

Do fragile and conflict-affected countries prioritise core government functions?

Stocktaking public expenditures on public sector
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4 | Pakistan's transition from military rule to democratisation

June 2019

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Preface

This research explores the relationship between ‘core government functions’ (CGF) and transitions in fragile and conflict-affected situations (FCAS), using the context of five countries including Colombia, Myanmar, Pakistan, Sierra Leone and South Sudan as case studies. The report is part of a multi-country research project commissioned by UNDP that seeks to understand whether (and how) prioritising public spending on CGF can lead to more successful transitions towards peace in fragile and conflict-affected countries. It aims to do this by comparing the experience of different FCAS countries and assessing the extent to which these transitions have been facilitated (or not) by increased investment to rebuild CGF.

CGF are described as those functions that ‘are required to make and implement policy’ (UN-World Bank, 2017) and are defined as:

- **Executive coordination at the centre of government:** the ability of the core executive to effectively integrate central government policies across the public sector and act as the final arbiters between different elements of the government apparatus.
- **Public revenue and expenditure management:** the ability of the government to raise adequate levels of revenue and to spend it effectively, in order to meet the basic service delivery needs of the general population.
- **Government employment and public administration:** the ability of the government to establish basic capacity for defining and administering policies, regulations and programmes, in order to provide public services in a professional and transparent manner.
- **Local governance:** the extent to which the government has been able to establish political and institutional structures and processes at the subnational level, which are responsive to the specific needs of diverse local populations.
- **Security sector:** the ability of the government to restore order and provide basic security for the population, consistent with a political settlement that enables the economic and social functions of society and local communities to resume.
- **Aid management:** the ability of the government to establish developmental partnerships and effectively manage external resources by directing them towards strategic priorities in line with national development plans.

Rebuilding CGF which are responsive and legitimate are viewed as critical undertakings for countries transitioning out of conflict. However, evidence of the connection between public spending and institutional restoration and resilience is sparse. While there are a number of studies which link public spending with improvements in institutional capacity to deliver necessary services, such evidence is largely absent from contexts of conflict and fragility. This research aims to begin addressing this gap.

Acknowledgements

This research was prepared under the direction of Jairo Acuña-Alfaro, Policy Advisor, Core Government Functions and Public Service Excellence at UNDP. It was developed under the supervision of Jose Cruz-Osorio, Team Leader, Responsive and Accountable Institutions Team, and Samuel Rizk, Team Leader a.i. Conflict Prevention, Prevention and Responsive Institutions Team. Patrick Keuleers, Director and Chief of Profession of Governance and Peacebuilding provided overall guidance. It received comments and feedback from Aditi Haté, Policy Specialist, Core Government Functions and Recovery, Pelle Lutken, Policy Specialist, Core Government Functions and Amita Gill, Policy Specialist Local Governance at UNDP's Governance and Peacebuilding cluster in New York.

The synthesis report was written by Yadaira Orsini and Jo Robinson from the Conflict, Security and Violence Team at Oxford Policy Management, with substantive inputs from Jairo Acuña-Alfaro, from UNDP.

Several authors contributed to the writing of the respective case studies as follows: Colombia by Yadaira Orsini and Dayna Conolly; Myanmar by Nick Travis and Thet Aung Lynn; Pakistan by Kiran Tariq; Sierra Leone by João Morgado and Jo Robinson and South Sudan by Florian Krätke and Manisha Marulasiddappa.

The authors would like to thank everyone who contributed to this research, including respondents from the five country governments, think tanks, donor agencies, NGOs and independent researchers, who took time to meet and share their knowledge and experience. Their insights have proved invaluable.

This research was produced in consultation with members of the UN Interagency Platform on Core Government Functions in Countries Impacted by Fragility and Conflict (IPCGF). The Interagency Platform is co-chaired by the United Nations Development Programme (UNDP) and the United Nations Department of Political and Peacebuilding Affairs (DPPA) and comprises of the UN Secretariat and UN agencies, funds, and programmes mandated to and involved in supporting the strengthening of CGFs in fragile and conflict-affected settings.

The research would not have been possible without contributions from the research team; Dayna Connolly, Alistair Grattidge, Florian Krätke, Thet Aung Lynn, Manisha Marulasiddappa, João Morgado, Kiran Tariq and Nick Travis, who variously supported the design of data collection tools, conducted field visits and undertook quantitative and qualitative data analysis. The authors are extremely grateful for all their hard work and critical insight. Particular thanks goes to Henlo Van Nieuwenhuyzen for his insightful and valuable comments on the draft of this report.

Any faults with the substance or analysis within the report rest solely with the authors.

UNDP led the development of this research with the generous support of the Government of Switzerland.

Executive Summary

Re-building Core Government Functions (CGFs) which are responsive and legitimate is a critical process in a country transitioning out of conflict. Although there is much evidence to support the need for effective government institutions to sustain transitions away from conflict, understanding what is required to successfully develop institutional capacity within core government apparatus in fragile and conflict affected situations (FCAS) is a largely neglected area. Indeed, evidence of the connection between public spending, institutional restoration/reform and resilience is sparse in FCAS. Addressing this gap in understanding is increasingly important in light of the continuing trend towards the concentration of poverty in FCAS.

With its ambition to leave no one behind, the 2030 Agenda poses great demands on governments core functions and institutions to provide integrated and multidimensional responses to development challenges. This is particularly relevant to countries affected by fragility and conflict, as the public administration becomes the chief provider of social protection and public goods while co-existing among formal and informal ineffective political power arrangements. These arrangements are products from protracted struggles between the various powers competing for control over resources.

The public administration of any country, developed, developing, or fragile, embodies a large and complex set of issues, procedures and structures related to the management of personnel, institutions and relationships. These issues are exacerbated in developing and fragile settings given their nascent institutions and the pressures deriving from the dependency of socioeconomically disadvantaged groups on the public sector.

The challenges associated with conditions of fragility and violent conflict are daunting and multidimensional. The strengthening of public institutions is at the heart of Sustainable Development Goal 16, as it aims to enable core functions of government as an essential strategy to promote just, peaceful and inclusive societies. It encompasses both technical and political aspects associated with the functioning of the government apparatus and the delivery of public services and goods.

By testing the hypothesis that - *Fragile and conflict-affected governments that prioritise restoring core government functionality in their national budgets are more successful in their transitions towards peace and development* – this study aims to assess whether countries that prioritised CGFs had better peacebuilding and state-building outcomes and to better understand whether, and how, prioritising spending on CGFs can lead to more successful transitions towards peace in FCAS. Quantitative and qualitative data has been collected across five case study countries: South Sudan, Myanmar, Colombia, Pakistan, and Sierra Leone.

In order to test this hypothesis, the research asked four key questions for each of case study countries. The questions and our findings are presented below.

1. What areas are prioritised in government expenditures in FCAS?

- Quantitative analysis of CGF spending over the full period of transition in each country demonstrates the primacy of the security sector in each case, and equally the lack of prioritisation given to the public administration sector.
- The type of transition influences the space for, nature and timing of specific reform, but restoration is never truly ‘starting from scratch’ and destruction through conflict will not necessarily erase the challenges which existed in previous institutions.
- What is common to all the case studies is the strength of the executive and the centralisation of political power, in opposition to devolution and effective local governance.
- Technocratic reforms such as in public revenue and expenditure management, and to a lesser extent public administration, tend to be more resilient even in complex political contexts, ongoing fragility and protracted crises.
- Successful reform is possible when there are reform-minded officials; ‘champions’ within ministries - even where the political leadership is not prioritising a particular reform agenda.
- Similarly, technocratic leadership has supported some of the most successful reform processes.

2. Do spending priorities change before, during and after a violent conflict? Does priority national budget spending shift in particular areas and timeframes during a transition?

- Timing and sequencing of reforms across the core government functions remains a challenging process to unpick.
- For countries facing protracted crisis, notable escalations of violence triggered a prioritisation of the security sector across the transition timeline.
- Commitments resulting from peace agreements or political settlements have considerably influenced spending patterns and government priorities.
- Security sector reform emerges as one of the most urgent priorities in many contexts, but is often highly politicised and requires government and donor alignment for meaningful and more transformative reform to take place.
- Expenditure is not the only indicator of prioritisation, or of improved functionality.

3. Are public expenditures and donor commitments on core government functions conducive and aligned to their restoration needs in fragile and conflict-affected settings?

- Donor commitments in protracted crises face challenges in the context of multiple transitions and cyclical phases of violence.
- Donor priorities have also shifted within particular functions over the course of transitions in protracted crises.
- In some cases, donor prioritisation of CGFs seems to wane after a certain period of time from the formal end to the conflict, or a key moment of transition (even where underlying fragility remains), and in situations of protracted crisis

- There does not appear to be a quantitative relationship between government and donor spending on core government functions over the transition periods we have investigated.
- The extent to which reforms can be donor-driven is closely linked to the financial influence of donors.
- Successful reforms have often come about when donor and domestic priorities align, and the best examples of success occur when there is sustained national ownership and leadership.

4. What implications does this have on the risk of relapse into conflict?

- Quantitative analysis shows little connection between government effectiveness and fragility.
- Lack of reforms or incomplete reforms are more connected to risks of conflict relapse than (increasing or decreasing) levels of expenditure.
- Similarly, and particularly in contexts of protracted crises, reform processes which are not inclusive or only provide benefits to a particular group (unless such efforts are intended as a protection measure) are un conducive to supporting peaceful transitions.

Conclusions

Our findings indicate that the research hypothesis does hold when three key conditions are true:

1. **When CGFs are prioritised by both governments and donors, and there is continued national ownership and leadership** for expenditure in particular areas to support meaningful reform.
2. **When CGFs are prioritised before the formal end of a conflict, and continue to be over a sustained period of time, even in protracted crises to deliver ‘complete’ reform**, rather than initial prioritisation and then a gradually declining interest by both governments and donors.
3. **When expenditure results in reforms which are genuine and equitable, benefitting society at large** rather than only a particular group or set of groups within it, or when expenditure on a function is being instrumentalised by the government for its own political agenda.

Since levels of expenditure and increased functionality are difficult to trace, the question of what success looks like remains open. For the purposes of this study, an indicator of success is a reduction in the risk of relapse into conflict. Success in CGF spending also encompasses other aspects such as service delivery, which points to a need to further unpack this idea and adapt it to what it looks like in each country.

Recommendations

In light of these findings, the research puts forward six key recommendations for the donor community:

1. Understand expenditure within the broader political economy to unpack the incentive structure behind potential government support (or not) for specific reforms, and drivers of particular prioritisation.

2. Engage consistently and continuously, even in the most challenging situations.
3. Tackle the challenging reforms early on, not only the short-term fixes.
4. (Re)Conceptualise transitions to develop a more nuanced understanding of the type of transition - or multiple transitions - a country is undergoing.
5. Raise the profile of the debate around CGFs, and promote the framework.
6. Understand what the picture of CGF expenditure and reform looks like in more FCAS contexts.

Pakistan's

*transition from military
rule to democratisation*

List of abbreviations

CGF	Core Government Function
CIGI	Centre for International Governance Innovation
DAC	Development Assistance Committee
DFID	Department for International Development
FATA	Federally Administered Tribal Areas
GDP	Gross Domestic Product
GST	General Sales Tax
IGC	International Growth Centre
IMF	International Monetary Fund
KP	Khyber Pakhtunkhwa
MDTF	Multi Donor Trust Fund
MTBF	Medium Term Budgetary Framework
NACTA	National Counter Terrorism Authority
NFC	National Finance Commission
NRB	National Reconstruction Bureau
OECD	Organisation for Economic Co-operation and Development
PCNA	Post Crisis Needs Assessment
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
PIDE	Pakistan Institute of Development Economics
PIFRA	Project for Improvement in Financial Reporting and Auditing
PKR	Pakistani Rupee
TARP	Tax Administration Reform Project
UNDP	United National Development Programme
US	United States
WDR	World Development Report

13 Introduction

The constant presence of tension and violence in Pakistan has severely hampered its transition from military rule to democracy, and the resulting reform of key state institutions.

As we shall see, Pakistan's is a fragile transition process that is endeavoring to address multiple sources of conflict, many of which are not even directly related to, or a consequence of, the military rule.

Although on the surface the transition to democratisation has been underway since 2008, the process has been constantly threatened by political, religious and economic dynamics. The country faces additional complexities related to the separate governance and law and order framework in the tribal areas, the ongoing ethnic violence in Balochistan and Karachi, and the war on terror spreading from neighbouring Afghanistan.

13.1 Objective and approach

This report is part of a cross-country study aimed at comparing experiences of countries transitioning out of conflict and the level to which they are invested in rebuilding core government functions (CGF). The study seeks to test the following hypothesis, formulated by UNDP: *'fragile and conflict-affected governments that prioritise restoring core government functionality in their national budgets, as well as their spending of humanitarian and development aid, are more successful in their transitions towards peace and development'*.

The study consists of five cases⁴⁵, which aim to better understand whether (and how) prioritising spending on core government functions can lead to more successful transitions towards peace in fragile and conflict-affected countries. Specific 'transition milestones' were identified around which to frame the analysis for each case study.

The study has used a mixed methods approach combining qualitative key informant interviews (KIIs) with quantitative expenditure trend analysis⁴⁶ across each of the CGFs. A certain number of methodological assumptions have been made to inform the latter, which are explained in detail in Annex B.

The Pakistan case offers a chance to explore spending on CGFs in a country undergoing a transition from military rule to democracy, in a state with a highly decentralised local governance structure, the presence of terrorist threats and long-standing ethnic violence. From our selection of case studies, Pakistan (and to a lesser extent, South Sudan) is perhaps the best example of what the 2011 WDR describes as 21st century conflicts: cycles of repeated

⁴⁵Five countries were chosen: Myanmar, Sierra Leone, South Sudan, Pakistan and Colombia

⁴⁶A trend analysis of public spending on core government functions (CGF), using two processes. Firstly, an overview of the composition of expenditure and revenue as well as the sustainability of public finances (e.g. fiscal balance) throughout the transition processes to understand whether variations in CGF-related expenditures were part of broader structural changes or isolated events surrounding transition points. Secondly, an in-depth analysis of CGF-related spending within the 16 year time-span surrounding the identified transition milestones, to explore whether these changes in public spending were motivated by the prioritization of certain policies/functions or by the availability (or lack thereof) of public resources.

violence, instability and weak governance either nationally or sub-nationally. In this sense, Pakistan does not fit the 'traditional' conflict model of civil war leading to a collapse of government functions, which ended followed by investment in core government functions ushering in a rebuilding of government capability. In two important aspects, Pakistan's situation is different from the traditional model: (i) the country maintains a high level of security expenditure and capability driven by the need to respond to possible conflict with India, interspersed with an internal security conflict which has waxed and waned during the period. As a result it is difficult to observe expenditure-driven transition points from insecurity to security. (ii) Pakistan has had pockets of fairly strong core government functionality throughout the period, indeed since the 1960s, so that transitions in state capability are also difficult to observe from the contextual analysis. In this respect, the Pakistan case is similar to that of Columbia – despite both countries being fragile and conflict affected, with high levels of violence, they have both managed to develop and/or maintain some strong institutions and pockets of stability and significant state capability. This point has been made by other observers, who treat it as a viable and coherent state that, within the limits and by the standards of its own region, does work:

*'Trying to understand Pakistan's internal structures is complicated ...[it] is divided, disorganised, economically backward, corrupt, violent ... and home to some extremely dangerous forms of extremism and terrorism – and yet it moves ...Pakistan contains islands of successful modernity and of excellent administration – not that many but enough to keep the country trundling along: ...a powerful, well-trained and disciplined army; and in every generation, a number of efficient, honest and devoted public servants ...none of these things is characteristic of truly failed states like Somalia, Afghanistan or the Congo'*⁴⁷

This case assesses the development of core government functions in Pakistan from 2002 to 2017, however due to data limitation expenditure patterns are only assessed from 2008 onwards. The democratic transition in 2008 represents an important landmark, which has influenced the development of CGFs for this case and from which a series of subsequent reforms can be traced, up until the Constitutional Amendment to merge Federally Administered Tribal areas with the neighbouring Khyber Pakhtunkhwa province in 2017.

This case study is structured around three key transitions:

The military coup turned presidential regime of General Pervez Musharraf in 2002, after he became the President of Pakistan in 2001 and won a controversial referendum in 2002, which awarded him five years of presidency. This coincided with a period of stability in Pakistan's economy from 2002 to 2005.

The democratic transition in 2008, leading to an increased emphasis on decentralisation picking up in 2009 and 2010. While this is happening, the military is waging war on Taliban forces in the Swat region, which halts when a short-lived peace agreement is reached in 2009. Eventually, after several military operations, the area is declared peaceful in 2010.

⁴⁷Anatol Lieven, *Pakistan: Hard Country*, Allen Lane, 2011

The disarmament, demobilization and reintegration of tribal regions in 2017 marks a key moment in the transition as reconstruction activities in Waziristan region begin following two major military operations (2014 and 2017) managed to disband militant factions. This drew attention once again to the long-standing issue of establishing law and order and mainstreaming governance mechanisms in the tribal regions. After consultations with tribal representatives, a Constitutional Amendment was passed in 2017 to merge Federally Administered Tribal Areas with the neighbouring Khyber Pakhtunkhwa province.

These three milestones are relevant turning points for understanding the trends in the development of core government functions since 2008 and for informing the design and effectiveness of external assistance in contexts of protracted conflict. This also ensures that the study can consider detailed budget data, allowing for analysis of expenditures on the various CGFs before and after each milestone.

13.2 Methodology and structure

The analysis presented in this research is based on interviews and discussions conducted (both in Islamabad and remotely) with a range of past and present officials of government agencies and international agencies, as well as technical advisers supporting various core government functions for the last two decades. These are listed in Annex A, and are complemented by an extensive review of available literature on Pakistan, as well as an analysis of government expenditure and aid data.

In Pakistan, data on domestic expenditures is only publicly available in the audited financial statements produced by the Controller General of Accounts from 2008 onwards. These have been used for most of the domestic expenditure analysis. A major limitation has been that the financial statements are only available as scanned images, which cannot be exported for data analysis, and the image quality is for older reports is poor. The expenditure data for this study has been cross-checked with budget documents, fiscal operations reports and other available datasets from the Government. Where further details were required, data has also been taken from the publicly available fiscal operations report that presents national expenditures (federal and provincial) and the federal budget books. The Government of Pakistan uses a SAP-based Integrated Financial Management System (IFMIS) for budgeting and accounting at federal, provincial and district levels. However, budget execution reports compiled by the Government are not publicly accessible and this has also constrained the data analysis significantly. The level of disaggregation required for an analysis of core government functions does not exist uniformly across the publicly available resources.

As a result of these data issues, the analysis of public expenditure does not cover the full time period of the study. Annex B presents further information on data sources for domestic expenditures on core government functions along with assumptions and limitations.

The data on external finance flows from OECD DAC Creditor Reporting System, which is available for Pakistan for 1999 onwards, reports aid commitments and disbursements in USD. Government revenue and spending is reported in PKR, however percentage shares in total expenditures have been included for comparability.

Relatively limited analysis is possible from existing data sources on the capabilities of Pakistan's core government institutions. Relevant datasets have been used where these are available – such as the Fragile States Index and World Governance Indicators. This is complemented by detailed interview evidence, from stakeholders with first-hand knowledge of Pakistan's core institutions, and literature available from secondary sources.

The following section (Section 2) presents an analysis of how the wider political economy evolved around the key milestones – notably how decision-making within government was affected by internal and external political and economic factors – as a framework to understanding the narrative around specific core government functions.

Section 3 provides a qualitative and quantitative assessment of how each of the six CGFs evolved across the milestones, detailing what reforms were prioritised and why, as well as the role of development partners in this process, as well as an analysis of government budget and aid spend on each CGF.

Section 4 summarises key factors and trends affecting the development of CGFs in a situation of protracted conflict.

14 Pakistan as a transition from military rule to democratisation

At first sight, Pakistan's case seems to be about a transition from military rule to democracy. However, as this report will show, multiple conflicts have coexisted, some of which are not even directly related to the issue of military rule (i.e. longstanding ethnic conflicts). The country's history is replete with efforts to grapple with federalism and the fragile center-provinces balance. This makes Pakistan an interesting case study when looking at factors influencing governance systems and priorities. Overall, government priorities seem to be influenced by three major factors: the nature of the political system, the escalation of security threats, and economic fragility.

The exercise of politics has often resulted in regime change in Pakistan. Since its independence, Pakistan's political system has fluctuated between civilian and military governments at various times throughout its political history. Political instability, the nature of State-citizen relations, and corruption allegations have resulted in periodic coup d'états by the military establishment against weak civilian governments, resulting in frequent enforcement of martial law across the country (in 1958, 1969, 1977 and 1999).

Since its first and last major civil war in 1971 that resulted in independence of East Pakistan (now known as Bangladesh), internal conflicts have generally been more localised to tribal regions and have had little influence in changing the power dynamics or influencing government priorities. However, conflicts arising from the exercise of politics have led to long periods of authoritarian military regimes and ineffective elected civilian rule, with the latest nine-year-long military regime ending in 2008 and the first politically elected government to complete a full term in Pakistan's political history from 2008 to 2013.

Even today, the military still retain a strong influence within Government. The Army received nearly half of the country's defence budget in the early 2000s. Hussain (2014) states that "while the military has seemingly taken a back seat, it has not lost its clout and remains a determinant of Pakistan's security and, to some extent, its foreign policy".⁴⁸ The speculated involvement of the military in shaping Pakistan's politics remains a concern to date, with the 2018 elections marred by allegations of wide-scale pre-poll rigging, with many pointing towards the military, and the EU Observation Mission declaring "a lack of equality and of opportunity".⁴⁹

In fact, in terms of the security sector, the overall priority has been strengthening the military apparatus. A report by the Centre for International Governance Innovation (CIGI) raises concerns over the non-military security sector in Pakistan, describing the "under-resourced police...inadequately trained, poorly equipped, outmanned and outgunned by the various foes they confront" alongside a "deficient criminal justice system". Up until 2002, Pakistan operated under the Police Act of 1860. The CIGI does, however, find that in Punjab and KP there have been some improvements linked to increased pay, an expanded force and better equipment.

⁴⁸Hussain, 2014. The construction and deconstruction of Pakistan.

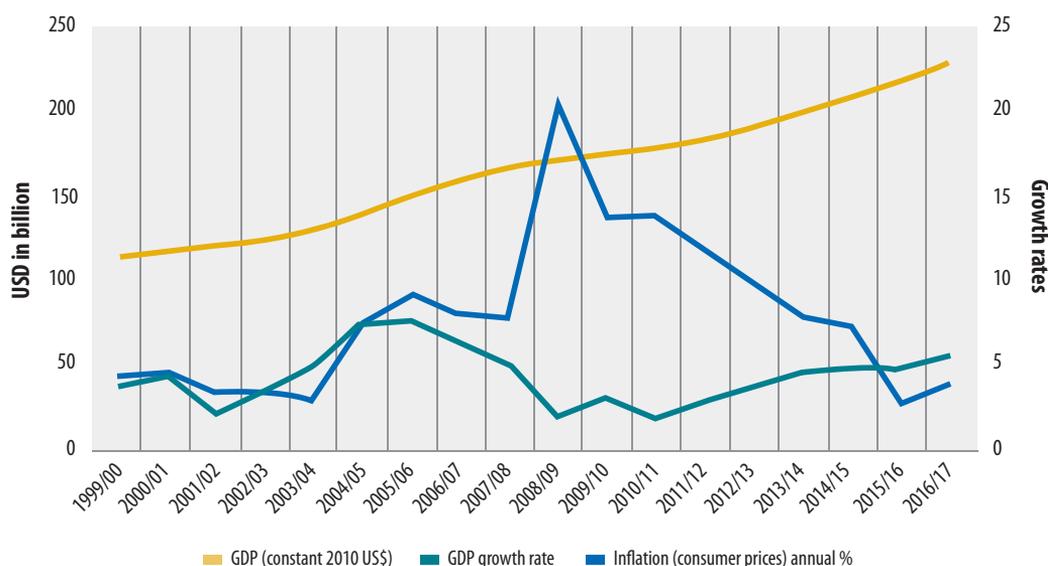
⁴⁹Preliminary statement on general elections 2018, European Union Election Observation Mission, https://eeas.europa.eu/sites/eeas/files/eu_eom_pakistan_2018_-_preliminary_statement_on_25_july_elections.pdf

In recent years, the war on terror has also determined government priorities. A long history of conflict in neighbouring Afghanistan, linked to Pakistan's own tribal regions, escalating tensions with India, and religious militancy elements have deteriorated Pakistan's internal security situation. From 2002 to 2014, at least 19,886 civilians died in or from incidents of terrorism and militancy, whereas an additional 6,015 security personnel, including four general officers have been killed by militants.⁵⁰

In its National Security Policy from 2014, the government reports that 13,721 terrorist incidents have taken place. Of these, 523 occurred between 2001 and 2005, and another 13,198 between 2007 and late 2013. According to data released by the US National Consortium for the Study of Terrorism and Responses for Terrorism (Start), out of 1404 terrorist attacks in Pakistan in 2012, more than one-third (33%) occurred in Khyber Pakhtunkhwa, followed by Balochistan (23%), FATA (19.6%) and Sindh (18%). This wave of terrorism has also resulted, according to government estimates, in losses of up to \$78 billion to the national economy as foreign investment dried up, businesses moved abroad, human capital emigrated, and the cost of doing business in Pakistan increased.

Against this backdrop, economic performance has been linked to fiscal management practices of the different governments, with periods of considerable growth between 2003 and 2007 during the

Figure 1 Economic performance of Pakistan



Source: OECD

⁵⁰“Fatalities in Terrorist Violence in Pakistan 2003-2014,” South Asia Terrorism Portal, www.satp.org/satporgtp/countries/pakistan/database/casualties.htm.

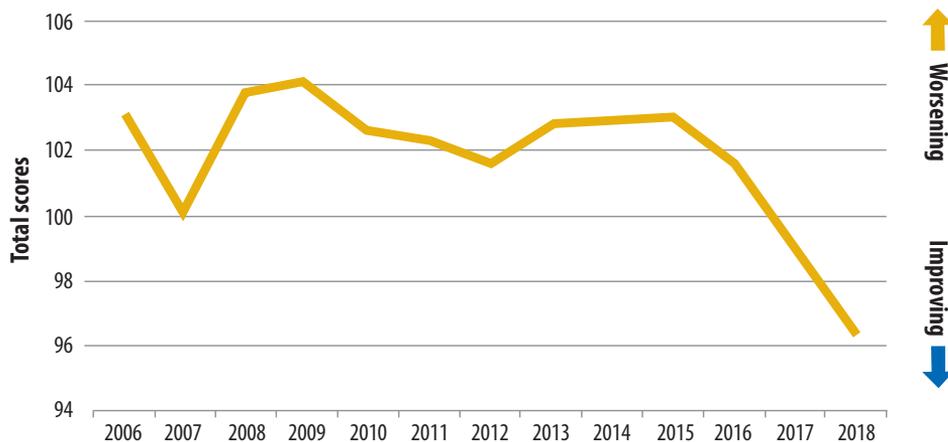
military regime of General Musharraf, followed by stagnating growth between the democratic government of 2008 and 2013, and muted recovery from 2013 onwards (see Figure 1). In addition, since 2008 there have been repeated incidences of Balance of Payment crises in Pakistan driven in large part by persistent fiscal deficits and underperformance of the export sector. Pakistan has held lower middle-income status for almost a decade, its tax to GDP remains low and Pakistan often runs large fiscal deficits. Therefore, Pakistan has been reliant on external financing, not only for bridging the financing gap for development, but as a source of foreign exchange to stabilize its Balance of Payments. The economic growth under Musharraf's regime is often attributed to sound fiscal policies and structural reforms that encouraged foreign direct investment in Pakistani markets.

14.1 Transition and emerging conflicts

This section provides an overview of the trends and factors that have affected three milestones in Pakistan's recent history, namely the military coup-turned-presidential regime of General Musharraf, the start of the democratisation process, and the disarmament, demobilization and reintegration of tribal regions. In summarising these political economy factors, this section also describes the headline trends in government revenues and spending, as well as donor commitments.

It is worth noting that throughout the transition timeline, Pakistan has actually improved its levels of fragility (see Figure 2), with sustained improvements since 2015. The Fragile States Index for Pakistan shows an improvement of -7.5 points change over the past ten years, with improvements in state legitimacy, economic inequalities, and to a lesser extent, the security apparatus.

Figure 2 Fragile States Index Pakistan 2006-2018



Source: Fragile states index

Transition from military to presidential regime (2002-2005)

In 1999, General Pervez Musharraf, then Chief of Army Staff, took over the government in a military coup from the democratically elected Prime Minister, declaring a state of emergency and appointing himself as the Chief Executive. In order to legitimize his rule, he led a liberal movement of “enlightened moderation” to neutralize the strong opposition from conservative religious parties, issued several amendments in the Constitution legalising his coup and strengthening his position of power. He also held general elections in 2002 that were won by parties supporting his regime. In a controversial referendum, he appointed himself as President while allying with the US Government on the war against terror. General Musharraf also instated a local government system that devolved significant powers from the provinces as a way to destabilise political strongholds of major parties in the provinces. This gave way to several governance reforms.

Meanwhile, the country was almost on the verge of a default crisis on its external payments in when President Musharraf took over in 1999. With the support of his appointed and trusted Prime Minister, he embarked on a set of multifaceted fiscal structural and economic reforms that included consolidation by raising tax revenues, reducing expenditures, cutting down subsidies of all kinds, containing the losses of public enterprises, and privatizing state-owned enterprises. These measures, along with considerable inflows of external finances to supplement development activities and trade liberalisation, led to the country’s gross domestic product experiencing rapid growth over the next five years. Pakistan attracted over \$5 billion in foreign direct investment in the 2006-07 fiscal year, ten times the figure of 2000-01.⁵¹

However, while this was a period of stability for the economy, the same could not be said for the security situation. There was a sharp rise of terrorism incidents during the latter half of General Musharraf’s presidency. As a major US ally in the war against terror, Pakistan had become a threat to the militant Taliban forces in tribal regions. In its search for Al-Qaida operatives, the military launched an offense in South Waziristan region in 2004, which led to a string of short-lived peace deals with the local tribes and militants between 2004 and 2009. The country reached a tipping point when Benazir Bhutto, head of a prominent political party who had recently been allowed to return to the country after a long exile, was assassinated in 2007 while leaving a rally.

Transition to democracy (2008-2016)

Pakistan’s recent transition to democracy begins in 2008 with the resignation of President Musharraf in order to avoid impeachment. The new elected federal government led by the Pakistan People’s Party undertook major constitutional reforms to correct federal imbalances and empower the provincial tier. Decentralization was a clear priority during 2009 and 2010. In fact, political consensus led to the Eighteenth Amendment of the constitution, passed with the support

⁵¹Foreign Direct Investment in Pakistan: The Role of International Political Relations
<https://www.oxfordtmcd.org/sites/www.tmd-oxford.org/files/SLPTMD-WP-039.pdf>

of all political parties in 2010. Under the 18th Amendment, the provincial governments were granted greater autonomy and an increase in key functions, especially service delivery functions like education and health. The provinces were also granted the ability to raise their own domestic resources through the Sales Tax on Services and the ability to raise certain loans autonomously. The provinces were also allowed a greater share in the national divisible pool of resources through the seventh National Finance Commission Award in 2009.

The government also restored the judiciary, previously deposed by General Musharraf.

Under the leadership of the Chief Justice of Pakistan, Iftikhar Chaudhry, the judicial sector gained prominence and, while it is sometimes criticised for overstepping, it succeeded in recasting the judiciary as a credible institution.

Despite such apparent progress, the war against Taliban forces in the Swat valley was steeply escalating since 2007. The Taliban had taken over the region and enforced their interpretation of Shariah law that not only enforced a strict form of modesty and virtuous behaviour under threat of violence, but also prevented inoculation against polio and other diseases as well as education for women. This led to a first military operation in the Swat valley that ended in a temporary ceasefire based on a peace agreement, which was criticised by the international community for potentially legitimizing human rights abuses. This peace agreement was also short-lived and fighting resumed. Eventually, after a number of decisive military operations the area was declared peaceful in 2010.

To assist in the crisis management and reconstruction efforts, multiple donors (Asian Development European Union, World Bank, and United Nations) collaborated to support the federal government, provincial governments of KP and Balochistan, and the FATA Secretariat to **conduct a Post Crisis Needs Assessment in 2010**. The PCNA was aimed at providing a helpful, pragmatic, coherent and sequenced peace building strategy. A Multi Donor Trust Fund (MDTF) was also established in August 2010 as one of the key instruments to support the reconstruction, rehabilitation, reforms and other interventions needed to build peace and create the conditions for sustainable development in the aftermath of the 2009 crisis. The MDTF is administered by the World Bank and supported by twelve development partners: Australia, Denmark, the European Union, Finland, Germany, Italy, Netherlands, Norway, Sweden, Switzerland, Turkey and the UK.

Despite this, fighting continued in the tribal regions. **The government's priority continued to be gaining territorial control and containing the terrorist threat through a strengthened military apparatus.** The 'establishment of peace' in the Waziristan region and the Swat valley came only after two decisive military operations in 2014 and 2017, which managed to disband militant factions.

Establishing peace (2017 onwards)

With the disarmament, demobilization and reintegration of tribal regions in 2017, reconstruction activities in the Waziristan region initiated. This brought the long-standing issue of establishing

law and order and mainstreaming governance mechanisms in the tribal regions to the fore once again. After consultations with the tribal representatives, a Constitutional Amendment was passed in 2017 to merge the Federally Administered Tribal Areas with the neighbouring Khyber Pakhtunkhwa province.

While establishing peace in Swat Valley and Waziristan region has been a key milestone in Pakistan's recent conflict history, assessing expenditure trends and aid flows for this period has been constrained by unavailability of data.

However, we do know that **the political settlement and peace agreement have led to important reforms in CGFs such as PFM and local governance.** For instance, a major change in the government's expenditure priorities can be evidenced by the additional 1% of net divisible taxes pool allocated to Khyber Pakhtunkhwa province in the National Finance Commission of 2009 for reconstruction and rehabilitation of areas affected by the war on terror. With the FATA merged with Khyber Pakhtunkhwa province through a Constitutional Amendment in May 2018, the government is giving consideration to assigning 3% of the total divisible pool for accelerated development of FATA.

14.2 Aggregate revenue and expenditure trends

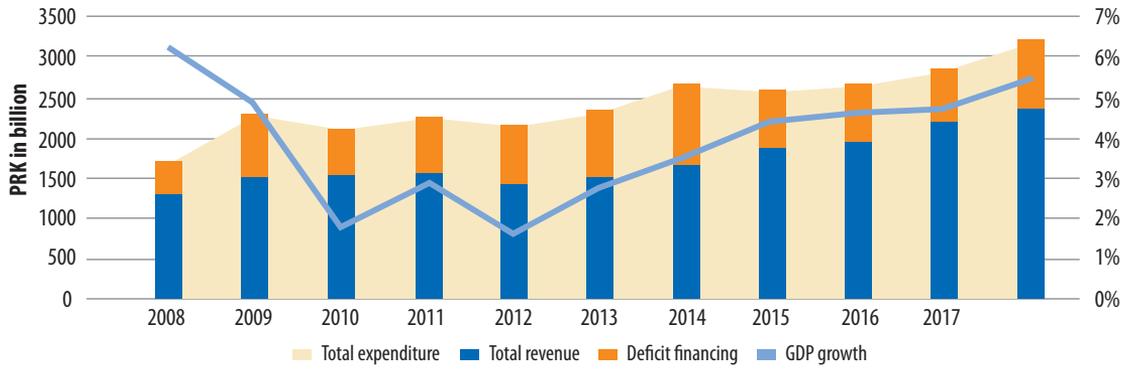
The aggregate revenue and expenditure trends in Pakistan show that revenues have increased slightly over the years, but as a percentage of GDP have remained stable around an average of 14%. The tax to GDP ratio improved from 10% in 2007 to 12% in 2017 (see Figure 3).

There was a spike in total government expenditure between 2008 and 2009, when the civilian democratic government took over from General Musharraf. Following years show a stagnant trend as the GDP growth faced the lowest slump in over seven years. The letter of intent from Pakistan Government to the IMF for a stand-by programme in 2008 attributed the decline to "adverse security developments, large exogenous price shocks (oil and food), global financial turmoil, and policy inaction during the political transition to the new government".

The other major spike in government spending is observed in 2014, is also when a new government passed its first budget and the expenditure rise is met from deficit financing rather than domestic revenues.

Over the years the biggest expenditure items of the federal government remain interest payments on mark-up, followed by spending on defence, public order and safety, education affairs and services, and health.

Figure 3 Aggregate national revenue and expenditure trends at constant prices



Source: Government fiscal operations report

15 Evolution of core government functions

This section presents the public expenditure trends and aid flows on core government functions in the backdrop of institutional architecture of the public sector in Pakistan and key reforms undertaken during the period. While detailed data on aid flows (in terms of commitments and disbursements) was available from the OECD database, data on actual public sector spend available to the team was limited to financial statements published by the Controller General of Accounts, federal budget data shared by the MTBF Cell in Finance Division, and information available from published budget documents on the government's official website. This has constrained the level of disaggregation in expenditure data available for the analysis.

15.1 Executive coordination at the centre of government

In its almost 70 years of history, Pakistan has experienced both presidential and parliamentary systems. The periods of presidential governments were all preceded by martial laws vehemently opposed by the political elite of the time. Devolution reforms since 2001 have sought to devolve major service delivery sectors like health, education, police, and levying and collection of GST on services to provincial governments, but has ended up in creating gaps between national interests and those at the local governance level.

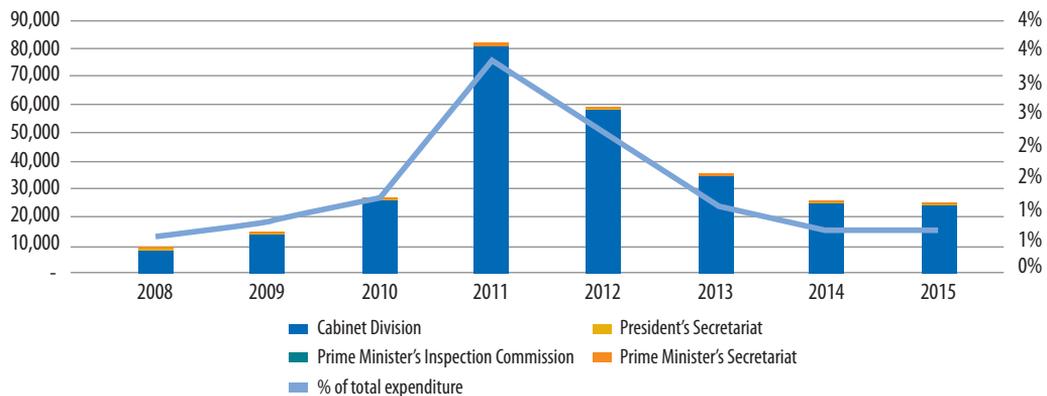
By far the largest amount of resources spent on executive coordination is attributable to the Cabinet Division that primarily is responsible for administrative support to the cabinet and cabinet committee and includes budget and privileges assigned to Ministers. Some of the Cabinet Divisions' assumed mandate has clear functional overlaps with other ministries and devolved functions, such as ensuring quality in relief measures, labour force training, and urban health centres. Other secondary functions include security of classified communications, federal intelligence, social welfare, land reforms, and preservation of state documents. The significant increase in expenditure by the Cabinet Division in 2011 is due to rural development initiatives taken by the government, funds which were placed under the control of the Cabinet Division. Otherwise, the expenditure on executive coordination budget lines has not witnessed an increased share in total expenditure over the years (see Figure 4).

The KIIs have highlighted that there are issues of coordination at every tier of the executive branch and in almost every sector. Recent efforts have focused on improving interdepartmental and intergovernmental coordination on specific issues, e.g. during times of humanitarian crises, when a number of ad hoc committees and bodies are formed. For instance, after the 2005 earthquake, an Earthquake Reconstruction and Rehabilitation Authority was formed at the national level that was mandated to coordinate relief efforts, undertake macro planning, developing sectoral strategies, arranging financing, monitoring and evaluation, and facilitating implementing partners, while physical implementation of the projects was mainly the responsibility of provincial governments. At the same time, a donor coordination and external financing database was also developed for improving coordination and data sharing on relief efforts.

Similarly, just before the devolution of 2010, in an attempt to strengthen interprovincial coordination, these functions were separated from the Cabinet Division and an Interprovincial Coordination Division was created under the Cabinet secretariat in 2007. This was later made into a full-fledged Ministry in 2008, which still exists to this date.

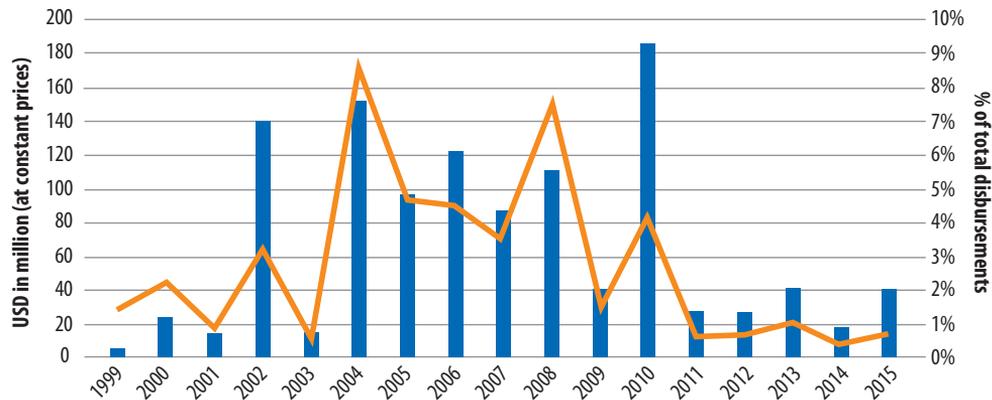
External aid disbursements on executive coordination (coupled with public administration here due to data challenges posed by the OECD DAC categorization) have remained erratic over the years, with major peaks in 2004 and 2008 (see Figure 5).

Figure 4 Composition of expenditure on executive coordination (PKR in million)



Source: Government budget documents (green book, financial statements)

Figure 5 Aid flows to executive coordination functions



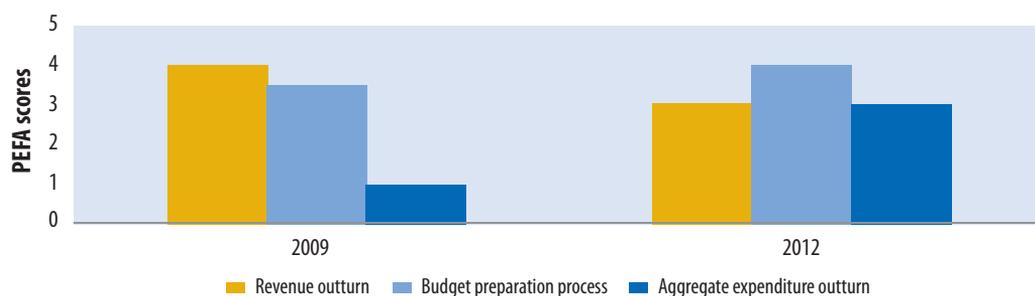
Source: OECD DAC Creditor Reporting System

15.2 Public finance

Pakistan has a fairly established PFM system with a single treasury account system and comprehensive budgeting and accounting management system. The government, recognizing the importance of sound public financial management, has maintained a trajectory of reforms, for instance, taking actions to enhance the accountability and effectiveness of public expenditures.

In terms of Pakistan's public financial management systems, the federal government's ability to collect revenue remains fairly weak.⁵² Despite numerous reforms, the IGC report states that the Federal Board of Revenue still performs poorly with limited signs of improvement. For instance, the tax to GDP ratio was 10.5% in 2017, compared to 14% in 1989-90. Although Pakistan showed an overall improvement in federal PEFA scores between 2009 and 2012 (see Figure 6), the 2012 PEFA states that "there are deficiencies in PFM that must be addressed with some urgency in order to strengthen the fiscal discipline and align management with international standards", including budget execution, procurement and control functions.⁵³

Figure 6 PEFA assessed rankings in 2009 and 2012 for public finance indicators



Despite this, in the last two decades, significant progress has been made in terms of the accuracy, comprehensiveness, reliability, and timeliness of financial and fiscal reporting; enhanced accountability and transparency; the use of financial information for informed decision-making; and oversight of the use of public monies through risk-based audits.⁵⁴

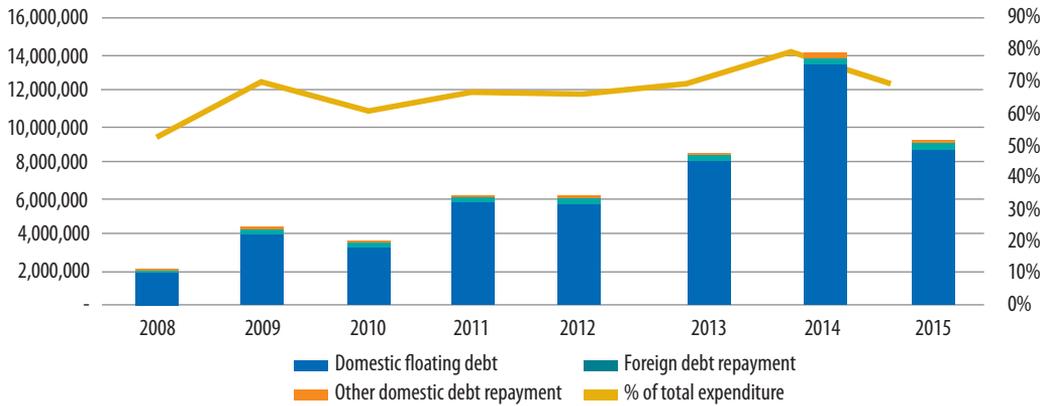
Domestic debt repayment is a major expense for the government and formed on average 70% of the total federal expenditure since 2009 (see figure 7).

When debt repayments are set aside, the biggest share of expenditure on public finance is done by the Finance Division (approx. 95%), followed by the Revenue Division (approx. 2%). Government spending on public financial management functions forms a significant percentage of total expenditures (see Figure 8).

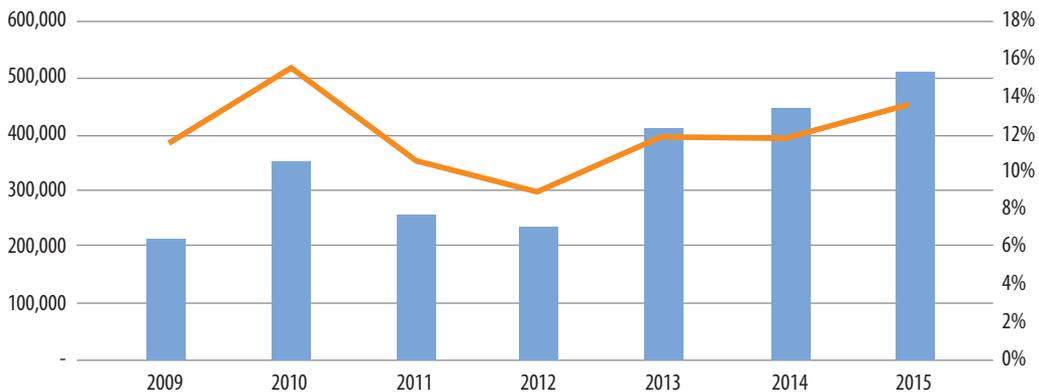
⁵²Hussain, 2014. *The construction and deconstruction of Pakistan*.

⁵³PEFA, 2012.

⁵⁴Pakistan PEFA Assessment 2012.

Figure 7 Debt repayment over the years (PKR in million)

Source: Financial Statements

Figure 8 Expenditure on public finance functions (expenditure and revenue management)

Source: Budget data provided by the MTBF Cell in Finance Division

Strengthening of the PFM systems has relied largely on the pace of implementation of the World Bank financed Project for Improvement in Financial Reporting and Auditing (PIFRA), which began assisting with PFM reforms in 1995. PIFRA was implemented at federal, provincial and district levels of the government in three phases from 1996 to 2014. 2001 was especially significant as a large number of PFM reforms were approved and promulgated through a number of ordinances, including the separation of audit and account functions and the establishment of the

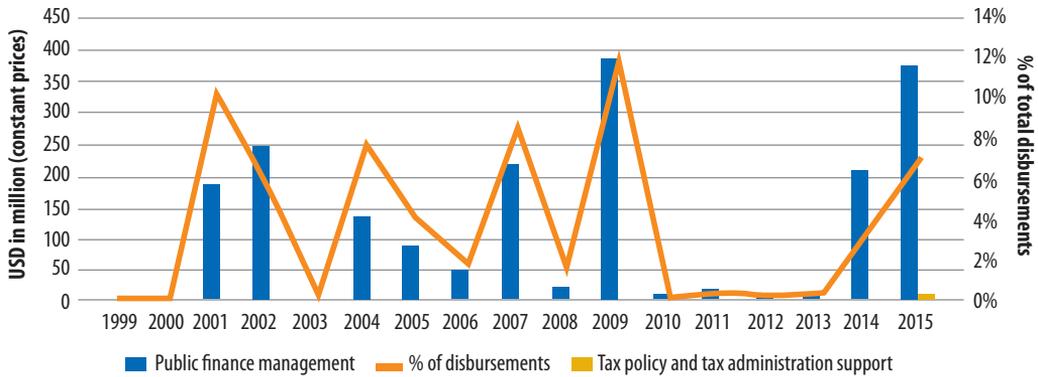
Controller General of Accounts, the Auditor General of Pakistan, and the Federal Tax Ombudsman office. A New Accounting Model was introduced in the year 2000 through approval by the Auditor General of Pakistan, to improve the traditional government accounting system by moving to a modified cash-basis of accounting, double-entry bookkeeping, commitment accounting, fixed asset accounting and a new multi-dimensional Chart of Accounts. However, the use of the system remains significantly limited. Despite having the capability within the system, the budgeting module is not used for planning purposes, with the planning division and line departments all using their own MIS/manual systems for planning purposes. The Finance Division and Controller General of Accounts both maintain separate servers causing issues of reconciliation, leading to records being manipulated manually.⁵⁵

DFID has been a key partner in supporting planning and medium term budgeting reforms. Medium term budgeting was first implemented in Pakistan in 2006 at the federal level, and in KP in 2010 along with output based budgeting. However, KIIs have indicated that despite significant technical assistance, an incremental approach to budgeting remains in practice and the implementation of output-based budgeting in line departments and field offices remains weak or missing. The PEFA assessment in 2012 noted that linkages between multi-year estimates and annual budgetary ceilings are weak, signalling unpredictability of resources.

The tax to GDP ratio of Pakistan has remained consistently low for years. On the advice of an IMF Mission in 2001, the Government devised and approved a Revenue Reform Strategy. From 2012 to 2016, the government implemented several reforms on the revenue management front through a \$149 million Tax Administration Reform Project (TARP) supported by the World Bank and DFID. The focus of the reforms were taxpayer facilitation, self-assessment for income tax and reorganisation of the federal Board of Revenue. With the support of the TARP, the Government of Pakistan has achieved some notable changes in tax administration. New information technology systems were also developed to improve efficiency, including a data warehouse, e-portal, payments and refunds system, and taxpayer accounts, along with the implementation of a single Tax Identification Number for all taxpayers for effective functioning of these systems. However, project evaluation upon completion noted that progress had been unsatisfactory and it was recommended that future revenue administration projects should incorporate a comprehensive political economy analysis of reforms and investment loans should be complimented with technical assistance.

The above-mentioned donor support to PFM functions is corroborated by the aid flows where disbursements for these functions increased as a percentage of total in 2001-02 and 2007 to 2009, and more recently in 2014-15 (see Figure 9)

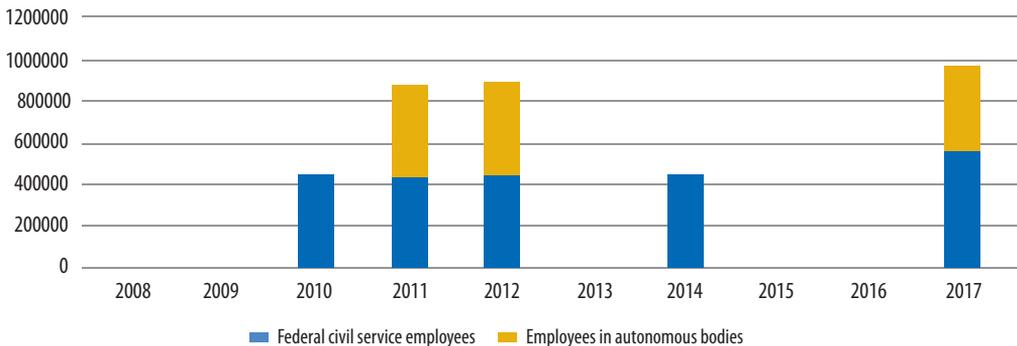
⁵⁵Interviews with officials in Finance Division and CGA

Figure 9 Composition of aid flows on PFM and aid management

Source: OECD DAC Creditor Reporting System

15.3 Government employment and public administration

The civil service structure of Pakistan has witnessed little improvements over the years, despite the size of the public sector growing considerably since the 1970s. Civil service remains constricted by archaic rules and procedures, along with a rigid hierarchical authority structure that undermines its effectiveness. Low salaries, insecure tenure, and obsolete accountability mechanisms have facilitated the spread of corruption and impunity.⁵⁶ Over the years efforts have been made to attract better quality candidates, reduce corruption, and improve accountability yet reforms have remained stuck at the design stage.

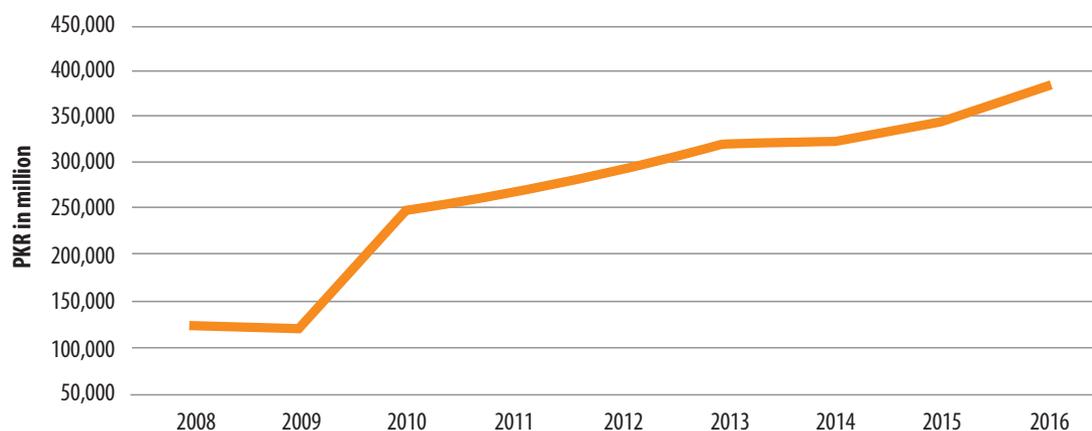
Figure 10 Number of federal government employees

Source: Establishment Division's Annual Statistical Bulletin on Federal Government Employees

⁵⁶IGC report on Reforming Pakistan's Civil Structure 2010 (<https://reliefweb.int/report/pakistan/reforming-pakistans-civil-service-icg-report>)

More recently, the overall number of permanent federal government employees has increased by 10% since 2011, despite an 8% decrease in employees in autonomous bodies⁵⁷ (see Figure 9). However, the federal expenditure on salaries and employees shows steep increase over the years, particularly from 2010 onwards (see Figure 11). This indicates that after the devolution of 2010, the rate of increase in government employment was accelerated at the provincial level to fill in gaps in public service delivery. The average public sector wages have also increased at a faster rate than average private sector wages as per the data reported in the World Bureaucracy Indicators (see figure 12). Despite increasing human resources and wages, performance management is notably weak and consists mainly of the annual Performance Evaluation Report⁵⁸. KIIs reported that while individual performance evaluations are done annually and form a critical element in the promotion criteria, however, these remain highly discretionary as performance

Figure 11 Government spending on salaries and employee benefits (constant at 2008)



Source: Federal government financial statements⁵⁹

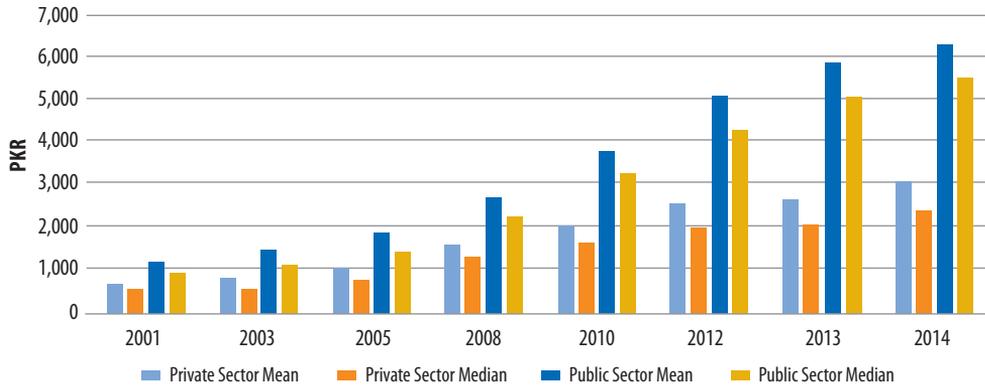
targets are not agreed at the start of the year. Objective and tangible performance yardsticks do not exist which makes the process of performance evaluation a mere formality and often a means to exercise politics within the bureaucratic.

The Public Services Commission and the Establishment Division are the primary institutions responsible for government employment and public administration at the federal level. The expenditure trends analysis shows that government expenditure on these two institutions decreased since 2008 but has increased slightly since 2014 (see Figure 13).

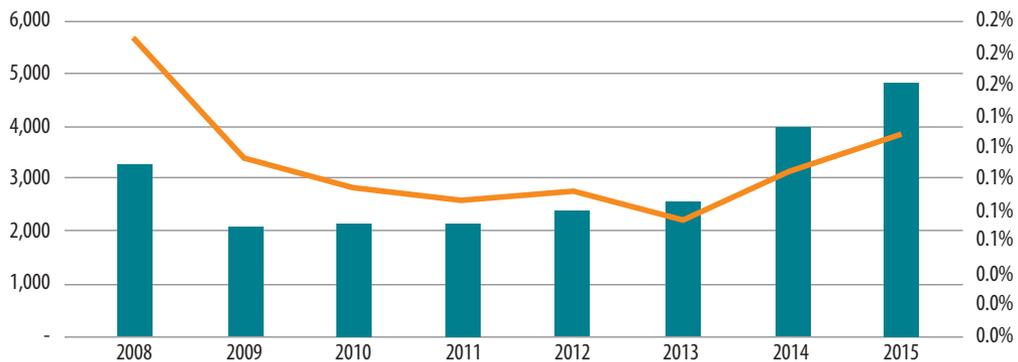
⁵⁷Data on provincial government employees was not made available.

⁵⁸Previously known as Annual Confidential Report (ACR), the report is filled by the superior officials for their subordinates and are counterchecked by countersigning officers.

⁵⁹Expenditures have been adjusted at constant 2008 prices using GDP deflator reported in national economic surveys

Figure 12 Average weekly wages (in local currency unit) in public and private sector in Pakistan over the years

Source: World Bureaucracy Indicators

Figure 13 Public expenditure on government employment and public administration

Source: Federal Budget Data

Based on interviews, it is clear that there is a slow shift in policy focus from general examination based hiring towards specialised recruitment caused by a demand for better quality of civil service. Civil service reforms are also inherently linked to the political economy. For instance, a look at the reform efforts undertaken in Musharraf's era (specifically in 2006-2008) show that the aim was to curtail powers of the elite and the all-powerful office of the District Management Group as cornerstones of the military rule. However, these efforts reverted due to weak ownership

and follow-through, caused by the weakening legitimacy of Musharraf's rule.⁶⁰ Before this, there had been many other short-lived reform efforts, and with the only major and sustained civil service reform taking place in 1973 under the government of Bhutto, which gave autonomy to the Federal Public Services Commission, created occupational groups/cadres, unified national pay scales, initiated joint pre-service training, and enabled lateral recruitment through competitive examination.

Yet, a review of the transition timeline shows that civil service reforms and administrative reforms take on a new life in times of transition towards peace and stability. After the 2018 elections, the nascent political government has set out to design civil service reforms anew with a focus on rightsizing and e-governance approaches.

Interviewees informed that there have also been several efforts to introduce performance evaluations, merit based promotions and a revision in remuneration and allowances over the years, which are usually set-aside after a slew of subsequent court cases and challenges. Anti-corruption and accountability reforms have also been a major focus of civil service reforms across the transition timeline. The National Accountability Bureau was formed in 1999 by a Presidential Order issued by General Musharraf and has gained constitutional sanctity since then. However, it is often accused of being mismanaged, playing favourites, taking off-books settlements, being unwilling to prosecute military officers, among others. The PTI-led government that rose to power in Khyber Pakhtunkhwa for the first time in 2013 established a provincial Accountability Bureau as a parallel mechanism which was wrapped up four years later in November 2018 amid complaints of mismanagement and overlaps with the National Accountability Bureau.

Payroll and pension contributions combined are the biggest item in the national budget. Payroll management and control has improved considerably through a better use of IT systems in budgeting, expenditure controls and audit. However, recent payroll audits conducted at the provincial level through the DFID funded Sub-National Governance programme have revealed that there is still opacity in the payroll data, with significant anomalies related to personnel data which is also reflected in the PEFA scores (see figure 14).⁶¹

15.4 Security

Pakistan's historically entrenched civil-military imbalance puts the military in the driver's seat on all issues related to national security, including internal security arrangements, and to a great extent foreign policy. At the federal level, the Ministry of Interior is the overall body responsible for law and order and security within Pakistan, mandated to deal with policy and administrative matters pertaining to the armed forces. In practice, the three branches of the armed forces—Army, Navy, and Air Force—are virtually autonomous and their linkage to the Ministry of Interior is merely administrative, the latter exerting little or no power over the budgeting, operations, or personnel management within the defence forces. As a result there is little disaggregation

⁶⁰<https://dailytimes.com.pk/304482/reforming-the-civil-service-avoiding-the-pitfalls/>

⁶¹KP IT based payroll audit report of Education Department, 2014

Figure 14 PEFA assessed rankings in 2009 and 2012 for government employment and public administration indicators

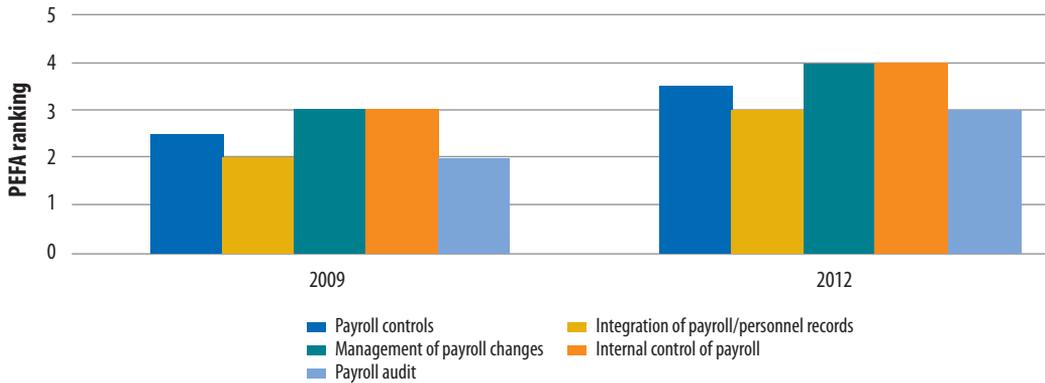
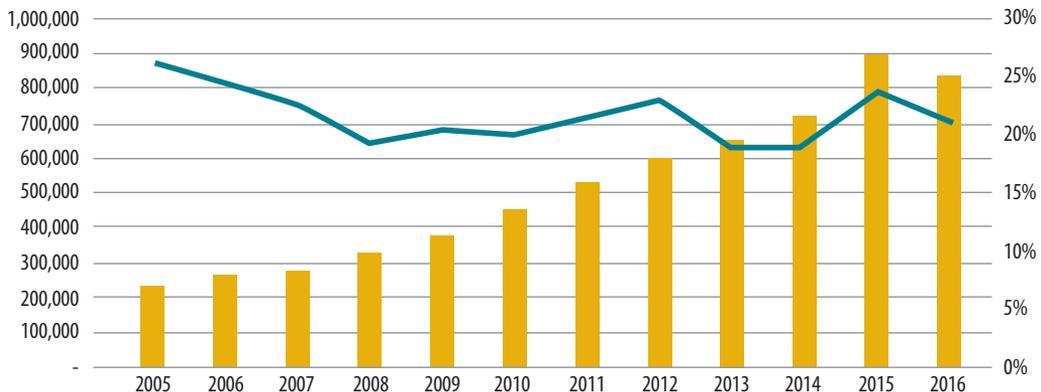


Figure 15 Government expenditure on security sector (PKR in million)



Source: Financial statements

available on Pakistan's defence expenditures. The only time when there seemed to have been stronger dialogue and relatively transparency between these institutions has been during the emergency relief efforts.

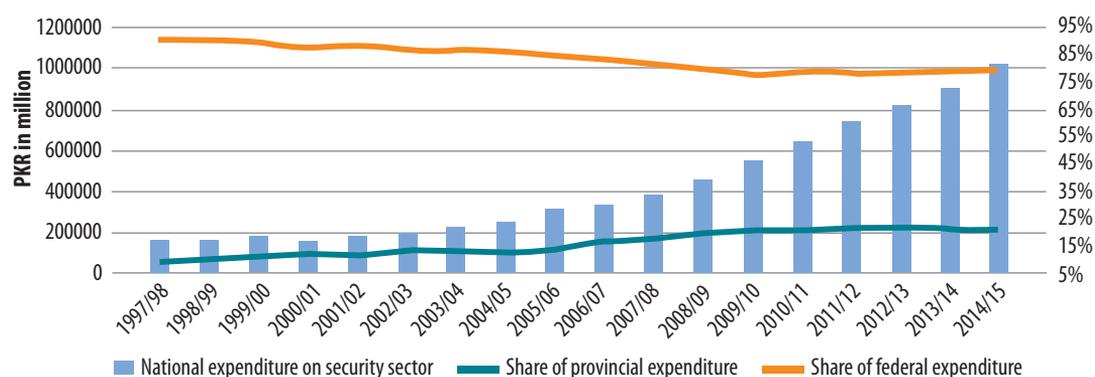
The Federal Government's expenditure on the security sector has risen year-on-year, reaching its highest in 2015 when the military operations in tribal regions were at their peak. **However, as a percentage of total expenditures, the security sector share has decreased** (see Figures 15 and 16).

There was a sharp increase in annual growth rate of spending on the security sector from 2003 to 2006, coinciding with bilateral aid received to support the country while combating militancy within its borders. While national spend on the security sector (including law & order and defence) has been on the rise in nominal terms, the federal share has been declining in terms of proportion of total spend whereas provinces share has increased. This is mainly due to:

- Increased spending on law and order by the provincial government after devolution of these services post 2010.
- Decreased spending on defence as a share of total expenditures at federal level

The highest annual growth rates in security sector spending at national level are evidenced during the period of military rule of General Musharraf and between 2008 and 2009 when the military offense against insurgency in tribal regions was at its peak. A minor increase in expenditure on law and order by the provincial governments is also noticed during the same time.

Figure 16 National level expenditure on security sector



Source: Financial statements

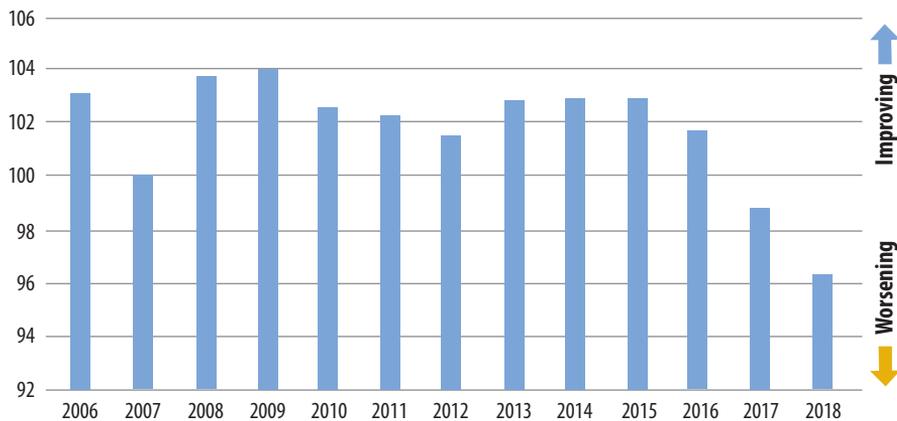
The focus of military operations in the Swat region of Khyber Pakhtunkhwa in 2007 and 2009 (Swat) and North Waziristan in 2013 is not reflected in aggregate federal expenditures on security and defence which show a downward trend over the period. While shifts in government priorities during this period is however clearly evidenced from a review of reforms during these periods. The adoption of the war on terror in led to significant reforms in the security sector. In 2010, the National Counter Terrorism Authority (NACTA) was created and given the mandate to formulate and monitor the implementation of national counterterrorism strategy. However, NACTA has remained largely ineffective since its inception, caught amidst various turf wars over information-sharing between the intelligence agencies and the Ministry of Interior and the placement of NACTA under the Ministry or the prime minister's office. The country's first ever National Internal Security Policy and National Action Plan were approved by the Cabinet in 2014, focusing on efforts to combat terrorism and militancy and address endemic insecurity and radicalization.

The Police force has been largely devolved to the provinces after the 18th Constitutional Amendment and is concentrated around urban centres. While there has been little progress on reforming law enforcement however, over the years the provinces have increased their allocations for improving the security situation, countering terrorism, and maintaining law and order.

There are eighteen federal law enforcement organizations and separate police forces in each of the four provinces since devolution of policing functions in 2010. These provincial and regional police organizations are organized along similar lines and abide by the same set of laws and rules. For instance, the procedural criminal laws (i.e., the Pakistan Penal Code, the Code of Criminal Procedure, and the Qanun-e-Shahadat Order) are uniformly applicable to all parts of the country (except FATA).

While security related expenditures decreased as a share of total expenditures, the security sector outcomes seem to have remained volatile in the medium term as determined by the Fragile States Index, however, improvement in the longer term is also evidenced (see figures 17 and 18).

Figure 17 Pakistan's total score on the Fragile State Index over the years



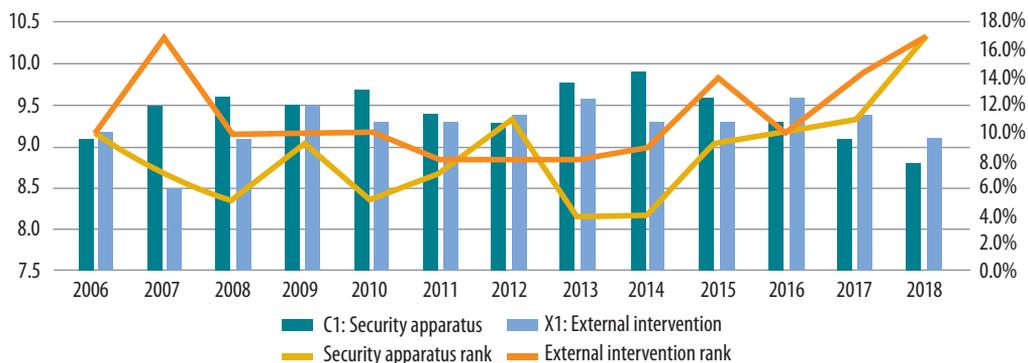
Source: *Fragile States Index*

On the other hand, Worldwide Governance Indicators report that perceptions about the state's effectiveness⁶² have deteriorated over the years (see figure 19), especially since 2006 as the Musharraf's regime was facing increasing external critique and legitimacy issues within Pakistan.

Aid flows to security sector were negligible prior to 2009; however these increased significantly in 2009 and 2010, driven primarily by aid from UK, US and Germany (see Figure 20).

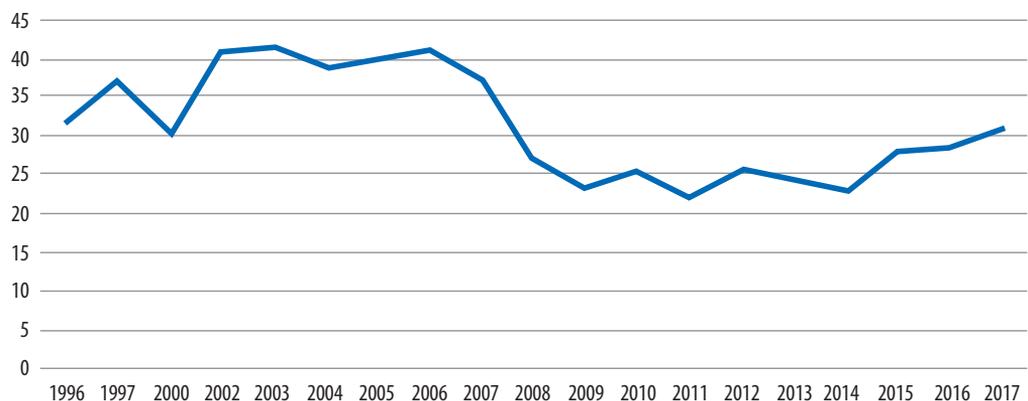
⁶²Defined as perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.

Figure 18 Fragile State Index selected indicators on security sector



Source: Fragile States Index

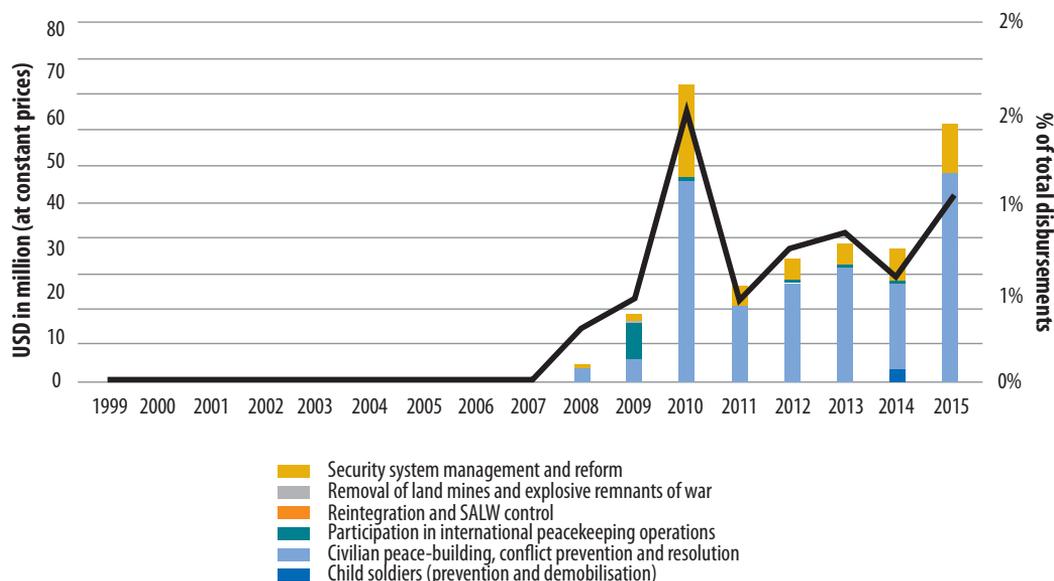
Figure 19 Percentile rank of State Effectiveness of Pakistan



Source: World Governance Indicators

15.5 Local governance

As a result of years of instability and violence, the local government system in Pakistan remains fragile and progress has been slow. Under Pakistan's constitution (1973), the country is envisioned as a federal republic with four constituent provinces and federally governed regions however, substantive federalism was only established in March 2010, post military rule. Local governments (tiers below the provincial level) have remained weaker institutions, with insufficient resources

Figure 20 Composition of aid flows to security sector

Source: OECD DAC Creditor Reporting System

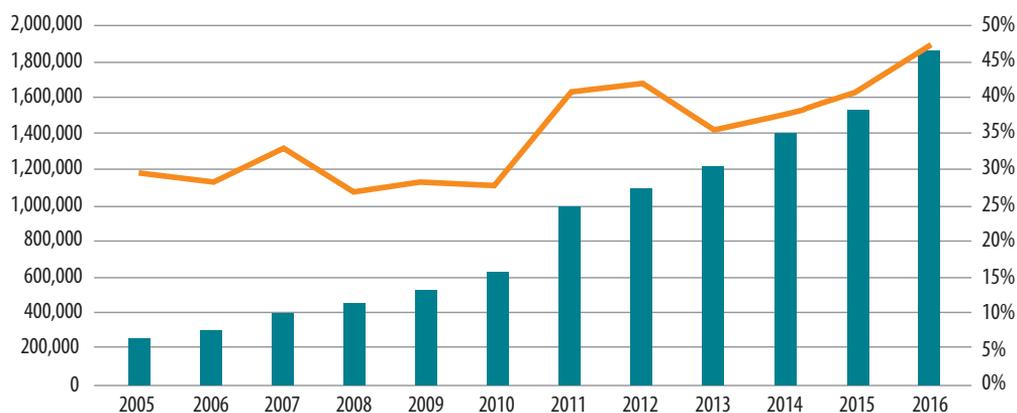
and powers and that has been used by the different martial law regimes to lend legitimacy to their rule and democratic regimes to exercise political patronage.⁶³

Since 2008, policymakers have initiated substantive efforts to address legitimacy-based drivers of fragility, with a strong focus on decentralisation, including the NFC award, which significantly increases the amount of annual fiscal transfers made to the provinces. According to the IGC, the revenue shares historically contributed to a great deal of mistrust between the federating units.⁶⁴

For the local governance function, substantial gains were made during General Musharraf's regime from 1999 onwards. A National Reconstruction Bureau (NRB) was established in 1999 as a federal independent institution tasked with economic recovery and prosperous development through the local government system. Recommended by the NRB, the Local Government Ordinance was promulgated by the provincial governments in August 2001. While significant service delivery functions were devolved to the local governments, the provincial governments neglected to provide the requisite capacities and funds.

⁶³In the absence of data on appropriate proxy indicators for measuring capacity of local government (e.g. budget utilisation, service delivery indicators, and compliant redressal) this opinion is based off multiple opinion papers such as: <https://www.pakistantoday.com.pk/2015/11/28/ineffectual-local-governments/> and <https://dailytimes.com.pk/302871/policy-issues-in-local-governance-reforms/>

⁶⁴IGC, 2018. *SSR Issue Papers No. 5 — January 2012 Security Sector Governance in Pakistan: Progress, But Many Challenges Persist.*

Figure 21 Transfers from federal government to provinces

Source: Fiscal operations reports

The primary source of resources for the provincial governments remains the federal transfers, which have increased over the years, particularly after the 9th National Finance Commission Award in 2010 (see Figure 21). With the devolution of Sales Tax on Services in 2013, some provinces, such as Punjab, quickly demonstrated better adaptation to new roles than others, assigning staff and setting up new administrative units. Still, all provinces continue to struggle to enhance their own revenues, collectively financing only 11 per cent of their expenditures through provincial tax and non-tax sources.

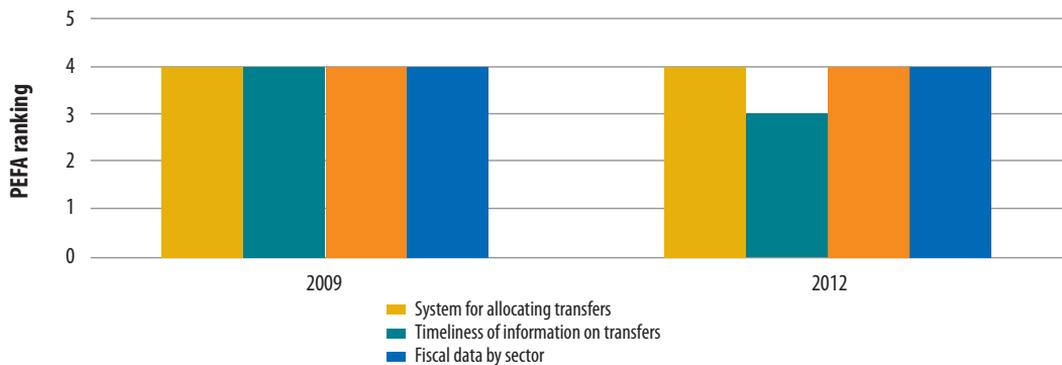
The shift in priorities when comparing provincial shares vs. government share under various NFC Awards over the year is also worth noting. The last two NFC Awards (1997 and 2009) have been significant for decentralisation and empowering provinces: the 1997 Award included all taxes in the divisible pool whereas previously only a percentage of income tax and sales tax were applicable, and the 2009 Award increased provincial share in the divisible pool while maintaining the size of the divisible pool (see Table 1).

The expenditures of sub-national governments (i.e. provinces and local governments) are not publicly available in a form that facilitates detailed analysis. However, literature suggests that the new local government ordinance of 2010, as a result of reforms led by President Musharraf, forced the provinces to give greater autonomy and resources to the local levels. In terms of the quality of the systems in place, successive PEFA assessments have shown that PFM performance for local governance has remained largely the same from 2009 to 2012, with some decline in timeliness of information of transfers (see Figure 22).

Table 1 Distribution of resources among government tiers under various National Finance Commission Awards

Assigned Shares to Provinces under various NFC Awards	NFC 1974	NFC 1990	NFC 1997	NFC 2009
Federal share in divisible pool	20	20	62.5	42.5
Provincial share in divisible pool	80	80	37.5	57.5
Horizontal shares of provinces				
Punjab	60.25	57.87	57.88	51.74
Sindh	22.50	23.29	23.28	24.55
NWFP	13.39	13.54	13.54	14.62
Balochistan	3.86	5.30	5.3	9.09

Source: PIDE Working Paper 2007:33⁶⁵ and federal budget documents

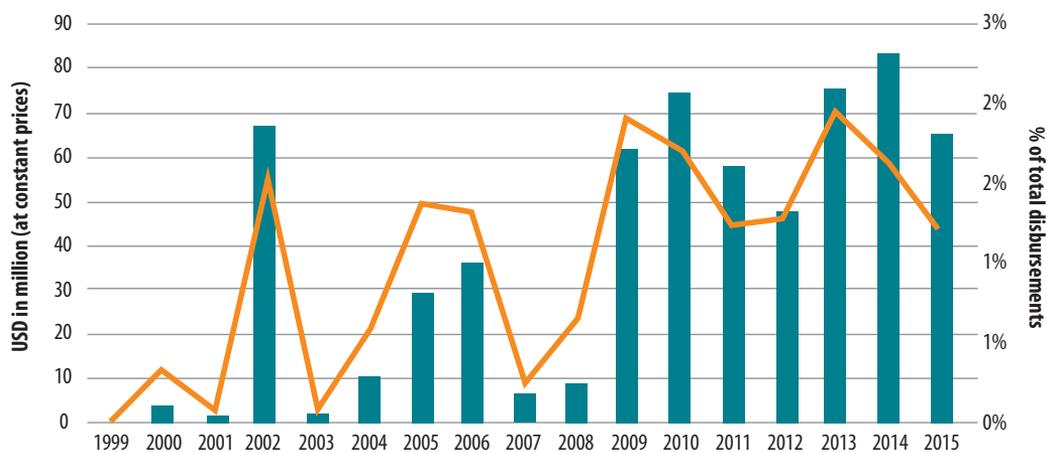
Figure 22 PEFA assessed rankings in 2009 and 2012 for local governance

Source: PEFA assessment reports

An analysis of aid flows shows that a shift in government priorities towards local governance system since 2001 onwards has been met with a substantial increase in development support (see Figure 23). After the 18th Constitutional Amendment, aid support for local governance has been routed to the provincial governments, however aid flows in this sector as a proportion of total disbursements has been less than 2% in any given year.

⁶⁵<http://pide.org.pk/pdf/Working%20Paper/WorkingPaper-33.pdf>

Figure 23 Aid flows to local governance



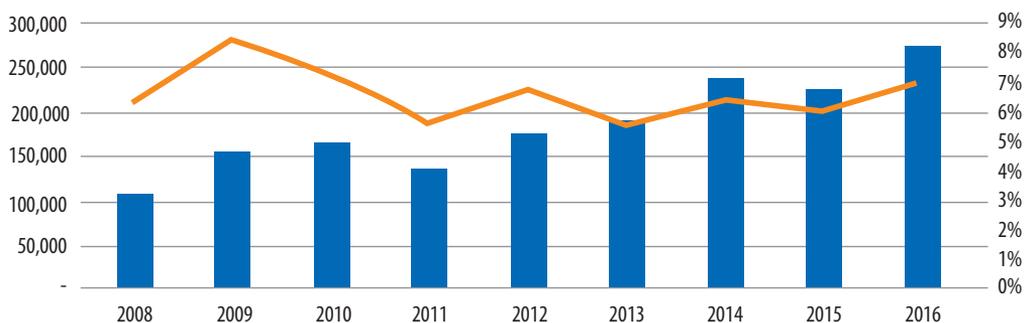
Source: OECD DAC Creditor Reporting System

15.6 Aid management & donor relations

The Economic Affairs Division is the central authority for coordinating foreign grants and loans in the country, including on behalf of provinces. Provinces, while authorised to raise certain types of loans within certain limits, must route all aid flows through the EAD. Over the years, government spending on aid has increased, especially in 2009, 2012, 2014 and 2016 (see Figure 24).

Since 9/11, Pakistan has received substantial foreign aid, military aid, loan write-offs and cheap loans in return for its active role in the 'war on terror'. The United States has been one of

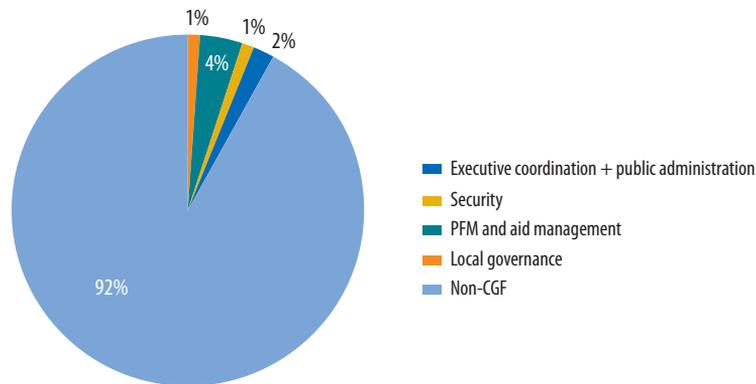
Figure 24 Expenditure composition on aid coordination



Source: Financial statements

Pakistan's largest donors, obligating nearly \$67 billion to Pakistan between 1951 and 2011, according to the Centre for Global Development.⁶⁶ Aid flows have however, been particularly volatile, and closely linked to specific geo-strategic events. Despite Pakistan's transformation from a military regime to an elected civilian government, international aid flows, particularly from the US, have been security related. Hence, it seems that the transition from military rule to democracy has not influenced expenditure on security, but rather that this increase is more closely connected to the escalation of terrorist violence and the adoption of the war on terror.

Figure 25 Composition of aid disbursements from 1999 to 2015 at constant prices 2010



Source: OECD data

According to the International Crisis Group, almost two thirds of US funding between 2002 and 2012 has been security related, double the \$7.8 billion of economic aid. An interesting development came in October 2009 with the Kerry-Lugar-Berman bill, which put security and development on two separate tracks, insulating the development agenda from unpredictable geopolitical and military events. The act authorized a tripling of US economic and development-related assistance to Pakistan, or \$7.5 billion over five years (2010 - 2014), to improve Pakistan's governance, support its economic growth, and invest in its people.⁶⁷

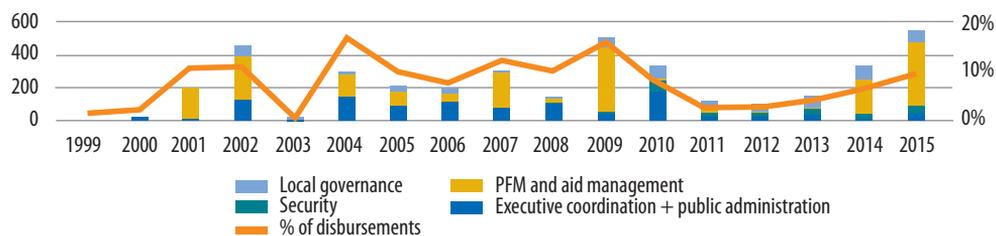
CGF related aid flows have constituted about 12% of the total aid disbursements on average in the fifteen years considered for this analysis (see Figures 26).

The MDTF has been a key financing mechanism in response to the Post Crisis Needs Assessment Strategy for directly supporting reconstruction and rehabilitation activities in the conflict affected areas of Khyber Pakhtunkhwa, Balochistan and erstwhile federally administered tribal areas. An

⁶⁶Centre for Global Development, 2013. *Aid to Pakistan by the Numbers*.

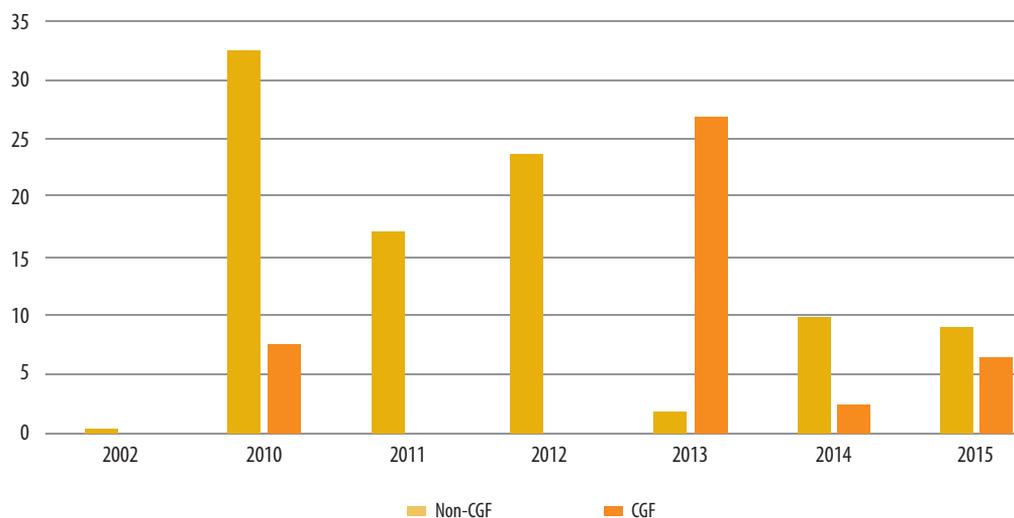
⁶⁷International Crisis Group, 2004. *Liberia and Sierra Leone: Rebuilding Failed States*

Figure 26 Total CGF related disbursements to Pakistan



Source: OECD data

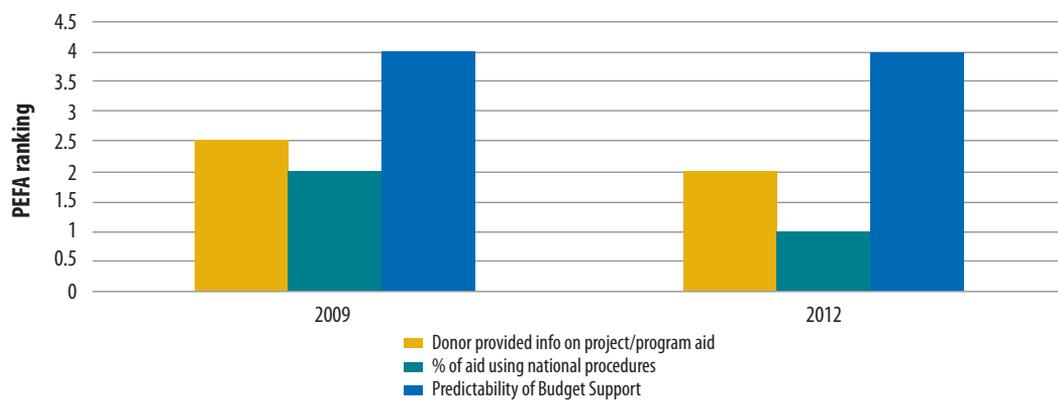
Figure 27 Aid disbursements under MDTF



Source: OECD data

analysis of MDTF aid flows shows that while total MDTF disbursements have decreased over time, the CGF related disbursements under MDTF have increased since 2012 (see Figure 27). This has been partly due to completion of most infrastructure related projects and an increased emphasis on PFM related technical assistance being provided to the provincial governments of KP, Balochistan and FATA Secretariat.

The PEFA scoring indicates that aid management was actually better in 2009 than in 2012 as seen from Figure 28.

Figure 28 PEFA assessment ratings on aid management in 2009 and 2012

Source: PEFA website

16 Conclusions

While Pakistan's context and significant constraints on the availability of public expenditure data, described in the introduction to this study, have made it difficult to observe clear expenditure patterns or to find substantive clues in the budget lines linked to core government functions, it is evident from analysis of priority reforms that **some of the core government functions were prioritised by the Government of Pakistan during the identified transition periods. This was especially the case for local governance, security, and public financial management.** The majority of KIIs corroborated this assessment.

The incentive for adopting a certain trajectory of reform has been linked to priorities stemming from three dynamics: the deterioration of the security situation, internal political strife and ethnic conflict and bleak economic performance. **Two core government functions emerged more prominently during the research: local governance and security.** Reforms to local governance have deepened the devolution process fiscally, administratively and at political levels. Local governance reform has also been a cornerstone of the transition from military to rule to democratisation. It was equally important issue to address when the war on terror was adopted and when peace was established in the most conflict affected areas of the country (in particular Khyber Pakhtunkhwa and the FATA). On the other hand, reforms in the security sector aimed at strengthening the military capacity in order to contain internal insurgencies as well as the threat of terrorism from neighbouring Afghanistan are difficult to observe in the expenditure data, although well reported through data sources in what is commonly regarded as a complex geopolitical context. More transformative reforms (accountability, human rights, oversight) are harder to observe, especially as the military are still regarded as the main powerholders in Pakistan.

Both CGF and non-CGF aid flows appear to be related to the country's transition milestones and changing government priorities. CGF-related aid has remained a smaller proportion of the total aid disbursements over the past decade and a half, with infrastructure and energy sectors overshadowing the rest. This signals a prioritisation of reconstruction and recovery efforts (especially following the 2005 earthquake and more recently under the integration of the FATA into Khyber Pakhtunkhwa province) which may not be CGFs but are definitely priorities for any country undergoing a transition.

Out of the CGF related expenditures, the highest share has been spent on sub-national governance (including local governments and provinces), followed by the security sector, public finance, aid coordination, executive coordination, and government employment and public administration, in that order.

While MDTF related aid disbursements have decreased over time, the CGF related disbursements as a proportion of MDTF aid flows has increased since 2012. The CGF related aid flows go mainly towards providing technical assistance to the provincial governments on investment management, expenditure management and tax policy and administration reforms, all of which are core government functions.

Public administration has perhaps been a critical area requiring extensive reform but has remained a challenge due to its complex political economy. Reform efforts were initiated within the observable pattern of the transition period, however failed due to weak authorization and absence of a sequenced approach. Some of the high impact areas that have remained a policy focus for many past governments, but with little progress, are merit- based service structures, performance-based remuneration, pension liability management, and human capital development. In the past year, this has emerged as key priority for the new government, which had included civil service reforms in its election manifesto as well as a key action area in the five-year development and reform strategy.

Local governance remains a priority for the new government, which seems to be focused on deepening devolution to town, village and neighbourhood councils (particularly in those parts of the country significantly affected by conflict and re-establishment of the writ of state). However, this needs to be coupled with concerted efforts to provide enabling systems and capacity to local governments and allowing greater financial autonomy on resource distribution.

What next for Pakistan

It is expected that spending priorities will continue under the new government, particularly on the security sector and local governance. The KP and FATA merge marks a historic landmark in Pakistan's road to democracy. This will have deep consequences in the country's local governance, particularly as tribal people will now have representation in the KP Assembly. Regarded as a 'win for democracy', the merge is a critical step to "establish beyond doubt Pakistan's status as a democratic entity which cannot function any other way".⁶⁸ The success will be up to the parties and political forces and with public pressure amounting, "their conduct will have to improve dramatically".

However, the road to deepening democracy is marred by challenges in the security sphere. Pakistan is still under pressure to demonstrate a genuine interest in cracking down on militants. For decades, Pakistan's military and intelligence have been accused of giving sanctuary to extremist groups subscribing to the state's anti-India agenda or Taliban allies in Afghanistan.⁶⁹ While Pakistan has continuously denied such allegations, the Financial Action Task Force's (FATF) decision to put Pakistan onto a "grey list" in 2018 due to 'strategic deficiencies' in its anti-money laundering and terrorism financing regime.

The country continues to walk a fine line between its military ways and the changes needed for a country still undergoing its transition into democracy. Additional warnings came from Western nations in 2018 calling for Pakistan to stop evicting some 22 non-governmental organizations, which operated in the country for many years. The government continues to crack down on civil society, with NGOs now required to obtain a "no-objection certificate" for their activities, which is practically never granted.

⁶⁸Nasir, Abbas, "Democracy wins again", in Dawn Paper, May 26, 2018.

⁶⁹Rashid, Ahmed, "Will Pakistan mend its ways on terror?", BBC News, June 8, 2018.

Nevertheless, security is expected to continue to be a priority, especially in light of the recent events with India. The attack on Indian-controlled Kashmir by Pakistani terrorists exacerbated existing and historic tensions, with the recent shoot down of Indian and Pakistani jets further igniting tensions and casting a nuclear shadow over the contested region.

Such instability in the region will continue to drive support of donors such as the US and the UK under the war on terror and radicalisation. However, Pakistan will still need to improve its economic performance and one such way is through foreign investment. That being said, China is now the biggest investor in Pakistan, with some \$60bn invested in infrastructure projects. However, if Pakistan is intent on diversifying and growing its economy, a grey list designation is certainly a deterrent for international businesses deciding whether to invest in the country. Such dynamics show that the positive effects of democratisation have yet to filter through to the economy or the security setup.

Annex G List of interviewees

Government

- Mr. Zafar Hassan Ulmas, Chief Macroeconomics Section, Planning Division
- Mr. Rauf Gandapur, former Deputy Secretary, Economic Affairs Division
- Dr Waqar Masood, former Secretary Finance, Ministry of Finance
- Sahibzada Saeed, former Additional Chief Secretary, Government of KP

Donors

- Dr. Muhammad Waheed, Senior Economist, World Bank
- Mr. Martin Waehlich, Desk Officer for Pakistan, DPA

Technical Advisors

- Mr. Nohman Ishtiaq, Consultant to the MTBF Cell, Finance Division
- Mr. Hanid Mukhtar, Freelance Consultant and Economist to the Government of Pakistan

Annex H Methodological Note

Core Government Functions	Data source (years available)	Domestic budget lines	Assumptions/limitations	Aligned OECD DAC Codes and notes
Executive coordination	Budget Estimates for Service Delivery (2011 onwards) Audited financial statements (2008 onwards)	Cabinet Division, President's Secretariat, Prime Minister's Inspection Commission, Prime Minister's Secretariat		15110 - Public sector policy and administrative management Includes i) General Personnel Services and ii) Executive Office
Public finance: Revenue and expenditure management	Audited financial statements (2008 onwards)	Finance Division (minus domestic debt repayment, debt servicing and subsidies), Planning and Development Division, Revenue Division, Tax Ombudsman, Controller General of Accounts, Accountant General Pakistan Revenue, and Auditor General.	Data may include some amounts relating to transfers to provinces which are covered under 'sub-national governance' as well.	15111 - Public Financial Management Includes debt and aid management 15114 - Domestic Revenue Mobilisation
Government employment & public administration	Audited financial statements (2008 onwards)	Establishment Division and Federal Public Service Commission		15110 Public sector policy and administrative management Includes i) General Personnel Services and ii) Executive Office.
Sub national governance	Fiscal operations report (2001 onwards)	Transfers (from federal) to provinces.	Does not include transfers from provinces to local governments. A part of these transfers may also be covered under 'public finance' expenditures. Limitations in available data disaggregation restricted the authors from preventing double counting of expenditures completely.	15112 - Decentralisation and support to subnational government
Aid coordination	Audited financial statements (2008 onwards)	Economic Affairs Division	Some foreign debt repayment expenditures are reported in the EAD budget and, where possible, have been identified and removed from the budget line.	15111 - Public Financial Management
Security	Audited financial statements (2008 onwards) Fiscal operations report (2001 onwards) approx. figures only	Functional classification heads of 'defence affairs' and 'public order & safety'. The figures are comparable to the sum of individual budget lines of Defence Division, defence services, defence production, interior division, and law & justice division, with minor differences.	Data excludes majority police related expenditures and provincial courts as they are devolved functions and are not included in federal budget. Unlike the audited financial statements, Functional classification used in fiscal operations report represents only recurrent expenditures, therefore these figures from 2001 to 2007 have been qualified as approximate expenditures only.	15210 - Security system management and reform 15240 - Reintegration and SALW control 15261 - Child soldiers (prevention and demobilisation) 15230 - Participation in international peacekeeping operations 15220 - Civilian peace-building, conflict prevention and resolution 15250 - Removal of land mines and explosive remnants of war

