsening fiscal deficit and a precarious balance of payments situation. Progress in the social sectors has been largely neutralised by high population growth and incidence of poverty is on the rise. Selected socio-economic indicators are shown below (also see Annex 1).

Pakistan went through economic adjustment and reform programmes during the last decade with support from the Bretton Woods institutions, until recently with disappointing results. An IMF programme was suspended in July 1999 and the Sharif government was found to have misreported fiscal data. The new government, announcing a clean break from the past, launched a wide-ranging economic reform programme and agreed on a stand-by arrangement with the IMF in November 2000 which was successfully concluded in September 2001. A three-year medium-term successor programme under the IMF’s Poverty Reduction and Growth Facility which enables Pakistan to borrow US \$ 1.3 billion at low interest was approved by the Executive Board of the Fund on 6 December 2001.

4.2.1 Economic situation, structure and performance

Considering that Pakistan did not have much of a manufacturing base at the time of independence, the development of the industrial sector, which now accounts for 23.3% of GDP (2000 data), has been impressive. Agriculture, based in large part on an extensive canal irrigation system in the Indus plains, remains the largest sector in terms of employment and export earnings, contributing 26.3% to GDP. Services account for 50.4% of GDP.

Pakistan's GNP at market prices was worth 68.3 billion US\$ in 2000, equivalent to US\$ 490 per capita. The country experienced declining GDP growth from an annual average of 6% during the 1980s to 4.6% during the 1990s. Most recent data show that growth performance in 1999/2000 picked up to 4.8% as compared to 3.1% in the previous year, sustained by a 7% expansion in agriculture output with bumper cotton and wheat harvests. Expectations for 2000/2001 point towards lower growth as compared to the previous year as a serious drought will likely have a negative impact on overall economic performance. Inflation recorded a modest 3.6% in 1999/2000, down from 5.7% in the previous year and nearly 12% in 1997/1998.

Pakistan's exports continue to be dominated by textiles and apparel as well as agricultural products, despite the government's diversification efforts. Major imports include crude oil and petroleum products, wheat, machinery, chemicals, fertilisers, cooking oil and consumer products. The balance of payments position remains delicate, reflecting the vulnerability of the economy to external shocks. The current account deficit (including official transfers) was reduced substantially from US\$ 2.2 billion (3.8% of GDP) in 1998/1999 to US\$ 1 billion (1.6% of GDP) in 1999/2000, despite a deterioration of terms of trade mainly due to rising prices of petroleum. Exports of goods and services grew by 9.5% to US\$ 9.7 billion in 2000 from 1999, aided by improved external demand conditions and increased textile production, whereas imports remained virtually unchanged at US\$ 11.8 billion. However, the overall balance of payments performance falls substantially short of objectives, as a result of large shortfalls in the capital account. Whatever modest gains have recently been made in export performance will likely be nullified by drought induced balance of payments requirements and regional instability related to the crisis in neighbouring Afghanistan.

At US\$ 182 million the inflow of foreign investment in Pakistan dropped to an alarmingly low level during the 2000/2001 fiscal year, mainly because of heavy withdrawal of portfolio investment. This figure compares very unfavourably to foreign investment realised during the last decade.

With 33.3 billion US\$ in 2000/01 of total outstanding external debt, equivalent to 54% of GDP Pakistan has to be considered as a heavily indebted country. Further to the IMF stand-by loan in November 2000, Pakistan negotiated debt service arrangements with the Paris Club of sovereign investors in January and December 2001. The latter agreement provides for a comprehensive restructuring of a stock of debt amounting to US \$ 12.5 billion as of 30 November 2001.

Poverty in Pakistan is generally believed to be on the rise. Based on caloric requirements the proportion of people living in poverty has increased from 26.4% in 1987/1988 to 28.6% in 1999/2000 (29.29 in rural, 27.56% in urban areas). Other estimates put the figure at 33%. The available data imply that roughly one third of the population is affected, with poverty rising relatively faster in urban areas. Poor access to basic social services, inappropriate economic policies and lack of good governance are cited as underlying reasons for this development. Given low growth in real per capita income in recent years, inequality has risen, as Pakistan experienced an increase in the Gini coefficient from 0.35 in 1987 to 0.42 in 1994.

Social inequalities in Pakistan find expression in an unequal land distribution. Land reforms were carried out in 1959, 1972 and 1977, but did either not achieve the desired results, or, as in the last case, remained largely unimplemented. Follow-up support systems in terms of infrastructure and institutional back-up were absent. The Pakistan poverty reduction strategy proposes the distribution of about 3 million acres of available land linked with infrastructural support.

Environmental degradation threatens to permanently damage ecological systems and is particularly influencing the lives of the poorest sections of society. Availability of water resources has been steadily declining, and Pakistan's irrigated land is threatened by high degrees of waterlogging and salinity. The annual rate of deforestation is one of the highest in the world.

4.2.2 The Social Situation

While Pakistan's social welfare indicators have seen some improvements over the past two decades, progress remains too slow, and the challenges daunting. Population growth is at a high 2.4% (alternative estimates rate it at up to 3%), and low levels of education and poor health constrain productivity growth throughout the economy. Life expectancy is at 63 years. Pakistan's social indicators, particularly for women, compare unfavourably with those of other countries at a comparable stage of development.

According to the Population and Housing Census Report 1998 only 45% of the population is literate (32.6% for women) compared to an average literacy rate of 49% in South Asia and 65% in low-income countries world-wide. Gender disparities in education remain large, with 49% of Pakistan's girls enrolling in primary school compared to 69% of its boys. In Baluchistan, the country's largest in terms of surface and at the same time poorest province, only 2% of the women are literate.

Pakistan has achieved some slow improvements of its health indicators, although the overall situation remains dismal. One in every 38 deaths amongst women is from pregnancy-related causes. Infant mortality remains high, at 90 per 1,000 live births, compared with an average of 77 for low-income countries. 38% of children under the age of 5 are malnourished.

There is lack of information about the HIV/AIDS problem in Pakistan. Current estimates indicate there are between 50000 to 80000 infected persons in the country. However, certain activities and behaviours are prevalent which may facilitate the rapid spread of the disease. A National Survey on drug abuse from 1993 revealed that there are more than 3 million chronically addicted drug users in Pakistan, with growing trend towards drug injection.

4.2.3 The Public Sector

Considerable fiscal imbalances continue to pose a serious threat to Pakistan's macroeconomic stability. Fiscal deficits as a percentage of GDP averaged 7.5% during the first half of the 1990s, but declined marginally to 7.0% in the second half, mainly due to cuts in development expenditures. IMF conditionalities under the stand-by arrangement call for a reduction of the fiscal deficit to 5.2% of GDP in 2000/2001 from 6.4% in 1999/2000, making this a key target of government stabilisation policies.

At the end of the 1990s only 1.8 million persons, barely more than 1% of the population, were registered as tax payers, resulting in a narrow tax-to-GDP-ratio of 13%. The Pakistan Institute of Development Economists estimates that the country's informal economy is worth 51% of GDP (compared to 20% in 1973), leaving ample scope to widen the tax net. Almost 70% of tax earnings are from indirect taxes. Tax revenue was expected to rise to 13.8% of GDP in 2000/2001.

Overall budgetary expenditure during 2001/2002 was estimated at Rs. 751.7 billion (appr. US\$ 13 billion). About 62% of total expenditure are projected to go to debt servicing (44%) and defence (17.5%). As a consequence Pakistan can not adequately fund basic social services and other development needs. This is aggravated by poor governance: institutions engaged in providing social and economic services have largely lost their capacity to deliver such services to the target population. Nevertheless, fiscal projections for 2001/2002 feature a sizeable increase by 18.5% in social and poverty-related spending. The overall deficit is estimated at 4.9 % (IMF conditionality) of the anticipated GDP for the fiscal year 2001/2002.

Pakistan's federal and provincial administrations are staffed by 2.200.000 civil servants. They work under a rigid, overly centralised management structure with antiquated rules and regulations, low pay, lack of incentives for effective performance, and absence of accountability to the general public. The National Reconstruction Bureau designed an elaborate devolution plan for a three-level structure of elected local governments with enhanced responsibilities to become functional in August 2001 with the aim to improve service delivery at the local level.

4.2.4 Assessment of the Reform Process

Pakistan faces a number of challenges as it strives to join the ranks of middle class income countries. Judged by the country's history of economic development, good governance linked to structural reforms and investment in the social sectors can be identified as essential prerequisites for sustained growth and a more equitable income distribution pattern. The Economic Revival Plan of December 1999 features elements of a reform programme sufficiently comprehensive and far-reaching to address fundamental economic problems, with emphasis on tax reforms, devolution, accountability and a pro-poor shift in the budget.

The current administration has been consistent in implementing the reforms. All three tranches under the stand-by arrangement have been released as scheduled, causing the IMF to state that Pakistan's achievements under the programme have been encouraging and that the implementation of important structural reforms has been on track. Major challenges remain. What follows is an overview of achievements on key reform priorities.

On taxes and fiscal reforms, the focus is to broaden the tax base by carrying out a tax documentation and survey campaign, especially among traders and property owners, and extending general sales tax to the energy sector and agricultural inputs. Good progress was achieved despite initial wide-spread resistance in the commercial sector. More remains to be done on reforming the tax administration and bringing agricultural income into the tax net.

The objective of civil service reform is to evolve a decentralised, lean and efficient bureaucracy.

The Federal Public Service Commission was made more autonomous and provided with legal cover to dismiss corrupt and non-performing civil servants. Further tasks include developing proposals for police and judicial reform and implementation of civil service reform in the provinces.

Eradication of corruption is a key priorities in Pakistan, and the government is developing a long-term strategy to address the issue. Apart from efforts by the National Accountability Bureau to combat white collar crime, a more concerted effort is required to further tackle the root causes of corruption, which include lack of good governance and weak democratic control.

The need for devolution is based on an overly centralised administration which is widely held responsible for poor service delivery. Newly elected local governments have come into office in August 2001 and the provision of 33% of seats for women representatives has been described as a path-breaking measure. There is still uncertainty over the nature of administrative and fiscal responsibilities envisioned in the devolution plan. The development of financial management systems for local governments will be essential. There is also a need for financial reform at provincial level to improve delivery of public services which they will continue to handle.

Pakistan suffers from inadequate social service delivery, both in terms of quantity and quality, especially in rural areas. Particularly disadvantaged are the poor, women and girls. Expanding and improving the delivery of basic social services forms a crucial part of Pakistan's poverty reduction strategy. Recently some progress has been made on health indicators, in particular improved immunisation coverage and increasing the contraceptive prevalence rate from 24% in 1996/1997 to 32% in 1999/2000. Provision of primary and preventive health services requires more attention. Little has been achieved on the education front. Improvements are anticipated with the implementation of the devolution plan. The government has declared the intention to broaden the curricula of private religious schools (madrassas).

On poverty alleviation the government is aiming for a comprehensive approach through preparation of a poverty reduction strategy and with economic reforms that are expected to show results in the medium term. Increases in pro-poor public expenditures address short term needs through various programmes for local community infrastructure, public works, micro-credit, food support, and provision of land and housing.

In the energy sector the aim is to commercialise and eventually privatise Pakistan's inefficient public sector monopolies. The power tariff tussle between the government and independent power producers (Hubco dispute) has been resolved. A power regulatory agency is now operational and developing a credible pricing framework to complete financial restructuring of the power sector and to attract private investment is essential.

On private sector development plans are to improve the unsatisfactory investment climate by opening up activities previously monopolised by the public sector. A privatisation law has been promulgated which provides legal cover for investors' rights. 90% of privatisation proceeds are to be used for debt reduction and the balance for poverty alleviation programmes. However, the privatisation process has got off to a slow start and needs to be expedited. Laws relating to intellectual property rights, trademarks and industrial relations have been reviewed.

The government has moved ahead on banking sector reforms, by increasing the authority of the State Bank of Pakistan, pursuing loan defaulters and recovering non-performing loans. Privatisation of public sector banks is a key ingredient of financial sector reforms, but further restructuring is required to enhance attractiveness to private investors. In December 1999, Pakistan's Supreme Court declared all kinds of bank interest as un-Islamic and directed the government to introduce an interest-free economic system by 30 June 2001. Indications are that this may result in a parallel system where clients would only have to deal with Islamic banks if they choose to do so.

Micro finance has been made a key part of the Government's poverty reduction strategy. This has led to the creation of a Khushali Bank and the promulgation of an ordinance, the Micro Finance Ordinance 2001, that allows for private sector micro finance banks to be established.

4.2.5 External Aspects

In order to promote labour-intensive exports that will enhance employment opportunities the exchange rate of the Pakistani rupee is now determined by market forces. This led to a significant depreciation of the rupee. Monetary policy has been tightened significantly to counteract inflationary pressures that could result from the depreciation.

Pakistan's exports are overly dependent on a few product lines, especially cotton and textile products, and the number of major trading partners is limited. The government has embarked on an export promotion and facilitation drive. Exports grew by 9.5% in 2000 as compared to a decline of 11.8% in 1999.

In the field of trade policy, Pakistan will phase out quantitative import restrictions maintained for balance of payment reasons by end-June 2002. Tariffs are being rationalised: the number of tariff slabs is to be reduced from five to four. Maximum import tariffs will be lowered to 30% by June 2001 and 25% by June 2003.

Pakistan is one of the founding members of GATT and has always co-ordinated its trade policies with other developing countries, particularly within the G-77 framework. In this role it has often taken a critical stance towards developed countries and liberalisation of trade. On the other hand, Pakistan does agree, in principle, with the proposition that trade liberalisation is beneficial to the global economy, and it does not want to be associated too strongly with the G-77 since it has its own agenda.

Pakistan's position towards a new round of multilateral trade negotiations has veered from opposition and hesitation towards support arguing before the Doha meeting that it wants a new round agenda to focus on the 'built-in agenda' items of the Uruguay Round, including the problems that it (and many other developing countries) faces on implementation. Any inclusion of new issues such as labour standards and other social clauses, environment, trade, investment and competition was considered 'premature'. Despite these concerns, Pakistan played a constructive role in launching a new round and the Doha Development Agenda.

Pakistan is keen to gain improved market access where it has comparative advantages, namely in agriculture and textiles, which make up the bulk of its exports. It therefore has an interest in the liberalisation and integration of the textiles and clothing trade into the WTO. This is supported by the Pakistan business community, which wants for the WTO to further liberalise trade, remove textile quotas and eliminate agricultural subsidies. In March 2001 Pakistan and the European Community engaged in bilateral textile negotiations, which were concluded on 15 October 2001 with the initialling of a Memorandum of Understanding between EC and Pakistan negotiators. The agreement allows for an increase of Pakistani textile and clothing quotas by 15% in advance of their abolishment under the WTO ATC Agreement on 1 January 2005. In return, Pakistan will reduce its duties in the textile and clothing sector by 5% across the board and bind these rates in the WTO. In addition, the Community, following the 11 September events, agreed to offer Pakistan additional preferences under the GSP which apply to countries combating drugs.

Pakistan has expressed reservations on the EU's "Everything but Arms" initiative, fearing that the package may negatively affect those middle-income developing countries who have not managed to maintain sustainable growth levels and are suffering from a heavy debt burden.

4.3 Sustainability of Current Policies

The Economic Reform Programme addresses critical issues such as improving governance, reviving economic growth and reducing poverty as part of a comprehensive reform agenda. Past reform efforts were often short-lived, but the current administration has shown determination to fight resistance by vested interests. It is widely believed that many steps, once taken, are self-sustaining and irreversible: tax reforms and privatisation are examples. Some difficult tasks have been accomplished, for instance the registration drive to bring undocumented activities into the tax net.

On the other hand, deep-rooted structural problems could slow down the implementation of reforms. It is expected to take many years before substantive progress on fiscal and political devolution, improvement of health and education systems or the change of administrative culture will materialise. Significant risks remain:

The economy is vulnerable to shocks. An example is the recent drought which resulted in serious water shortages which reduced agricultural output, with effects throughout the economy.

The 11 September events have taken a substantial toll on global economic activity. Regional tensions linked to the crisis in Afghanistan have dramatically worsened the outlook for Pakistan's economy. Export growth is likely to be lower than previously foreseen, due to the expected further weakening of the external environment and greater concerns about the socio-political situation, which might affect freight and insure premia, as well as trade finance. In addition the envisaged privatisation programme and the expected improvement in FDI inflow may materialise at a pace slower than expected. Lower tax revenues, rising inflows of Afghan refugees, and greater domestic security concerns could exacerbate budgetary pressures.

It is difficult to predict how rapidly and to what extent investor confidence will be restored, given political instabilities and a precarious regional security environment.

Although a comprehensive debt-exit strategy has been prepared, shortfalls in external finance could constrain imports, growth and the balance of payment position. Traditional sources of capital inflow, including ODA, short-term commercial lending, remittances and portfolio investment have weakened for economic and political reasons. Keeping IMF support on track will be essential.

A major concern is the long-term viability of reform policies beyond October 2002. Political parties do not support all elements of the reform process and may opt to reverse some of the measures taken. President Musharraf announced that checks and balances at the highest level would ensure the continuity of reforms. But the question remains whether enough was done to involve political parties in shaping reforms and to inform the wider public on their purpose.

4.4 Medium-term Challenges

Overall, the medium-term economic outlook depends critically on political stability, achieving effective democratic rule, resumption of normal political relations with the international community and the implementation of macro- and structural reforms.

There is a compelling need to continue a clear strategy focussing on high economic growth of 6% per annum or more in a stable macroeconomic environment, characterised by low fiscal and external deficits with low inflation. If high growth does not materialise, and given the country's unequal income distribution, a significant increase in poverty would be the likely result. There are doubts whether Pakistan would have the necessary institutional and administrative strength to cope with a further increase in poverty, without facing major political and social problems.

It is essential for Pakistan to return to democratic rule and genuine political participation. Failure to empower large parts of the population has resulted in legitimacy problems for successive regimes. To this date no democratically elected government has completed a full term in office and the military has traditionally played an interventionist role, weakening confidence in the democratic system. A stable political system would encourage private investment in the economy.

In order to enhance the earning capacity of the poor, it is necessary that expenditures for social services are expanded while ensuring the quality of social service provision. The donor community can play an important role in this respect.

Improving governance has rightly been identified as one of the country's key priorities. Issues that need to be addressed include accountability, competence in formulating policies and delivering services, and respect for human rights and rule of the law to provide a framework for economic and social activity.

5 OVERVIEW OF PAST AND ONGOING EC COOPERATION (LESSONS & EXPERIENCE), INFORMATION ON PROGRAMMES OF EU MEMBER STATES AND OTHER DONORS.

5.1 Overview of Past and Ongoing EC Co-operation (lessons and experience)

Since the start of its co-operation with Pakistan in 1976, the EC has committed more than €300 million on projects and programmes. At present the Community's open portfolio stands at more than €220 million of commitments. Ongoing projects generally address the central objective of poverty alleviation, be it in education, health, combining environmental protection with the promotion of alternative economic activities or electrification of villages. Projects involve either state or para-statal agencies, as well as civil society, through community based organisations or formally established NGOs.

Experience in implementing these projects has been mixed. In some areas, notably water supply and livestock development there were identifiable impacts on provincial governments policies, but sustainability was questionable. In practically all projects, there have been unacceptable delays in execution, due to political interference, weak counterpart implementation or absorption capacity, lengthy procedures or inappropriate technical assistance. The present portfolio has been considerably streamlined and these problems are being actively addressed. Some of the most effective projects have been with NGOs, the Aga Khan Development Network on elementary teacher training and sustainable development in the Northern Areas and the National Rural Support Programme.

More lately, the Community has oriented its activities in Pakistan away from infrastructure projects towards support to policy-based sector investment programmes, placing greater emphasis on human development and environmental management in accordance with shifts in government policy. The gender dimension of development, together with close participation of local communities, form essential aspects of project design and implementation. Examples that illustrate the shift in focus include the EC's € 71 million contribution to the SAP (Social Action Programme), the € 25 million Rural Social Development Programme, which aims at building the capacity of local CBOs and NGOs in basic social service delivery, and a € 25.2 million project on environmental rehabilitation in NWFP and Punjab, supporting local communities in the sustainable management of their natural resources. The latter two projects are in the early stages of implementation and no clear assessment can be made of actual results.

SAP was launched by the government in 1993 to expand and improve the scope of social services in elementary education, primary health, population welfare, and rural water supply and sanitation, including through NGOs, the private sector and local communities. With involvement of World Bank and other major donors, it serves as a means for policy dialogue with the government on social sector development. The first phase of SAP had a positive measured impact in terms of higher enrolment for girls, increased immunisation of children and better awareness on family planning. Disbursement, which were behind schedule due to management and governance problems as well as highly complex implementation arrangements, have been accelerated following the 11 September events.

In addition to funding relatively large-scale development projects, the EC has also provided support to smaller-scale interventions, often in collaboration with NGOs, in areas such as population welfare, income generation, drug demand reduction and rural health. These activities, although modest in terms of their financial scale, are significant not only in terms of direct impact they have on the local population, but also because of the lessons they provide about the most effective ways of collaborating with the local communities.

In 2000, an EC policy co-ordination process on democracy and human rights led to the identification of a number of priority areas for Pakistan in preparation of a call for proposals under the European Initiative for Democracy and Human Rights (Chapter B7-7 of the Budget), including (a) support for education, training and awareness in the area of human rights, (b) support for measures to protect minorities, (c) promoting and protecting the rights of children, (d) initiatives aimed at the abolition of the death penalty, (e) contributions to promoting and strengthening the rule of the law, the independence of the judiciary and a humane prison system, (f) promoting the participation of the people in the decision-making process in particular by promoting the equal participation of men and women in civil society, in economic life and in politics.

Activities under EC economic co-operation programmes have, in the past, had a strong focus on individual industrial sectors. Technical assistance has been provided to selected enterprises in the engineering sector, to manufacturers and exporters of leather products, to the jewellery sector, to horticultural enterprises, and to export processing zones. Emphasis was placed on assisting these enterprises to gain a better understanding of the European market, including quality standards and consumer preferences. Pakistan also benefited from a regional project to improve human resources in the tourism sector. More recently the emphasis has shifted to regional programmes, however Pakistan has to date only benefited from such programmes in a limited way.

5.2 Information on EU Member States Programmes and other Donors

Pakistan is a major recipient of loans from international financial institutions for its development, whereas grant aid from donor agencies has become less important over time. Donors took a more reserved approach towards Pakistan in recent years for various reasons: the nuclear tests, questions about democracy and human rights, the presence of corruption, high military spending and its still limited absorption capacity.

In spite of multiple political and social constraints affecting the country since independence, Pakistan has historically been a recipient of considerable foreign aid from the European Union (both from the Community and the Member States bilateral aid) and other donors. In consequence, Pakistan has developed a certain dependence on foreign aid, which is considered as “revenue” in the federal budget.

However, the results of co-operation over these years have been mixed. Despite the large amount of financial resources and expertise provided by donors, the stop-go pattern of implementing reforms by the Government and the general lack of absorption capacity with both governments and NGOs have hampered the achievement of concrete results, and indeed have often generated a broad sense of frustration. In regard to donor co-ordination, there is a good exchange of information at the aggregate level, but there could be improvement at the sectoral level.

The largest EU providers of bilateral aid to Pakistan have been United Kingdom, Germany the Netherlands and France. Their programmes are described in Annex 3 along with those of other major donors. It should be noted that the donor community, and in particular the US, has substantially re-engaged its co-operation with Pakistan following the 11 September events.

6 THE EC RESPONSE STRATEGY, COHERENCE WITH EU POLICIES, COMPLEMENTARITY WITHIN THE EU AND WITH OTHER DONORS

6.1 The EC Response Strategy

Poverty reduction and eventually eradication is the central aim of EU development policy. This is highly relevant in the case of Pakistan, since incidence of poverty is high at an estimated one third of the population and reportedly on the rise. A further key priority is linking development with trade and economic co-operation and furthering Pakistan's integration in the world economy.

Co-operation between the European Community and Pakistan is covered by a new 3rd Generation Co-operation Agreement which features "respect for human rights and democratic principles" as its basis under Article 1 and opens up new areas of co-operation, for instance regional co-operation, science and technology, energy, special measures against drug trade and money laundering.

The Community has in the past put too much emphasis on projects, spreading its resources too thinly over too many areas, thus limiting impact, especially since adequate government co-operation was often not forthcoming. On the basis of this experience it would seem appropriate that EC development aid should essentially be delivered through sectoral programmes, which would allow to achieve a critical mass for better impact of interventions and reinforces co-ordination with Member States and other donors. This being said, some room for projects should be kept, to be implemented primarily by NGOs and civil society organisations with a good track record of quality interventions. This would allow the Commission to build on its previous experience and maintain a sufficient degree of flexibility, while building up necessary know-how in sectoral programme design and management.

With the preparation of a Poverty Reduction Strategy Paper there is now a comprehensive approach based on economic growth, delivery of social services and improved governance as the main factors leading to poverty alleviation. A policy framework is thus being worked out which would enable EC co-operation programmes to reinforce Pakistan's own efforts towards overcoming its massive poverty problems.

Based on the above analysis the following two priorities have been identified for EC co-operation with Pakistan during the reference period:

1) **Human development in the education sector with focus on poverty reduction :** given Pakistan's bleak social indicators and the fact that it represents the 7th largest population in the world, targeted attention to this sector will receive priority attention in line with the overarching objectives for Community co-operation spelled out in Article 177 of the EU Treaty as well as the guidelines included in Council Regulation 443/92 on financial and technical assistance and economic co-operation with developing countries in Asia and Latin America. It is estimated that up to 80 % of available resources will be allocated to this area.

2) **Trade development and promotion of business and institutional links :** Pakistan is an important trading partner of the EU, however the current economic and commercial relations are below potential. There is a need for reinforced efforts aiming strengthening of economic institutions and commercial links to enhance Pakistan's capability to interact more effectively with the EU. Approximately 8 % of resources will be earmarked for these activities.

Other areas of great relevance include child labour, good governance, drugs and rural development. Other budget lines may address activities suitable to contribute towards restoration of democracy, as the EU considers the application of democratic principles is a fundamental prerequisite for economic and social development, the furthering of human rights, support towards HIV and population related operations, aid to uprooted persons and co-operation in the area of migration.

The Community will continue to actively engage in co-operation with non-governmental organisations, as it considers civil society one of the key pillars of its development policy. Close co-operation with and promotion of civil society is essential to ensure the widest possible participation of all sectors of society to provide the conditions for greater equity, inclusion of the poor in the benefits of economic growth and strengthening the democratic fabric of society.

6.1.1 Human development in the education sector with focus on poverty reduction

Contributing to the overall goal of poverty alleviation, human development in the education sector will receive priority attention as part of EC development co-operation with Pakistan. The focus will be on basic education. Education plays a strategic role in poverty alleviation and economic development, as better knowledge and skills enable people to better exploit economic opportunities. There is a strong causal link between poverty in Pakistan and the lack of commitment and public resources for educational development. However, it is not merely a lack of resources that explains the poor state of public infrastructure, rather the institutions responsible to provide social services have severe constraints in delivering to the target population.

SAP has been reviewed and the procedures for the release of outstanding tranches have been modified. The complex SAP reimbursement mechanism managed by the World Bank, while linked to funding a share of expenditures on agreed government programmes, had resulted in reduced or delayed donor disbursements. The new arrangement allows release of funds against process indicators of reform and reinforce EC support to the reform agenda in the social sectors, which has been given impetus by the devolution process and the preparation of a poverty reduction strategy to be funded from mid-2002 under a € 350 million World Bank Structural Adjustment Credit.

In the field of education, the EC will stay involved through a sector programme intervention, with the major aim of improving access to and enhancing the quality of basic education. While planning for a renewed major financial commitment, there is clearly a role for the Community to focus on quality and capacity issues as opposed to administrative questions related to disbursements which appear to have dominated over the policy dialogue so far.

Lack of good governance has been identified as a core impediment to socio-economic development in Pakistan and the government is fully aware of the need for an efficient, transparent and responsive administrative system. EC involvement in this field could be designed as complementing programme support in the education sector. Strengthening governance in connection with the devolution plan represents a formidable challenge, as the plan intends to increase the accountability of district governments in terms of delivery of basic social services to their population. The objective of a possible intervention would be to support institutional capacity building and managing educational service provision in a transparent, accountable and participative manner. Community participation and NGO involvement would be of particular value here.

Considering that the EC had a rewarding collaboration with NGOs in the education sector, especially with the Aga Khan Foundation on teacher training and raising the quality and accessibility of education, similar initiatives would benefit from further funding. Since some of the major NGOs benefit from a close working relationship with regional governments and engage themselves in the national dialogue on education policy, longer-term impact and sustainability of these programmes can be expected to be enhanced. However, while the tendency to increasingly channel resources through NGOs, often encouraged by the government, may be a solution in the short term, it will in the medium-term be necessary to restructure and revitalise public educational institutions to ensure sustainability. It may also be vital to facilitate alignment of the curricula of the madrassas to that of the public educational institutions.

Addressing gender disparities is a key objective of the EC's co-operation with Pakistan in the social sectors, as defined in the Council Resolution on Integrating Gender Issues in Development Co-operation. Particular emphasis will be placed on incorporating gender analysis in conception, design and implementation of programmes and projects in education.

Given the above, it is all the more important to further develop and strengthen the policy dialogue with the government on the quality of service delivery in education to cover topics such as the role of the public and private sector in the social sectors and what services they should provide, and restructuring public sector institutions and service delivery within the overall framework of decentralisation.

It needs to be pointed out, however, that the current levels of social sector spending, including donor contributions, are hardly sufficient to modify the country's social indicators in any significant way. There is even a danger that social indicators might deteriorate, given the country's high population growth. It is therefore difficult to define concrete indicators to measure success of EC involvement. The challenge is rather to stay involved and to contribute to improved delivery of social services through quality interventions and dialogue.

6.1.2 Trade development and promotion of business and institutional links

The key objective here is to engage Pakistan in the economic field, to foster trade, investment and business links which should contribute to the creation of income and employment. Given the positive correlation between economic growth and poverty such links should also support the aim of poverty eradication. Co-operation will be both through regional, demand driven programmes, as well as bilateral, targeted projects.

Experience with the use of economic co-operation instruments has been limited, in part due to the fact that that Pakistan's exports are heavily concentrated on textiles and in part due to the fact that the country lacks a dynamic sector of small- and medium-size enterprises willing to engage in new business/investor ventures in a competitive environment. It is also a factor that business confidence by third parties in Pakistan's economy has been lacking. Much will therefore depend on whether the Pakistani government is able – through the implementation of reform oriented macroeconomic policies and a more trade friendly attitude – to create a conducive environment for business to business ventures in trade and investment.

Nonetheless there is a continued need to provide improved opportunities for further increase and diversification of trade and investment for the mutual interest of the EU and Pakistan. The strategy for economic co-operation will continue to focus on programmes contributing to (1) strengthening Pakistan's economic institutions, policy instruments and infrastructure management, (2) trade development, an improved investment environment and enhanced business-to-business co-operation, (3) mutual understanding and co-operation in the academic, scientific and cultural spheres. Means of economic co-operation will encompass regional projects and programmes with decentralised implementation structures, including:

- The Asia-Invest programme was set up primarily to assist small and medium-sized European companies in investment decisions and matchmaking with potential Asian partners;
- A Regional Civil Aviation Programme will be launched offering possibilities for business-to-business links as well as co-operation on air-traffic management and other regulatory aspects;
- The Asia Information Technology and Telecommunications Programme (Asia – IT&C) has the aim to strengthen technical links between Europe and Asia and increase the integration of more Asian countries into the global information society;
- The Asia-Urbs Programme offers the possibility of co-operation between municipal authorities, there are currently three on-going projects in Pakistan. There is scope for assisting local municipal authorities in connection with the devolution process through strengthening the political, cultural and economic potential for decentralised co-operation with Europe focusing on the sharing of know-how and techniques;
- The Asia-Link Programme encourages and develops links between European and Asian institutions of higher education, thus facilitating the exchange and pooling of experiences among the academic community.

A reinforcement of the EC Delegation to Pakistan as part of the de-concentration effort should help in enabling a more pro-active approach through encouraging better participation in these programmes.

At the bilateral level, the EC and Pakistani authorities will identify suitable measures of trade development, taking into account the Doha Development Agenda, and institutional capacity building, which, inter alia, could address questions related to quality and standards, intellectual property rights, WTO issues, market access for textiles and other products, as well as co-operation in the areas of customs and statistics.

Pakistan has expressed interest in exploring possibilities for co-operation in the field of science and technology as one of the areas mentioned in the 3rd generation Agreement.

EC support for the European Studies facility of the Area Studies Centre of the University of Karachi is under implementation. In general, an institutional exchange programme involving Pakistani academics, businessmen, journalists and representatives from civil society could go a long way in deepening Pakistan's understanding of its major trading partner. The EC will make efforts to specify further initiatives suitable to contribute to this goal.

6.1.3 Other areas of co-operation

On 8 May 2001, the Commission adopted a new Communication on the role of the EU in promoting human rights and democratisation in third countries (COM(2001)252 final). This document encourages a complementary use of funding instruments for the promotion and protection of human rights. Whilst co-operation with states and especially in the field of economic, social and cultural rights should be undertaken through development assistance, the promotion of civil and political rights in co-operation with NGOs and international organisations can best be carried out through the European Initiative for Democracy and Human Rights. The implementation of the initiative will be subject to pluri-annual programming and the aim is to focus on a limited number of themes and countries. Pakistan has been declared a priority country under this initiative.

The forthcoming elections in Pakistan are an opportunity for Pakistan to demonstrate its commitment for a return to democracy, and for the Community to put into practice the principles set out in the April 2000 communication on EU election assistance and observation. A decision on whether the EU should field electoral observers will be taken closer to the October 2002 elections. The Community is further providing electoral assistance for the forthcoming general elections, comprising public awareness and civic education campaigns as well as promoting inner-party democracy within political parties.

The EC is currently supporting a programme which addresses the multi-faceted problems of child labour through measures of prevention, withdrawal and rehabilitation. It is foreseen that support in this field should continue.

The EC may also consider co-operating through NGOs and community-based organisations on poverty alleviation schemes, which could involve provision of micro-credits to individuals and grants and technical assistance to communities for small infrastructure projects such as water supply schemes and roads. It is envisaged to co-operate with civil society in the field of population, focusing on reducing maternal mortality by developing community-based intervention strategies to help increase the utilisation of existing reproductive health services. The Community supports the Asia Initiative for Reproductive Health, a regional programme implemented through UNFPA, where Pakistan is one of the beneficiary countries.

The EU follows an integrated approach with respect to drugs, combining repressive policies with efforts to reduce consumption of drugs. Pakistan is neighbouring Afghanistan, one of the world's biggest producer of illicit heroin, and faces a rising addiction problem, with severe health and criminal effects. The Community is prepared to consider NGO projects on demand reduction in target sectors of the Pakistani population. This would also be important for limiting the spread of HIV/AIDS.

Civil society in Pakistan is in great need of a legal framework within which it can operate. To this extent the government has invited civil society to draft legislation itself by summer 2002. Considering the fact that a large part of present and future assistance is channelled through civil society, this process is most urgent and may benefit from support under the Rapid Reaction Mechanism. In order to provide enhanced flexibility for co-operation with civil society, Pakistan will benefit from a Small Project Facility, following completion of de-concentration to the Delegation.

In view of Pakistan's location in a volatile region, with fears of continuing instabilities in neighbouring Afghanistan and a high level of tension with India over Kashmir, there is a need to further develop suitable measures in confidence building and conflict prevention under active involvement of Pakistan, including civil society.

Special attention should be given to the rising phenomenon of illegal migration and trafficking in human beings which requires increased co-operation between the EU and Pakistan. Following establishment of a legal base under the Amsterdam Treaty (Art. 63.3 b) the Community has been authorised to conclude readmission agreements with a number of third countries, including Pakistan. Efforts in this field will be reinforced with projects under a new budget line for co-operation with third countries in the area of migration, if appropriate.

Pakistan hosts around 1,200,000 refugees from Afghanistan living in camps who fled to Pakistan in several waves during prolonged conflict and more recently drought. Beyond that, the number of Afghan refugees competing for scarce resources in urban areas is around 1,800,000 according to government sources. For several years Pakistan has been exhibiting signs of asylum fatigue, in November 2000 this culminated in the decision to close borders to new arrivals. Nevertheless the post 11 September crisis triggered a fresh influx of refugees.

Afghan refugees in Pakistan have benefited from three budget lines, i.e. (a) for aid to uprooted people, (b) for food aid and food security and (c) for humanitarian and emergency aid. In 2001, approximately € 100 million were committed to the Afghan crisis, although it should be said that the bulk of assistance is provided in Afghanistan itself. A new regulation on uprooted people has been approved by Parliament and Council and the related programming is underway. ECHO continues to provide medico-nutritional projects, shelter construction and water and sanitation in the camps.

The Community is further committing, still in 2001, a project in the livestock/veterinary services sector, with the aim to improve farmers' livelihoods through better provision of livestock services, especially disease control. The majority of beneficiaries engage in smallholder production characterised by small herds. The project is thus expected to contribute to the overall aim of poverty alleviation in Pakistan.

6.1.4 EC response to the crisis in the region surrounding Afghanistan

Without the September 11th events and Pakistan's crucial role in confronting the ensuing crisis, co-operation (kept at a low level since the military take over in October 1999) was set to gradually resume in 2001/2002, in the light of the government's continued commitment to the road-map to democracy (announced in August 2001 and leading to general elections proposed for October 2002) and the relatively good reform track record of the Musharraf government.

Against this background, a Country Strategy Paper for 2002 – 2006 was under preparation. With approximately 15 M€ per year from the multi-annual Asia budget allocation (earmarked for up to 80% to Education, 8% to trade development and economic co-operation and 12% to various other activities such as good governance, rural development initiatives) the programme would have been comparatively modest and limited in impact.

A Ministerial Troika visit to Pakistan on September 25th paved the way for an accelerated increase of EC assistance to Pakistan in view of helping this country to address the economic and political problems faced as a consequence of the international crisis in and around Afghanistan. The General Affairs Council of October 8th 2001 concluded that the dialogue with Pakistan should be further developed and that Community assistance should be reinforced.

On the **political front**, the EC decided to resume the regular political dialogue and propose the advancing of the signature of the 3rd generation co-operation agreement, now accomplished on 24 November 2001 during a visit to Islamabad by Prime Minister Verhofstadt and President Prodi.

Regarding **development co-operation**, Commission services were asked to provide an aid-package which could both have a quick economic impact and meet overall EC development policies. With this objective in mind, an additional 50 M€ were earmarked for 2002 from the Asia budget in support of a Financial Services Reform Programme. Community assistance will be primarily used to encourage further improvements in the regulatory environment, the reinforcement of institutional capacities and in regard to improving services of financial institutions and emphasising greater outreach in rural areas, based on mutually agreed indicators. The programme will contribute towards Pakistan's Poverty Reduction Strategy.

Furthermore, it was proposed to accelerate the disbursement of €31 million originating from an ongoing Social Action Programme (SAP), provided problems encountered in the implementation done jointly with the World Bank could be solved.

Lastly, it was agreed to commit, in 2001, 22,9 M€ for a pipeline project aimed at strengthening livestock services also under the perspective of assisting Pakistan in the provision of services in a time of exceptional budgetary squeezes.

These three initiatives combined make up a 100 M€ special aid package, of which 50% are additional, and 50% have been accelerated.

On the trade side, the Commission showed great flexibility by proposing to the Council increased market access for Pakistani textiles and clothing to the European market for the period from 2002 – 2004. These measures, which have been agreed, foresee quota increases for Pakistani textiles and clothing by 15% against improved access for EU clothing and textile exporters as well as the introduction of Pakistan into the special drugs regime under the new Generalised System of Preferences (GSP) Scheme. This highlights the importance the Community attaches to the complementarity of trade and development, and is also evidence of a concerted Community response to the current crisis.

6.2 Coherence with EU Policies and Complementarity within the EU and as well as with other Donors

The strategy outlined in this paper is coherent with relevant EU policies. The overall objective of EU co-operation with Pakistan is fostering sustainable economic and social development while helping to reduce poverty and contributing towards Pakistan's integration into the world economy. The priority sectors outlined above take account of these issues, by focusing on human development in the social sectors as well as trade development and business facilitation.

The strategy is fundamentally compatible with the EU's political objectives. First and foremost, the EU is interested in seeing Pakistan return to a stable democracy. The proposed EC priorities should help to contribute towards sustainable economic development and social stability.

The current administration is putting emphasis on economic and institutional reforms, arguing that current restrictions on political freedoms are necessary in order not to distract from this task. The European Union continues to believe that the promotion of democratic principles is essential for economic and social development and that the period of transition to democracy requires an atmosphere of trust.

The European Union is deeply concerned about how the precarious security environment in South Asia is affecting economic prospects for the entire region. In this connection Pakistan should be encouraged, in as far as conditions allow, to contribute towards regional co-operation suitable to enhance political and economic confidence amongst the nations of the sub-continent. The Community follows the SAFTA process with interest and is prepared to contribute to the advancement of SAARC.

In the field of trade policy, the Community will continue to make efforts to convince Pakistan that there are mutual benefits to be gained during a new round of comprehensive WTO negotiations. Pakistan considers that it is put at a disadvantage by the "Everything but Arms" initiative, which grants duty- and quota-free access to the European market for least-developed countries. Such concerns are best addressed in a new round.

In regard to the "policy mix", recent proposals on increased market access for Pakistani textiles and clothing to the European market highlight the importance the Community attaches to the complementarity of trade and development. The restoration of democracy and support to human rights concerns form an active part of the Community strategy, thus contributing towards socio-economic development.

The matrix on donor co-ordination under Annex 3 shows how EC actions relate to those of Member States and other donors. Duplication is avoided by ensuring consultations at various levels to improve coherence, in particular at the EU level. The process of establishing the CSP and the new multi-annual planning cycle should allow for an even more effective co-ordination in future.

There is broad agreement amongst donors, both at EU Member States level, as well as other donors operating in Pakistan (especially those providing grants) on the development needs and priorities of the country. Indeed, those donors still active in the country already operate together either in the social sector, or in environmental rehabilitation in a broadly complementary manner. In the specific case of the Social Action Programme the resources of all the Donors involved (WB, ADB, EC, DFID, Netherlands, CIDA) have added political weight to the programme.

7 A TENTATIVE WORK PROGRAMME

Development Co-operation

The proposed new initiative in the area of micro-credit financing institutions will be finalised in early 2002 (with a final discussion foreseen with Pakistani officials in Islamabad) and will be presented to the ALA-committee in March 2002.

The Community will launch a programming mission to identify areas of possible future intervention in the area of education with emphasis on poverty reduction. This activity was planned for 2001 but had to be delayed for security reasons in view of the Afghan crisis. A more detailed programming document will be prepared during the first half of 2002. A programming mission in early 2002 will take possible measures in the field of good governance related to education into account, after the new allocation of administrative and financial powers related to the devolution plan has been clarified.

Support to European NGOs with an interest in operating in Pakistan through co-financing will continue. Humanitarian initiatives will be undertaken following established procedures if and when the need arises.

Economic Co-operation

The Community plans to field a programming mission in early 2002 to look at possible trade development measures as well as activities suitable to enhance mutual understanding between the European Union and Pakistan by way of institutional co-operation and networking.

Asia-wide economic co-operation instruments such as Asia-Invest, Asia-Urbs, Asia-Ecobest, Asia-IT&C, Asia-Link can build on the interest generated among Pakistani counterparts following in-country information seminars. Detailed implementation activities under these programmes should be further encouraged and pursued.

Human Rights/Democracy

An exploratory mission in preparation of a possible observation of the October 2002 elections to the National Assembly will be carried out in March 2002.

A programming and identification mission under the European Initiative for Democracy and Human Rights is scheduled for April 2002.

A NIP (Order for Services) for the period 2002-2004 will be developed on the basis of the above-mentioned programming missions.

PAKISTAN : SOCIO-ECONOMIC INDICATORS (2000, most recent estimates)

Poverty and Social	
Population, mid year (millions)	138.1
GNP per capita (Atlas method, US \$)	490
GNP (Atlas method, US \$ billions)	68.3
Population growth (% of annual average, 94-00)	2.4
Labour force growth (% of annual average, 94-00)	3.0
Poverty (% of population below national poverty line)	33
Urban population (% of total population)	37
Life expectancy at birth (years)	63
Infant mortality (per 1.000 live births)	90
Child malnutrition (% of children under 5)	38
Access to improved water source (% of population)	88
Illiteracy (% of population age 15+)	54
Gross primary enrolment (% of school-age population)	74
Male	101
Female	45
Structure of the Economy (% of GDP)	
Agriculture	26.3
Industry	23.3
Services	50.4
Prices and Government Finance	
Consumer price increase (%)	3.6
Current revenue (% of GDP, includes current grants)	16.5
Current budget balance (% of GDP, includes current grants)	- 3.5
Overall surplus/deficit (% of GDP, includes current grants)	- 6.5
Trade (US \$ millions)	
Total exports (fob)	8.569
Total imports (cif)	10.361
Balance of payments (US \$ millions)	
Exports of goods and services	9.678
Imports of goods and services	11.818
Resource balance	- 2.140
Net income	- 2.065
Net current transfers	3.195
Current account balance	-1. 010
External Debt and Resource Flows (US \$ millions)	
Total debt outstanding and disbursed	33.272
Total debt service (Medium and LT)	4.277

Source : Pakistan at a glance, World Bank 16/05/2001

OVERVIEW ON DONOR PROGRAMMES IN PAKISTAN

United Kingdom

Following the military take-over of October 12, 1999, the UK froze its government to government bilateral aid to Pakistan. Annual expenditure was about £40 million, managed by DFID (Department for International Development), on purely grant terms, encompassing both technical co-operation and financial aid, both to government and NGOs.

In May 2000, DFID informed the Government of Pakistan of a resumption of aid to government in support of stated key reforms in pro-poor areas of the government's reform process. In May 2001, a more strategic approach was developed focussing on three objectives to help reduce poverty:

- creating the economic conditions for poverty reduction
- improving health outcomes
- improving education outcomes

DFID provides a range of support for the social sectors. A major component of involvement in Pakistan's development is through the Government of Pakistan's Social Action Programme, which seeks to increase investment in key social services and to improve access to and the quality of:

- primary and elementary education
- primary health care
- rural water supply and sanitation

DFID also supports the government's aim to increase the demand for family planning and the use of modern contraceptive methods through the public and private sectors and through non-governmental services.

DFID also has a substantial programme of assistance (approximately £10-12 million annually) through non-governmental organisations and supports a number of rural support programmes throughout Pakistan, including the Aga Khan Rural Support Programmes in Chitral and Gilgit. These programmes help to establish community organisations, which become integral to village life and, eventually, district level governance.

Following 11 September, £11 million of short term assistance has been allocated to help host communities affected by the refugee influx. In recognition of progress with economic reform to date and linked to a new Poverty Reduction and Growth Facility with the IMF, the Secretary of State has also approved £15 million of budgetary aid (rising to £45 million in 2002/03). This is in addition to the ongoing technical assistance programme. In total, DFID's Pakistan programme is likely to amount to £65 million in each of the next three years.

Germany

German development co-operation began in 1961 and has represented a vital part of its relations with Pakistan. For the period 1997/98 an amount of about €35 million was initially committed for technical and financial co-operation. However, the political events in Pakistan since May 1998 (nuclear tests) led to a temporary interruption of collaboration. Therefore the assignment for 1998/99 dropped to €4.5 million to assure the financing of ongoing basic need projects.

Germany is currently fully restoring bilateral assistance, having ranked Pakistan amongst its priority partner countries already in September 2000. Priority areas of co-operation are, inter alia, health and renewable energy. Bilateral negotiations took place on 3 – 5 December 2001. Financing for 2001 development co-operation was increased to €25 million. In addition, food emergency aid to Pakistan is provided since late spring (€0.85 million).

Pakistan was offered €25 million debt-for-development swaps for 2001, an additional offer of the same volume for 2002 is under consideration. Bilateral debt (€145 million) has been rescheduled in May 2001. Germany fully supports generous debt rescheduling within the Paris Club, especially in order to ease peak dues over the coming 3 – 4 years. Export credit insurance is currently provided for an export volume of €50 million.

Netherlands

Since 1957 the Government of the Netherlands has been closely engaged with the promotion of social, economic and ecological development in Pakistan, with an overall disbursement of about €590 million in grant aid.

Annual disbursements since 1990 have varied between €14 - 28 million, to finance a large number of projects with the principal aim of alleviating poverty. Other goals include good governance, participation of women in political decision making and the development process, and environment. The Netherlands is contributing to the Social Action Plan €17 million for a period of 5 years, focussing on basic education and population issues.

In July 1999 the Government of the Netherlands decided to discontinue its structural development co-operation programme with Pakistan. Instead, it proposed a more focussed relationship targeting good governance, human rights, democratisation and environment. In December 2000 it was decided that pivotal elements of the reform agenda of the Government of Pakistan could be supported on a government to government basis.

France

France's development co-operation activities support infrastructure, where priorities are energy, rural telecommunications, water treatment, irrigation and health-related projects. More than €400 million in soft loans were committed in this field over the past decade. For 2001, France is contemplating the possibility of financing a water treatment project of €20 million.

French funds are also directed towards supporting France-Pakistan co-operation in culture, science and technology, and development projects. Since 1995, more than €1.6 million of grants annually have been allocated for this purpose. Activities include language training, academic research and technical assistance.

At the multilateral level, France is one of the major contributors to the rescheduling of Pakistani debt by the Paris Club agreed on 23rd January 2001, its share amounting to nearly US\$300 million out of US\$1.8 billion.

Other EU Member States activities in Pakistan

Spain has provided about €95 million in mixed loans for infrastructure, health and environmental sectors. Italy contributed emergency food aid and support to tuberculosis control programmes. Other EU Member States have been active in Pakistan with co-operation through their national NGOs.

World Bank

Since 1952 the Bank has approved 237 loans for Pakistan amounting to about US \$13 billion (IDA US \$6 billion and IBRD US \$7 billion) of which US \$10 billion has been disbursed to date.

To date loans have been used for human development (in particular Social Action Programme), infrastructure (major highways, Indus Basin System, Mangla, Tarbela & Gazi Barotha dams, major irrigation and drainage, oil & gas, power transmission, distribution and generation), rural development and finance (banking sector reform).

The Bank's ongoing assistance strategy is focussed on promoting pro-poor and sustainable economic growth, investing in people and raising productivity. The Bank is involved in a dialogue on fiscal reform and restructuring public expenditure to improve public service delivery, including devolution to local governments, communities and the private sector. The Bank further offers advice on structural reforms in several areas, including power, oil and gas, banking, infrastructure, rural development, education and health, and private sector development.

World Bank operations under discussion are: a Structural Adjustment Loan (to support reforms in governance, energy, tax, banking, oil & gas, public expenditure), a Power Sector Loan (to support restructuring of WAPDA), and a Provincial Farm Water Management Project (to support farm investments in all provinces).

Asian Development Bank (ADB)

In Pakistan ADB has traditionally financed projects in agriculture and natural resources, the social sectors, industry and finance. However, due to the constraints of recent years in Pakistan, the current portfolio of ADB projects has shrunk. The operational framework of March 1999 reflects changed economic circumstances faced by Pakistan following the nuclear tests, with emphasis on improving economic efficiency and export competitiveness, human and social development, and strengthening governance. A new operational strategy will be formulated in 2001, and is expected to focus more directly on poverty reduction.

Cumulative ADB lending to Pakistan as of 3rd December 2000 was US\$ 10.5 billion. In 1999 the net flow of ADB financing to Pakistan was only US \$10 million, (Pakistan received US \$473 million and repaid US \$463 million). In 2000, ADB approved seven loans totaling US\$ 707 million for the rural development, industry, financial and energy sectors. ADB's contributes to the Social Action Programme (about US \$200 million). For 2001, the ADB has increased its assistance from a planned US \$ 626 million to US \$ 950 million to help reduce Pakistan's economic and financial difficulties. The additional US \$ 324 million will be provided on a fast-track basis.

Other Donors' activities

Other Donors currently active in Pakistan are: WFP (World Food Programme), UNDP UNICEF, ILO, NORAD (Norway), CIDA (Canada) and JICA (Japan) and the Swiss Co-operation, involved mainly in projects in the social sector (with a particular emphasis on gender, child labour, reproductive health) and environmental protection. CIDA is also partner in the Social Action Programme.

Matrix for EU Donor Co-ordination

Annex 3

	CEC	Member States	Other donors	EC Commitments (Meuros)	EC Disbursement (Meuros)	Comments
Agriculture and Food Security	X	G-UK	WB-UN-A.DB-Japan-CIDA-Australia	6.3	3.7	Agricultural sector does not appear to be a priority for most EU MSs but actions for improving the production method and for agri research activities are financed. Support in this area is being given importance by all important donors. Human resource development and sectors are key elements of the EC Strategy.
Support to the social and economic reform process - Human Resource development, education, training, academic exchanges -Promotion of WTO integration - Support to economic reform and promotion of market economy - Accompanying social consequences of reform and supporting employment and income generation activities - Linkages between enterprises (S\4Es), cities and regions	X	F-G-IT-AR.-ES-SW-UK	WB-UN-ADB-Japan-CIDA-Australia-US UN ADB-WB-UN	125.4	42.1	
	X	G-ES	WB-ADB-Japan-CIDA			
	X	F-G-N-ES-LTL:	WB-ADB-Japan-CIDA-Australia			
	X	F-G-NL-UK				
Environment - Environmental standards and enforcement, policy advice - Clean energy technologies, clean coal, natural gas, energy efficiency - Biodiversity/protection - Forestry - Water conservation	X	F-G-Ni= ES-UK F-G-NL-ES-SW-UK	WB-ADB-UN-Japan-Australia WB-ADB-UN-Japan-SDC	30	8.8	The environment sector is <i>given</i> a priority by almost all the donors. EC is financing one of the major projects in the forestry and environment sector tin Pakistan. Individual FU AM also have projects targeting forest conservation.
	X	G-F-Fin	SDC-Norway			
	X	G-NL-F	WB -ADB-SDC			
		NL-G-1TL	ADB-UN-WB			

Good governance and strengthening of the rule of law						
- Administrative reform		UK	ADB-WB-Japan-UN			ADB, WB, UN and Japan are the major donors in this area,
- Support to legal and judicial development	X	UK	ADB-WB-Japan-UN			
- Human rights (civil and political, economic and social)		F-G-UK-NL~S	ADB-WB-Japan-UN			
- Strengthening of civil society through support to NGOs	X	F-G-UK-NL-S	ADB-WB-Japan-UN			
Multisectoral/Cross cutting						Human Resource Development, poverty reduction, education and primary and reproductive health are the major cross cutting themes of all the donor funded projects in Pakistan.
- Multisectoral aid for basic social services	X	F-G-N'L-ES-S-I-S-UK	ADB-NVB-Japan-UN			
- Urban development and management	X	F-G-NL-ES-S-I-S-	ADB-WB-Japan-UN			
- Rural Development	X	F-G-NL-ES-S-I-S-UK	ADB-WB-Japan-UN			
- Multisector education/training	X	F-G-NL-ES-S-I-S-UK	ADB-WB-Japan-UN			