Document of

The World Bank

Report No. ICR**1782**

IMPLEMENTATION COMPLETION AND RESULTS REPORT

(IDA-45590)

ON A

CREDIT

IN THE AMOUNT OF SDR 321.3 MILLION

(US$500 MILLION EQUIVALENT)

TO THE ISLAMIC REPUBLIC OF PAKISTAN

FOR A

POVERTY REDUCTION AND ECONOMIC SUPPORT OPERATION

March 28, 2011

Economic Policy and Poverty Group
South Asia Region

PAKISTAN—GOVERNMENT'S FISCAL YEAR
July 1–June 30

CURRENCY EQUIVALENTS
(Exchange Rate Effective as of March 22, 2011)
Currency Unit = Pakistan Rupees (PKRs)
US$1 = 85.47 PKRs

ABBREVIATIONS AND ACRONYMS

BISP	Benazir Income Support Program
CAD	Current Account Deficit
CCP	Competition Commission of Pakistan
CDNS	Central Directorate of National Savings
DFID	UK Department for International Development
DPL	Development Policy Lending
FBR	Federal Board of Revenue
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GoP	Government of Pakistan
IFC	International Finance Corporation
IMF	International Monetary Fund
ISR	Implementation Status Report
LTU	Large Taxpayer Unit
MoF	Ministry of Finance
M&E	Monitoring and Evaluation
MTB	Market Treasury Bill
MTBF	Medium Term Budgetary Framework
NEPRA	National Electric Power Regulatory Authority
OGRA	Oil and Gas Regulatory Authority
PDL	Petroleum Development Levy
PDO	Program Development Objective
PIB	Pakistan Investment Bond
PPRA	Public Procurement Regulatory Authority
PRESO	Poverty Reduction and Economic Support Operation
PRSC	Poverty Reduction Support Credit
PRSP-II	Poverty Reduction Strategy Paper-II
PSDP	Public Sector Development Program
SBA	Stand By Arrangements
SBP	State Bank of Pakistan
TSA	Treasury Single Account
VAT	Value Added Tax
WAPDA	Water and Power Development Authority
RTO	Regional Tax Office

Vice President:	Isabel Guerrero
Country Director:	Rachid Benmessaoud
Sector Manager:	Deepak Bhattasali
Task Team Leader:	Muhammad Waheed

Contents

A. BASIC INFORMATION

Country:	Pakistan	Program Name:	Pakistan Poverty Reduction and Economic Support Operation (PRESO)
Program ID:	P113372	L/C/TF Number(s):	IDA-45590
ICR Date:	12/08/2010	ICR Type:	Core ICR
Lending Instrument:	DPL	Borrower:	Government of Pakistan
Original Total Commitment:	US$500 million	Disbursed Amount:	US$500 million
Revised Amount:	US$500M		
Implementing Agencies: MoF, GoP			
Co financiers and Other External Partners:			

B. KEY DATES

Process	Date	Process	Original Date	Revised / Actual Date(s)
Concept Review:	12/15/2008	Effectiveness:	03/27/2009	03/27/2009
Appraisal:	01/26/2009	Restructuring(s):	N/A	
Approval:	03/26/2009	Mid-term Review:		
		Closing:	03/31/2010	03/31/2010

C. SUMMARY RATINGS

C1: PERFORMANCE RATING BY ICR

Outcomes:	Moderately Unsatisfactory
Risk to Development Outcome:	High
Bank Performance:	Moderately Satisfactory
Borrower Performance:	Moderately Unsatisfactory

C2: DETAILED RATINGS OF BANK AND BORROWER PERFORMANCE (by ICR)

Bank	Ratings	Borrower	Ratings
Quality at Entry:	Moderately Satisfactory	Government:	Not Applicable
Quality of Supervision:	Satisfactory	Implementing Agency/Agencies:	
Overall Bank Performance:	Moderately Satisfactory	**Overall Borrower Performance:**	Moderately Unsatisfactory

C3: QUALITY AT ENTRY AND IMPLEMENTING PERFORMANCE INDICATORS

Implementation Performance	Indicators	QAG Assessments (if any)	Rating:
Potential Problem Program at any time (Yes/No):	No	Quality at Entry (QEA):	None
Problem Program at any time (Yes/No):	No	Quality of Supervision (QSA):	None
DO rating before Closing/Inactive status:	N/A		

D. SECTOR AND THEME CODES

	Original	Actual
Sector Code (as percent of total Bank financing)		
Banking	10	10
Central government administration	50	50
Oil and gas	10	10
Other social services	10	10
Power	20	20
Theme Code (as percent of total Bank financing)		
Debt management and fiscal sustainability	30	30
Public expenditure, financial management and procurement	10	10
Regulation and competition policy	20	20
Social safety nets	10	10
Tax policy and administration	30	30

E. BANK STAFF

Positions	At ICR	At Approval
Vice President:	Isabel M. Guerrero	Isabel M. Guerrero
Country Director:	Rachid Benmessaoud	Yusupha B. Crookes
Sector Manager:	Deepak Bhattasali	Miria A. Pigato
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F. RESULTS FRAMEWORK ANALYSIS

Program Development Objectives

The proposed Poverty Reduction and Economic Support Operation (PRESO) supports:

a Regaining and maintaining macroeconomic stability through increased tax revenue mobilization, adjustment of fuel prices and power tariffs, improved efficiency of public spending, and strengthened GoP debt management;

b Enhancing competitiveness through reduced barriers to business entry and exit, and strengthened financial sector; and

c Protecting the poor and vulnerable through improved targeting of safety nets and cash transfer programs, and strengthened statistical systems.

Revised Program Development Objectives (If any, as approved by original approving authority)

(a) PDO Indicator (s)

For PRESO Core Indicators, please see Annex 2 at the end of document.

(b) Intermediate Outcome Indicators

For PRESO Core Indicators, please see Annex 2 at the end of document.

G. RATINGS OF PROGRAM PERFORMANCE IN ISRs

No ISR's were prepared for this operation.

H. RESTRUCTRING IF ANY

Not applicable

1. Program Context, Development Objectives and Design

1.1 Context at Appraisal

The Poverty Reduction and Economic Support Operation (PRESO) was the most recent of a series of budget support operations in Pakistan. PRESO was carried out under very difficult circumstances. The Government of Pakistan (GoP) has found it difficult to sustain reform momentum through a volatile political and economic context, as well as natural disasters like the 2005 earthquake and exogenous external shocks.

After several years of strong economic performance, growth slowed down in 2008, as Pakistan faced both external and internal shocks. On the external side, international oil and food commodity prices rose sharply in 2007/08 and increased Pakistan's import bill, while the subsequent slowdown in the global economy dampened the external demand for Pakistan's exports. On the internal side, Pakistan's political turmoil and escalating violence affected investor confidence, which together with the widening macroeconomic imbalances, led to capital outflows as well as a downgrading of Pakistan's credit rating by international rating agencies.

The political situation made it difficult for the authorities to take timely corrective action. The authorities did not pass on any of the international price increases to consumers until after the February 2008 Parliamentary elections, but before that happened, fully financed that incremental increase through the GoP budget by increasing subsidies. As a result, the fiscal and current account deficits widened substantially.

Only in March 2008 did the authorities start taking steps to stabilize the economy. These included not only passing on some of the international fuel price increases to consumers, but restricting the size of the fiscal deficit in 2007/08 and the 2008/09 budgets, increasing the policy discount rate, and allowing greater flexibility in the exchange rate. However, these corrective actions did not prevent rising inflation and output contraction.

Faced with the risk of a balance of payments crisis and to avoid default on foreign debt payments in the fall of 2008, the authorities decided to put in place adjustment measures aimed at facilitating the resumption of inclusive growth with low inflation over the medium term. In November 2008, the authorities entered into a Stand-By Arrangement (SBA) with the International Monetary Fund (IMF) and also requested assistance from the World Bank to support the structural reform process.

PRESO was initially prepared as the start of a new series of Development Policy Lending (DPL) (supporting GoP's multi-year program of reforms), but was processed as a stand-alone operation focused on supporting the authorities' shorter-term efforts to promote stabilization and economic recovery. The Poverty Reduction Strategy Paper-II (PRSP-II) was prepared by GoP at the end of 2008, which provided the framework for the policy agenda. PRESO supported PRSP-II objectives related to macroeconomic stabilization, improving competitiveness and protecting the poor. However, given the magnitude of macroeconomic imbalances, it was recognized that regaining macroeconomic stability and putting the economy

back on a path of sustainable growth would require multi-year policy adjustments. After PRESO, it was anticipated that the later years of the framework could be supported through follow up successive operations.

PRESO helped to fund the GoP's budgetary needs in 2008/09. PRESO financing was a key part of the GoP's financing plan for 2008/09. The IMF's SBA assumed World Bank disbursements of US$1.4 billion in 2008/09, including US$500 million through PRESO.

1.2 Original Program Development Objectives (PDO) and Key Indicators (as approved)

PRESO was prepared as a stand-alone operation in order to support the authorities' short-term policy measures to promote economic recovery, along with the needed stabilization. Following are PRESO's main objectives and the outcomes expected in three areas:

a. Regaining and maintaining macroeconomic stability.

- Fiscal deficit reduced from 7.4 percent of Gross Domestic Product (GDP) in 2007/08 to or below 4.3 percent of GDP in 2008/09.
- Current account deficit (CAD) reduced from 8.4 percent of GDP in 2007/08 to or below 5.9 percent of GDP in 2008/09.

b. Enhancing competitiveness.

- Improved Doing Business indicators including inter alia Starting-a-Business indicator reduced from 27 days in 2008 to 22 days in 2009.

c. Protecting the poor and vulnerable.

- Improved access to social safety net programs; measured by increased coverage of the poorest 25 percent of the population by the Benazir Income Support Program (BISP).

1.3 Revised PDO (as approved by original approving authority) and Key Indicators, and Reasons/Justification

Not Applicable

1.4 Original Policy Areas Supported by the Program (as approved)

The reform areas supported by PRESO built on the two previous Poverty Reduction Support Credits (PRSCs) of 2004 and 2007 and were aligned with GoP's Poverty Reduction Strategy Paper-II (PRSP-II). PRESO highlighted efforts in three areas:

a. Regaining and maintaining macroeconomic stability through measures in the following areas: increased tax revenue mobilization, adjustment of fuel prices and power tariffs, improved efficiency of public spending, and strengthened GoP debt management.

b. Enhancing competitiveness through measures in the following areas: reduced barriers to business entry and exit, and strengthened financial sector.

c. Protecting the poor and vulnerable through measures in the following areas: improved targeting of safety nets and cash transfer programs, and strengthened statistical systems.

TABLE 1: MAPPING OF PRESO REFORM INITIATIVES FROM PRSP-II

PRSP-II Pillars	PRESO Reform Objectives
• Macroeconomic Stability and Real Sector Growth	• Increased Revenue Mobilization • Improved Efficiency of Public Spending • Strengthened GoP Debt Management
• Integrated Energy Development Program	• Adjustment of Fuel Prices and Power Tariffs
• Making Industry Internationally Competitive	• Reduced Barriers to Business Entry and Exit
• Capital and Finance for Development	• Strengthened Financial Sector
• Protecting the Poor and Vulnerable	• Better Targeted Social Safety Nets
• Monitoring and Evaluation of PRSP-II	• Strengthened Statistical System

1.5 Revised Policy Areas

There was no revised policy area.

1.6 Other Significant Changes

There were no significant changes.

2. Key Factors Affecting Implementation and Outcomes

2.1 Program Performance

Progress on the overall reform program supported by PRESO was mixed. Reforms progressed well in most areas but despite strong efforts fell short of expectations in eliminating power sector subsidies and raising revenue collection. The 10 upfront actions highlighted by the PRESO are noted in Table 2 below. The core indicators on the PDO are tabulated in Annex 2.

TABLE 2: UP-FRONT ACTIONS HIGHLIGHTED BY PRESO

Objectives	Prior Actions	Prior Action
Pillar I: Regaining and Maintaining Macroeconomic Stability	1	GoP approved establishment of a new integrated tax administration on functional basis and related Federal Board of Revenue (FBR) top management changes implemented.
	2	GoP approved policy action plan to amend legislation of domestic indirect taxes to ensure comprehensive taxation of goods and services in the form of Value Added Tax (VAT).
	3	Automatic monthly adjustment of consumer fuel prices introduced, and a minimum level of Petroleum Development

		Levy (PDL) specified.
	4	Monthly determination of fuel adjustment surcharge introduced; new electricity tariffs notified in 15 days from determination or re-determination.
	5	A satisfactory plan to eliminate power sector subsidies by end June 2009 consistent with the budget adopted and implemented.
	6	Public Sector Development Program (PSDP) portfolio consolidated by at least 20 percent consistent with development priorities.
	7	Ministry of Finance (MoF) amended rules defining roles and decision-making rights for Pakistan Investment Bond (PIB) issuance and issued related instructions to State Bank of Pakistan (SBP).
Pillar II: Enhancing competitiveness	8	Competition Commission of Pakistan (CCP) rules notified providing the terms and conditions of its members; and automatic source of financing.
	9	Prudential regulations amended to introduce a phased reduction in the group credit exposure limit from 50 percent to 25 percent over time.
Pillar III: Protecting the Poor and Vulnerable	10	GoP adopted the scorecard as the new targeting instrument for Benazir Income Support Program (BISP) and notified the plan for its roll out, with the roll-out launched in January 2009.

The following paragraphs consider the various components of the reform program in turn, grouped under the three pillars of the program. The outcome level assessments are presented subsequently in Section 3.

Pillar 1: Regaining and Maintaining Macroeconomic Stability

Progress under this pillar was mixed with overall meaningful gains, but slippage or late reversals in two areas. However, even if some actions did not meet their stated targets, the situation would likely have been worse in the absence of the reform program.

Increased Revenue Mobilization

The sustainability of the macroeconomic program rested heavily on boosting revenue mobilization. Inadequate revenue mobilization remained the most critical concern as revenues fell short of targets. Tax revenue as a share of GDP declined from 10.6 percent in 2007/08 to 10.2 percent in 2008/09, and further in 2009/10. Progress was made on improving tax administration, but core tax policy reforms were not implemented and several of the administrative measures highlighted in PRESO reform program were modified or delayed. For instance, GoP approved the plan for the FBR restructuring, consistent with its tax administration reform strategy of 2003, and made one change in the FBR Board according to the plan under PRESO in 2008/09 (Upfront Action 1 of 10). However, in the summer 2009, well after the

PRESO Board, GoP backtracked on this reform due to pressure from vested interests. The Bank, jointly with the IMF, started addressing the reversal to get it back on track. The authorities made adjustments to their plan and started its implementation in the fall 2009. In addition, PRESO highlighted approval of a policy action plan to amend legislation on the levying of domestic indirect taxes to ensure comprehensive taxation of goods and services in the form of a VAT (upfront action 2 of 10). While the action plan was prepared, GoP has been unable to sustain it and follow through. The revised approach to amend the legislation governing General Sales Tax in the 2010/11 budget, in order to make it more like a VAT (broadening the tax base and reducing the zero-ratings and exemptions), awaits implementation due to a lack of political consensus among key stakeholders, including the provinces. Implementation of VAT remains at the center of the economic policy dialogue between GoP and the Bank in the recent past and the Bank continues providing timely and adequate technical assistance. In addition, there was a decline in revenue collection at sub-national levels as provinces only collected 1.16, 1.02 and 0.84 percent of GDP during 2007/08, 2008/09 and 2009/10 respectively.

Adjustment of Fuel Prices and Power Tariffs

GoP successfully eliminated the subsidies on domestic fuel prices by allowing the Oil and Gas Regulatory Authority (OGRA) to notify domestic fuel prices in accordance with changes in international prices, while keeping a minimum level of a PDL specified. The automatic fuel price adjustment mechanism was re-introduced in early 2009 (Upfront Action 3 of 10) and enabled monthly adjustments of domestic prices on fuel products, which are consistent with the changes in the import parity price. This sharply reduced the fiscal burden of subsidies on fuel products. The process was helped by the falling international price of fuel during much of 2009. It is worth noting, however, due to political pressures, GoP put at risk this important reform on January 6, 2011, when it barred OGRA from *automatically* notifying fuel prices based on international oil price movements. However, it later restarted fuel price adjustments on March 1, 2011. This partial reversal again exposes the authorities to political pressures each time higher international prices would call for increases in the domestic price, and fiscal pressures in the event of any subsequent delays.

The power sector remains one of the most contentious and unresolved areas of reform. The core issue is restoring the financial viability of the power sector, and reducing large and unsustainable GoP subsidies to the sector. As part of reforms under PRSC I and II, the National Electric Power Regulatory Authority (NEPRA) started, in February 2007, determining the tariffs for unbundled Water and Power Development Authority (WAPDA) distribution companies on the basis of the cost of service of each distribution company. The tariffs for each distribution company were posted on NEPRA's website. However, these tariffs were not notified or implemented. Instead, on February 24, 2007, GoP notified a uniform consumer tariff across all distribution companies. For political reasons, GoP avoided having different electricity tariffs across the country and decided to cover the difference between the NEPRA-determined and government-notified uniform consumer tariff through 'tariff differential subsidies', a practice

since 2007. During PRESO period, power differential subsidies decreased. The budgetary subsidy to power sector utilities which was 1.3 percent of GDP in 2007/08, decreased to 0.8 percent of GDP in 2008/09.

PRESO also supported GoP's efforts to make regular power tariff adjustments, including the preparation of an actual amendment authorizing NEPRA to determine tariff adjustments attributed to movements in fuel costs on a monthly basis. Addressing a sizeable portion of power generation costs, this reform (Upfront Action 4 of 10) was one component of the tariff adjustment plan which would have enabled the Government to contain tariff differential subsidies at Rs. 55 billion in 2009/10. In addition to monthly adjustments in tariffs to reflect fuel price changes, the Government also needed to notify consumer tariffs for the distribution companies, as per NEPRA's determination. Following a plan to eliminate power sector subsidies by end June (the preparation of the plan was Upfront Action 5 of 10) the fiscal drain associated with electricity was to cease from July 2009 onwards. However, the tariff adjustment mechanism (involving monthly adjustments on account of fuel price changes, as well as periodic notification of consumer level tariffs for all distribution companies) was only implemented for a few months, and later stopped. It was also not implemented in a timely manner. Later in 2009, it turned out that GoP's action plan for subsidy elimination was based on incorrect estimates provided by the authorities, which underestimated the actual amount of subsidy needs.

Furthermore, at the beginning of 2010/11, the ordinance empowering NEPRA to notify fuel adjustment directly lapsed, because it was not ratified by Parliament. Consequently, NEPRA has reverted to the earlier practice of only recommending tariff revisions to GoP, which would then need to go the further step of notifying the tariffs. Since GoP did not promptly notify monthly fuel adjustments as determined by NEPRA, and the regular quarterly determinations are also not being promptly and fully notified, therefore, fundamental goal of containing power sector subsidies remains elusive: Overall, electricity tariff differential subsidies rose to Rs. 188 billion in 2009/10 (1.3 percent of GDP), but are projected to fall again to an estimated Rs 143 billion (0.8 percent of GDP) in 2010/11. Despite the major efforts done by the Bank and other donors to address this problem, GoP has still not formally submitted an alternative amendment of the NEPRA Act to Parliament, which would achieve the desired automaticity and depoliticize tariff setting.

The agreements under PRESO were designed to promote automaticity in the tariff determination and notification process, particularly to account for changes in fuel costs which were very volatile at that time. Actual implementation of the agreed program was, however, deficient in two aspects: (a) the Government did not promptly notify NEPRA determined adjustments on account of fuel price changes; and (b) the Government agreed under PRESO to do only a one-time adjustment (4%) in electricity tariffs, without evaluating by how much power supply costs had changed, and were expected to change, over the full fiscal year. For these reasons, the Bank proposed that the Government consider (a) empowering NEPRA to notify all tariff adjustments (i.e. Government discretion to notify adjustments due to fuel cost changes, or overall tariffs,

should be eliminated); and (b) monthly adjustments on account of fuel cost changes be revised to reflect the full change in the distribution companies' power purchase costs, not only on account of changes in fuel prices.

In sum, the reforms supported by PRESO in this area have not proven durable yet, and much more will need to be done in the power sector if it is to cease siphoning off scarce public resources and constraining growth.

Improved Efficiency of Public Spending

Consistent with the broader goal of macroeconomic stability, PRESO emphasized steps to improve the efficiency of public sector spending. This included rationalizing PSDP portfolio, strengthening budget planning, implementing effective cash management, and enhancing transparency in procurement. Good progress was made in consolidating the PSDP, surpassing the 20 targets highlighted in PRESO (Upfront Action 6 of 10). This was done by re-evaluating the economic and financial viability of the projects that were significantly delayed, cutting allocations where the existing allocation was less than 10 percent of the total anticipated financing needs, and terminating projects that were inconsistent with GoP's development priorities.

In other areas of public expenditure management, GoP also made meaningful progress. GoP is moving away from a single-year budgeting process to a Medium-term Budget Framework (MTBF), and after a slow and hesitant start, the process continues to gain momentum. The authorities have established a Treasury Single Account (TSA), aiming to stop the leakage of funds. Completing the transition to the TSA will require transferring the balances held by various GoP ministries and agencies in commercial banks, and then closing those accounts. Owing to strong vested interests, GoP has only partially been able to follow through on this. Procurement reforms have progressed well, with contract awards over Rs. 50 million posted on the Public Procurement Regulatory Authority (PPRA) website, among other rule based mechanisms in place, and active training programs have been established to enhance compliance with procurement procedures.

Strengthened GoP Debt Management

Improving public debt management was also an important part of the overall effort towards the goal of macroeconomic stability. This hinges on implementing debt policy consistent with sound monetary and fiscal policy, proceeding with GoP borrowing in a manner conducive to the development of a securities market, and improving the reliability of debt service forecasts.

In past years, one area of concern was GoP borrowing from the central bank. MoF committed to zero net borrowing from the central bank from November 1, 2008. GoP successfully remained within this ceiling agreed under IMF's SBA and PRESO until March 2010. However, due to a shortfall in domestic revenues and over-spending, in the context of

limited access to external financing, GoP started to borrow substantially from SBP in the last quarter of 2009/10, going above the ceiling agreed with the IMF under the SBA.

PRESO supported GoP efforts to use public borrowing to help develop GoP securities market. A key part of this is the issuance of a credible calendar for PIB auctions, helping to stabilize Pakistan's financial markets. Market participants believe that the GoP has greater credibility and commitment to market-based funding costs in the primary market due to the publication of, and adherence to, an auction calendar, which enables the market to plan for issuance and better absorb GoP's funding needs. Almost all wholesale issuance now occurs according to a calendar. While Market Treasury Bills (MTBs) have been issued fortnightly under long-standing practice, an auction calendar of PIBs was introduced for the first time in the 2008/09 fiscal year. For MTBs, the calendar covers 3 months. It specifies auction dates, the tenors to be offered at each auction, and the total target volume; tenor-specific target volumes are not announced. For PIBs, the calendar covers 6 months. It specifies auction dates, the tenors to be offered at each auction, the total target volume, and (in contrast to the practice for MTBs) the target volume for each tenor. Importantly, GoP discontinued its prior practice of applying low or arbitrary cut-off yields in auctions. Bid acceptance respects the volumes announced in the calendars. In addition, the roles of MoF and SBP have been clarified (Upfront Action 7 of 10). These factors have contributed meaningfully to increasing the credibility of the GoP in the domestic debt market.

Pillar 2: Enhancing Competitiveness

Reduced Barriers to Business Entry and Exit

Recognizing that the private sector is the engine of growth, PRESO also focused on "Reduced Time to Start a Business" like issues and strengthening of the financial sector. One of the overall outcome goals was that starting-a-business indicator should be improved by reducing the number of days from 27 in 2008 to 22 in 2009. According to the IFC/World Bank Doing Business 2010 Report, this goal was successfully achieved, as starting a business required only 20 days in 2009. Also, it was envisaged that the enhancement of competition is an important ingredient for the development of the private sector. In this regard it was deemed important to improve competition policy framework by enhancing the role of CCP. Key steps in this process were notifying CCP rules regarding the terms and condition of appointment, and the establishment of an automatic financing mechanism for CCP (Upfront Action 8 of 10). The latter, however, was implemented with delays, and resource transfers from the other regulators have been limited, leaving CCP in a highly resource constrained budget environment. After many delays, CCP Act was ratified by the Parliament on October 6, 2010. This was not part of PRESO, but the Bank team continued efforts to support CCP after PRESO. Despite these constraints, it is notable that CCP has been very active, successfully holding hearings on anticompetitive practices in the cement, energy, automobile, polyester, and fertilizer sectors and action was taken against illegal practices. It is essential that the legal and policy framework promote competition, which is stifled in many areas by cartels and collusions among existing

suppliers. Also, remaining barriers to business entry and exit still need to be lessened. For example, Pakistan is still lacking a well-functioning bankruptcy framework which is consistent with international practice.

Strengthened Financial Sector

In order to strengthen the financial system and reduce systemic risks, SBP endeavored to amend prudential regulations with a view to phasing in a reduction in group credit exposure limits from 50 percent to 25 percent over time (Upfront Action 9 of 10). The goal of this reform was the diversification of lending portfolio and progress has been made in this regard. SBP has issued prudential regulations that have asked financial institutions to decrease the group exposure limit in a staggered manner to 25 percent over the period from 2009 to 2013. Currently this exposure limit stands at 40 percent and is moving in the right direction

Pillar 3: Protecting the Poor and Vulnerable

Improved Targeting of Safety Nets and Cash Transfer Program

In parallel with the stabilization program, GoP sought to protect the poor during the economic adjustment, and efforts were made to strengthen the social safety net system. Even though Pakistan has had a myriad of safety net programs targeted primarily at the chronically poor, ranging from (unconditional) cash transfers to social care services and microfinance programs, they have had little impact on poverty and vulnerability. These programs have been fragmented and often duplicative, with limited coverage and weak targeting mechanisms. To strengthen the safety net systems and increase coverage, GoP launched the BISP in September 2008, with the objective of providing cash grants to the poorest families in the country identified on the basis of a robust targeting methodology. The program intended to cover the 5 million poorest families in 2009/10 with the medium term objective of reaching 7 million families, prospectively covering close to 25 percent of the population. At present, BISP's poverty score-card mechanism is being implemented in 15 districts and the program has doubled Pakistan's social safety net spending to GDP ratio from 0.4 percent to close to 1 percent. As such, BISP is by far the largest social safety net program in Pakistan and became the core safety net system in the country.

PRESO highlighted measures to improve targeting efficiency, as well as program operations and administration, and significant progress was made in this area. Under PRESO, GoP developed and adopted a Proxy Means Test based on a "poverty scorecard" as the new targeting instrument (Upfront Action 10 of 10) that would replace ad-hoc mechanism of selecting the beneficiaries through parliamentary lists. A pilot phase in 15 selected districts was launched with the technical support of the Bank and funding by United Kingdom's Department for International Development (DFID). In parallel, BISP stopped Parliamentarian based identification of beneficiaries in April 2009. Upon successful completion of the test phase and shifting of beneficiaries to the new eligibility list in the districts where the poverty scorecard data was available, BISP is now in the process of completing the national rollout of the poverty

scorecard survey. The survey is expected to be completed by June 2011, and the beneficiary lists will be updated accordingly as and when the poverty scorecard data is available for completed districts. The Bank is providing technical assistance for completion of this survey as well as strengthening of safety net administration systems. The Bank is also discussing with the GoP the development of long-term exit/graduation-from-poverty strategies such as conditional cash transfers linked with education and health, and employment activation through skills-training. In addition, the Bank is assisting the GoP in the design of a viable health insurance model that assists the poor in improving their access to health care services and reduces their income loss due to catastrophic health shocks.

Strengthened the National Statistical System

GoP recognizes that the availability of consistent, reliable, and credible economic and social data in a timely manner is essential for sound policy analysis and formulation. In this regard, PRESO supported the presentation (and approval) of a new Statistical Law by the Cabinet which would provide greater autonomy and enhance the functioning of the National Statistical System. While Cabinet approval was obtained, Parliamentary approval is pending. It is still under discussion with the Parliamentary Committee and once it is signed it will be tabled in Parliament for approval.

2.2 Major Factors Affecting Implementation:

The fluidity of the political and security situation played a major role in delaying the implementation of the reform program supported by PRESO. The operation was agreed by a coalition government which was dealing with a very difficult security situation and a possible balance of payments crisis, posing major challenges to GoP's commitment to reforms. For example, PRESO highlighted reforms aimed at improving revenue mobilization and the elimination of power sector subsidies. However, political will was limited and these reforms did not gain sufficient traction within the political system and society. In addition, the worsening security situation diverted significant resources towards security related expenditures, concomitantly undermining fiscal adjustment.

Implementation and continuation of reforms after PRESO were also hampered by Pakistan's continuing vulnerability to exogenous shocks. This is the case of the July-August 2010 floods, which inundated a large part of the country and are requiring massive resources for recovery and rehabilitation. Spending associated with the recovery efforts is further weakening the fiscal accounts. Ownership of reforms was critical for its design. While the overall commitment of the highest authority was firm and PRESO program was based on GoP's own home-grown design, it looks as if some of the key stake holders involved in its implementation were not taken on board while agreeing on reform agenda. For example, restructuring of FBR was one of the key reforms envisaged for the enhancement of efficiency and effectiveness in revenue collection organization. However, this initiative faced severe resistance within FBR and issue was only resolved after lengthy legal arbitration through Apex courts. While GoP was in process of implementing this restructuring, uncertainty within the organization had impacted the

revenue collection efforts. Similarly, GoP first proposed a broad-based VAT, but as reform approached, vested interest emerged in full force.

2.3 Monitoring and Evaluation (M&E) Design, Implementation and Utilization

PRESO contained a detailed Medium-term Policy Framework of the GoP and SBP with an extensive list of indicators to facilitate continuous monitoring of progress toward the GoP's overall development objectives. Many of the indicators were quantitative and, for the most part, readily available. For example, indicators on revenues, spending, fiscal deficit, debt, and current account deficit, foreign flows such as Foreign Direct Investment (FDI) etc are collected regularly as part of macroeconomic monitoring carried out by Bank staff. Other data, like those on "Start-a-business" indicators are taken from the IFC/World Bank's Doing Business Report indicators. This M&E effort was supported by timely and comprehensive monitoring of GoP's overall reform agenda and Bank staff regularly monitored the indicators identified as a part of PRESO.

2.4 Expected Next Phase/Follow-up Operation (if any)

PRESO was part of multi-year program of reforms and it was envisaged that it would be followed by a new PRSC series. However, due to new Country Partnership Strategy which was under consideration during 2009/10, the initiation of new series was delayed. The Bank tried to re-engage and launch a new series of DPLs in the second half of 2009/10 but due to non fulfillment of 2 out of 8 prior actions specifically in the power and cash management sectors, this attempt is delayed. The new series is to support full implementation of key reforms that were initiated under PRESO. Later, as the IMF's SBA became off track in early 2010/11, this DPL operation remains under preparation, while the Government continues to implement proposed measures of its reform program..

3. Assessment of Outcomes

3.1 Relevance of Objectives, Design and Implementation

PRESO was prepared as a stand-alone operation in order to support the authorities' short-term policy measures to promote economic recovery, along with the needed stabilization. PRSP-II was adopted at the end of 2008 and provided the framework for the policy agenda. PRESO supported PRSP-II objectives related to macroeconomic stabilization, enhancement of competitiveness and growth recovery, and poverty mitigation. However, given the magnitude of macroeconomic imbalances, it was recognized that regaining macroeconomic stability and putting the economy back on a path of high sustainable growth would require continued decisive policy adjustment in 2009/10 and 2010/11. For this reason, the package included a draft medium-term policy framework of GoP and SBP that lays out the envisaged road map for adjustment. It was anticipated that the later years of the framework could be supported through a separate series of programmatic operations. The financing provided through PRESO helped to finance the GoP's budgetary needs, and thereby supported the authorities' commitment to eliminate central bank financing of GoP. While the IMF-supported SBA provided Pakistan with

much needed balance-of-payments support, budgetary support was also urgently required. The PRESO financing was a key part of the GoP's financing plan.

Rating: Moderately Satisfactory

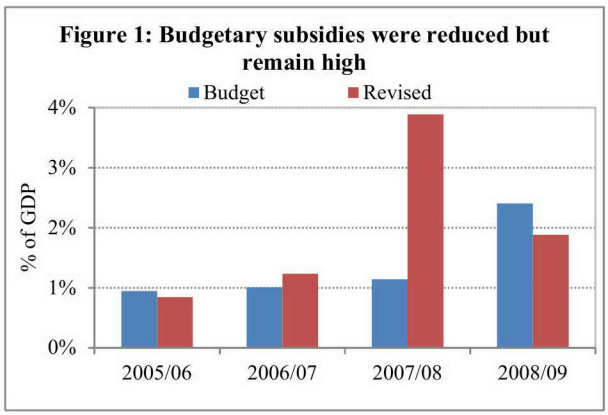
3.2 Achievement of Program Development Objectives

PRESO was prepared as a stand-alone operation in order to support critical policy measures aimed at promoting economic recovery and macroeconomic stabilization. PRESO supported PRSP-II objectives related to macroeconomic stabilization, enhancement of competitiveness, growth recovery and poverty mitigation. All upfront actions were achieved but not all were sustained. Given the political constraints affecting a few key areas of the program, especially in tax and power sector reforms, some actions were reversed or not implemented, and efforts to get them back on track continue by both the Bank and the GoP. The overall performance under the program remained Moderately Unsatisfactory. This is discussed in detail below.

Rating: Moderately Unsatisfactory

Pillar 1: Regaining and Maintaining Macroeconomic Stability

Sub Rating: Moderately Unsatisfactory



Progress under this pillar was mixed, with some meaningful gains, but slippage or outcomes falling short of expectations in other areas. Several initiatives appear to have been overwhelmed by deterioration in the wider context, and while they did not meet their stated targets, results would likely have been worse in the absence of the reform program. The fiscal deficit (excluding grants) declined from 7.6 percent of GDP in 2007/08 to 5.3 percent of GDP in 2008/09, but fell well short of the target of 4.2 percent of GDP envisaged in PRESO (Table 3). However, it deteriorated again to 6.3 percent of GDP in 2009/10 and the situation has not improved in 2010/11. Revenues continued to underperform. In particular, tax revenues have plummeted as the economic slowdown has reduced the buoyancy of Pakistan's two main tax bases, manufacturing and imports. Subsidies, especially on Power tariffs, decreased but remain substantial (**Figure 1**) and, predictably, spending on security increased. Overall, after

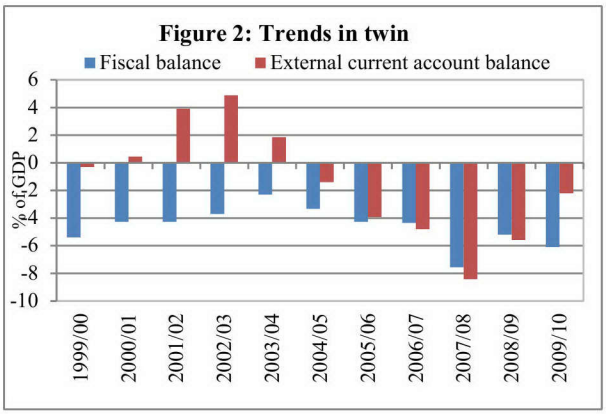


Table 3: Pakistan Selected Indicators, 2001/02 to 2009/10

	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10 1/
									Percentage
Output and prices									
Real GDP at factor cost (percent)	3.1	4.7	7.5	9.0	5.8	6.8	3.7	1.2	4.1
Consumer prices (period average)	2.5	3.1	4.6	9.3	7.9	7.8	12.0	20.8	11.7
Public finances									
Total Revenues (% of GDP)	14.2	14.8	14.3	13.8	14.2	14.9	14.4	14.4	14.2
Tax Revenue (% of GDP)	*10.9*	*11.5*	*11.0*	*0.0*	*10.6*	*10.2*	*10.6*	*10.2*	*10.2*
of which : FBR (% of GDP)	9.3	9.4	9.2	9.1	9.3	9.6	9.8	8.8	9.1
Total Expenditures (% of GDP)	18.3	18.5	16.7	17.2	18.5	19.1	21.7	19.0	20.5
Consolidated GoP budget balance (include. earthquake related expenditures but excluding grants)	-4.3	-3.7	-2.4	-3.3	-4.3	-4.3	-7.6	-5.3	-6.3
Total GoP debt	80.8	74.5	67.8	62.9	57.4	54.1	58.5	55.6	56.4
External GoP debt (% of GDP)	40.4	35.6	32.1	29.4	26.6	24.2	26.7	26.2	25.6
Domestic GoP debt (% of GDP)	40.4	38.9	35.7	33.5	30.8	29.9	31.8	29.4	30.8
Monetary sector									
Broad money (annual change in %)	15.4	18.0	19.6	19.3	14.9	19.3	15.3	9.6	12.5
Private credit (annual change in %)	4.8	18.9	29.8	33.2	23.2	17.2	16.4	0.7	11.6
Six-month treasury bill rate (period average; in %)	8.2	4.1	1.7	4.7	8.2	8.8	9.6	13.1	..
External sector									
Merchandise exports, US$ (growth rate; in %)	2.3	20.1	13.5	16.2	14.3	4.4	18.2	-6.4	2.7
Merchandise imports, US$ (growth rate; in %)	-7.5	20.1	21.2	38.3	31.7	8.0	31.2	-10.3	-2.2
Current account balance (as % of GDP)	3.9	4.9	1.8	-1.4	-3.9	-4.8	-8.4	-5.6	-2.2
Current account balance (US$ millions)	2,833	4,070	1,812	-1,534	-4,990	-6,878	-13,874	-9,261	-3,495
Gross official reserves (US$ million)	4,337	9,529	10,564	9,805	10,765	14,302	8,731	9,529	13,953
In months of next year's imports of goods and services	3.7	6.5	5.0	3.5	3.7	3.8	2.6	2.9	3.9

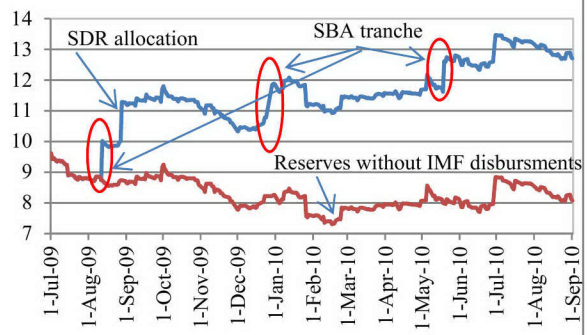
Source:
1/ The source for 2009/10 numbers are GoP's and the numbers are preliminary (September 2010).
2/ GoP and IMF

moderating, by October 2009, inflationary pressures resurfaced again. The 12-month moving average headline inflation which peaked to 22.1 percent in March 2009 moderated to 11.7 percent by June 2010, but started to gain momentum afterwards and hovered around 13.9 percent in December 2010.

The current account deficit (CAD) narrowed beyond the set target of 5.9 percent of GDP to 5.6 percent of GDP in 2008/09 (**Figure 2**), driven by a deceleration in imports (exceeding that of exports) and growing workers' remittances. This improvement continued in 2009/10 as CAD was recorded at 2.2 percent of GDP. Financial inflows have continued contracting. Net capital inflows decreased by 26 percent in 2008/09 and 13 percent in 2009/10.

FDI which was at US$5.3 billion in 2007/08 declined to US$3.7 billion in 2008/09 and to US$2.1 billion in 2009/10. However, despite decreased financial inflows, SBP's official foreign exchange reserves increased to US$13.1 billion by end-June 2010, largely due to IMF disbursements, without which, SBP reserves would have been substantially lower than their end-June 2009 level of US$9.1 billion. Overall, this indicates the improved but still vulnerable external sector **(Figure 3)**.

Figure 3: SBP's Foreign Exchange Reserves (US$ billion)



Pillar 2: Enhancing Competitiveness

Sub-rating: Moderately Satisfactory

Recognizing that the private sector is the engine of growth, PRESO also focused on issues like barriers to entry and strengthening of the financial sector. The outcome goal that "starting-a-business" indicator envisaged an improvement of 5 days by reducing the number of days from 27 in 2008 to 22 in 2009. This was achieved as "IFC/World Bank Doing Business Report" observed an actual improvement of 7 days. In addition, it was deemed important in PRESO to improve competition policy framework by enhancing the role of CCP by strengthening its institutional framework. For this CCP rules regarding the terms and condition of appointment were notified and a mechanism of automatic sources of financing for CCP were set up in accordance with PRESO. In order to strengthen the financial system and save it from systemic risks it was agreed with SBP that prudential regulation would be amended to introduce a phased reduction in group credit exposure limit from 50 percent to 25 percent over time. SBP has amended the regulations and moving in the right direction. However, rigidities in the labor markets would need to be tackled. GoP is moving forward with labor law reforms, albeit progress has been slow.

Pillar 3: Protecting the Poor and Vulnerable

Sub-rating: Moderately Satisfactory

In parallel with the stabilization program, PRESO aimed to improve GoP's social safety net program BISP to protect the poor during economic adjustment. PRESO envisaged that a better targeting mechanism is imperative for BISP to contribute towards protection of poor and vulnerable from economic cycles. It was agreed with GoP that BISP would adopt a Proxy Means Test based "poverty scorecard" as the new targeting instrument that would replace an ad-hoc mechanism of selecting the beneficiaries through parliamentarians. A pilot phase in 15 selected districts was launched with technical support from the Bank and funding from DFID. Upon successful completion of the test phase and shifting of beneficiaries to the new eligibility list in the districts where the poverty scorecard data was available, BISP is now in the process of completing the national rollout of the poverty scorecard survey. This would bring transparency

and credibility to the system. Another area to improve the transparency and credibility of GoP is the improvement in the National Statistical System. In this regard, in GoP and the Bank agreed in PRESO that a new Statistical Law will be approved by Cabinet which would provide autonomy and basis for effective functioning of National Statistical System. This had also been achieved too although there has not been much movement in terms of its approval from Parliament.

3.3 Justification of Overall Outcome Rating

Rating: Moderately Unsatisfactory

Overall performance of the operation remained mixed, with reforms progressing in two areas, while stalling in the most important area of economic stabilization where outcomes were partial or could not be sustained. Pillar 1 of PRESO was the lynchpin of the program and was focused on regaining and maintaining macroeconomic stability in the near term. For regaining of macroeconomic stability, current account deficit came down from 8.4 percent of GDP in 2007/08 to 5.2 percent in 2008/09 and further improved to 2.2 percent in 2009/10, and the fiscal deficit also improved albeit less than programmed as it declined from 7.6 percent of GDP in 2007/08 to 5.2 percent in 2008/09. However, these gains could not be consolidated as the macroeconomic situation became fragile by mid-2010. Inflation which has come down from 22.1 percent in 2008/09 to 11.7 percent at end 2009/10, started to deteriorate again. Structural issues on the revenue mobilization agenda made some progress. FBR restructuring was a major achievement and is supporting reinvigorated tax administration. Implementation of VAT, however, is still unclear and this uncertainty has significantly affected the revenue mobilization effort. The temporary introduction of monthly adjustment in consumer fuel prices was also notable, and should not be let dismantled. The dialogue on the power sector remained difficult, with the outcome falling short of expectations and significant power sector subsidies continuing. On Pillar 2, there is good movement on enhancing competition in the private sector and consolidation of the financial sector. There is significant progress in Pillar 3, with perceived improvement in targeting mechanism through a poverty scorecard for poor and vulnerable. Therefore, Overall performance of the program is rated as ***Moderately Unsatisfactory***.

3.4 Overarching Themes, Other Outcomes and Impacts

(a) Poverty Impacts, Gender Aspects, and Social Development

As per Bank estimates, poverty rates in Pakistan have decreased significantly between 2001/02 and 2007/08, from 34.5 to 17.2 percent. The real GDP growth rate averaged well above 6.5 percent between 2002/03 and 2005/06, peaking at 9.0 percent in 2004/05, raising household incomes and pushing up the per capita income to US$878 in 2006/07—an 18.3 percent increase from US$742 of two years earlier. However, given the economic slowdown and the impact of the recent floods over the last two years, poverty in Pakistan is on the rise, particularly in the rural areas. (especially the crisis- and flood-affected areas) . To mitigate this, the Bank has joined hands with GoP in designing a cash transfer program such as BISP to protect the vulnerable

population from falling into poverty and is also designing a new cash transfer program to deal with floods.

(b) Institutional Change/Strengthening

As discussed earlier, reforming and bringing institutional changes through PRESO initiatives remains an unfinished agenda notwithstanding some successes. One of the successes in early 2010/11 was the approval of a new integrated tax administration on a functional basis. This was achieved despite a very strong resistance by some stakeholders. Similarly, PRESO envisaged the improvement of competition policy framework by enhancing the role of CCP. Key steps in this process were notifying CCP rules regarding the terms and condition of appointment, and the establishment of an automatic financing mechanism for CCP. The Bank also helped BISP in designing and implementing the Proxy Means Test based "poverty scorecard" as the new targeting instrument that would replace an ad-hoc mechanism of selecting the beneficiaries through parliamentarians. The temporary introduction of monthly adjustment to consumer fuel prices and debt management are other two areas where significant progress was made. The role of NEPRA and OGRA as regulator has weakened as GoP was unable to bring desired legal amendments in the laws to empower these regulators to fulfill their functions independently.

(c) Other Unintended Outcomes and Impacts (positive or negative, if any)

Not applicable

3.5 Summary of Findings of Beneficiary Survey and/or Stakeholder Workshops

Not applicable

4. Assessment of Risk to Development Outcomes

Rating: High

Progress on key reforms has been real, but slow and in a few cases reversed, mainly hampered by political constraints and weak institutional capacity. Some reform initiatives suffered from lack of policy will for implementation. It is also worth noting that Pakistan remains vulnerable to exogenous shocks, as exemplified by recent floods of August-September 2010. In case of political and security risks, not much can be done to mitigate them, besides remaining realistic and holding consultations with key stakeholders, which occurred under this loan. In the case of fiscal and external risks, full implementation of PRESO was to mitigate these risks in short run. PRESO highlighted the need for reducing inflation through correction of domestic and external imbalances, enhanced revenue mobilization, adequately dealing with expenditure pressures to reduce considerable short-term risks to macroeconomic sustainability, and better managed public debt. Despite early success in 2008/09, Pakistan's economy remains vulnerable to external shocks as depicted by the recent surge in international oil prices. Had GoP implemented PRESO reform agenda fully and timely, economy's resilience to such shocks would have had improved. Foreign exchange reserves increased in part through IMF's disbursements, and in part due to exports and remittances. Further disbursements under IMF's

SBA remain uncertain. Reforms in power sector have moved slowly, and in some cases reversed, and large power sector subsidies are declining, but still persist. In fact, on January 6, 2011, GoP modified a good reform on automatic fuel price adjustment by OGRA where it has taken away the regulator's power to notify fuel prices vis-à-vis international oil prices, only to reintroduce fuel price adjustments in March on a discretional move. Political considerations have stalled reform on implementation of VAT which is so crucial for the macroeconomic stability in the medium term. All this indicates the persistence of structural weaknesses in the economy in general, and in the fiscal and external sector in particular. Over time, full implementation of PRESO's agenda and adjustment of policies (identified in the Program Document) could have helped reduce the risk of resurfacing macroeconomic instability since 2010. All this is in the context of a persistent insecurity situation that has hampered efforts to consolidate fiscal situation and depressed investment.

5. Assessment of Bank and Borrower Performance

5.1 Bank Performance

(a) Bank Performance in Ensuring Quality at Entry

Rating: Moderately Satisfactory

The project team performance during identification, preparation, and appraisal was Moderately Satisfactory. Despite a very fluid economic and political situation at the time of conception of PRESO, the project team did reasonably well. The program yielded good results although several initiatives designed in Pillar 1 appear to have been overwhelmed by deterioration in the wider context, and while they did not meet their stated targets, results would likely have been worse in the absence of this program. The team also showed considerable resilience in trying to put reforms on track. However, the program team under estimated the political dynamics of power and tax sectors subsidies and, even if it cannot be held responsible for policy reversals in a context like Pakistan, it were too ambitious especially in eliminating long-standing issues like large power sector subsidies or low revenue collection in a relatively short time period.

(b) Quality of Supervision

Rating: Satisfactory

The Bank team continued its dialogue on reforms with GoP on the broad range of strategic priorities supported by PRESO. It maintained a close policy dialogue, and this process was facilitated by regular monitoring of outcomes, ongoing technical assistance, analytical work, and other engagements as part of the overall lending program.

(c) Justification of Rating for Overall Bank Performance

Rating: Moderately Satisfactory

Overall, Bank performance was Moderately Satisfactory. The Bank supported macroeconomic stabilization at a critical juncture, thus assisting GoP regain stability. Overall, the operation was prepared in crisis circumstances in a couple of months. The operation built on highly relevant reform actions and design addressed key issues in GoP's program of institutional and policy reforms. However, it took place in the context of difficult political and economic constraints. Perhaps, more could have been done to understand the political dynamics of these reforms which would have helped Bank team to tailor a few measures in consonance with more gradual and less ambitious program of reforms. Yet it is important to acknowledge that most circumstances were beyond the control of Bank team. In some areas, GoP reversed actions taken after the PRESO was approved by the Bank's Board. The Bank team was provided incorrect estimates in the case of power sector. It turned out that the Government's action plan for power sector subsidy elimination, which was provided to the Bank and the IMF, was based on incorrect estimates.

5.2 Borrower Performance

(a) GoP Performance

Rating: Moderately Unsatisfactory

The operation was agreed by a coalition government which was dealing with a very significant security situation and a looming balance of payments crisis, posing major challenges to GoP's commitment to reforms. PRESO highlighted reforms in very crucial areas such as improving revenue mobilization and elimination of power sector subsidies, which were imperative for regaining macroeconomic stability and putting the country back on a sustainable growth path. However, it failed in developing political consensus and political constraints led some reforms lose sufficient ownership within the political system and society. Given the delays mentioned above, the reversal of a few key reforms, and a vulnerable macroeconomic picture, (albeit under a very demanding political situation) , borrower performance is rated Moderately Unsatisfactory.

(b) Implementing Agency or Agencies Performance

Rating: Not Applicable

(c) Justification of Rating for Overall Borrower Performance

Rating: Moderately Unsatisfactory

Given the delays and partial policy reversals under a very demanding political situation mentioned above and the ensuing mixed macroeconomic picture, which has deteriorated since the project closed, borrower performance is rated Moderately Unsatisfactory.

6. Lesson Learned

Several lessons emerge from PRESO.

- PRESO program implementation was partly set back by lack of political will to complete reform of the power sector timely and improve revenue mobilization on a sustainable basis.

The PRESO team should have had to help create a broad-based constituency for these reforms through a wider and inclusive stakeholder engagement. Thus, increased awareness of the indirect (and second round) effects of the political economy of reforms would have helped the Bank to fine tune the scope and timing of the reforms.

- Ensuring ownership at the highest levels of GoP and other stakeholders is necessary, but was not sufficient enough to achieve the development objective of the program. Continuous dialogue and engagement with stakeholders beyond the GoP is necessary to facilitate passage for reform. In addition, GoP may be asked to carry out a continuous outreach and public awareness campaign to prepare the groundwork for successful implementation.
- Prior experience suggests the need to address capacity and institutional issues upfront with continuous technical assistance and capacity building to ensure that the reforms are followed through, and are not reversed.
- For Development Policy Lending to be successful it needs to be underpinned by robust and timely analytical work based on quality and reliable data in each proposed reform area in order to achieve informed policy decisions.
- In a high risk environment where reform reversals are common, the Bank should continue with stand alone operation within a multi-year Government reform program. Their flexibility is more appropriate to changing circumstances and adjustable to context and policy changes, which should be highly relevant for the preparation of future operations.

7. ***Comments on Issues Raised by Borrowers /Implementing Agencies/Partners***

(a) Borrower/Implementing agencies

Not Applicable.

(b) Co-financiers

Not Applicable

(c) Other partners and stakeholders

Not Applicable

Annex 1: Bank Lending and Implementation Support/Supervision Process

(a) Task Team Members

Names	Title	Unit	Responsibility/ Specialty
Lending			
Anjum Ahmad	Sr. Energy Specialist	SARDE	
Shamsuddin Ahmad	Sr. Financial Sector Specialist	FPDPO	
Rashid Aziz	Sr. Energy Specialist	SARDE	
Gregory Horman	Consultant	SASEP	
Satu Kahkonen	Sector Manager	ECSP2	
Shabana Khawar	Sr. Private Sector Development Specialist	CMEPI	
Andy Kotikula	Economist	SASEP	
Iftikhar Muhammad Malik	Sr. Social Protection Specialist	SASSP	
Shaheen Malik	Research Analyst	SASEP	
Eric David Manes	Sr. Economist	SASFP	
Saadia Refaqat	Economist	SASEP	
Kaspar Richter	Sr. Economist	ECSP2	
Martin Serrano	Sr. Counsel	LEGES	
Andrea Vermehren	Sr. Social Protection Specialist	SASSP	
Tara Vishwanath	Lead Economist	MNSPR	
Nobuo Yoshida	Sr. Economist	PRMPR	
Rashid Aziz	Sr. Energy Specialist	SARDE	
Anwar Ali Bhatti	Financial Analyst	SACPK	
Christian Eigen- Zucchi	Special Assistant	MDM	
Gregory Horman	Consultant	SASEP	
Muhammad Waheed	Economist	SASEP	

(b) Staff Time and Cost

Stage	Staff Time and Cost (Bank Budget Only)	
	No. of staff weeks	US$ '000 (including travel and consultant costs)
Lending		
Total:	58.08	311647.89
Supervision/ICR		
Total:	10.81	46547.41

Annex 2: PRESO Project Development Outcomes Core Indicators (Up-Front Actions in Bold)

Outcome indicators and targets:	2007/2008 Baseline	2008/2009 Actual
Pillar I: Regaining and Maintaining Macroeconomic Stability		
Increased Revenue Mobilization:		
Outcome goals: Increased tax to GDP ratio through broadening of tax bases.		
Outcome indicators and targets:		
FBR tax revenues to GDP ratio increased by 0.4 percent of GDP in 2008/09.	9.8	8.8
Actions to achieve outcome goal		
Government approved establishment of a new integrated tax administration on functional basis, and related FBR top management changes implemented.		Completed
Task forces to pursue unregistered entities, non-filers and stop filers established, and preparation of risk-based compliance strategies launched.		Completed
Large taxpayer Unit (LTU) or Regional Tax Office (RTO) selected as pilot for the new Integrated Tax Systems based on System 2009.		Completed
Government approved policy action plan to amend legislation of domestic indirect taxes to ensure comprehensive taxation of goods and services in the form of VAT.		Completed
Measures to limit revenue leakage implemented.		
Adjustment of Fuel Prices and Power Tariffs		
Outcome goals: Reduced GoP subsidy bill.		
Outcome indicators and targets:		
1. Fuel subsidies eliminated by end 2008.	1.6 percent of GDP	Completed but reform partly reversed in 2010/11
2. Power sector subsidies eliminated by end June 2009.	1.3 percent of GDP	Not completed
Actions to achieve outcome goal		
Automatic monthly adjustment of consumer fuel prices introduced, and a minimum level of PDL specified.		Completed but reform partly reversed in 2010/11
Monthly determination of fuel adjustment surcharge introduced; new electricity tariffs notified in 15 days from determination or re-determination.		Completed but reform partly reversed

A satisfactory plan to eliminate power sector subsidies by end June 2009 consistent with the budget adopted and implemented.		Completed but later it turned out that GoP plan was based on faulty numbers and was modified.
Improved Efficiency of Public Spending		
Outcome goal: Better prioritized development spending with medium-term focus on the budget.		
Outcome indicators and targets:		
1. PSDP throw-forward reduced from 6.1 to 4.9 years in 2008/09.		
2. Efficient cash balance management in place.		Not Completed
3. Medium-term budget planning established		Completed
4. Social and poverty-related public spending at least 4.5 percent of GDP.		Not completed
Actions to achieve outcome goal		
PSDP portfolio consolidated by at least 20 percent consistent with development priorities.		Completed
MTBF expanded to all federal ministries, revised Budget Call Circular and 3-year indicative ceilings provided to line ministries.		Completed
Use of assignment accounts for budget expenditure fully operational.		Completed
Contract awards over Rs. 50 million posted on PPRA's website.		Completed
Strengthened GoP Debt Management:		
Outcome goal: GoP debt managed at lowest cost, subject to prudent level of risk and consistent with sound monetary and fiscal policy.		
Outcome indicators and targets:		
1. GoP borrowing consistent with sound monetary and fiscal policy.		Completed but reversed in 2009/10
2. Domestic debt-servicing forecast of National Saving Schemes instruments differs from actual outturn by less than 5 percent.		Completed
3. Public guarantees annually at or below 2 percent of GDP.		Completed
Actions to achieve outcome goal		
Credible January-June 2009 calendar for PIB auctions published and adhered to, with quarterly updates.		Completed
MoF amended rules defining roles and decision-making rights for PIB issuance and issued related instructions to SBP.		Completed
Central Directorate of National Savings (CDNS) has gathered complete data on outstanding and early encashment of Defense Savings Certificates due to mature in 2008/09 and 2009/10.		Completed
Pillar II: Enhancing Competitiveness		

Reduced Barriers to Competition		
Outcome goal: Enhanced competition in domestic markets.		
Outcome indicator and target:		
1. Starting a business time reduced from 27 days in 2008 to 22 days in 2009.		Completed (20 days)
Actions to achieve outcome goal		
CCP rules notified providing the terms and conditions of CCP members; and automatic source of financing.		Completed
Electronic platform for business registration system rolled out and announced.		Completed
Strengthened Financial Sector:		
Outcome goal: Increased soundness and stability of the financial sector.		
Outcome indicator and target:		
1. Lending portfolio of banks diversified over time.		Completed
Actions to achieve outcome goal		
Prudential regulations amended to introduce a phased reduction in the group credit exposure limit from 50 percent to 25 percent over time.	Group Exposure limit 50 percent of Bank's equity at end 2008	Group Exposure limit 45 percent of Bank's equity at end 2009
Pillar III: Protection of the Poor and Vulnerable		
Better Targeted Social Safety Net:		
Outcome goal: Improved targeting and implementation of cash transfer and safety net programs.		
Outcome indicator and target:		
1. Increased coverage of the poorest 25 percent of the population by BISP.		Not Completed
Actions to achieve outcome goal		
Government adopted the scorecard as the new targeting instrument for BISP and notified the plan for its roll out, with the roll-out launched in January 2009.		Completed
Strengthened National Statistical System:		
Outcome goal: More reliable and timely economic and social data for policy analysis and formulation.		
Outcome indicator and target:		
1. Increased reliability of the national statistical system.		Completed
Actions to achieve outcome goal		
A new Statistics Law, strengthening autonomy and functioning of national statistical system, approved by Cabinet.		Completed

Annex 3: PRESO Policy Matrix

Overall outcome goals:	**Overall outcome indicators and targets:**
1. Reduced macroeconomic imbalances. 2. Improved equity and efficiency of public finances. 3. Enhanced competitiveness. 4. Improved protection of the poor and vulnerable.	1. Fiscal deficit (excl. grants) reduced from 7.4 percent of GDP in 2007/08 to or below 4.3 percent of GDP in 2008/09. 2. Current account deficit reduced from 8.4 percent of GDP in 2007/08 to or below 5.9 percent of GDP in 2008/09. 3. Improved Doing Business Indicators. 4. Improved access to social safety nets for the poorest 25 percent of the population.

Pillar I: Regaining and Maintaining Macroeconomic Stability		
Increased Revenue Mobilization:		
Outcome goal: Increased tax to GDP ratio through broadening of tax bases.		**Outcome indicator and target:** 1. FBR tax revenues to GDP ratio increased by 0.4 percent of GDP in 2008/09.
Actions	• **Government approved establishment of a new integrated tax administration on functional basis, and related FBR top management changes implemented.**	
	• Task forces to pursue unregistered entities, non-filers and stop filers established, and preparation of risk-based compliance strategies launched..	
	• LTU or RTO selected as pilot for the new Integrated Tax Systems based on System 2009.	
	• **Government approved policy action plan to amend legislation of domestic indirect taxes to ensure comprehensive taxation of goods and services in the form of VAT.**	
	• Measures to limit revenue leakage implemented.	
Adjustment of fuel prices and power tariffs:		
Outcome goal: Reduced GoP subsidy bill.		**Outcome indicators and targets:** 1. Fuel subsidies eliminated by end 2008. 2. Power sector subsidies eliminated by end June 2009.
Actions	• **Automatic monthly adjustment of consumer fuel prices introduced, and a minimum level of PDL specified.**	
	• **Monthly determination of fuel adjustment surcharge introduced; new electricity tariffs notified in 15 days from determination or re-determination**.	
	• **A satisfactory plan to eliminate power sector subsidies by end June 2009 consistent with the budget adopted and implemented**.	
Improved efficiency of public spending:		
Outcome goal: Better prioritized development spending with medium-term		**Outcome indicators and targets:** 1. PSDP throw-forward reduced from 6.1 to 4.9 years in 2008/09. 2. Efficient cash balance management in place.

focus on the budget.		3. Medium-term budget planning established 4. Social and poverty-related public spending at least 4.5 percent of GDP.
Actions	• **The PSDP portfolio consolidated by at least 20 percent consistent with development priorities.**	
	• MTBF expanded to all federal ministries, revised Budget Call Circular and 3-year indicative ceilings provided to line ministries.	
	• Use of assignment accounts for budget expenditure fully operational.	
	• Contract awards over Rs. 50 million posted on PPRA's website.	
Strengthened GoP debt management:		
Outcome goal: GoP debt managed at lowest cost, subject to prudent level of risk and consistent with sound monetary and fiscal policy.		**Outcome indicators and targets:** 1. Government borrowing consistent with sound monetary and fiscal policy. 2. Domestic debt-servicing forecast of NSS instruments differs from actual outturn by less than 5%. 3. Public guarantees annually at or below 2 percent of GDP.
Actions	• Credible January-June 2009 calendar for PIB auctions published and adhered to, with quarterly updates.	
	• **MoF amended rules defining roles and decision-making rights for PIB issuance and issued related instructions to SBP.**	
	• CDNS has gathered complete data on outstanding and early encashment of Defense Savings Certificates due to mature in 2008/09 and 2009/10.	
Pillar II: Enhancing Competitiveness		
Reduced barriers to competition:		
Outcome goal: Enhanced competition in domestic markets.		**Outcome indicator and target:** 1. Starting a business time reduced from 27 days in 2008 to 22 days in 2009.
Actio n	• **CCP rules notified providing the terms and conditions of CCP members; and automatic source of financing.**	
	• Electronic platform for business registration system rolled out and announced.	
Strengthened Financial Sector:		
Outcome goal: Increased soundness and stability of the financial sector.		**Outcome indicator and target:** 1. Lending portfolio of banks diversified over time.
	• **Prudential regulations amended to introduce a phased reduction in the group credit exposure limit from 50 percent to 25 percent over time.**	
Pillar III: Protection of the Poor and Vulnerable		

Better targeted social safety net:	
Outcome goal: Improved targeting and implementation of cash transfer and safety net programs.	**Outcome indicator and target:** 1. Increased coverage of the poorest 25 percent of the population by BISP.
• **Government adopted the scorecard as the new targeting instrument for BISP and notified the plan for its roll out, with the roll-out launched in January 2009.**	
Strengthened national statistical system:	
Outcome goal: More reliable and timely economic and social data for policy analysis and formulation.	**Outcome indicator and target:** 1. Increased reliability of the national statistical system.
• A new Statistics Law, strengthening autonomy and functioning of national statistical system, approved by Cabinet.	

Annex 4: Summary of Borrower's ICR and/or Comments on Draft ICR

Government of Pakistan Comments on Draft ICR:

We believe that the overall ICR rating of Pakistan's performance in PRESO as 'Moderately Unsatisfactory' due to slippages in some macroeconomic indicators is not a correct evaluation of the circumstances, and thus gives an incomplete picture of the challenges faced by the policymakers (as discussed below). Additionally, in two out of three pillars of PRESO, the country is rated "moderately satisfactory", which only further justifies for Pakistan an overall rating of 'moderately satisfactory'.

Regaining and Maintaining Macroeconomic Stability

While talking about regaining and maintaining macroeconomic stability the ICR ignores the key challenges facing Pakistan. These challenges (detailed below) are caused by both endogenous and exogenous factors and are the major reasons behind deteriorating macroeconomic situation of the country.

First, Pakistan's status as a frontline state in war on terror has fuelled the security related expenditure and especially expenses related to the issue of IDPs during the past two years. Further, the security related challenges have worsened the local investment environment, decreasing the net flow of foreign investment to 0.8 percent of GDP in FY2011 from 21 percent in FY2009.

Secondly, Pakistan's economy remains stressed in the aftermath of the unprecedented floods. The government reprioritized its spending pattern and scaled down Development expenditures to create space for the flood relief activities. The spending shock (e.g., for flood relief) as well as the unexpected weakness in the revenue receipts (also partly a consequence of floods) duplicated the pressures on the fiscal side and undermined the key macro indicators. Similarly, this report has also not considered the effect of economic slowdown of the world economies on the Pakistan economy. FODP have not fully honored their commitment, which further intensified pressure on macro indicator.

In the wake of building up of pressure on the macroeconomic indicators due to fiscal constraints, efforts are being made to underline the urgent need to broaden the tax base, and rationalize spending growth, to better insulate the economy from shocks. There are some signs of progress in containing expenditure, with cuts in development spending, moves towards reduction in subsidies, and progress towards the devolution of ministries to provinces.

The government is cognizant of the continued delays in the implementation of key economic reforms. While the growing macroeconomic imbalances in the economy are still quite manageable, further delay in implementing critical structural adjustments risks significantly increasing the future costs to the economy. Recognizing the urgent need, the government have initiated following reforms:

Reorganizing FBR - Institutional and operational measures to improve the receipts mechanism of the FBR is well underway. FBR has been reorganized in order to improve efficiency through better accountability, follow up and coordination by reducing the number of positions of Board Members from twelve to eight. Two positions of Members Policy, Direct & Indirect Taxes and Two positions of Members Operations (North/South) have been abolished and two new slots of Member Inland Revenue and Member RGST have been created. **Integrating domestic Taxes -** The Tax administration has been successfully restructured on integrated and functional lines. All the three domestic taxes i.e. Income Tax, Sales Tax and Federal Excise have been brought under Inland Revenue. **Strengthening Policy Framework -** Revenue Division has been reinvigorated in order to consolidate the Fiscal Policy framework. It is now properly staffed with one Additional Secretary, one joint Secretary and two Deputy Secretaries.

Broadening Tax Base - With the purpose of a focused and comprehensive approach towards one of the major challenges of Broadening the Tax Base, a new Directorate has been setup. The new DG (Broadening of Tax Base) has been posted and serious work on broadening of tax base is in progress. **Enforcement -** Following enforcement measures are being taken to enhance compliance for which the time lines have been set: Filing of sales tax returns to be ensured from the top 1,000 short filer/non-filer companies by 15th April, 2011; audit of withholding tax in respect of all banks to be conducted and completed all over the country by 15th April, 2011. DG (BTB) to ensure implementation of this decision, Member (IR) will ensure compliance of WHT on air tickets by the three domestic airlines; recovery of inadmissible input tax adjustment of sales tax and supplies made by blacklisted companies, as identified by the IT system by single point audit, is to be ensured by 30th April, 2011. With the technical assistance of the World Bank, FBR is in the process of institutionalizing a standard set of performance indicators produced automatically by the operational IT Systems. RGST Bill has already been passed by Senate (upper House) and is under legislative process before the National Assembly. FBR is working on the operational aspects of proposed RGST to be prepared for implementation in case the bill is passed by the Parliament.

Elimination of public subsidies on fuel and electricity is a central part of moving Government's finances onto a sustainable footing. The Government eliminated petroleum subsidies by December 2008. In January 2009, the Government again started the monthly automatic adjustment of consumer fuel prices to pass on changes in international prices. Similar effort is being carried out in the area of energy, which has been progressing adequately though at a slower pace.

Protecting the Poor and the Vulnerable

Nevertheless, given the economic slowdown in the country since FY 2008/09 and the impact of internal and external factors including recent floods in Year 2010, poverty in Pakistan is presumably on the rise, particularly in the rural areas. In order to prop up these effects, several initiatives/reform programs were initiated by the Government of Pakistan (GOP) both on the social and economic fronts.

On the social front, Pakistan has a fairly elaborate network of direct and indirect social protection and social safety net mechanisms. Under the PRESO support, nevertheless, efforts were made to strengthen the social safety net system in Pakistan through initiation of Benazir Income Support Program (BISP) for chronic and transitory poor and the vulnerable in Pakistan. Under the BISP, GOP not only focused to disburse small cash grants to the poor but also introduced, developed and adopted the Poverty Score Card to segregate poorest of the poor and non poor at the country level. In fulfillment of the requirement of the PRESO, at the close of FY, 20009/10, the GOP has collected Poverty Score data from 56 districts and NADRA is in the process of compiling the same. The data collection for Poverty Score Card is in process now in 29 districts making the total to 85. The survey is expected to be completed by June 2011 and beneficiary lists would be updated accordingly as and when PSC data is available.

The management and implementation of social safety nets program has shown large positive growth during last two fiscal years from FY 2008/09 to FY 2009/10. Under the PRESO, BISP has increased both its outreach and beneficiary support. Overall transfers through all programs showed a net increase of 69 percent in terms of grants and 39 percent in terms of beneficiaries during FY 2009/10 compared to the last FY 2008/09. During FY 2009/10, 78 percent i.e. Rs. 42.26 billion of the grants were of the budgetary mode and 22 percent i.e. Rs. 11.74 billion were of the non budgetary mode against 66 percent and 44 percent, receptively in the same period last year. During FY 2009/10 a large proportion of the amount, about 59 percent was disbursed through Benazir Income Support Program; followed by 15 percent through Punjab Sasti Roti Program, 12 percent through Employees Old age Beneficiary Institutions (EOBI), 5 percent through Zakat, 5 percent through Workers Welfare Fund and 4 percent through Pakistan Batiul-ul-Mal. These disbursements were made to 6,070,160 beneficiaries; 39 percent more than the comparable period last fiscal year. A total of Rs. 33,775 million, 15 percent more under the microcredit was disbursed in terms of Rs.1,966,457 loans during FY 2009/10 against Rs. 28,669 million and 1,939,050 loans compared to FY 2008/09. A detailed table on the social safety nets program is annexed.

Under the **PRESO objective C** for protecting the poor and vulnerable, there has been more than satisfactory performance particularly under the BISP as explained above. Some other elements are given as under:

- In order to strengthen the safety net system and increase coverage, under the PRESO, the process of collection and compilation of Poverty Score Card data is fully taken off now in the remaining districts and completion of the process would further help in better and transparent targeting.
- During FY 2009/10, a large proportion of the social safety net support, about 59 percent in terms of grant and around 50 percent in terms of beneficiaries, was given through the Benazir Income Support Program (BISP) to the poor and the vulnerable, which ensured that better management and implementation capacities are in place.

- In almost two years' time, the BISP has increased its outreach and access in all parts of the country both with institutional and administrative set up and in the year to the completion of the PSC survey, which would help to target 5-7 million families from 2.29 million families now.
- The positive impact of the poverty related, social protection and other social safety nets programs on the income and vulnerability of the poor will be more visible in the years to come.

Amjad Mahmood

Joint Secretary

External Finance Policy

Annex

Social Safety Nets Programme			
Programme	**Disbursement / Beneficiaries**	**FY 2008/09**	**FY 2009/10**
Budgetary Transfers			
Pakistan Bait-ul-Mal (all Programmes)	Amount disbursed (Rs. millions)	3,432	2,261
	Total beneficiaries	1,158,922	2,110,355
BISP	Amount disbursed (Rs. billion)	15.8	32.0
	Total beneficiaries	17,60,000	22,90,000
Punjab Sasti Roti Program (PSRP)	Amount disbursed (Rs. billion)	1.90	8.0
	Total beneficiaries (million)	-	-
1. Sub Total: Budgetary Transfers	**Amount disbursed (Rs. billion)**	**21.13**	**42.26**
	Total beneficiaries	**2,9189,22**	**4,400,355**
Non – Budgetary Transfers			
Zakat	Amount disbursed (Rs. millions)	2,877	2,874
	Total beneficiaries	1,085,378	1,289,050
EOBI	Amount disbursed (Rs. millions)	5,787	6,442
	Total beneficiaries	290,000	310,352

Workers Welfare Fund (WWF)*	Amount disbursed (Rs. millions)	2,087	2,432
	Total beneficiaries	63,008	70,403
2. Sub Total: Non budgetary transfers	**Amount disbursed (Rs. millions)**	**10,751**	**11,748**
	Total beneficiaries	**14,38,386**	**1,669,805**
Total: 1+2	**Amount disbursed (Rs. In billions)**	**31.88**	**54.01**
	Total beneficiaries	**4,357,308**	**6,070,160**
Micro Finance (micro credit only)	**Amount disbursed (Rs. millions)**	**28,669**	**33,775**
	Total Loans	**1,939,050**	**1,966,457**

Annex 5: List of Supporting Documents

IMF (2008) "Pakistan: 2007 Article IV Consultation – Staff Report; Staff Statement; Public Information Notice on the executive Board Discussion; and Statement by the Executive Director for Pakistan"

IMF (2009) "Pakistan: 2009 Article IV Consultation and First Review Under the Stand-By Arrangement—Staff Report; Staff Statement; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for Pakistan"

IMF (2010) "Public Information Notice (PIN) No. 00/108 December 14, 2000"

Implementation Completion and Results Report (June 2010), Poverty Reduction Support Credit II, ICR00001344

Implementation Completion and Results Report (June 2010), Poverty Reduction Support Credit I, ICR00001556

Presentation, Pakistan Power Sector Reforms, September 27, 2010

PRSC II, Agreed Minutes of Negotiations between Government of Pakistan (GoP) and International Development Association (IDA), at Islamabad, Pakistan, on March 26, 2007

PRSC II, Aide Memoire dated August 23, 2005 – Summary of Status of PRSC II Prior Actions and Next Steps.

PRSC II, Aide Memoire dated February 12, 2007.

World Bank (2009) "Pakistan Joint IDA-IMF Staff Advisory Note on the Second Poverty Reduction Strategy Paper (PRSP-II)"

Annex 6: List of People Consulted

From the GoP

Chaudhry Naveed Akbar, Director Operations, BISP

Dr. Ashfaque H. Khan, Dean, National University of Science and Technology Business School

Dr. Joseph Wilson, Commissioner, CCP

Dr. Waqar Masood Khan, Secretary, MoF

Mr. Abdullah Yusuf, Ex-Chairman, FBR

Mr. Ahmed Qadir, Director, Competition Commission Pakistan.

Mr. Amjad Mehmood, Joint Secretary, External Finance Policy, , MoF

Mr. Arif Mehmood Cheema, Director General, Federal Bureau of Statistics

Mr. Khurram Humayun, Director General, BISP

Mr. Mahmood Akhtar, Additional Secretary, Planning and Development Division, MoF

Mr. Masroor Qureshi, Director General (DPCO), MoF

Mr. Mohammad Sher Khan, Managing Director, BISP

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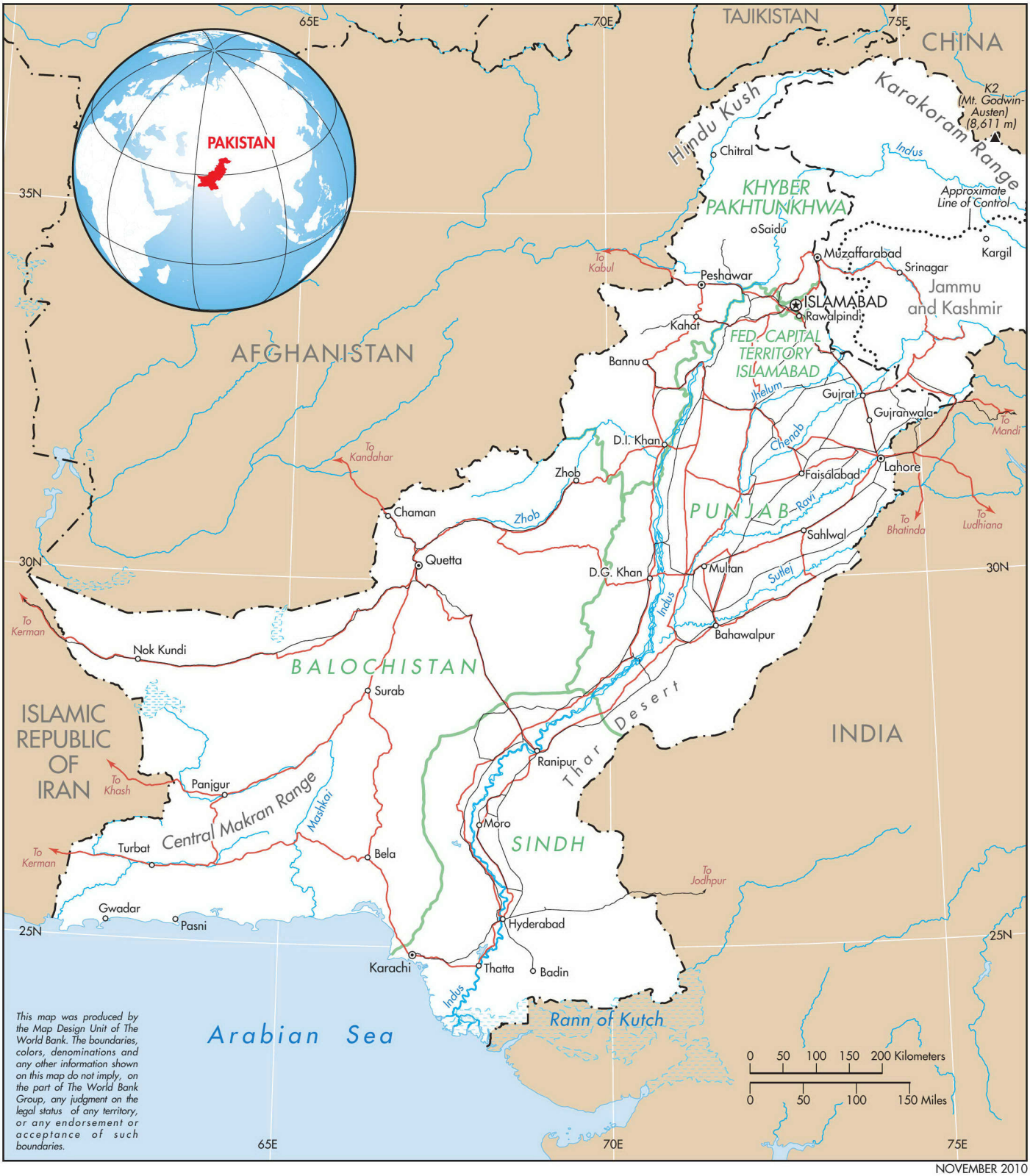
PAKISTAN

SELECTED CITIES AND TOWNS
PROVINCE CAPITALS
NATIONAL CAPITAL
RIVERS
MAIN ROADS
RAILROADS
PROVINCE BOUNDARIES
INTERNATIONAL BOUNDARIES



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