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Report No. 34101

PROJECT PERFORMANCE ASSESSMENT REPORT

THE ISLAMIC REPUBLIC OF PAKISTAN

PUBLIC SECTOR ADJUSTMENT LOAN/CREDIT
(LOAN NO. 3645–PAK AND CREDIT NO. 2542–PAK)

STRUCTURAL ADJUSTMENT LOAN
(LOAN NO. 4435–PAK)

STRUCTURAL ADJUSTMENT CREDIT
(CREDIT NO. 3515–PAK)

SECOND STRUCTURAL ADJUSTMENT CREDIT
(CREDIT NO. 3655–PAK)

December 19, 2005

Country Evaluation and Regional Relations
Independent Evaluation Group

Currency Equivalents (annual averages)

Currency Unit = Pakistani Rupee (Pr.)

1998	US$1.00 = Pr. 43.19	2001	US$1.00 = Pr. 61.93
1999	US$1.00 = Pr. 49.50	2003	US$1.00 = Pr. 57.75
		2004	US$1.00 = Pr. 59.37

Abbreviations and Acronyms

ADB	Asian Development Bank
AIDS	Acquired Immune Deficiency Syndrome
BOP	Balance of Payments
BSRPP	Banking Sector Restructuring and Privatization Project
CAE	Country Assistance Evaluation
CAS	Country Assistance Strategy
CBR	Central Board of Revenue
CGA	Controller General of Accounts
CPI	Consumer Price Index
DISCOs	Power Distribution Companies
EFF	Extended Fund Facility
ESAF	Enhanced Structural Adjustment Facility
ESW	Economic and Sector Work
FPSC	Federal Public Service Commission
FY	Fiscal Year
GDP	Gross Domestic Product
GENCOs	Power Generation Companies
GOP	Government of Pakistan
GRA	Global Research Alliance
GST	Goods and Services Tax
HIPC	Heavily Indebted Poor Country
HIV/AIDS	Human Immunodeficiency Virus
HUBCO	HUB Power Company Limited
IBRD	International Bank for Reconstruction and Development
ICR	Implementation Completion Report
IDA	International Development Association
IEG	Independent Evaluation Group
IFI	International Financial Institutions
IMF	International Monetary Fund
IPP	Independent Power Producer
I-PRSP	Interim Poverty Reduction Strategy Paper
JBIC	Japan Bank for International Cooperation (formerly OECF)
JSA	Joint Staff Assessment
KAPCO	Kot Addu Power Company
KESC	Karachi Electric Supply Corporation
LPG	Liquefied Petroleum Gas
NEPRA	National Electric Power Development Authority
NWFD	National Water and Forestry Directorate
OECF	Overseas Economic Cooperation Fund (now JBIC)
OED	Operations Evaluation Department*
PAC	Public Accounts Committees
PEPCO	Pakistan Electric Power Company
PFP	Policy Framework Paper
PIFRA	Improvement to Finance Reporting and Auditing Project
PPAR	Project Performance Assessment Report
PPL	Pakistan Petroleum Limited
PPRA	Pakistan Procurement Regulatory Authority
PRA	Pakistan Revenue Authority
PRGF	Poverty Reduction and Growth Facility
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
PSAL	Public Sector Adjustment Loan/Credit
PSDP	Public Sector Development Program
SAC I	Structural Adjustment Credit
SAC II	Second Structural Adjustment Credit
SAL	Structural Adjustment Loan
SAP	Social Action Program
SBA	Stand-By Agreement
SBP	State Bank of Pakistan
SOE	State Operated Enterprise
SOP	Standard Operating Procedure
SRO	Statutory Regulatory Orders
TB	Tuberculosis
UCH	UCH Power Limited
WAPDA	Water and Power Development Authority

* OED has changed its official name to Independent Evaluation Group (IEG). The new designation "IEG" will be inserted in all IEG's publications, review forms, databases, and web sites in the next few weeks.

Fiscal Year

Government: July 1 – June 30

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IEG Mission: Enhancing development effectiveness through excellence and independence in evaluation.

About this Report

The Independent Evaluation Group assesses the programs and activities of the World Bank for two purposes: first, to ensure the integrity of the Bank's self-evaluation process and to verify that the Bank's work is producing the expected results, and second, to help develop improved directions, policies, and procedures through the dissemination of lessons drawn from experience. As part of this work, IEG annually assesses about 25 percent of the Bank's lending operations. In selecting operations for assessment, preference is given to those that are innovative, large, or complex; those that are relevant to upcoming studies or country evaluations; those for which Executive Directors or Bank management have requested assessments; and those that are likely to generate important lessons. The projects, topics, and analytical approaches selected for assessment support larger evaluation studies.

A Project Performance Assessment Report (PPAR) is based on a review of the Implementation Completion Report (a self-evaluation by the responsible Bank department) and fieldwork conducted by IEG. To prepare PPARs, IEG staff examine project files and other documents, interview operational staff, and in most cases visit the borrowing country for onsite discussions with project staff and beneficiaries. The PPAR thereby seeks to validate and augment the information provided in the ICR, as well as examine issues of special interest to broader IEG studies.

Each PPAR is subject to a peer review process and IEG management approval. Once cleared internally, the PPAR is reviewed by the responsible Bank department and amended as necessary. The completed PPAR is then sent to the borrower for review; the borrowers' comments are attached to the document that is sent to the Bank's Board of Executive Directors. After an assessment report has been sent to the Board, it is disclosed to the public.

About the IEG Rating System

The time-tested evaluation methods used by IEG are suited to the broad range of the World Bank's work. The methods offer both rigor and a necessary level of flexibility to adapt to lending instrument, project design, or sectoral approach. IEG evaluators all apply the same basic method to arrive at their project ratings. Following is the definition and rating scale used for each evaluation criterion (more information is available on the IEG website: http://worldbank.org/oed/eta-mainpage.html).

Relevance of Objectives: The extent to which the project's objectives are consistent with the country's current development priorities and with current Bank country and sectoral assistance strategies and corporate goals (expressed in Poverty Reduction Strategy Papers, Country Assistance Strategies, Sector Strategy Papers, Operational Policies). *Possible ratings:* High, Substantial, Modest, Negligible.

Efficacy: The extent to which the project's objectives were achieved, or expected to be achieved, taking into account their relative importance. *Possible ratings:* High, Substantial, Modest, Negligible.

Efficiency: The extent to which the project achieved, or is expected to achieve, a return higher than the opportunity cost of capital and benefits at least cost compared to alternatives. *Possible ratings:* High, Substantial, Modest, Negligible. This rating is not generally applied to adjustment operations.

Sustainability: The resilience to risk of net benefits flows over time. *Possible ratings:* Highly Likely, Likely, Unlikely, Highly Unlikely, Not Evaluable.

Institutional Development Impact: The extent to which a project improves the ability of a country or region to make more efficient, equitable and sustainable use of its human, financial, and natural resources through: (a) better definition, stability, transparency, enforceability, and predictability of institutional arrangements and/or (b) better alignment of the mission and capacity of an organization with its mandate, which derives from these institutional arrangements. Institutional Development Impact includes both intended and unintended effects of a project. *Possible ratings:* High, Substantial, Modest, Negligible.

Outcome: The extent to which the project's major relevant objectives were achieved, or are expected to be achieved, efficiently. *Possible ratings:* Highly Satisfactory, Satisfactory, Moderately Satisfactory, Moderately Unsatisfactory, Unsatisfactory, Highly Unsatisfactory.

Bank Performance: The extent to which services provided by the Bank ensured quality at entry and supported implementation through appropriate supervision (including ensuring adequate transition arrangements for regular operation of the project). *Possible ratings:* Highly Satisfactory, Satisfactory, Unsatisfactory, Highly Unsatisfactory.

Borrower Performance: The extent to which the borrower assumed ownership and responsibility to ensure quality of preparation and implementation, and complied with covenants and agreements, towards the achievement of development objectives and sustainability. Possible ratings: Highly Satisfactory, Satisfactory, Unsatisfactory, Highly Unsatisfactory.

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Principal Ratings

	ICR	IEG Review	PPAR
Public Sector Adjustment Loan/Credit (Loan 3645- PAK and Credit 2542-PAK)			
Outcome:	Marginally Satisfactory	Marginally Satisfactory	Moderately unsatisfactory
Institutional Development	Negligible	Negligible	Negligible
Sustainability	Uncertain	Uncertain	Likely
Bank Performance	Satisfactory	Satisfactory	Unsatisfactory
Borrower Performance	Not rated	Not rated	Unsatisfactory
Structural Adjustment Loan (Loan 4435-PAK)			
Outcome	Satisfactory	Marginally Satisfactory	Moderately unsatisfactory
Institutional Development	Partial	Negligible	Negligible
Sustainability	Likely	Likely	Likely
Bank Performance	Satisfactory	Satisfactory	Satisfactory
Borrower Performance	Satisfactory	Satisfactory	Unsatisfactory
Structural Adjustment Credit (Credit 3515-PAK)			
Outcome	Satisfactory	Satisfactory	Satisfactory
Institutional Development	Modest	Modest	Modest
Sustainability	Likely	Likely	Likely
Bank Performance	Satisfactory	Satisfactory	Satisfactory
Borrower Performance	Satisfactory	Satisfactory	Satisfactory
Structural Adjustment Credit Ii (Credit 3655-PAK)			
Outcome	Satisfactory	Moderately satisfactory	Moderately satisfactory
Institutional Development	Modest	Modest	Modest
Sustainability	Likely	Likely	Likely
Bank Performance	Satisfactory	Satisfactory	Satisfactory
Borrower Performance	Satisfactory	Satisfactory	Satisfactory

* The Implementation Completion Report (ICR) is a self-evaluation by the responsible operational division of the Bank. The ICR Review is an intermediate Independent Evaluation Group (IEG) product that seeks to independently verify the findings of the ICR.

Key Staff Responsible

Project	*Task Manager/Leader*	*Division Chief/ Sector Director*	*Country Director*
Public Sector Adjustment Loan/Credit (Loan 3645- PAK and Credit 2542-PAK)			
Appraisal	Regina Bendokat	Manuel Peñalver	Paul Isenman
Completion	Shahrokh Fardoust	Lorene Yap	Paul Isenman
Structural Adjustment Loan (Loan 4435-PAK)			
Appraisal	John Wall	Roberto Zagha	Sadiq Ahmed
Completion	Ahmad Jamshidi	Roberto Zagha	John Wall
Structural Adjustment Credit (Credit 3515–Pak)			
Appraisal	John Panzer	Roberto Zagha	John Wall
Completion	John Panzer	Sadiq Ahmed	John Wall
Second Structural Adjustment Credit(Credit 3655-PAK)			
Appraisal	John Panzer	Sadiq Ahmed	John Wall
Completion	Manuel Ferro and John Panzer	Ijaz Nabi	John Wall

Preface

This report evaluates four adjustment loans/credits to Pakistan during the decade 1993-2002. The *Public Sector Adjustment Loan/Credit* (PSAL), in the amount of US$250 million equivalent (loan of US$150 million and credit of US$100 million equivalent), was approved on September 14, 1993, and fully disbursed in two tranches before closing on December 31, 1995, as originally scheduled. The other three loans/credits were single tranche operations that disbursed within days of approval. The *Structural Adjustment Loan* (SAL), in the amount of US$350 million, was approved on January 21, 1999, and closed on June 30, 1999. The *Structural Adjustment Credit* (SACI), in the amount of US$350 million equivalent, was approved on June 12, 2001, and closed on December 31, 2001. The *Second Structural Adjustment Credit* (SAC II), in the amount of US$500 million equivalent, was approved on June 11, 2002, and closed on December 31, 2002.

The PPAR is based on all relevant Bank and Fund documents and on interviews with Bank and Fund staff. A mission visited Pakistan in October/November 2004 to discuss performance with federal and provincial officials who implemented the projects, representatives of donors, and members of the Bank resident mission. Their cooperation and assistance in preparing this report is gratefully acknowledged.

Comments from the Bank's Regional Management have been incorporated in the report. A draft report was sent to the Government of Pakistan for comment and their comments are attached in Annex B. A copy of the draft report was also sent to Japan Bank of International Cooperation (JBIC) -- formerly Japanese Overseas Economic and Cooperation Fund (OECF) -- that co-financed the *PSAL* operation, and they had no comments.

This report was prepared by Gene Tidrick (Consultant), who assessed these projects in October/November 2004, under the supervision of Lily Chu (Task Manager). Vikki Taaka and Roziah Baba provided administrative support.

Summary

1. During the 1970s and 1980s Pakistan maintained a high rate of economic growth (over 6 percent), and the incidence of poverty fell steadily – from about 50 percent in the early 1970s to around 20 percent by 1988. By the late 1980s, however, Pakistan faced increasingly serious obstacles to continued growth. Growing current account and fiscal imbalances raised the level of debt and undermined investor confidence. A narrow tax base kept the tax/GDP ratio low while high defense expenditures, numerous subsidies, and growing interest payments created strong pressures for continued deficit spending. Trade restrictions biased incentives against exports. Inefficient state-owned enterprises dominated infrastructure, banking and much of industry while controls and price distortions limited private sector growth.

2. Since 1988, successive governments have tried to come to grips with Pakistan's legacy of fiscal weakness, poor policy, and institutional decay. Governments have repeatedly introduced programs of stabilization and endorsed deregulation, privatization, and reforms in trade, banking, power, energy, and public finance. But political instability, deep-rooted corruption, and weakened institutions had left the country poorly equipped to cope with a series of shocks – some exogenous and some self-inflicted – including regional conflict, floods, droughts, and economic sanctions. The net results were that, during the 1990s, growth slowed, the ratio of debt remained high, and poverty grew.

3. Structural adjustment during the 1990s was a stop-go process. Some important and lasting reforms did take place but outcomes were mixed. Since 1999, however, the Government has pursued a more consistent program of stabilization and structural adjustment. (See Table 1 for selected macroeconomic indicators for the period 1992/93 – 2003/04). One indicator of the change is that whereas Pakistan failed to complete any of its six IMF programs during 1988-99, it completed the 2000 Stand-By Arrangement and has remained on track throughout the PRGF program initiated in 2001.

4. This report evaluates four adjustment loans/credits to Pakistan during the decade 1993-2002: the *Public Sector Adjustment Loan/Credit* (PSAL), the *Structural Adjustment Loan* (SAL), the *Structural Adjustment Credit* (SAC I), and the *Second Structural Adjustment Credit* (SAC II).

5. The main objective of the PSAL was to improve public sector management through: better expenditure allocation and higher revenue collection; deregulation of the economy and privatization of government enterprises; and trade reform. The PSAL helped improve fiscal management over a period of fifteen months and had some success in promoting trade reform, deregulation, and better development expenditure management. But progress on stabilization, resource mobilization, civil service reform, and governance was not sustained. Second tranche release took place in December 1994 after a delay of six months, but by July 1995 Pakistan was off track with the Fund. The PSAL had no lasting impact on the main structural problem – the weak fiscal system. The PSAL's objectives were substantially relevant to Pakistan's development challenges, but efficacy was modest. Key reforms of tax administration and broadening the tax base were not achieved, leaving public finances susceptible to later shocks. Fears of stop-go

were fully realized, as were warnings about risks of poor governance undermining the reform program. PSAL's outcome is rated *moderately unsatisfactory.* The main net benefits of the PSAL were progress on trade liberalization and privatization, cotton market liberalization, and improvements in PSDP control and monitoring. These achievements, though modest in comparison with original objectives, have proven (and are likely to remain) resilient to risk. Sustainability is therefore rated as *likely*. Institutional development is rated as *negligible.* The fundamental strategy of all parties to constrain the incoming government through second-tranche conditionality is questionable: the conditions were too numerous and vague to be effective and may have contributed to the new Government's lack of ownership for the program. The Government complied more with the letter than the spirit of conditionality. Overall, both Bank and Borrower performance are rated *unsatisfactory*.

6. The SAL's immediate (and overriding) objective was to help Pakistan overcome its external financing crisis (Pakistan was on the verge of default to preferred creditors). Its medium-term objective was to support further reform in fiscal and financial governance. The SAL played a crucial part in helping Pakistan overcome its balance of payments crisis, but it did little to advance structural reform and the macroeconomic framework failed to hold. Eventually, reforms resumed and macroeconomic policies improved, but only after the military takeover in October 1999. Although the relevance of SAL's objectives was high, efficacy was modest. The operation helped prevent default, but satisfactory fiscal and macro performance lasted only a few months and most of the follow-up reforms were not implemented until after a change of Government. The outcome is rated as *moderately unsatisfactory.* Improvements in loan repayment have been sustained and are likely to continue. Subsequent debt rescheduling and improvements in macro management have also reduced the threat of default. Even though debt service levels remain high, sustainability of these net benefits is rated *likely.* Institutional reform was *negligible* under the loan. Because of the failure to implement the reform program, Borrower performance is rated *unsatisfactory.* The problems with SAL reflect a lack of broad-based commitment in Pakistan, not the program design; Bank performance is rated *satisfactory*.

7. The objective of SAC I was to help maintain the macroeconomic stability needed to support the implementation of structural reforms grouped under the objectives (or pillars) of the Government's new Poverty Reduction Strategy: improving governance, growth prospects and the delivery of social services. The relevance of SAC I objectives was substantial and the extent to which they were achieved (efficacy) was also substantial. Progress was made in the critical area of tax reform and administration, and the Government followed through in implanting reforms on a broad front. Important exceptions were the power sector and social sector spending. Overall, outcome of SAC I is rated *satisfactory.* The systemic nature of many of the reforms, along with continued monitoring and support by the Bank, make sustainability of project achievements *likely*. There were promising institutional reforms in tax administration, public financial management, and price setting, but continuing resistance to change in the power sector. Overall institutional development impact is rated *modest.* Performance of both the Bank and the Borrower are rated *satisfactory*.

8. The main objective of SAC II was to support the implementation of the I-PRSP, with a particular focus on growth and employment, governance, social protection, and human development. Although immediate balance of payments assistance was not an objective of SAC II, it did provide substantial longer-term assistance in debt management by providing US$500 million equivalent (about 0.7 percent of GDP) on IDA terms. Implementation of SAC II started strongly on the basis of well defined prior actions taken before Board approval, but slowed down during elections in October 2002 and the transition to a new government after the elections. Although the economic team remained in place and the new government continued to support reforms, the implementation was sufficiently delayed that the Bank did not process a third SAC as planned. In contrast with the mixed performance and protracted implementation of structural reforms, Pakistan's macro performance after SAC II was strong—although it is not clear how much of the improvement was due to SAC II. The relevance of SAC II objectives was substantial, but efficacy of implementation was modest, and the overall outcome is rated as *moderately satisfactory*. Sustainability of net project benefits is rated *likely*. SAC II had important institutional objectives in tax administration, public financial management, civil service reform, procurement, and utility restructuring and regulation. Overall institutional development impact is rated *modest*. Both Bank and Borrower performance are rated *satisfactory*.

9. The main lessons from these loans are:

- A series of one-tranche loans in a programmatic framework can be an effective instrument to support reforms in a country with a poor track record. However, effectiveness of a series of one-tranche loans depends on a willingness to withhold lending until a critical mass of previously-agreed prior actions have been undertaken. The delay between the SAL and the first SAC was particularly effective in this respect.

- Complex or politically difficult sector reforms are best supported through dedicated sector operations. A multi-sector operation can play only a secondary or facilitating role when dealing with institutional development (as in tax reform or civil service reform), deep-rooted reluctance to reform (as in power), need for specific funding to offset costs of adjustment (as in banking), or weak service delivery (as in health and education).

Vinod Thomas
Director-General, Evaluation

1. Introduction

1.1 During the 1970s and 1980s Pakistan maintained a high rate of economic growth (over 6 percent), and the incidence of poverty fell steadily – from about 50 percent in the early 1970s to around 20 percent by 1988. By the late 1980s, however, Pakistan faced increasingly serious obstacles to continued growth. Growing current account and fiscal imbalances raised the level of debt and undermined investor confidence. A narrow tax base kept the tax/GDP ratio low while high defense expenditures, numerous subsidies, and growing interest payments created strong pressures for continued deficit spending. Trade restrictions biased incentives against exports. Inefficient state-owned enterprises dominated infrastructure, banking and much of industry while controls and price distortions limited private sector growth. Political appointments, low salaries, and corruption had undermined government institutions. And despite the favorable impact of growth on poverty reduction, Pakistan's social indicators lagged behind those of most other low-income countries.

1.2 These macro imbalances and structural weaknesses prompted the Government to launch a medium-term structural adjustment program in mid-1988. The program, which was supported by the IMF, World Bank, and Asian Development Bank, aimed to put growth on a more sustainable path and address poverty and social concerns by redressing macro imbalances and restructuring the roles of the private and public sectors.

1.3 Since 1988 successive governments have tried to come to grips with Pakistan's legacy of fiscal weakness, poor policy, and institutional decay. Governments have repeatedly introduced programs of stabilization and endorsed deregulation, privatization, and reforms in trade, banking, power, energy, and public finance. But political instability, deep-rooted corruption, and weakened institutions had left the country poorly equipped to cope with a series of shocks – some exogenous and some self-inflicted – including regional conflict, floods, droughts, and economic sanctions. The net results were that, during the 1990s, growth slowed, the ratio of debt remained high, and poverty grew:

- Per capita GDP rose by less than 13 percent during the 1990s compared to over 34 percent during the previous decade.
- The debt/GDP ratio hovered around 90 percent throughout the 1990s.
- The incidence of poverty rose steadily after 1988, reaching 32.1 percent in 2001.
- Social indicators improved slowly or not at all. Net primary enrollment fell during the decade.

1.4 Structural adjustment during the 1990s was a stop-go process. Some important and lasting reforms did take place but outcomes were mixed. Since 1999, however, the Government has pursued a more consistent program of stabilization and structural adjustment. (See Table 1 for selected macroeconomic indicators for the period 1992/93 – 2003/04). One indicator of the change is that whereas Pakistan failed to complete any of its six IMF programs during 1988-99, it completed the 2000 Stand-By Arrangement and has remained on track throughout the PRGF program initiated in 2001.

1.5 This report evaluates four World Bank adjustment loans/credits to Pakistan during the decade 1993-2002. It has been carried out in parallel with the Pakistan Country Assistance Evaluation which reviews the Bank's overall assistance to Pakistan during the period 1994-2003, and can best be read in conjunction with that report (forthcoming). The next four sections review outcomes operation by operation. A final section summarizes overall performance during the decade and tries to draw some lessons of general interest.

Table 1 : Selected Macroeconomic Indicators (Percent of GDP, except where noted)

	1992/ 93	1993/ 94	1994/ 95	1995/ 96	1996/ 97	1997/ 98	1998/ 99	1999/ 2000	2000/ 01(a)	2001/ 02(a)	2002/ 03(a)	2003/ 04(a)
GDP at factor cost (percent per annum)	2.1	4.3	5.1	6.6	1.7	3.5	4.2	3.9	2.2	3.4	5.1	6.4
Total revenue and grants	17.9	17.2	17.0	17.5	16.1	15.8	16.3	16.6	17.3	19.5	20.8	18.3
Tax revenue	13.3	13.3	13.8	15.0	13.4	13.0	13.3	12.8	12.9	13.2	13.8	13.5
Non-tax revenue	4.6	4.0	3.2	2.5	2.7	2.8	3.0	3.7	3.3	4.0	4.1	4.0
Grants		-	-	-	-	-	-	0.1	1.2	2.3	2.8	0.7
Expenditures	26.0	23.5	23.7	25.3	22.9	23.5	22.4	22.9	21.4	22.8	22.4	21.6
Budget balance (excluding grants)	-8.2	-6.3	-6.7	-7.8	-6.8	-7.7	-6.1	-6.4	-5.2	-5.2	-4.5	-4.0
Exports	13.1	12.7	13.0	13.1	12.9	13.5	12.9	13.3	15.2	15.4	15.2	15.7
Imports	19.4	16.6	16.8	18.9	17.9	16.5	16.5	15.6	17.4	15.9	16.5	16.0
Current Account (excluding official transfers)	-7.1	-3.8	-4.5	-7.6	-6.1	-3.1	-4.1	-3.4	-3.3	0.2	4.6	2.1
Total Public Debt	n/a	93.2	86.8	86.3	87.5	89.4	91.9	91.6	108.0	96.7	89.2	84.1
o/w External Debt	45.9	49.3	45.4	42.7	43.9	43.4	46.0	45.7	55.4	48.3	42.0	39.4
Total Reserves (mos. of imports)	0.7	2.7	2.2	1.7	1.1	1.0	1.7	0.9	1.7	3.7	6.5	6.0
Inflation (CPI, annual percent)	9.3	10.0	12.4	12.3	10.4	11.4	6.2	4.1	4.4	2.7	3.1	4.1
Reer exchange rate index (end of year)	97.9	97.6	91.4	87.9	94.5	84.4	85.5	85.2	85.3	84.1	79.4	76.1

Source: IMF Country Reports for Pakistan; Global Development Finance as reported in the CAE. Growth rates and figures for 1992/93 are from Pakistan Development Policy Review (report no. 23916-PAK). (a) Provisional Actual.

2. Public Sector Adjustment Loan/Credit (9/14/1993)

Background and Overview

2.1 During 1988-92 outcomes of the reform program launched in 1988 were mixed, in part due to political instability. (See Annex C for a timeline of political and other events). There was some progress on privatization, de-licensing of industry, and deregulation, but weak performance on fiscal reform, with fiscal deficits averaging over 7 percent of GDP. The Bank provided three sector adjustment loans during this period which had moderately successful outcomes overall. In late 1992, floods and blight of the cotton crop contributed to an economic crisis and further political instability. The growth rate fell, the fiscal deficit rose to over 9 percent of GDP, and gross foreign exchange reserves fell to less than two weeks of imports. Following the resignation of Prime Minister Nawaz Sharif and the

President in July, 1993, Moeen Qureshi took over as interim Prime Minister, pending elections in October of that year. The interim Government took several measures to stabilize the economy and negotiated a Stand-By Arrangement (SBA) with the IMF and the Public Sector Adjustment Loan/Credit (PSAL) with the World Bank.

2.2 The priorities of the Bank's country assistance strategy during this period were, first, to support structural adjustment, primarily by improving public expenditure management and the enabling environment for the private sector, and second, to promote better social sector outcomes.[1] The PSAL was intended to be the main instrument for achieving the first goal and the Social Action Program (SAP) project was to be the main instrument for social sector development. The overarching objective of the PSAL, as the name implies, was to improve public sector management through: better expenditure allocation and higher revenue collection; deregulation of the economy and privatization of government enterprises; and trade reform. The PSAL and SAP were complementary in the sense that better public expenditure allocation and higher revenues would augment resources for social sector expenditure.

2.3 The Bank and Fund programs were also highly complementary. Measures taken during July and August served as prior actions for both the PSAL and Fund program (which started off as an SBA in September, 1993, and evolved into a US$1.4 billion Extended Fund Facility/ Enhanced Structural Adjustment Facility - ESAF/EFF in February, 1994). The main measures included devaluation, an increase in interest rates, reduction of the maximum tariff by 28 percent, and energy and other price increases amounting to 0.7 percent of GDP. Privatization of 69 industrial units (out of an ultimate target of 100 enterprises) during FY91-93 was also considered to be a prior action under the PSAL. The main stabilization target was to reduce the fiscal deficit by five percentage points of GDP in three years. The PSAL public expenditure measures complemented this ambitious target.

2.4 Although resource transfer was clearly a factor in the timing of the operation, the main consideration seems to have been to take advantage of the interim Government's tenure to negotiate a stabilization and reform program (there had been five abortive appraisal missions before the sixth successful one in August)[2] and to tie the hands of the successor elected government.

Design, Implementation, and Outcome

2.5 The operation provided a loan of US$150 million and a credit of US$100 million equivalent in two equal tranches. The Japanese Overseas Economic Cooperation Fund provided co-financing of US$150 million equivalent.

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[1] As discussed in the CAE (forthcoming), the Bank's stated objectives were more complex and included things like improving the environment, but these were the priorities.

[2] Originally, Pakistan was to have received a low-conditionality loan to offset the effects of the Gulf War, but the war ended quickly and the case for low conditionality could not be maintained. This was a matter of some resentment. Moreover, some in the Government felt that the delay in loan processing meant Pakistan got no credit for actions taken in earlier years.

2.6 There were five specific conditions for second tranche release:

- adoption of a satisfactory macroeconomic framework for FY95 (in practice linked to the framework agreed between the new government and the Fund);
- adoption of an agreed Public Sector Development Program (PSDP) for FY95;
- preparation of plans for liquidating an agreed list of public sector industrial units;
- implementation of an agreed action plan to reform public administration; and
- increasing FY95 spending on basic social services under the SAP by at least 0.1 percent of GDP.

2.7 These five conditions were among 28 “actions to be taken by end-June 1994”, along with 15 “actions already taken”. In the event, release of the second tranche was delayed until December, 1994, but there was generally satisfactory progress up to the final supervision mission in November 1994 on overall PSAL/ESAF/EFF implementation.

2.8 The problem is that this generally satisfactory progress was not sustained. There were some significant accomplishments in trade reform (including abolition of export duties and import license fees and surcharges as well as tariff reduction), deregulation of cotton marketing, and in improving PSDP control and monitoring, but implementation was already acknowledged to have been weak in several areas by the time of ICR review, including: resource mobilization (including cost recovery in irrigation and shortfalls in tax collection and in tax restructuring), civil service reform (little systemic reform and reversals of some staff reductions), and in governance (political interference in decisions of autonomous agencies, continued granting of special exemptions and subsidies). Subsequent budget actual figures showed that, while the allocation to basic social services increased by 0.1 percent of GDP, the increased allocation was not spent – actual expenditure remained constant as a share of GDP. Most importantly, a satisfactory macro framework was not maintained. Although Pakistan was still on track with the Fund’s ESAF/EFF at the end of 1994 when the second tranche release took place, it went off track in July 1995. A new SBA was negotiated and approved in December, 1995, but little progress was made in fiscal deficit reduction, which the PSAL’s complementary structural reforms were supposed to support.

2.9 The ICR noted a number of weaknesses in design and implementation, including: narrow “ownership” of the reforms within Pakistan; too many vague and un-prioritized measures; and overemphasis on privatizing or liquidating a given number of enterprises rather than on the *process* of privatization and regulation. At a more general level, there were three underlying weaknesses:

- *Unintended consequences.* Some of the successes of specific reforms undermined other objectives. Most notably, although tariff reduction was carried out as planned and had the intended effect of improving incentives, it also had the unintended effect of reducing government revenue because the substitution of domestic taxation took much longer than expected. Elimination of the export tax on cotton also benefited farmers, but textile producers took much longer than expected to adjust. The problem was not so much that design of the program lacked coherence, but rather that there were unrealistic expectations about how long some measures or adjustments would take to carry out.

- *Failure to come to grips with institutional weakness.* The main structural problem was (and still is) the weak fiscal system. Although the PSAL initiated some improvements in expenditure management and taxes, there was too much emphasis on specific measures (as with privatization) and too little attention paid to systemic or institutional change. A SAL can do little by itself to promote such change; this is mainly a criticism of failure to tackle the fundamental problem through other instruments. In the case of public administration reform, the Bank had done no prior ESW. The PSAL's conditionality was based on a government report which staff had not yet seen.
- *Placing conditionality on a reluctant reformer.* Trying to tie the hands of the incoming government through second tranche conditionality did not work very well or for very long. Such an approach may work for specific stroke-of-the-pen actions, but not for complex processes that require cooperation of a willing and committed partner.

Ratings

Outcome

2.10 The PSAL's objectives were substantially relevant to Pakistan's development challenges, but efficacy was modest. The ICR gave an excellent overview of design and implementation of the operation. It also gave the benefit of a doubt on outcome, which was rated marginally satisfactory. IEG concurred with that rating at the time. While there were some lasting accomplishments in trade reform, cotton marketing, and privatization, it is clear after the passage of nine more years that some things that were thought to have been achieved at the time (such as increased expenditure on social programs) were not, and that neither macro stabilization nor fiscal improvements were sustained. Key reforms of tax administration and broadening the tax base were not achieved, leaving public finances susceptible to later shocks. Fears of stop-go were fully realized, as were warnings about risks of poor governance undermining the reform program. In retrospect, outcome is rated *moderately unsatisfactory.*[3]

Sustainability

2.11 Both the ICR and IEG rated sustainability uncertain shortly after closing of the loan. It is now known that some of the accomplishments were sustained, and that others were not. Sustainability is defined as "resilience to risk of the net benefits over time". The main net benefits of the PSAL were progress on trade liberalization and privatization, cotton market liberalization, and improvements in PSDP control and monitoring. These

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[3] The Borrower disagrees with the rating (see Annex B). The policy improvements that took place in 2001-02 were made under a new Government and with the support of new Bank operations. These policy changes are reflected in the ratings for SAC I and SAC II. The changes cannot be attributed to the PSAL.

achievements, though modest in comparison with original objectives, have proven (and are likely to remain) resilient to risk. Sustainability is therefore rated as *likely*.

Institutional development impact

2.12 Institutional development is rated as *negligible* (unchanged from the ICR and previous IEG review).

Bank and Borrower performance

2.13 The ICR evaluated components of Bank and Borrower performance but gave no overall rating. IEG rated overall Bank performance as satisfactory, but gave no rating for Borrower performance.

2.14 The identification and preparation stages were lengthy and contentious, and the Bank inadvertently gave mixed messages on the prerequisites for an adjustment program. The ICR concluded that the main constraints to preparation were on the Government side, but that both parties' performance was deficient.

2.15 Final appraisal and negotiations were characterized by close agreement between Bank and Government views, with good Bank-Fund (and OECF) coordination. The project design addressed relevant issues but was flawed in having too many un-prioritized conditions and insufficient focus on tax reform. Nevertheless, the ICR concluded that overall Bank performance at this stage was satisfactory. The Government was criticized for leaving too much of the initiative for design to the Bank and Fund. In addition, however, the fundamental strategy of all parties to constrain the incoming government through second-tranche conditionality is questionable. The ICR concluded that this provided a useful and timely "nudge" to action on a number of fronts, but the conditions were too numerous and vague to be effective and may have contributed to the new Government's lack of ownership for the program.

2.16 Finally, implementation was rated satisfactory by the ICR. In retrospect, however, implementation was not as effective as it appeared at that time and the Government complied more with the letter than the spirit of conditionality.

2.17 Overall, both Bank and Borrower performance are rated *unsatisfactory*.

3. Structural Adjustment Loan (1/21/1999)

Background and Overview

3.1 The period between release of the second tranche of the PSAL in December 1994 and approval of the SAL in January 1999 was difficult both economically and politically for Pakistan. Growth of GDP averaged only 3.3 percent during 1995-98, exports fluctuated with no clear trend, and the fiscal deficit averaged over 7 percent of GDP. In

October 1996 the government of Benazir Bhutto was dismissed on corruption charges[1]. The new government under Nawaz Sharif embarked on an anti-corruption campaign and economic reform program, and in October 1997 reached agreement on a Policy Framework Paper (PFP) with the Bank and Fund. This underpinned a three-year US$1.56 billion ESAF/EFF arrangement with the IMF in October 1997; a US$250 million Bank Sector Adjustment Loan with the Bank (and an equivalent amount of co-financing from Japan's OECF) in December 1997; and a Capital Market Development loan of US$250 million with ADB (plus an equivalent amount of co-financing from Export Import Bank of Japan) in January 1998. The reforms and extraordinary support helped overcome a severe foreign exchange crisis and began to promote economic recovery.

3.2 Recovery abruptly halted after Pakistan tested a nuclear device in May 1998. This was widely condemned and major industrial countries imposed economic sanctions, including opposition to any new lending by international financial institutions (IFIs) except as needed to meet basic human needs. Sanctions led to severe balance of payments problems. Despite tax increases, spending cuts, import restrictions, and accumulation of US$1.7 billion in arrears, reserves fell by nearly US$1 billion to US$400 million (weeks of imports) in early December. In November 1998 the Government reached agreement with the IFIs on a new program of stabilization and reforms to be supported by the SAL, fast-disbursing loans from the ADB, and continued purchases under the ESAF/EFF arrangement with the Fund.

3.3 The SAL's medium-term objective was to support further reform in fiscal and financial governance. Its immediate (and overriding) objective was to help Pakistan overcome its external financing crisis. Pakistan was on the verge of default to preferred creditors. The IMF could only go to the Board for continuation of the ESAF/EFF if Pakistan's arrears to all preferred creditors (US$400 million) could be cleared. A Fund program had to be in place to pave the way for Paris and London Club debt rescheduling. Pakistan therefore needed up-front external assistance to prevent financial meltdown.

Design, Implementation, and Outcome

3.4 The SAL provided a US$350 million IBRD loan to be disbursed in a single tranche. The stated objectives were to help Pakistan overcome its external financing crisis and to restore investors' confidence and creditworthiness by supporting a major program of reform to improve fiscal and financial governance. The SAL was the second in a proposed series of Bank-supported adjustment loans, building on the Banking Sector Adjustment Loan approved in November 1997, with emphasis on deepening reforms in banking, energy, and taxation. (A Power Sector Adjustment Loan was projected to follow, perhaps as early as June 1999, but this never materialized.) It was expected that the reforms supported by this operation and further anticipated follow up reforms, would lead to: (a) a banking system that is largely in private hands, operating under banking regulations and prudential norms that meet international standards; (b) a financially viable energy sector with a growing role for private investors, with independent

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[1] The Borrower comments that this statement is inappropriate (see Annex B). This information is publicly available and helps explain the political environment that made reform difficult.

regulatory authorities; (c) an autonomous, efficient and equitable tax administration that progressively raises the tax to GDP ratio by broadening the tax base and improving enforcement; and (d) an expenditure policy that subjects public spending to rigorous appraisal and spending ceilings.

3.5 Prior actions for the loan (see Annex C for complete list) included:

- *Macroeconomic framework.* Agreement with the Bank and Fund on a framework for deficit reduction.
- *Banking.* Administrative steps to accelerate loan recovery; improvement in the collateral foreclosure system.
- *Power.* Introduce legislation to allow for WAPDA restructuring; implement agreed framework for resolving disputes with Independent Power Producers; implement loss and theft reduction program; clear up government arrears to WAPDA; ensure that regulatory authority (NEPRA) is fully operational.
- *Natural gas.* Recovery of overdues; introduction of legislation for regulatory authority.
- *Taxation.* Recover tax arrears (specific target); submit legislation to create Pakistan Revenue Authority (PRA); increase number of registered taxpayers and tax tribunals.
- *Public expenditure.* Reduce size of PSDP and protect core programs; reduce size and composition of non-budgetary PSDP; ensure adequate funding of SAP.

3.6 The SAL achieved its main short-term objective, which was to overcome Pakistan's balance of payments crisis and prevent default. Up-front financing from the SAL permitted the IMF program to continue and subsequent debt rescheduling to take place. Prior actions under the SAL also helped reduce the fiscal deficit as the Government met or exceeded all tax and arrears collection targets. With respect to structural reform, the most significant accomplishment was the creation in the power sector of new corporatized entities for generation, transmission, and distribution under a new regulatory authority, though follow-up implementation has been slow. There was also progress in settling some (but not all) IPP disputes. Finally, implementation of prior actions in the banking sector represented a modest step forward in a reform program mainly carried out – slowly but effectively – in other sector-specific operations.

3.7 Most of the SAL's reform objectives were not achieved. Legislation on gas regulation and creation of the PRA were submitted to the National Assembly, but were not enacted. Measures to restore WAPDA's financial viability were not fully implemented, and there was no prospect of a power sector adjustment loan being feasible. In tax administration, the targets for identifying new taxpayers were met, but reform of tax administration did not take place and the tax/GDP ratio improved only temporarily. In public expenditure, agreed cuts in the PSDP were uneven and partial. Spending in many low-priority projects and programs was close to the original allocation whereas spending on the high priority core program fell short of the original allocation by as much as 10 percent.

3.8 Pakistan's fiscal effort and reform implementation slowed after early 1999. By September 1999 the IMF program went off track for lack of progress in implementing fiscal reforms. It later emerged that the Government had been misreporting fiscal data since the early 1990s and that the fiscal deficit was larger than previously estimated[2].

3.9 In summary, the SAL played a crucial part in helping Pakistan overcome its balance of payments crisis, but it did little to advance structural reform and the macroeconomic framework failed to hold. Eventually, reforms resumed and macroeconomic policies improved, but only after the military takeover in October 1999.

3.10 From the beginning there were questions about the design of the operation, or whether it should go forward at all. The Region's claim that Pakistan's performance merited a high base case designation (a prerequisite for this operation) was questionable. At the Board discussion of the loan, six speakers abstained from voting on the grounds that Pakistan had yet to demonstrate that its commitment to reform was irreversible. The proposal for a single tranche operation was also controversial. A note was circulated by several board members proposing phased-in support through a tranched operation. Bank Staff acknowledged that the risks of going ahead were high, but argued that the risks of doing nothing were even higher. A default would be very disruptive and create hardship for the poor. Staff also argued that a series of simple- tranche loans would mitigate the risk of policy reversal and in effect act like a multi-tranche loan.

3.11 The role of the Bank in providing short-term balance of payments (BOP) support was also an issue. Short-term BOP support is the mandate of the Fund. In this case, however, the Fund could not complete its review nor extend further support unless Pakistan cleared its arrears, despite Pakistan's compliance with the Fund program in other respects. The SAL was the only feasible source of short-term BOP finance available. Given the exceptional circumstances and the fact that Bank support was undertaken in close collaboration with the Fund, and that it opened the way for both Fund financing and bilateral debt rescheduling, short-term BOP financing through the SAL was justifiable.

3.12 Much of the case for the SAL hinged on the unknown consequences of default. Would default have been the calamity that was feared? Would it have led to chaos, more political instability, and hardships for the poor – or would it have provoked an earlier change of government? It was reasonable for the Bank to take the risk of going forward with the loan. Nevertheless, the outcome was very mixed. The SAL helped avoid an imminent train wreck and kept the economy and reform program headed in the right direction. But forward progress soon stalled and the SAL failed to remove obstacles which could lead to necessary changes further down the line.

3.13 Could the program have been designed to promote a more favorable outcome? The Bank was supporting what was said to be a home-grown program of reforms, but commitment was limited to a fairly narrow range of officials. Identifying the underlying problem as one of governance was perceptive. Corruption and vested interests—and a broader culture of non-payment—affected public utilities, banks, and tax collection. The

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[2] The Borrower comments that this statement is out of place (see Annex B). The statement is intended to show that Pakistan was further off track than thought at the time.

proposed solutions included ad hoc measures and proposals for longer term institutional change like that embodied in regulatory and organizational reform. However, the reform program was modest and lacking in a sense of urgency and only the ad hoc measures were implemented.

3.14 Might the Bank might have used the crisis to force more drastic change, i.e. should the Bank have imposed stronger conditionality? It is true that the prior actions were modest and that most of the revenue and cost recovery targets were exceeded. It does not appear, however, that these targets were set knowing that they had already been met. Staff involved in preparation and design stated that the targets were set in June, not at negotiations in November. Moreover we have no evidence that the loan was motivated primarily by considerations of defensive lending (to finance repayment to the Bank and Fund) rather than the stated rationale of preventing severe consequences to Pakistan and providing a breathing space for reforms to take hold and improve the country's creditworthiness. Rather than impose its own program through stronger conditionality the Bank chose to support the Government's reform program. This weaker concept of conditionality is normally a better guide for Bank operations in the sense that it entails less risk of non- performance. In the event, however, that weaker standard of conditionality failed because the Government was unable to follow through with legislative approval of structured reforms. It is unlikely that a multi-tranche operation would have been more successful. The logic of a series of one-tranche operations is that succeeding programs only go forward when agreed actions under a previous adjustment loan have been fully met in spirit. This should mean that while it may occasionally be necessary to "pay" twice for a reform, adjustment loans should not have to pay twice for the promise of a reform.

3.15 In brief, the SAL didn't succeed, but this was due to lack of broad-based commitment in Pakistan, not to program design.

Ratings

Outcome

3.16 The ICR rated outcome satisfactory. IEG's earlier desk review downgraded the rating to marginally satisfactory. We have rated outcome as *moderately unsatisfactory*. Although the relevance of the objectives was high, efficacy was modest. The operation helped prevent default, but satisfactory fiscal and macro performance lasted only a few months and most of the follow-ups reforms were not implemented until after a change of Government[3].

Sustainability

3.17 The main benefits achieved under the loan were preventing default, improving loan recovery in the banking system, and starting the process of corporatization in the power sector. The fiscal and macro improvements supported by the loan were not

[3] The Borrower disagrees with the rating (see Annex B). Reforms implemented after the change of Government are reflected in the ratings for SAC I and SAC II. Exogenous events affected fiscal and macro performance as well, but under OED's methodology exogenous events also affect outcome.

sustained. Progress of power sector corporatization begun under the SAL has been slow – legal change has not been matched by a change in corporate culture. Improvements in loan repayment have been sustained and are likely to continue. Subsequent debt rescheduling and improvements in macro management have also reduced the threat of default. Even through debt service levels remain high, sustainability of these net benefits is rated *likely*. It should be noted that while this rating is unchanged from previous ratings, the net benefits to which the current rating applies are less than previously envisaged.

Institutional development impact

3.18 Institutional reform was negligible under the loan (unchanged from previous IEG ratings).

Bank and Borrower performance

3.19 For the reasons given in paras. 3.10 -3.15, Bank performance is rated *satisfactory*.

3.20 Because of the failure to implement the reform program, Borrower performance is rated *unsatisfactory* (downgraded from previous ratings).

4. Structural Adjustment Credit (6/12/2001)

Background and Overview

4.1 After the previous Government's reform program stalled in mid-1999 with important parts of the 1999 SAL program unimplemented, there was a pause in Bank lending. The Fund also decided not to negotiate a new program after suspending the ESAF/EFF program in September 1999. As Pakistan had failed to complete any of its programs with the Fund during the period 1988-99, the Fund insisted that the new Government establish a strong track record before becoming eligible for any new arrangement. A new IMF program (a 10-month, non-concessional SBA) was approved only in November 2000.

4.2 The new Government was committed to far-reaching political and economic reforms. It focused on reviving the economy, improving governance (especially reducing corruption), and devolving power to lower levels of government. The Government assembled a strong economic team, including technocrats and Pakistanis working in prominent positions abroad. There was a sense of urgency in promoting its program, as elections were scheduled for October, 2002.

4.3 Despite a severe drought, adverse terms of trade, and the absence of support from the Bank and the Fund, the new Government made substantial progress in stabilizing the economy and resuming structural reforms. The fiscal and current account deficits were reduced, disputes with the IPPs were finally resolved, more predictable market-based pricing policies for oil products were introduced, banking reforms continued, and the Gas

Regulatory Authority Act was enacted. The Pakistan Revenue Authority was not established, but some reforms of the Central Board of Revenue were initiated.

4.4 In the six months prior to the SAC, Pakistan maintained a generally good track record of macroeconomic management under the SBA and met all major targets except for revenue and foreign exchange reserves. The former shortfall reflected slow GDP growth due to drought and, as in the past, slower than anticipated improvements in tax administration. The shortfall in reaching the reserve target reflected adverse terms of trade. Despite the SBA and new debt rescheduling with the Paris Club in January 2001, foreign exchange reserves had fallen below three weeks of imports by May 2001. Pakistan's fragile external payments obviously provided part of the motivation for renewed adjustment lending by the Bank.

4.5 Although the Bank approved no new loans between June 1999 and April 2001, the Bank, Fund, and ADB were all engaged in analytical work and policy dialogue with the Government. This dialogue formed the basis for renewed lending in support of the Poverty Reduction Strategy developed by the Government during this period.

4.6 In a CAS Progress Report accompanying the presentation of the SAC to the Board, the Bank reiterated its strategy of using a series of one-tranche operations. The one-tranche disbursement strategy was seen as a way for Pakistan to build a credible track record while giving the Bank flexibility to respond to policy reversals. The SAC was to be the first in a new series of one-tranche operations and was linked to ongoing and planned operations, including the Improvement to Financial Reporting and Auditing Project (PIFRA), the Banking Sector Restructuring and Privatization Project (BSRPP), and the Fund's SBA.

4.7 The objective of the SAC was to help maintain the macroeconomic stability needed to support the implementation of structural reforms. More specifically, the Credit was to support an array of measures grouped under the objectives (or pillars) of the Government's new Poverty Reduction Strategy:

- *Improving governance* – tax reform, devolution, decentralization, improved financial management, civil service reform, and public access to information.
- *Strengthening the foundations for economic growth* – power, oil, and gas pricing, regulatory reforms, and privatization.
- *Improving delivery of social services* – by strengthening leadership, improving incentives influencing delivery of services and transition from provincial-based to district-based delivery of services.

Design, Implementation, and Outcome

4.8 The SAC provided an IDA credit of US$350 million equivalent disbursed in one tranche.

4.9 The Government took the following actions which were deemed to be prior actions for the SAC (see Annex D for a complete list of prior actions and related measures):

Improving governance

- Extended coverage of the general sales tax or GST (actually a value added tax) to include services previously subject to excise taxes.
- Established fiscal monitoring committees to reconcile expenditure data at both the federal and provincial levels. The target for reconciliation at the federal level was six months, which was met for first semester of FY00-01.
- Adopted a revised, modern accounting system for integrated financial management.
- Issued ordinance to separate public accounting and auditing systems.
- Established ad hoc federal and provincial Public Accounts Committees (PACs) and opened up federal PAC hearings to the press.
- Amended the Federal Public Service Commission (FPSC) ordinance to increase independence and jurisdiction of FPSC.

Achieving broad-based growth

- Issued a Privatization Ordinance to provide for increase transparency and settlement of disputes.
- Liberalized petroleum products marketing and introduced a mechanism for quarterly adjustment of prices.
- Announced new gas pricing framework providing for links to international oil prices and phasing out of subsidies except for fertilizer and a consumer lifeline rate.
- Revised power tariff and set a formula for periodic revision.
- Reduced or eliminated differential excise tariffs to bring down the maximum effective tariff to 35 percent (except for 11 products).

Human development

- Developed an education sector reform program and action plan for the federal, provincial, and territorial governments.
- Provincial and territorial governments introduced a competitive selection system for new teachers and started making appointments under a school-based or area-specific contract system.
- Consolidated investment programs to complete ongoing works.
- Introduced programs at the provincial and territorial levels to monitor and discipline teacher and health staff absenteeism.

4.10 All the main prior actions were implemented before Board discussion and most were sustained and extended in the following year. Implementation of the SAC-supported program bolstered Pakistan's track record and, along with successful completion of the SBA in September 2001 and a favorable review of Pakistan's I-PRSP in November, helped pave the way for a three year US$1.25 billion PRGF with the Fund and debt rescheduling with the Paris Club in December 2001. The events of September 11, 2001, had both negative and positive effects on Pakistan. On the one hand, the resulting uncertainty and war in neighboring Afghanistan limited the supply response to reforms and made it more difficult to attain revenue and other targets. On the other hand, in the aftermath of September 11, bilateral aid and remittances both increased substantially, easing the balances of payments constraint.

4.11 Important achievements of the SAC prior actions and follow-up measures included:

- *Tax policy and administration.* The GST was extended to services, provinces began to tax agricultural income and an ordinance for a simpler and more equitable income tax was issued. These and follow-up measures under SAC II helped raise the tax/GDP ratio from 12.9 percent in 2000/01 to 13.2 percent in 2001/02 and 13.8 percent in 2002/03.
- *Public financial management.* Fiscal monitoring committees helped improve the timeliness of expenditure reporting; accounting and auditing functions were separated; the new accounting model was implemented with help from the ongoing PIFRA project; after some delay PACs were established and opened to the press at the federal level.
- *Civil service reform.* Measures to strengthen the FPSC helped improve recruitment based on merit and facilitated removal of over 5,000 inefficient or corrupt staff.
- *Trade reform and deregulation.* The maximum tariff was lowered to 30 percent and the number of slabs reduced to four; trade in agricultural products was liberalized further; no new exemptions for income taxes, customs duties or GST are being granted, and old exemptions are being phased out.
- *Petroleum sector.* Retail prices were either deregulated completely or adjusted quarterly in line with international prices. Significant subsidies and other distortions remained, but subsidies to refineries were made transparent and were provided through the budget.
- *Social sectors.* A start was made on implementing the Education Reform Strategy, including initiatives at the provincial level for better recruitment, training, and reduction of absenteeism of teachers.

4.12 In addition to these reforms promoted under the SAC, there was substantial progress in financial sector reform, supported separately under the BSRPP of October 2001.

4.13 There were also some significant shortcomings in follow-up implementation of the SAC:

- *Privatization.* Although the Government continued preparations to bring a number of State Operated Enterprises (SOE) to the point of sale, only one SOE was fully privatized in the year following the SAC. This was due to uncertainty in the business environment after September 11 and was largely outside Government control.

- *Power sector.* After completion of the prior actions, reforms slowed for several months. Little progress was made, therefore, in WAPDA's restructuring or financial position.
- *Natural gas.* The price increase made prior to SAC approval was maintained but the semi-annual adjustment scheduled for September 2001 was delayed until March 2002. Implementation of a new well-head pricing agreement for the state-owned Pakistan Petroleum Limited (PPL) was also postponed until March 2002, when the Cabinet agreed (supported by SAC II) to an initial increase of 50 percent and a five-year phase-in to international prices.
- *Social sector spending.* Spending on education was significantly below budgeted levels in FY01-02 and the budget allocation for several high-priority health programs fell short of agreed levels until additional donor financing was made available after September 11.

4.14 Progress under the SAC was broadly satisfactory. The main reasons for improved performance compared to previous operations under review were stronger Government commitment and better program design.

4.15 The Government was more fully committed to reform than previous governments, was more securely in power, and had a longer time horizon. For reasons of both pragmatism and pride, the Government was particularly determined to improve Pakistan's reputation for good management, good governance, and follow-through on reforms.

4.16 The SAC program design was based on stronger, and better-defined, prior actions. Conditionality was backed up by prior ESW and policy dialogue. It also helped that there was some room for maneuver on the timing of the SAC. The balance of payments crisis was not so severe that the Bank was forced to choose between timely support and substantive up-front actions. Finally, the SAC design included indicative actions for a follow-up program. This not only provided a good basis for designing SAC II, but also provided an incentive for following through on implementation of SAC I.

Ratings

Outcome

4.17 The relevance of SAC objectives was substantial and the extent to which they were achieved (efficacy) was also substantial. Progress was made in the critical area of tax reform and administration, and the Government followed through in implanting reforms on a broad front. Important exceptions were the power sector, in which there are strong vested interests opposed to reform, and social sector spending in which weak implementation capacity, lack of leverage by the central government on lower levels, and widespread indifference to social development led to shortfalls in performance. Overall, outcome is rated *satisfactory*.

Sustainability

4.18 The systemic nature of many of the reforms, along with continued monitoring and support by the Bank, make sustainability of project achievements *likely*.

Institutional development impact

4.19 There were promising institutional reforms in tax administration, public financial management, and price setting, but continuing resistance to change in the power sector. Overall institutional development impact is rated *modest*.

Bank and Borrower performance

4.20 Performance of both the Bank and the Borrower are rated *satisfactory* (unchanged).

5. Second Structural Adjustment Credit (6/11/2002)

Background and Overview

5.1 In the year between approvals of the first and second SACs, Pakistan's external circumstance changed dramatically. The events of September 11 just three months after approval of SAC I jeopardized the economic recovery which was underway in response to the Government's reform program. GDP growth had been recovering despite a severe drought and was on course to rise from 2.6 percent in 2000/01 to 4.0 percent in 2001/02. After September 11 prospects for foreign direct investment, privatization, and export growth were reduced. Growth of exports (in current US dollars) fell from 9.1 percent in 2000/01 to 2.3 percent in 2001/02 and actual GDPMP growth in 2001/02 was 2.8 percent with knock-on effects on budget revenues. Both external and internal security deteriorated after September 11 as Pakistan was inevitably affected by the war in Afghanistan, and tensions with India rose. Military expenditure, which had been falling, increased by 0.4 percent of GDP.

5.2 Despite the external shock, Pakistan's macro management and structural reform program stayed on course. Based on Pakistan's successful completion of the SBA before September 11 and presentation of an I- PRSP which was reviewed favorably in the Bank-Fund JSA, the Fund approved a three year US$1.25 billion PRGF program in December 2001. The international community also helped offset the shocks through increased aid and debt rescheduling and relief. Grant aid increased from 1.2 percent if GDP in 200/01 to 2.3 percent of GDP in 2001/02. The Paris club agreed to a debt rescheduling with some implicit debt relief.

5.3 Several donor countries followed up with debt swaps or outright debt relief. The net effect was to provide substantial liquidity relief for Pakistan for a three-year period, but overall external debt indicators remained above HIPC levels of sustainability.

5.4 The second SAC was unusual in three respects. First, its timing was distinctive. It was the first of the four operations under review that took place when Pakistan was not facing an external liquidity crisis. Reserves were above three months of imports and continued to increase. Second, SAC II followed a period of sustained good performance. Pakistan had successfully completed its first program with the Fund (the SBA) in 13 years, was on track with the PRGF, and had successfully completed and sustained most of the structural reforms agreed under the first SAC. Third, the SAC II program had largely been pre-defined under indicative targets set during SAC 1 negotiations. It was the first follow-on operation in a series of programmatic one-tranche operations to be carried out as planned.

5.5 Although immediate balance of payments assistance was not an objective of SAC II, it did provide substantial longer-term assistance in debt management by providing US$500 million equivalent (about 0.7 percent of GDP) on IDA terms. The program document argued that the loan size was justified because exceptional financing requirements would remain high for another two years, notwithstanding projected flows of bilateral grant assistance. The size of this operation remains debatable; however SAC II was followed by two provincial SACs approved in July 2002.

5.6 SAC II was presented along with a new CAS, the first since 1995. The CAS proposed three main instruments to support the Government's I-PRSP: analytical work and other non-lending services to support knowledge transfer and policy dialogue; policy-based fast disbursing lending at both the federal and provincial levels; and programmatic sector and investment lending to improve economic infrastructure and delivery of social services. SAC II was seen as the main instrument for Bank support of the I-PRSP and medium-term reform agenda over the following year.

Design, implementation and outcome

5.7 The second SAC provided an IDA credit of US$500 million equivalent disbursed in one tranche, The main objective of the operation was to support the implementation of the I-PRSP which focuses on:

- *Engendering Growth* by addressing the debt problem through fiscal consolidation and building the base for faster export growth; creating fiscal space for social sector and infrastructure by increasing revenue mobilization and changing the composition of expenditure; strengthening the business environment by improving the credibility of government policies, removing distortions and implementing power sector reforms.
- *Improving governance* through tax administration reforms, devolution of powers to newly established local governments; improved public finance management, and civil service reforms.
- *Improving human development* by strengthening delivery and funding of social services.
- *Improving social protection and employment opportunities* through access to credit, redistribution of public lands, implementation of community based infrastructure programs, and direct cash transfers to the most needy**.**

5.8 Implementation of the program started strongly on the basis of well defined prior actions taken before Board approval, but slowed down during elections in October 2002 and the transition to a new government after the elections. Although the economic team remained in place and the new government continued to support reforms, the implementation was sufficiently delayed that the Bank did not process a third SAC as planned[1]. A Poverty Reduction Support Credit (PRSC) approved in September 2004 continues Bank support for reforms and the Government's PRSP. The PRSC is intended to be the first in a new series of one-tranche development policy loans.

5.9 The main policy measures supported through SACII fell into the first two categories, Annex D presents a detailed list of prior actions and related measures along with indicators of follow-up actions intended to be supported under future operations.

5.10 The main actions under SAC II included the following:

- *Trade reform and deregulation.* The maximum tariff was reduced to 30 percent on all remaining products before the Board and to 25 percent after the Board; CBR cleared the backlog of GST refunds to exporters and introduced measures for quicker and more transparent refunds in future; price controls on 64 of 66 previously-controlled products were removed; and there was some progress on follow-up actions to rationalize labor laws and outdated industrial regulations.
- *Petroleum sector.* Petroleum product price adjustments in line with international prices began to be made fortnightly rather than quarterly. With the exception of a brief lapse during March-May 2002, these adjustments have continued regularly even in the face of changing international oil prices.
- *Tax policy and administration.* An action plan for fundamental reform of Central Board of Revenue (CBR) was introduced; integrated large taxpayer and medium taxpayer units were set up in Karachi and Lahore, respectively; and GST was extended to agricultural inputs including fertilizer.
- *Public financial management.* Provincial as well as federal Public Accounts Committees (PACs) opened up their proceedings to the press; separation of accounting and auditing begun under SACI was advanced with the help of PIFRA; and reconciliation of accounts improved from almost nil a few years ago to between 50 and 100 percent (with federal reconciliations at the high end).
- *Civil service reform*. Pay and pension reform has been implemented through revision of pay scales and rationalization of pension benefits. New pay scales restored 75 percent of lost value after 1994, folded many allowances into salaries and resulted in a modest decompression. The federal public service commission (FPSC) was given responsibility for recruitment of all middle and higher level professionals, but the cabinet overturned a provision of the FSPC amendment ordinance suggested by SACI which provided for the FPSC to recruit grades 11- 16.
- *Social Sector Spending*. Increased resources for education were allocated for lower level governments. Expended or new special health programs were launched for Lady Health workers, immunization of children, TB control and HIV/AIDS prevention.

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[1] The Borrower comments that the reasons for delay should be mentioned (see Annex B). The main reason was the need to form a coalition Government with the lengthy bargaining process that such a process entails.

5.11 Significant progress continued to be made in banking sector reform as well. Three nationalized commercial banks were restructured (including branch closures and voluntary retirement of 8,000 staff), one was privatized and the non-performing National Finance Development Corporation was closed through a merger with the state-owned National Bank of Pakistan. Although these measures were included in SAC II conditionality, the conditions were redundant as reforms were carried out under other dedicated operations.

5.12 As in the case of SACI there were mixed results and some significant shortcomings in implementation, in many of the same areas as in SACI.

- *Privatization.* Several large utilities and banks moved forward to the point of expressions of interest and pre-qualification but in the year following approval of SAC II only one bank was privatized, largely because of the difficult international environment. However, as of early 2005 another bank has been privatized and the Government has successfully divested shares of several state corporations to domestic investors.
- *Power sector.* Corporatization continued to proceed slowly and almost no progress has been made in improving the sector's financial performance by reducing system losses (still about 25 percent) due to inefficiency and theft of power, nor to improving bill collection. The electricity price set by NEPRA was scaled back 20 percent after a request for review by the Government. While technically within the terms of the law, this may have compromised NEPRA's independence and it contributed to shortfalls in revenue in FY03. In 2002/03 budgetary subsidies to the power sector amounted to 1.6 percent of GDP.
- *Natural Gas.* Price adjustments for both consumers and producers have been inconsistent. Three of seven scheduled semi-annual price adjustments have been missed, subsidies have not been phased out and reform of the household lifeline subsidy (whose limit is set too high and consequently benefits mainly the non-poor) has yet to take place.
- *Procurement reform.* An independent Pakistan Procurement Regulatory Authority (PPRA) was established as a prior action under SAC II. Staffing of the new unit and formulation of new procurement rules were very slow, but in 2004 the Government gazetted new public procurement rules which are to be followed by all federal departments and agencies and by public sector corporations.

5.13 Most of the structural reform accomplishments of SAC II were the result of prior actions before Board approval. Most lapses in performance and other shortcomings occurred later during the run-up to elections in October 2002 and the subsequent formation of a new government. The Bank reacted appropriately to the slowdown in implementation (following the logic of a series of one-tranche operations) by not going ahead with a scheduled third SAC. After implementation improved, the Bank processed a PRSC in support of the full PRSP prepared by the Government.

5.14 In contrast with the mixed performance and protracted implementation of structural reforms, Pakistan's macro performance after SAC II was strong. Growth of GDP and exports accelerated, reserves increased, the fiscal deficit excluding grants fell below 5 percent of GDP in 2002/03 for the first time in 25 years, the share of social expenditure increased and the debt burden was reduced. It is not clear how much of the improvement was due to SAC II, however, nor is it clear that increased social sector expenditure has had an appreciable impact on poverty. Improvements in tax administration and public expenditure management played a role in better fiscal performance but much of the improvement in the foreign exchange position and other macro indicators reflected increased bilateral aid and debt rescheduling/relief, a large increase in remittances, and lower interest payments (due to good internal management domestic debt and lower international interest rates). Nevertheless the SAC II operation did contribute to improving Pakistan's creditworthiness directly (through provision of IDA funds) and indirectly by helping to sustain Pakistan's reform program.

Ratings

Outcome

5.15 The ICR rated outcome satisfactory. The initial IEG review reduced this to moderately satisfactory because of numerous shortcomings. In the time that has elapsed since previous reviews it appears that the overall reform program has resumed. However, implementation has been protracted and reform in the power sector has remained unsatisfactory. The relevance of the project objectives was substantial, but efficacy of implementation was modest. This review rates overall outcome as *moderately satisfactory*[2].

Sustainability

5.16 Sustainability of net project benefits is rated *likely*.

Institutional Development Impact

5.17 SAC II had important institutional objectives in tax administration, public financial management, civil service reform, procurement, and utility restructuring and regulation. Overall institutional development impact is rated *modest*.

Bank and Borrower Performance

5.18 Both Bank and Borrower performance are rated *satisfactory*.

6. Overall Progress and Lessons

Overall Progress

6.1 The four operations under review were the main instruments of Bank support for Pakistan's growth and reform for over a decade. Although emphasis varied from loan to loan, certain broad objectives were common to all operations: funding a medium-term (and sometimes immediate) external financing gap; improving public sector management

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[2] The Borrower disagrees with the rating (see Annex B). The report cited was prepared by the South Asia Region of the World Bank. OED's rating is based on its independent assessment.

and allocation of resources; and promoting a better climate for private sector development. How successful were these operations in achieving these and other more specific objectives?

6.2 *Balance of payment support and debt management.* Avoiding default was in itself a significant accomplishment for Pakistan over the decade after 1993. Pakistan managed to overcome or muddle through recurring balance of payments crises, external and internal shocks, and HIPC-like debt levels without financial meltdown. Bank assistance through these loans played a part in this achievement, but the following observations are pertinent:

- Bank assistance was always part of a Fund-led effort and was normally secondary in importance. The exception was the 1999 SAL in which Bank participation was a critical link in preventing default.

- Structural reforms supported by the Bank were meant to help prevent future balance of payments crises. The first two operations essentially failed to achieve necessary structural changes to reduce the likelihood of future crises. It was only after first the Fund and then the Bank held up financing until strong prior actions were taken that overall macro performance improved.

- Under SAC I and II, the debt/GDP ratio fell from 108 percent in 2000/01 to 84 percent in 2003/04. This was mainly attributable to bilateral support and good internal debt management, though Bank-supported trade reforms also helped.

6.3 *Creating fiscal space.* A major objective of these four operations has been to increase fiscal space by raising the share of tax revenue and reducing certain categories of expenditure: interest costs, wasteful development projects and subsidies for non-poor consumers and for loss-making enterprises. (Defense spending was outside the Bank's purview). Throughout the 1990s tax revenue remained stuck at around 13 percent of GDP (low in comparison to other countries at a similar income level), while defense and interest payments claimed about 70 percent of tax revenue. (See Table 2 and Figures 1, 2, and 3). This squeezed out development and social sector expenditure and made it difficult to cut the fiscal deficit. Attempts to cut the budget deficit in fact resulted in reductions in PSDP expenditure from 5.2 percent of GDP in 1993/94 to 2.6 percent in 2000/01, though the PSDP review processes put in place under the PSAL may have helped improve the quality of public investment. In the last (three) years tax revenue has increased by 0.6-0.8 percent of GDP, partly in response to the tax administration reforms supported under the two SACs. The share of expenditure has also declined, reducing the fiscal deficit below 5 percent of GDP. The biggest factor accounting for expenditure reduction was the decline in interest rates which, as noted above, had little to do with Bank operations. Finally, the Bank structural adjustment operations helped reduce the budgetary drain of some loss-making SOEs (no quantitative estimates are available), but they have largely failed to reduce losses and subsidies in the power sector or in natural gas. As of 2002/03 power sector subsidies were estimated to be around 1.6 percent of GDP and gas sector subsidies about 0.2 percent.

Table 2 : Consolidated Government Budget

Pakistan	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/2000	2000/01 (c)	2001/02 (c)	2002/03 (c)	2003/04
Total revenue and grants	17.3	16.5	17.5	16.1	15.8	16.3	16.6	17.3	19.5	20.8	18.2
Tax revenue (a)	13.7	13.7	15.0	13.4	13.0	13.3	12.8	12.9	13.2	13.8	13.5
Non tax revenue	3.6	2.7	2.5	2.7	2.8	3.0	3.7	3.3	4.0	4.1	4.0
Grants	-	-	-	-	-	-	0.1	1.2	2.3	2.8	0.7
Total expenditure (a)	23.9	23.2	25.3	22.9	23.5	22.4	23.0	21.0	22.8	22.4	21.5
Current expenditure	19.1	18.4	20.1	19.2	19.5	19.3	20.3	18.9	19.3	19.7	17.8
of which:											
- Interest	6.0	5.2	6.2	6.5	7.3	7.3	7.6	6.8	6.8	5.2	4.5
- Military expenditure (b)	6.0	6.1	5.6	5.5	5.1	4.9	4.7	3.1	4.1	4.0	4.0
Public Sector Development Program	5.2	5.0	5.6	3.8	3.9	3.7	3.2	2.6	3.5	3.2	3.4
Budget balance (excluding Grants)	-6.7	-6.7	-7.8	-6.8	-7.7	-6.1	-6.5	-5.2	-6.7	-4.5	-4.0
Budget balance (including Grants)	-6.7	-6.7	-7.8	-6.8	-7.7	-6.1	-6.4	-4.1	-4.4	-1.7	-3.3
Primary Balance (excluding grants)	-0.7	-1.5	-1.6	-0.3	-0.4	1.2	1.1	1.6	0.1	0.7	0.6
Primary Balance (including grants)	-0.7	-1.5	-1.6	-0.3	-0.4	1.2	1.2	2.7	2.4	3.6	1.3
Financing	6.7	6.7	7.8	6.8	7.7	6.1	6.4	4.1	4.4	1.6	3.3
External	1.5	1.7	1.8	1.0	1.4	5.0	2.2	2.3	1.4	0.0	-0.4
Domestic	5.0	4.4	5.4	5.7	6.2	1.0	4.2	1.7	2.7	1.6	3.7

Source: IMF Country Reports for Pakistan as reported in the CAE (forthcoming). For 2003/04 figures are from Bank Data. Note figures used are prior to the recent rebasing exercise by the National Bureau of Statistics.
Notes: For Pakistan, data reported as the "Consolidated Government Budget"
"-" = Data not available or reported. Totals may not add up due to rounding.
(a) "Total expenditure" is defined as total expenditure and net lending.
(b) Note that after 2000/01, military pensions were consolidated with civilians pensions; hence, the military expenditure line is not directly comparable
(c) Prov. Act. for the FY for Pakistan

Figure 1 : Revenue and Expenditures 1993/94 - 2003/04

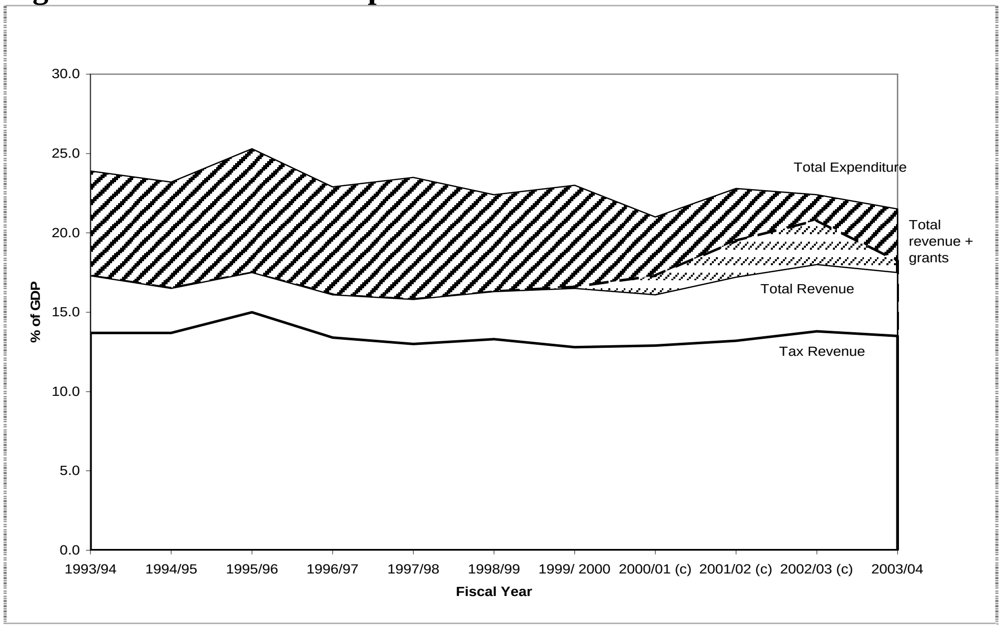


Figure 2 : Composition of Expenditure 1993/94- 2003/04

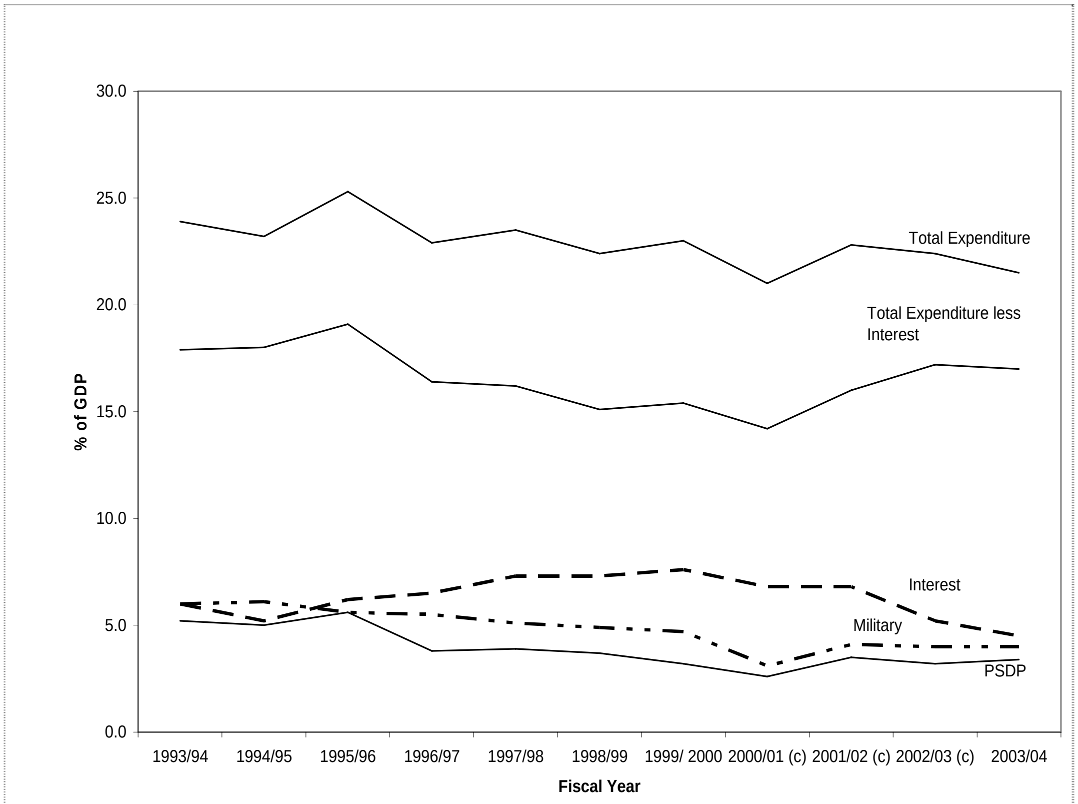
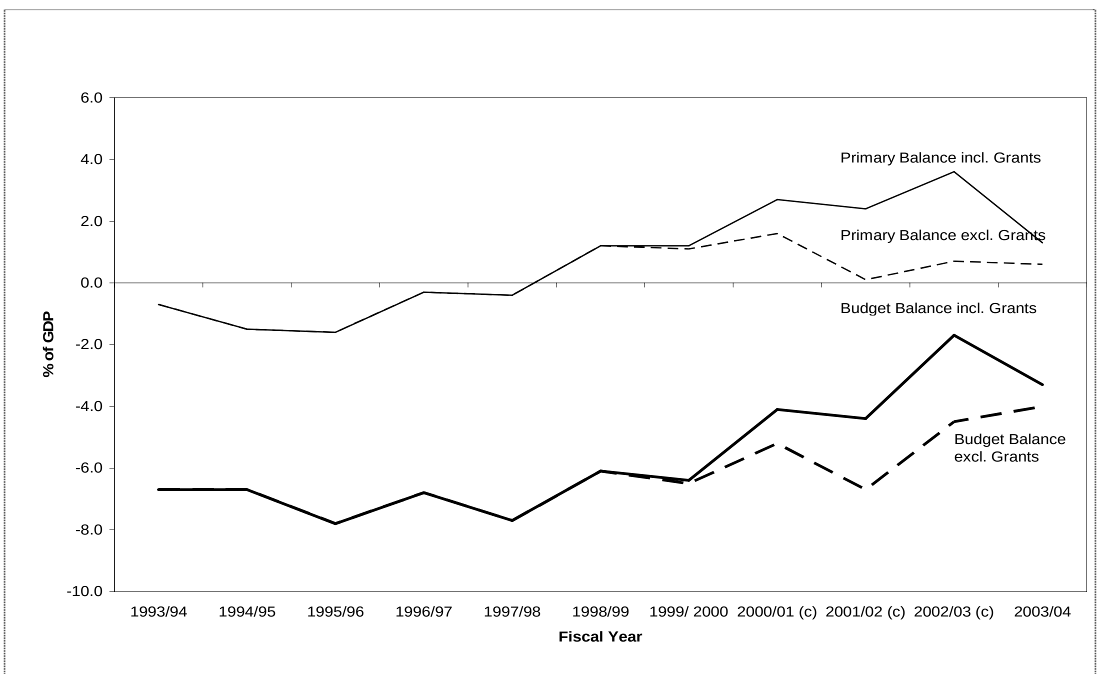


Figure 3 : Budget Balance 1993/94 - 2003/04



6.4 It is worth highlighting the *importance of interest rates and of grants*. Falling interest payments were mainly responsible for the improvement in the overall budget balance and the primary balance (Figures. 2 and 3). From 1999/00 to 2003/04, the overall budget balance including grants improved as a share of GDP by 3.1 percentage points. Interest payments also fell by 3.1 percentage points over the same period. (Revenues increased by 1.6 points as well -- tax revenue by 0.7 points, non-tax revenues by 0.3 points, and grants by 0.6 points -- but this was offset by a rise in non-interest expenditure). The fall in interest payments was due to debt relief, low international rates, and good internal debt management. Grants surged after September 1, reaching 2.8 percent of GDP in 2002/03. It is important to distinguish between balances with and without grants. The shift to primary fiscal surplus and the reduction in the overall deficit are important achievements, but balances excluding grants are a better measure of Pakistan's own efforts and of likely sustainability. Grants have started to decline and international interest rates may rise. The sustainability of recent fiscal improvements is therefore a matter of concern.

6.5 *Tax reform.* Although the *quantity* of taxes (tax/GDP ratio) remained unchanged during the 1990s, the *quality* of taxes improved as other broader-based and more efficient domestic taxes substituted for the loss of tariff revenue under trade reform. More recently, the tax/GDP ratio has risen somewhat. Equally important, tax administration reforms have started to change the culture from one of extortion to one based on transparency and integrity. Much remains to be done, however an investment climate survey in 2003 found that the private sector still regarded official harassment, especially from CBR, as a serious impediment.

6.6 *Public financial management.* There has been progress in accounting and financial reporting (especially reconciliation of accounts), auditing, legislative oversight through PACs, and more recently, in procurement reform. There has also been modest progress in civil service reform.

6.7 *Trade reform.* Significant reforms in the trade regime have taken place. Export taxes and other restrictions on exports have been largely eliminated. The maximum tariff level was reduced from 125 percent in 1990/91 to 25 percent in 2002/03 and the effective tariff rate (net customs duties as a share of dutiable imports) has fallen from 73 percent to 16 percent during the same period. Pakistan's level of protection is now among the lowest in South Asia, but still in the highest 20 percent of developing countries. All quantitative restrictions have been banned (with the significant exception of trade with India), and exemptions are being phased out.

6.8 *Power sector.* Although some progress has been made in unbundling through creation of independent corporations, efforts to improve the sector's efficiency and financial performance have failed. In light of the failure to reform the power sector through multi sector adjustment loans, the Bank has decided to start over again. The PRSC approved in September 2004 has only one condition related to the power sector—to prepare an action plan. Bank strategy is help prepare a medium- term adjustment strategy for the sector supported by a dedicated sector operation, which aims to eliminate the sectors drawn in the budget on a more gradual basis.

6.9 *Petroleum and natural gas.* Progress has been made since 2000 in improving the autonomy and commercial orientation of SOE's, most of which are moving toward privatization. Many product prices have been completely deregulated. Remaining price controls have been regularly adjusted for petroleum products, but there are still significant subsidies in the gas sector and price adjustments have not always taken place as scheduled.

6.10 *Banking sector.* Significant progress has been made in restructuring and privatizing the banking sector. Although conditionality on banking sector reform has been included in the four operations under review, progress is mainly due to support from sector-specific operations.

6.11 *Social sectors.* Spending on health and education has increased as a share of GDP in recent years, but it remains low by international standards. The impact of increased spending has been limited due to weak implementation capacity and the limited jurisdiction and influence of the federal government. The overall impact on poverty reduction is questionable. However, the Region reports that preliminary data from a Core Welfare Indicators Questionnaire completed in early 2005 show substantial improvements in a range of social indicators. Higher economic growth and increased public social expenditure may thus be beginning to have more impact on poverty and social indicators.

Lessons

- A series of one-tranche loans in a programmatic framework can be an effective instrument for support reforms of a country with a poor track record. However, effectiveness of a series of one-tranche loans depends on a willingness to withhold lending until a critical mass of previously-agreed prior actions have been undertaken. The delay between the SAL and the first SAC was particularly effective in this respect.
- Complex or politically-difficult sector reforms are best supported through dedicated sector operations. A multi-sector operation can play only a secondary or facilitating role when dealing with institutional development (as in tax reform or civil service reform), deep-rooted reluctance to reform (as in power), need for specific funding to offset costs of adjustment (as in banking), or weak service delivery (as in health and education). Of course, even a dedicated sector operation can succeed only if there is commitment to reform.

Annex A. Basic Data Sheet

PUBLIC SECTOR ADJUSTMENT LOAN/CREDIT (LOAN NO. 3645-PAK AND CREDIT NO. 2542-PAK)

Key Project Data *(amounts in US$ million)*

	Appraisal estimate	*Actual or current estimate*	*Actual as percent of appraisal estimate*
Original commitment	250	250	100
Total cancellation	n/a	n/a	n/a
Cancellation	n/a	n/a	n/a
Cofinancing			
OECF	150	150	100

Project Dates

	Original	*Actual*
Departure of Appraisal Mission	11/1991	Nov. 1991; Feb/ Apr/ Aug 1992; May/Aug 1993
Board approval	09/14/1993	09/14/1993
Signing	09/15/1993	09/15/1993
Effectiveness	09/27/1993	09/27/1993
Closing date	12/31/1995	12/31/1995

Staff Inputs (staff weeks)

	Actual/Latest Estimate	
	No. Staff weeks	*US$'000s)*
Preappraisal	37.0	120.2
Appraisal	139.1	427.1
Negotiations	4.0	14.6
Supervision	54.6	130.4
Other	15.0	25.8
Total	249.7	718.1

Mission Data

	Date (month/year)	*No. of persons*	*Staff days in field*	*Specializations represented*	*Performance rating*	*Rating trend*
Identification/ Preparation	4/92	8	13	A	- -	
Appraisal	9/93	2	0	S-2	2	2
Supervision						
First	11/93	4[1]	12	S-1	1	1
Second	2/94	3[1]	7	S-1	1	1
Third	5/94	7[2]	17	S-2	1	1
Third	7/94	6	0[3]	S-2	HS	HS
Fourth	10-11/94	12[2]	19	A	HS	HS
Completion	3/96	1	9	C	- -	- -

Specialized staff skills represented:
A = Task manager, legal issues, transportation pricing, agricultural pricing, trade, procurement, implementation, cofinancing, private sector development, privatization, pubic enterprises, industrial pricing, energy pricing.
S-I = Task manager, industrial economist, privatization, regulations, transport, macroeconomics, trade, agriculture, labor mobility.
S-2 = Task manager (macro), industrial economist, privatization, regulations, trade, energy, agriculture, transport, labor mobility.
C = Macroeconomist/evaluator.
1 OECF participation in mission wrap-up meeting.
2 OECF full mission participation.
3 Policy discussions with Government held in Washington.

Other Project Data

Borrower/Executing Agency:

FOLLOW-ON OPERATIONS

Operation	***Credit no./Loan no.***	***Amount (US$ million)***	***Board date***
Social Action Program	Cr. 2593	140	03/31/1994
Power Sector Development	Ln. 3764	250	06/23/1994
Financial Sector Deepening and intermediation	Ln. 3808	216	11/15/1994
Private Sector Energy 11	Ln. 3812	250	11/29/1994
Telecommunication Regulation and Privatization	Ln. 3950	35	11/09/1995

STRUCTURAL ADJUSTMENT LOAN (LOAN NO. 4435-PAK)

Key Project Data *(amounts in US$ million)*

	Appraisal estimate	*Actual or current estimate*	*Actual as percent of appraisal estimate*
Original commitment	350	350	100
Total cancellation	n/a	n/a	n/a
Total project cost	350	350	100
Cancellation	-	-	-

Project Dates

	Original	*Actual*
Departure of Appraisal Mission	12/10/1998	12/14/1998
Board approval	01/21/1999	01/21/1999
Signing	01/21/1999	01/21/1999
Effectiveness	01/22/1999	01/22/1999
Closing date	06/30/1999	06/30/1999

Staff Inputs (staff weeks)

	Actual/Latest Estimate	
	No. Staff weeks	*US$('000)*
Preappraisal	19	109
Appraisal/ Negotiations	38	153
Supervision	-	-
Other - ICR	8	21
Total	55	28

Mission Data

	Date (month/year)	*No. of persons*	*Specializations represented*	*Performance rating*	
				Implementation Progress	Development Objective
Identification/ Preparation	09/1998	11	Country Director Lead Economist Macro-Economists Financial Analysts Energy Specialists Banking Specialists	S	S
Appraisal	11/998	12	(Same as above)	S	S
Supervision		11	(Same as above)	S	S
Completion	July/ Dec 1999	7	(Same as above)	S	S

Other Project Data

Borrower/Executing Agency:

FOLLOW-ON OPERATIONS			
Operation	*Credit no.*	*Amount (US$ million)*	*Board date*
Structural Adjustment Credit	Cr. 3515	350	06/21/2001

STRUCTURAL ADJUSTMENT CREDIT (CREDIT NO. 3515-PAK)

Key Project Data *(amounts in US$ million)*

	Appraisal estimate	*Actual or current estimate*	*Actual as percent of appraisal estimate*
Original commitment	350	350	100
Total cancellation	-	-	-
Total project cost	350	350	100

Project Dates

	Original	*Actual*
Departure of Appraisal Mission	04/10/2001	04/10/2001
Board approval	006/12/2001	06/12/2001
Signing	06/12/2001	06/12/2001
Effectiveness	06/13/2001	06/13/2001
Closing date	12/31/2001	12/31/2001

Staff Inputs *(staff weeks)*

	Actual/Latest Estimate	
	No. Staff weeks	*US$('000)*
Preappraisal	41.95	157.7
Appraisal/ Negotiations	Included above	Included above
Supervision		
Other - ICR	6.11	33.7
Total	48.06	191.14

**includes labor, travel and other costs*

Mission Data

	Date (month/year)	*No. of persons*	*Specializations represented*	*Performance rating*	
				Implementation Progress	*Development Objective*
Identification/ Preparation	Dec 2000 March 2001	3 2 1 2 2	Economists Financial Mgmt Specialists Procurement Specialists Legal Research Analyst	S	S
Appraisal/ Negotiation	April 2001 June 2001	3 2 1 2 2	Economists Financial Mgmt Specialists Procurement Specialists Legal Research Analyst	S	S
Supervision	See ICR				
Completion - ICR	Dec 2001 May 2002	2	Economist	S	S

Other Project Data

Borrower/Executing Agency:

FOLLOW-ON OPERATIONS

Operation	*Credit no.*	*Amount (US$ million)*	*Board date*
Second Structural Adjustment Credit	Cr. 3655	500	06/11/2002

SECOND STRUCTURAL ADJUSTMENT CREDIT (CREDIT NO. 3655-PAK)

Key Project Data *(amounts in US$ million)*

	Appraisal estimate	*Actual or current estimate*	*Actual as percent of appraisal estimate*
Original commitment	500	500	100
Total cancellation	-	-	-
Total project cost	500	500	-
Cancellation	-	-	-

Project Dates

	Original	*Actual*
Departure of Appraisal Mission	04/23/2002	05/07/2002
Board approval	06/11/2002	06/11/2002
Signing	06/11/2002	06/11/2002
Effectiveness	06/12/2002	06/12/2002
Closing date	12/31/2002	12/31/2002

Staff Inputs *(staff weeks)*

	Actual/Latest Estimate	
	No. Staff weeks	*US$('000)*
Preappraisal	47.79	256.9
Appraisal/ Negotiations	Included above	Included above
Supervision		
Other - ICR	1.73	19.1
Total	49.52	*276

**includes labor, travel and other costs*

Mission Data

	Date (month/year)	*No. of persons*	*Staff days in field*	*Specializations represented*	*Performance rating*	
					Implementation Progress	*Development Objective*
Identification/ Preparation	Dec 2001 March 2002	2 1 1 1 2		Economists Financial Mgmt Specialist Education Specialist Health Specialist Power Specialist	S	S
Appraisal/ Negotiation	April 2002 June 2002	3 1 1 1 2		Economists Financial Mgmt Specialist Education Specialist Health Specialist Power Specialist	S	S
Supervision	Sept 2002- May 2003	4 1 2 1 2		Economists Financial Mgmt Specialist Education Specialist Health Specialist Power Specialist	S	S
Completion - ICR	Dec 2001 May 2002	2		Economist	S	S

Other Project Data

Borrower/Executing Agency:

FOLLOW-ON OPERATIONS

Operation	***Credit no.***	***Amount (US$ million)***	***Board date***
Second Structural Adjustment Credit Project (SAC2) for the North West Frontier Province (NWFP)	Cr. 3932	90	06/22/2004
Punjab Education Sector Adjustment Credit	Cr. 3855	100	02/10/2004
Sindh Structural Adjustment Credit	Cr. 3686	100	07/09/2002
Pakistan PRSC I	Cr. 3974	300	09/02/2004

Annex B. Borrower Comments

No 5(6)WB/90.
GOVERNMENT OF PAKISTAN
MINISTRY OF ECONOMIC AFFAIRS & STATISTICS
(ECONOMIC AFFAIRS DIVISION)

THE WORLD BANK
ISLAMABAD
1 NOV 2005
RECEIVED

FROM : Section Officer
TELE : 051-9201437
FAX : 9218976

Islamabad, the 14th November, 2005

SUBJECT: Public Sector Adjustment Loan/Credit(Lno.3645-PAK. 2542-PAK) Structural Adjustment Loan (Lno.4435-PAK) Structural Adjustment Credit (Cr.3515-PAK) and Second Structural Adjustment Credit (Cr.3655-PAK) Draft Project Performance Assessment Report

Dear Mr. Hasan,

Please refer to the World Bank's letter dated September 15, 2005 received from Mr.Yvonne Tsikata, World Bank, Washington DC on the subject captioned above.

2. I am pleased to forward herewith a copy of the Finance Division's letter No.3(81)-EF(C-II)/2003, dated October 29, 2005 containing comments on behalf of Government of Pakistan for further action at your end.

With regards,

Your's Sincerely,

(Shazia Amjad)

Mr. Abid Hasan,
Operations Adviser,
World Bank,
Islamabad.

241.

Immediate.

No.F.3(81)-EF(C-II)/2003
Government of Pakistan
Finance Division
(External Finance & Policy Wing)
*****

Islamabad, the October 29, 2005

OFFICE MEMORANDUM

Subject:- PAKISTAN: PUBLIC SECTOR ADJUSTMENT LOAN/CREDIT (LN.3645-PAK; 2542-PAK); STRUCTURAL ADJUSTMENT LOAN (LN.4435-PAK); STRUCTURAL ADJUSTMENT CREDIT (CR. 3515-PAK); AND SECOND STRUCTURAL ADJUSTMENT CREDIT -(CR.3655-PAK DRAFT PROJECT PERFORMANCE ASSESSMENT REPORT.

p.246/e

No. 1549/EAD/WB/05
31/10

The undersigned is directed to refer to EAD's O.M.No.5(6)WB/90 dated 25th October, 2005 on the above subject and to enclose comments of Finance Division on the Draft Project Performance Assessment Report for above mentioned loans/credits for onward transmission to the World Bank.

(Mohammad Ikram)
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COMMENT OF FINANCE DIVISION

Subject:- PAKISTAN: PUBLIC SECTOR ADJUSTMENT LOAN/CREDIT (LN.3645-PAK; 2542-PAK); STRUCTURAL ADJUSTMENT LOAN (LN.4435-PAK); STRUCTURAL ADJUSTMENT CREDIT (CR. 3515-PAK); AND SECOND STRUCTURAL ADJUSTMENT CREDIT -(CR.3655-PAK DRAFT PROJECT PERFORMANCE ASSESSMENT REPORT.

OED Assessment	Finance Division Comments
Ratings **Outcome:** **Section 2.10** says that the PSAL's objectives were substantially relevant to Pakistan's development challenges, but efiicacy was modest. The ICR giave an excellent overview of design and implementation of the operation. It also gave the benefit of a doubt on outcome, which was rated marginally satisfactory. OED concurred with that rating at the time. While there were some lasting a accomplishments in trade reform, cotton marketing and privatization, it is clear after the passage of nine more years that some things that were thought to have been achieved at the time (such as increased expenditure on social programs) were not, and that neither macro stabilization nor fiscal improvements were sustained. Key reforms of tax administration and broadening the tax base were not achieved, leaving public finances susceptible to later shocks. Fears of stop-go were fully realized as were warning s about risks of poor governance undermining the reform program. In retrospect, outcome is rated moderately unsatisfactory	**Comments:** In this regard, it is stated that GOP has been implementing all the agreed reforms since obtaining the SAL in 1999, therefore, the position mentioned in the under line sentences does not seem to be correct. Pakistan's Economy began to gather momentum since 2001-02 and this fact is acknowledged is section 3.9 which says that ." reform resumed and macroeconomic policies improved, but after the military takeover in October 1999" This shows that on one side the OED recognizes Pakistan efforts and on the other hand it is denying the fact. Therefore, we may inform OED not to change the rating assigned in ICR.
3.1 Section says that in October 1996 the government of Benazir	**Comments:** Though it is a fact but in the report, which is for the

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Bhutto was dismissed on corruption charges.	loan obtained in 1999, does not seem appropriate to mention internal political events of GOP took place during 1996.
Section 3.8 describes that Pakistan's fiscal effort and reform implementation slowed after early 1999. By September 1999 the IMF program went off track for lack of progress in implementing fiscal reforms. It later emerged that the Government had been misreporting fiscal data since the early 1990s and that the fiscal deficit was larger than previously estimated.	**Comments:** though the last sentence is a fact but there seem unappropriate to mention here, as it is not directly related to SAL.
3.16 The ICR rated outcome satisfactory. OED's earlier desk review downgraded the rating to marginally satisfactory. OED have rated outcome as moderately unsatisfactory. Although the relevance of the objective was high, efficacy was modest. The operation helped prevent default, but satisfactory fiscal and macro performance lasted only a few months and most of the follow-ups reforms were not implemented until after a change of Government.	**Comments:-**The loan was obtained in early 1999 and there is short period from early 1999 to September 1999 when GoP was off the track. After the change in Govt. in October 1999, a wide ranging reforms were introduced and sound macroeconomic policies were pursued. During the period Pakistan faced unprecedented drought, the adverse impact of 9/11 and tension with India peaked in 2002 which adversely affected various sectors of the economy and budget. These factors must be taken into account by OED while evaluating the program in Pakistan. The approval of IDA credit in 2001 SAC (Cr. 3315-Pak) also confirms that GOP reform process was on track as revealed by perusing the background & overview mentioned in section 4.2 of the report.
Section 4.3 In last sentence the	be changed with Central <u>Board</u> of Revenue.

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words central Bureau of Revenue **Section 5.8** of the report evaluated that implementation of the program started strongly on the basis of well defined prior action taken before Board approval, but slowed down during elections in October 2002 and the transition to a new government after the elections. Although the economic team remained in place and the new government continued to support reforms, the implementation was sufficiently delayed that the Bank did not process a third SAC as planned.	Paras 4&13 World Bank report No. 28268-PK explain the reasons for slowdown the pace of reforms. The OED should mention the reasons for this slow down.
Section 5.15 says that The ICR rated outcome satisfactory. The initial OED review reduced this to moderately satisfactory because of numerous shortcoming. After that review it appeared that the overall reform program has resumed. However implementation has been protected and reform in power sector has remained unsatisfactory. The relevance of project objectives was substantial, but efficacy of implementation was modest.	**Comments:** World Bank report No. 28268-Pak F/K(paras 3,4,8 & 15 in particular and others upto para 28 in general) negate the findings of OED mentioned in section 5.13 & 5.15. Therefore, we may suggest OED to maintain the rating assessed in ICR instead of reducing it.

Annex C. Timeline

TIMELINE DATE	ADJUSTMENT OPERATIONS	RELATED OPERATIONS	IMF	New Govt	MISC
02/12/1988				Benazir Bhutto	
08/06/1990				Jatoi (caretaker)	
11/06/1990				Nawaz Sharif	
					Floods
04/18/1993				Mazari (caretaker)	
05/26/1993				Nawaz Sharif	
07/08/1993				Qureshi (caretaker)	
09/14/1993	PSAL				
09/16/1993			SBA		
10/19/1993				Benazir Bhutto	
02/22/1994			ESAF		
03/31/1994		SAP			
11/15/1994		Fin Sec Deepening			
11/29/1994		Priv Sec Energy 2			
12/22/1994	PSAL 2nd tr.				
12/13/1995			SBA		
09/17/1996		PIFRA			
11/06/1996				Khalid (caretaker)	
02/17/1997				Nawaz Sharif	
10/20/1997			ESAF		
12/09/1997		Bank Sec AL			
01/1998		ADB Cap Mkt DL			
03/24/1998		SAP 2			
05/28/1998					Nuclear test
01/21/1999	SAL				
06/19/1999		Pov Allev Fund			
09/1999			ESAF susp.		
10/12/1999				Musharraf	Coup
11/20/2000			SBA		
06/12/2001	SAC				
10/23/2001		Bank Sec Restr/Pr			
09/11/2001					WTC attack
11/2001					I-PRSP
12/06/2001			PRGF		
06/11/2002	SAC II				
07/09/2002		NWFP SAC			
07/09/2002		Sindh SAC			
12/2002		Paris Club			

Annex D. Structural Adjustment Loan (Loan No. 4435)

Loan 4435-PAK: ADDITIONAL INFORMATION

Key Indicators for Program Implementation and Operation

Action	Outcome (July – December 1998)	Additional Outcomes (January – June 1999)	Comments.
Macroeconomic Framework			
Agree with the World Bank and IMF on adequate macroeconomic framework for 1998/99 and beyond	Complied. Agreement with the Bank and IMF reached on Policy Framework Paper and ESAF/EFF program	Most ESAF/EFF targets met	
Banking			
Take a set of administrative steps to facilitate recovery by financial institutions of debt in default and accelerate loan recovery. These include (a) issuing an approved panel of public auctioneers to banking courts to assist in the sale of properties belonging to judgment debtors; and (b) issuing guidelines for use by the banking courts in restricting the number of times a property can be put up for auction in cases where the same property is required to be put up for auction more than once because of dispute arising over the value of the bids obtained.	Complied. Target of Rs. 12 billion cash recovery against nonperforming loans met. Rs. 13.6 billion collected. Administrative measures implemented.	Additional Rs.8billion collected between January and May 1201999.	
Power			
Executive Order empowering PEPCO to manage the Reform Program and act as owner's representative in corporatized entities issued.	Complied. Executive Order issued October 1998.		Although a Chief Executive Officer has yet to be appointed, PEPCO is fully operational. Recruitment of consultants underway.
Introduce amendment to WAPDA Act into the National Assembly to allow for: the corporatization of the National Grid Company NGC); and provide evidence of the legal basis to all (a) transfer of consumer contracts from WAPDA to the DISCO's; and (b) transfer of WAPDA staff to the corporatized entities.	Complied. Ordinances incorporating all three issues issued December 1998, reissued May 1999.		Formal confirmation by Government of Pakistan of legal basis for corporatization of National Grid Company required.
Implement agreed orderly framework for resolving Independent Power Producers.	Partially complied. Implementation of orderly framework satisfactory.	Progress in resolving issues initially slow, but much has been achieved since October 1999. Disputes with HUBCO and KAPCO remain unresolved.	Continued progress in implementing orderly Framework and in resolving issues with Independent Power Producers essential for restoring investor confidence.
WAPDA to design and begin to implement vigorous loss and theft reduction campaigns.	Complied	Comprehensive theft and loss reduction program being implemented by WAPDA.	Focus on loss and theft reduction campaign will be maintained for the foreseeable future.

Action	Outcome (July – December 1998)	Additional Outcomes (January – June 1999)	Comments.
Clear up federal and provincial government arrears (federal and provincial government to be current on WAPDA bills from July 1 onwards)	Partially complied	Full program for clearing up, government arrears not implemented.	Arbitration proceedings on Sindh government bills must be completed as soon as possible.
Ensure that the Ministry of Water and Power to issue a statement on the Government's socio- and economic policy objectives regarding tariff setting to NEPRA.	Complied. Statement issued to NEPRA December 12, 1998.		
Ensure that NEPRA has issued under the NEPRA Act its Tariff Standards and Procedures Rules, and other terms and conditions related to generation, transmission and distribution by licensees.	Complied. Tariff Rules issued December 31, 1998.	Distribution License Rules issued April 10, 99; Generation License Rules approved by Government May 1999. NEPRA has also prepared timetable for finalization of remaining rules, regulations, and standards.	Remaining rules, regulations, and standards to be finalized and notified.
WAPDA/DISCOs to submit a comprehensive Tariff Filing to NEPRA,	Complied. Tariff submitted by WAPDA December 1998.	NEPRA approved WAPDA's request for tariff increase in March 1999. Request included additional reductions in cross- subsidies between various customer categories.	
Natural Gas			
Collect Rs. 1.6 billion of overdues from government and private consumers, between June 12th, 1998 and December 31st 1998.	Complied	By July 1, 1999, WAPDA had recovered Rs. 4.55 billion for fiscal year 1999.	
WAPDA & KESC to be current on billing of gas and oil companies on a monthly basis.	Complied	Complied during FY1999	
Natural Gas Regulatory Act which strengthen the collection of gas tariffs and the de-politicization of tariff setting to be submitted to the National Assembly.	Complied	Natural Gas Regulatory Authority Act approved by Parliament July 1999; enactment pending	
Taxation			
Collect Rs. 3 billion of tax arrears between June 12, 1998 and December 31, 1998.	Complied. Target exceeded, with Rs. 3.9 billion in tax arrears collected.	Rs. 4.0 billion in tax arrears collected between January and June 1999. Rs. 7.9 billion in tax arrears collected between July 1998 and May 1999.	
Pakistan Revenue Authority Act to be submitted to the National Assembly by December 31, 1998.	Complied	Still pending	
Increase numbers of income taxpayers ID to 1.6 million by December 31, 1998	Complied	Number of taxpayers reached 1.75 million in May 1999.	
Increase numbers of fully operational Tax Tribunals from 7 to 15 by December 31.	Complied	Number of fully staffed courts reached 15	Shortage of well trained accountants reduces effectiveness of tribunals.

Action	Outcome (July – December 1998)	Additional Outcomes (January – June 1999)	Comments.
Public Sector Expenditure			
Government reduces the size of the budgetary PSDP to Rs 98 billion in line with the macroeconomic framework, and specifies the composition of the budgetary PSDP in line with development priorities.	Complied. Program reduced to specified level. Bank agreed to cuts in allocations.		Actual expenditure was lower than budgeted expenditure. Expenditures deviated from agreed on allocations, however.
Government specifies and adjusts size and composition of non-budgetary PSDP in line with macroeconomic situation and sectoral priorities. The Government agreed to withhold approval and expenditure on any new projects by autonomous public agencies that involve any government financing through cash, debt, guarantees or contingent liabilities	Partially complied.		
Provide federal and provincial funding to meet agreed levels of 1998/99 expenditure and ensure provincial ways and means position will permit substantial non-salary expenditures for education and health.	Partially complied. Adverse fiscal situation in the provinces,' and the resulting cash-flow problems, caused some nonwage expenditures to fall short of agreed allocations.		

Annex E: Public Sector Adjustment Loan: Second Tranche Conditions (Loan No. 3645 and Credit No. 2542)

STATUS OF SECOND TRANCHE RELEASE CONDITIONS AND OTHER MEASURES IN THE LETTER OF DEVELOPMENT POLICY

POLICY ACTIONS	STATUS
MACROECONOMIC FRAMEWORK	**MACROECONOMIC FRAMEWORK**
1) Satisfactory implementation of the 1993/94 macroeconomic program agreed with the IMF and the Bank	1) Performance in 1993/94 was satisfactory. All end-June 1994 performance criteria under the IMF's ESAF/EFF arrangements were met, and preliminary information indicates that all end-September 1994 performance criteria were also met. For 1993/94, however, there were small deviations with respect to two indicative targets: total federal revenues (a shortfall of 4.8 percent) and budget deficit (a rise of 0.4 percent of GDP).
2) Adoption of an agreed macroeconomic program for 1994/95.	2) Complied with. Agreement has been reached with the Bank and the IMF on the 1994/95 macroeconomic framework. The targets are: a GDP growth rate of 6.6 an annual inflation of 7 percent; and an improvement in gross official reserves to a level equivalent of about 14 weeks of imports. Budget deficit will be reduced to 4 percent of GDP.
PRIVATIZATION	**PRIVATIZATION**
1) Complete privatization of most of the remaining industrial units included in the initial list (103 industrial units);	1) The list of 103 units was expanded to 118 units of which 84 units were sold by end-October 1994.
2) Prepare liquidation plans for an agreed list of industrial units which were listed for privatization in 1990/91 and for which negotiations for sale were riot well-advanced as of March 31, 1994;	2) Complied with. Three units have been identified for liquidation. As for the remaining units, the Government intends to sell all units or their assets. It has prepared a timetable for the rest of the industrial units to be privatized in three batches in December 1994, February and April 1995.
3) Complete sale of at least I of the 2 remaining nationalized commercial banks left in the public sector;	3) The Government has decided to privatize the United Bank Limited by end-June 1994 through sale of 26 percent of its shares to a strategic investor and transfer of management.
4) Complete a portfolio audit of the second nationalized commercial bank;	4) An audit of assets of the Habib Bank Limited has been performed by the State Bank of Pakistan.
5) Implement action program for privatization of industrial enterprises not covered in the initial list, non-bank financial institutions, public sector investments banks and public sector trading houses;	5) The Government has already privatized a number of the units that have been added to the original privatization list and has prepared for privatization 30 additional enterprises and assets, comprising industrial units and public shares in investment banks and other nonbank financial institutions.

POLICY ACTIONS	STATUS
6) Satisfactory progress with privatization of the Pakistan Telecommunication Corporation (PTC);	6) The Government has moved swiftly to privatize PTC: the public offering of its share vouchers (about 2 percent of PTC) in August 1994 was heavily oversubscribed: and the second round of public offering abroad (about 10 percent of PTC) in September 1994 was also very successful. About US$I billion (US$870 million in foreign exchange) has been raised. The vouchers will be exchanged for shares when the company is privatized in the next 12 to 18 months. The Government is proceeding with privatization through sale of 26 percent of shares to a strategic investor. The Telecommunication Ordinance, which would pave way for the privatization, was signed by the President on July 13, 1994. Regulatory bodies for telecommunication were established under a Presidential Ordinance in May 1994.
7) Develop plans for the privatization of one thermal power generation and one distribution district;	7) An amendment to the Water and Power Development Authority (WAPDA) Act, which would allow corporatization and privatization of certain pans of WAPDA, was approved by the National Assembly in April 1994. The first phase includes privatization of the Kot Addu and Jamshoro power units, and on the distribution side, the Faisalabad Distribution Board. The Government intends to sell 26 percent of shares in each of these units to a strategic investor. Valuation work has been completed and a financial advisor has been appointed for the sale of the two thermal stations.
8) Develop satisfactory plans for regulating the private sector in selected areas (including power and telecommunications) with dated action plans for implementation and;	8) See (7) and (8) above. The newly established regulatory bodies are the Pakistan Telecommunications Authority and the Frequency Allocation Board. The regulatory framework for the power sector is being finalized.
9) Ensure that proceeds from privatization are used only to meet the costs of privatization (including workers' retraining and redundancy pays). and retire public debt.	9) Total privatization receipts over the past three years (as of end-October 1994) were: Rs 10.9 billion in local currency and US$870 million in foreign exchange. The Government reached agreement with the Bank on using a maximum of Rs 3 billion in 1993/94 and Rs 5 billion in 1994/95 to finance a portion of SAP. Of the local currency component, some Rs 2.2 billion has been used to cover costs of privatization (including worker redundancy pay and acquisition of financial institutions' shares in the privatized industrial units). In 1994195, the Government will use privatization proceeds primarily to retire public debt.
PUBLIC FINANCE	**PUBLIC FINANCE**
1) Approval of the 1994/95 budget consistent with the agreed macroeconomic framework.	1) The 1994/95 budget, which was approved by the National Assembly in June 1994, is consistent with the agreed macroeconomic framework and contains the key revenue, expenditure and trade policy reform measures agreed with the Bank and the Fund.
2) Adopt tax reform measures to increase total budgetary revenue to GDP ratio to 19 percent in 1994/95	2) Measures implemented by the Government in the federal context of the 1994/95 budget include: reductions in exemptions and concessions, widening the sectoral coverage, and simplifying the tax rate. The ratio of federal budgetary revenues to GDP is programmed to increase from 17.3 percent in 1993/94 to 20.4 a in 1994195.
3) Increase proportions of income and wealth taxes, and consumption taxes in total tax revenue.	3) Proportion of income and wealth taxes to total tax revenues is expected to increase from 21.4 percent to 22 percent through

POLICY ACTIONS	STATUS
	expanded use of withholding taxes, moderating tax rates and strengthening administration; and proportion of consumption taxes is expected to rise to 44.5 percent.
4) Prepare and implement a plan for strengthening tax administration	4) The authorities have implemented a number of measures to strengthen tax administration. These measures include training of staff and computerization of the tax administration process.
5) Implementation of an agreed action plan to reform public administration, and aimed at containing current expenditures, based on the findings of the Economy Commission.	5) Complied with. Actions already implemented include: (i) imposition of a ban on hiring and creation of new posts in the Federal Secretariat and affiliated departments and organizations; (ii) reduction in the number of Divisions in the Federal Secretariat from 46 to 36; (iii) declaring 663 posts of officers and 1872 posts of staff as surplus; 0 percent) closing 7 foreign missions and abolishing more than 100 diplomatic posts in other foreign missions: and (v) abolishing 15 Departments. The annual fiscal savings from the actions already implemented is estimated to be about Rs 500 million (in 1992/93 prices). Action to be completed by end December 1995 in accordance with the agreed action plan concerns rationalizing the work program and staffing of 55 organizations affiliated with the Federal Secretariat. As of end-October 1994, the Government has completed detailed studies on more than half of the organizations and reached agreement with the concerned Ministries on the respective action plans. The Government has agreed to implement the decisions on the 55 organizations by end-December 1995 in the context of 1995/96 budget.
6) Contain defense expenditures in the 1994/95 budget at a level that strikes an adequate balance between resources availability and security needs.	6) In the 1994/95 budget, the allocation for defense rose by 8 percent in nominal terms over its level in 1993/94. This implies a fall in defense expenditures as a proportion of GDP from 5.95 in 1993/94 to 5.6 percent of GDP in 1994/95.
7) Implementation of the agreed 1993194 Public Sector Development Expenditure Program (PSDP).	7) Overall, implementation of the PSDP in terms of achieving agreed sectoral priorities and protecting the core investment from budgetary cuts has been satisfactory. The 1993194 budgetary PSDP is estimated Rs 72.5 billion compared to target of Rs 78 billion, reflecting mainly a shortfall in provincial contributions to their development programs. Based on preliminary information, overall implementation of the 1993194 core investment program appears to have been consistent with the agreed program, although there was an average shortfall of about 10 percent compared to the Government's target. The shortfall was concentrated in the irrigation and drainage and the social sectors. In both sectors corrective actions have been taken to improve implementation in the context of the 1994/95 core program.
8) Agreement with the Bank on the size and composition of the PSDP for 1994/95 and reflection of this in the approved budget 1994/9.5.	8) Complied with. The agreed investment program is consistent with the 1994195 macroeconomic framework; the 1994/95 budgetary PSDP amounts to Rs 90 billion (including Rs 5 billion contribution from the provinces to their own annual development programs), which is 24 percent higher than that in 1993/94. In the 1994/95 PSDP there is a shift in emphasis away from transportation, communication sectors towards the water (irrigation and drainage), energy (mainly because of rural electrification and transmission projects) and social sectors. The PSDP Review mission submitted to the authorities a list with suggested allocations for core projects in May 1994195. The review of the

POLICY ACTIONS	STATUS
	1994/95 core investment program was coordinated with the Asian Development Bank: and the Overseas Economic Cooperation Fund (Japan). The agreed core program contains high priority projects in transportation. Agriculture, environment, irrigation and drainage, power, and the federal social sectors. The total amount of funding required to carry out the core program is about Rs 51 billion (compared to preliminary actual estimate of Rs 44 billion in 1993/94), with additional funding to be made available to some of the core projects during the mid-term budget review depending on physical progress.
9) Finalize the 3-year rolling investment program for 1993/94 to 1995196.	9) The 3-year rolling investment program for 1993/94 to 1995196 was finalized in March 1994.
10) Prepare a 3-year rolling investment program 1994/95 to 1996/97, ensuring consistency with the 1994/95 PSDP.	l0) The 3-year rolling program for 1994/95 to 1996/97 containing the agreed investment program for 1994/95, has been prepared.
11) After consultation with donors, restructure or close projects that are no longer consistent with Government's priorities.	11) Over the last 12 months, the Government has conducted three major reviews of problematic foreign-aided projects. Overall, some 64 projects have been reviewed. The Government has decided that for most of these projects an extension of the closing date would not be granted and several of them are being restructured to improve their performance.
12) Set up and implement an improved monitoring system for PSDP.	12) Several new monitoring instruments were put in place at the Planning Commission during 1993/94: (i) establishment of a Management Information System (MIS); (ii) preparation of Progress Reports and Status Reports; and (iii) introduction of review meetings for problematic foreign aided projects (see 11 above).
SOCIAL SECTORS	**SOCIAL SECTORS**
1) Satisfactory implementation of the 1993/94 SA P.	1) The total SAP expenditures for 1993194 is estimated at Rs 31.2 billion (compared with target of Rs 35.2 billion), of which Rs 24.6 billion was financed by the federal and provincial Governments, and Rs 6.6 billion by donors (compared with a budgeted allocation of Rs 8.9 billion). Following a slow start in development expenditures during the first half of 1993/94, spending picked up substantially in the second half of the year. Nationally, development expenditures for the year (as a percentage of the allocations) were 89 percent for education, 86 percent for health, 80 percent for rural water supply and sanitation, and 69 percent for population welfare. Recurrent expenditure figures were 100 percent for education, 95 percent for health, and 96 percent for rural water supply and sanitation.
2) Preparation of detailed operational plans for the 1994/95 SAP (current budgets, development plans, implementation and policy reforms agreeable to the Bank).	2) Following a joint supervision mission by the Bank, the Asian Development Bank and Netherlands Government, agreements were reached during October and November 1994 on virtually all Operational Plans for each of the subprograms under the SAP.
3) Provide financing for the 1994/95 SAP that will allow expenditures to rise by at least 0.1 percent of GDP over the previous year (and that will maintain total expenditures so as to reach the 1997/98 target of 2.6 percent of GDP).	3) Complied with: The agreed budgeted total for 1994/95 SAP-related expenditures is Rs 45.8 billion, of which Rs 35.1 billion is to be financed by the federal and provincial Governments and the remaining Rs 10.7 billion by the donors. The agreed levels of the Federal Government's cash development loans/grants to provinces for SAP-related investments, which are included in the above sums, are increased from Rs 6.6 billion in 1993/94 to Rs 7.0 billion in 1994/95. The Government has budgeted an amount for SAP in

POLICY ACTIONS	STATUS
	1994/95 that will allow expenditures to rise by more than 0.1 percent of GDP over the budgeted 'level in 1993,'9.1. Overall, total SAP expenditures are expected to rise from 1.7 percent of GDP in 1992/93 to about 2.5 percent GDP in 1994/95.
TRADE REFORM	**TRADE REFORM**
1) Announce and adopt a trade policy reform package that significantly reduces the maximum tariff rate further.	1) The Government is implementing a comprehensive trade policy reform program which was public!;; announced in June 1994, in the context of the 1994/95 budget. All import taxes were consolidated into one all-inclusive tariff schedule. The maximum tariff rate was reduced from 92 percent to 70 percent and a minimum tariff rate of 10 percent was imposed. (The tariff rate on imported automobiles, which remains above the maximum rate, will be brought down by the end of the program). The maximum rate will be reduced to 45 percent by end-June 1995 and 357c by end-June 1996.
2) Eliminate most exemptions and simplify the tariff schedule to reduce dispersions.	2) Additional key measures introduced are: (i) reduction in intermediate tariff rates on imports; (ii) withdrawal of one-third of the import tariff exemptions and concessions: arid (iii) reduction in the number of tariff bands to further reduce dispersion. The remaining exemptions and concessions will be imitated during the 1995/96-1996197 period, except for existing contractual agreements.
OTHER SECTORAL POLICIES	**OTHER SECTORAL POLICIES**
1) Implement agreed increases in irrigation water charges for 1994/95.	1) To meet cost recovery targets all provinces have agreed to substantially increase revenue from water charges by increasing water charges and improving assessment and collection performance, according to different schedules. The Federal Government and provinces have agreed that irrigation water charges will be increased by 25'0 effective from the Kharif crop of 1994 (Balochistan and NWFP have already implemented the agreed increase).
3) Carry out liberalization and deregulation of distribution of nitrogenous and phosphatic fertilizers	3) The liberalization and deregulation of the distribution of nitrogenous and phosphatic fertilizers is nearly complete. The distribution of phosphatic fertilizers (mainly diammonium phosphate fertilizer (DAP)) has also been deregulated since August 1993. Its prices have been decontrolled, and subsidies terminated. Imports of phosphatic fertilizers are allocated and sold to the "public/private" sector distributing agencies in accordance with their existing market share. The only remaining fertilizer subsidy is on imported potassic fertilizers. The Government has agreed to ;n--, ease the price of Sulfate of Potash (SOP) by Rs 45 per 50 kg bag in semi-annual installments beginning 1993/94 and one final installment in order to eliminate the residual subsidy by October '.995. Tee price was increased Rs 55/bag in June 1994 and by Rs 50/bag in November 1994.
4) Liberalization of gas prices for households and residential consumers.	4) According to agreement the Bank, the price of gas for household use is to reach the border price of fuel-oil by April 1995 with the following interim targets: 80 percent of parity in April 1994; 90 percent of parity by September 1994; and 100 of parity by April 1995. The price of gas was increased by to 90. Parity with the imported fuel-oil price in November 1994

Annex F. Pakistan: Matrix of Policy Measures

OBJECTIVES	ACTIONS		
	SAC I – Prior Actions (Board June 2001)	SAC II – Prior Actions (Board June 2002)	Follow-up Actions (Fiscal Years 2003-2005)
	Pillar 1: Engendering Growth		
PRIVATIZATION AND DEREGULATION FOR IMPROVED BUSINESS ENVIRONMENT To promote growth by improving the business environment: Increasing consistency and predictability of policies, limiting the opportunities for rent-seeking behavior, and reducing the role of the state in productive activities.	• The Cabinet has approved a short and medium term strategy and timetable for privatization focused on the critical large public enterprises in power, telecommunications, banking, oil and gas. • To facilitate privatization, a Privatization Ordinance was enacted in September 2000. • The privatization of Sui South LPG Plant has been completed.	• The President has constituted an inter-Ministerial Deregulation Committee chaired by the Minister of Finance to oversee and guide regulatory reforms across sectors. • Price and profiteering and hoarding controls on all but two of the sixty-six essential products specified in the Schedule to the Borrower's Price Control and Prevention of Profiteering and Hoarding Act, 1977 [Act No. XXIX of 1977] have been removed • Continued implementation of program to grant no new exemptions or special privileges regarding income tax, custom duties, GST, or to impose new regulatory duties. Phasing out of time-bound regulatory import duties and no adoption of new ones except for existing contracts or international commitments. • The privatization of Sui North LPG Plant has been completed The bidding for the privatization of Saudi-Pak fertilizer company and Nine Working Interests in Oil and Gas have been completed.	• The government will have brought to the point of sale Pakistan Telecommunications Company Limited, United Bank Limited, Karachi Electricity Supply Company, Pakistan State Oil, Oil Gas Development Corporation; and Faisalabad Electricity Supply Company. • The Ministerial Committee on Deregulation will have accelerated the implementation of its program by: (a) amending labor laws to encourage employment while protecting worker' rights; (b) implementing a program to eliminate administrative barriers; and (c) working in conjunction with CBR carried out a comprehensive review of SRO system and implemented an action plan to eliminate unnecessary ones, monitor lapsing of time-bound SROs, and define clear criteria for maintaining required ones. • Continued implementation of program to grant no new tax or duty exemptions or special privileges regarding income tax, custom duties, or GST. No new regulatory duties to be imposed. Phasing out of time-bound regulatory import duties and no adoption of new ones except for existing contracts or international commitments. Policy changes to be confined to regular and transparent forums, such as the annual budget. • The government will have issued the Competition Law Ordinance (replacing the Monopoly and Restrictive Trade Practices Act of 1978) to control and eliminate anti-competitive business practices and unfair methods of competition that adversely affect trade and economic development.

OBJECTIVES	ACTIONS		
	SAC I – Prior Actions (Board June 2001)	SAC II – Prior Actions (Board June 2002)	Follow-up Actions (Fiscal Years 2003-2005)
TRADE REFORM To improve export performance by reducing anti-export bias of trade policy and through institutional reforms.	• To reduce nominal protection and bring the maximum nominal effective tariff to 35 percent, the differential application of excise taxes on imported and domestic products has been eliminated for all but eleven products which are subject to regulatory duties. • To promote the exports of small and medium enterprises, the government in combination with the banking sector has established an Export Finance Guarantee Facility	• To reduce the anti-export bias and encourage exports, the maximum tariff rate has been reduced from 35 percent to 30 percent and the tariff slabs reduced from five to four. • (a) Actions have been taken by CBR to increase the transparency and speed of refunds of GST and duty drawbacks to exporters; and (b) such refunds in the first 9 months of FY 2001/02 have registered an increase of about 45 percent over such refunds in the corresponding period of fiscal year 2000/01.	• To reduce the anti-export bias and encourage exports, the maximum tariff rate will have been reduced from 30 percent to 25 percent and the tariff slabs reduced from four to three. • To reduce the anti-export bias the government will have eliminated the duties on polyester and other critical inputs used by textile exporters. • The Central Board of Revenue would have continued the implementation of its action plan to increase transparency and expediency in the refund of the General Sales Tax and duty drawback to exporters in the context of the broader CBR reforms. New administrative procedures replacing SRO 417 (I)/2000 for GST refunds would have been established .
BANKING AND FINANCIAL SECTOR REFORM Improve sector governance through restructuring, privatization and strengthened banking supervision.	• In preparation for privatization, the Cabinet has approved restructuring programs for the three large nationalized commercial banks based on a significant reduction in personnel and unproductive branches. • To strengthen bank supervision, the Banking Companies Act has been amended to enforce capital adequacy ratios in line with international standards. • The government has divested 8 percent of its shares in Muslim Commercial Bank and reduced its minority shares to 15 percent.	• The restructuring of the three nationalized commercial banks has been initiated. Six hundred and fifty branches have been closed and eight thousand staff have taken voluntary retirement. • As part of the restructuring non-performing financial institutions, the country's largest non-bank institution -- National Finance Development Corporation has been closed through a merger with the state-owned National Bank of Pakistan. • To strengthen banking system regulations and enhance the quality of monetary policy, the non-core functions of the State Bank of Pakistan (SBP) have been devolved to a newly created SBP Banking Services Corporation. • To improve financial sector governance and strengthen the banking system, the 1997 Loan Recovery Act has been amended to facilitate foreclosure of bank collateral. • The government has divested 10 percent of its shares in the National Bank of Pakistan, and further divested its minority shares of Muslim Commercial Bank from 15 to 9 percent.	• The restructuring of the three nationalized commercial banks will have been completed. More than eight hundred branches would have been closed and more than twenty five thousand staff taken voluntary retirement. • The government will have carried through the privatization of the three large nationalized commercial banks (United Bank Ltd., Habib Bank Ltd., and National Bank of Pakistan). The process would be launched by bringing United Bank Ltd. to the point of sale in fiscal year 2002/03. • The government will have divested all its minority shareholdings in Muslim Commercial Bank (9 percent) and Allied Commercial Bank (49 percent). • The government will have carried out the restructuring effort for non-bank state-owned financial institutions (DFIs) with a view to close those that have not been restructured successfully. • Continued strengthening of prudential regulations by increasing minimum capital requirement for banks and financial institutions and strengthen capacity of the regulator to enforce regulations.

OBJECTIVES	ACTIONS		
	SAC I – Prior Actions (Board June 2001)	SAC II – Prior Actions (Board June 2002)	Follow-up Actions (Fiscal Years 2003-2005)
AGRICULTURE SECTOR REFORM	• To eliminate distortions and promote agriculture exports, unit value of export norms for agriculture products have been eliminated, and raw cotton exports have been liberalized. • The subsidy on wheat has been reduced by increasing its procurement price to a level similar to international prices. Wheat exports have been authorized, yet not on a permanent basis	• The federal and provincial governments have removed all restrictions to inter-district and/or inter-province transport of agriculture commodities including wheat. • The provincial governments have removed all restrictions to the free movement of certified seeds throughout each province. • The government has liberalized the imports and exports of all agriculture products.	• The government will have carried an analysis of existing rural policies with a focus on land markets. • To promote quality in production and foster exports, the federal and provincial governments will have (a) established a national grading and standardization system for cotton; (b) liberalized the sugar market by eliminating restrictions for the merger and consolidation of sugar mills, and removed zoning requirements for sale/purchase of sugar cane; and (c) reduce the role of government in wheat marketing. • The federal and provincial governments will have accelerated the pace of institutional reforms in irrigation to enhance efficiency of water use, reduce subsidies to operation and maintenance, and regulate ground water use. The government will have given priority to the construction of the national drainage system.
NATURAL GAS SECTOR REFORM To enhance sector development through tariff reform, privatization, and improved regulatory environment.	• A new Gas Regulatory Authority (GRA) has been established. • Adoption of a new gas pricing framework providing for: (i) the setting of well-head prices based on international crude (or fuel) oil prices; (ii) the semi-annual revision of consumer prices; (iii) the phasing out of subsidies over a three-year period, except in relation to the fertilizer sector and a lifeline rate for domestic consumers; and (iv) the phased adjustment of consumer prices, so as to reflect the cost of service. • The first bi-annual consumer price adjustment of 14.4 percent under said new gas pricing framework for the semester ending June 30, 2001. •	• (a) A new Gas Pricing Framework for PPL gas has been established, which will bring the PPL well-head price up to, and maintain it at, a level equal to fifty percent (50 percent) of the well-head price fixed from time to time for the Zone III gas fields as defined in the Borrower's Petroleum Exploration & Production Policy dated May 1, 2001, through successive semi-annual adjustments over a period of five years; and (b) the first adjustment of PPL gas prices under such Framework has taken place and is reflected in consumer prices. • The government has issued an ordinance to establish the Oil and Gas Regulatory Authority.	• As a part of the program to develop a sound gas pricing framework: (a) the government will have rationalized access to the lifeline rate for domestic consumers to improve its targeting to the poor; and (b) the Cabinet will have approved a mechanism to include all feedstock gas subsidies to the fertilizer industry in the budget. Implementation to start with the budget for fiscal year 2003/04. • As a part of the program to develop a sound gas pricing framework, the government will have established transport and distribution charges policy based on volumetric basis in a manner that encourages efficiency and is not related to guaranteed returns. • The Oil and Gas Regulatory Authority (OGRA) will have been made operational through the notification of its Tariff and Licensing Rules.

OBJECTIVES	ACTIONS		
	SAC I – Prior Actions (Board June 2001)	SAC II – Prior Actions (Board June 2002)	Follow-up Actions (Fiscal Years 2003-2005)
PETROLEUM SECTOR REFORM To increase efficiency and growth through deregulation, market liberalization, and enhanced competition. To protect the environment through adoption of cleaner better quality products.	• The Government has established a system of quarterly adjustments of petroleum product prices at the consumer level in line with international price movements. • The furnace oil market has been deregulated since July 1, 2000 through liberalization of imports, transport, and prices through the production and distribution chain. • The market for LPG has been deregulated by liberalizing prices through the production and distribution chain from Oct 1, 2000. • The privatization of Sui South LPG plant has been completed. • The use of low quality RON 80 gasoline has been discontinued.	• *A formula has been adopted by the Borrower under which retail and ex-refinery prices of all petroleum products are based upon international prices and adjusted automatically on a fortnightly basis.* • The import of oil products has been liberalized with refineries and the oil marketing companies authorized to import their requirements directly. • The transport prices of petroleum products have been deregulated for secondary markets. Prices allowed to differ across some geographical areas. • The provision of subsidies to the refineries have been made transparent and are provided through the national budget. • The privatization of Sui North LPG Plant has been completed. • The bidding for the privatization working interest in nine oil field has been completed. • As a part of the program to improve the quality of petroleum products, unleaded gasoline has been made available throughout seventy percent of the country.	• To promote enhanced competition and efficiency in the oil sector the government will have: (a) set the ex-refinery prices of all petroleum products on the basis of import (or export) parity prices as ceilings; and (b) as part of this process the government will have reviewed and initiated reforms to phase out the current system of guaranteed returns to the refineries. • The government will have carried through with the privatization of the main companies in the sector: Oil and Gas Development Corporation and Pakistan State Oil. • The government will have developed internationally-accepted standards for petroleum product specifications and will have announced a mandatory time-frame for their adoption. The latter would include the phasing-out of unleaded gasoline, and limits to the sulfur content in diesel to a maximum of 0.5 percent.

OBJECTIVES	ACTIONS		
	SAC I – Prior Actions (Board June 2001)	SAC II – Prior Actions (Board June 2002)	Follow-up Actions (Fiscal Years 2003-2005)
POWER SECTOR REFORM To establish a competitive electric power system consisting of privately-owned, financially viable, and efficiently operated companies.	• As a part of it WAPDA's financial restructuring, US$ 650 million of outstanding debt service liabilities to GOP were converted into GOP equity. • Implementation of 4.9 percent tariff increase in December 2000 and 4.5 percent in March 2001 to help WAPDA reach targets of its financial restructuring plan. • A formula-based automatic fuel adjustment clause for quarterly adjustments has been notified. Two adjustments undertaken under these provisions. • Ministry of Water and Power has issued new tariff setting policies to NEPRA, that will allow for: ♦ Differential tariffs for KESC and for each of the DISCOs. ♦ Reduction of cross subsidies between consumer categories, except for lifeline rates. ♦ Establishment of formula-based multi year tariff adjustments.	• With a view to completing the corporatization of WAPDA: (a) the transfer of staff in Basic Pay Scales (BPS) 1-16 from WAPDA to the GENCOs, the NTDC, and the DISCOs, has been completed; (b) valid operating licenses have been issued by NEPRA to the DISCOs; and (c) supplementary Business Transfer Agreements, providing for the transfer of assets and liabilities, other rights and obligations from WAPDA to the GENCOs, the NTDC and the DISCOs, respectively, have been approved by the Borrower. • *(a) A financial improvement plan has been agreed between the Borrower and WAPDA, setting out the measures needed for WAPDA, the GENCOs, NTDC and the DISCOs to become financially viable, including tariff and non-tariff adjustments which will enable WAPDA, the GENCOs, NTDC and the DISCOs to achieve, under a reasonable forecast of revenues and expenditures, an overall debt/service coverage ratio of 1.2 by the end of FY2002/03; and (b) pursuant to such plan, a tariff increase of Rs. 0.0045 per kilowatt hour on account of the fuel adjustment cost determined by NEPRA as at end of March 2002, together with an interim structural tariff increase of Rs. 0.08 per kilowatt hour has been introduced effective May 15, 2002.*	• The government will have maintained full adherence to its financial improvement plan for WAPDA and its corporate successors. This would lead to achievement of the financial target of a debt service coverage ratio of 1.2 at then end of fiscal year 2002/03. As a result WAPDA would no have financing claims on the budget. The power sector financing would also be fully consistent with the agreed macroeconomic framework. • The unbundling of WAPDA's power wing will have been fully completed. The new corporatized entities would be functioning in an autonomous manner under professional management. • The privatization of KESC will have been completed • The government will have announced and started to implement its program for the introduction of a competitive wholesale electricity market. • The government will have brought to the point of sale in fiscal year 2003 FESCO and JAMCO; and developed and started implementation of the follow-up plan for the privatization of the other distributions and generation companies.
PILLAR 2: IMPROVING GOVERNANCE			
EFFICIENT AND EQUITABLE MOBILIZATION OF RESOURCES To improve tax policy and tax administration to increase revenues and improve governance.	• To document the economy and broaden the tax base a tax survey and registration drive has been launched. First two phases based on the twenty six largest cities completed leading to updated documentation of about 1.3 million businesses and individuals and the registration of 120,000 new tax payers. • To broaden tax base and achieve a more equitable distribution of the tax burden, agricultural income is being	• A medium-term reform strategy and action plan for CBR has been approved by the Borrower, providing for a modern, progressive, effective and credible organization for optimizing revenue by providing quality service and promoting compliance with tax laws. • The functional reorganization of CBR has been completed as prescribed by the recently approved medium term strategy. • A new Income Tax Ordinance based on self assessment, minimal exemptions, and simplified and more equitable rates has been promulgated.	• Accelerated implementation of the medium term program of CBR reforms. As a part of that program: ♦ CBR will have completed its human resourced audit, and based on its recommendations implemented human resource reforms. It will have established new recruitment, performance assessment, training, and promotion procedures or programs. A new performance-based pay-scale will have been approved by government. The rightsizing of personnel based on skills needed will have started.

OBJECTIVES	ACTIONS		
	SAC I – Prior Actions (Board June 2001)	SAC II – Prior Actions (Board June 2002)	Follow-up Actions (Fiscal Years 2003-2005)
	brought into the tax net. The Provinces have introduced a two-tier agricultural income tax with acreage-based land tax and income tax for large farms. • To increase the efficiency of the tax system, the GST has been extended to services which were subject to excise taxes, and to some agriculture inputs.	• To increase the efficiency of the tax system the GST has been extended to agricultural inputs, including fertilizer, and non-essential pharmaceuticals. • To increase the efficiency of the tax system the GST compliance requirements have been extended to all traders with annual turn-over in excess of Rs. 5 million.	♦ CBR will have established outcome indicators and targets, as well as a program to measure progress. This information will be shared with the public on a regular basis. ♦ CBR will have initiated the implementation of an information technology based anonymous system of tax assessment and audit. ♦ A Large Tax Payer Unit will have been established in Karachi and then extended to the other large commercial centers.
EFFICIENT AND ACCOUNTABLE USE OF RESOURCES To strengthen expenditure controls and improve the quality of the expenditure program.	• To improve quality of the public investment program the process of project approval has been strengthened. All proposals subject to the scrutiny of the Planning Commission, the Central Development Working Party, and final approval by the Executive Committee of the National Economic Council. • To improve expenditure programming by increasing predictability in budget releases a "New system of financial controls and budgeting" has been implemented since July 2000.	• To improve the quality of the public investment program: (a) the Planning Commission's Chief Economist signs-off on all project appraisals submitted for the approval of the Central Development Working Party the Executive Committee of the National Economic Council; (b) progress reports of project implementation are being prepared on a semi-annual basis; and (c) the public investment program is being prepared as a three-year- rolling plan for a medium term budget framework. • The federal budget for fiscal year 2001/02 has been prepared within a medium term budget framework. • The federal and the provincial budgets of Sindh and NWFP for fiscal year 2002/03 are being prepared within a medium term budget framework.	• To improve the quality and the transparency of the public investment program: (a) the Planning Commission will have prepared summary Project Information Documents of the most important projects in the investment programs and made them available to the public; and (b) make public the semi-annual reports of progress in project implementation. • The federal budget for fiscal year 2002/03 and years beyond will have been prepared under a more detailed medium term budget framework.
To improve public financial management through improvements in accounting and audits.	• To separate the public accounting and auditing functions The government has issued: (a) an Ordinance defining the functions, powers and terms and conditions of service of the Auditor General of Pakistan; and (b) an Ordinance establishing a new office of the Controller General of Accounts (CGA). • To improve the quality and reporting of the public accounts the President has approved the revised form, Principles and Methods of Accounting for the	• The government has implemented the separation of the audit and accounting functions. The accounting function is now under the purview of the CGA. • The CGA has established a short and medium term program of reforms to improve reconciliation, reduce unidentified expenditures, and strengthen internal controls. Reconciliation of revenues and expenditures are close to 100 percent in federal government and all provinces, except Punjab. • The CGA has established systems to improve reliability and timeliness of accounts by: (a) eliminating settlement accounts; and (b) requiring daily bank reconciliations.	• The federal and provincial governments will have achieved full reconciliation of expenditures and revenues at federal and provincial levels on a quarterly basis. • The federal government will have reduced its reported unidentified expenditures to no more than 0.1 percent of GDP at end FY03, and a significant reduction in unidentified expenditures at end FY02 when compared to FY01. • The Proportion of government transactions under new

OBJECTIVES	ACTIONS		
	SAC I – Prior Actions (Board June 2001)	SAC II – Prior Actions (Board June 2002)	Follow-up Actions (Fiscal Years 2003-2005)
	Federation and the Provinces prescribed by the Auditor General. • To oversee the preparation and dissemination of timely reconciled expenditure data, fiscal monitoring committees have been established at the federal and provincial level. The preparation and dissemination of such data at the federal level was completed for the first semester of FY 2000/01.		modernized and computerized accounting system will have reached 80 percent by end FY03 and 100 percent by end FY05. • At the end of FY05 the timeliness and accuracy federal and provincial accounts will allow for fully on-time reconciled reports.
To promote efficiency in the use of resources through fiscal transparency and external oversight	• The government has established federal and provincial ad-hoc Public Accounts Committees (PAC), and opened hearings of the federal PAC to the press.	• The ad hoc Public Accounts Committees wherever existing in the Borrower's provinces and territories have opened up their proceedings to the press on the lines of the Borrower's federal ad hoc Public Accounts Committee. • The federal PAC has completed and made public the review of the 1996/97 Audit Reports and initiated review of the reports for FY1999/00, FY1998/ 99, and FY1997/98 with a view to clear the backlog in these reviews by end-October 2002. • The FY2000/01 Public Audit Report has been carried in a timely manner, with increased attention to the audit of systemic problems. It has been released and made public in March 2002.	• The federal PAC Accounts Committee will have completed the review of all outstanding Audit Reports (FY98, 99, and 00). • Audit reports will be submitted to the legislature no later than six months after the end a FY starting with the FY04 report. • The government will have initiated the tracking and monitoring of: (a) cash recoveries mandated by the PAC and (b) the percentage of Auditor's General recommendations approved by government starting in FY04 based on audit reports of FY03.
To promote the efficiency in the use of resources through more effective public procurement.		• The Borrower's Procurement Regulatory Authority Ordinance, 2002 [Ordinance No. XXII of 2002] has been issued, with a view to regulating the procurement of goods, services and works by the public sector	• The Pakistan Procurement Regulatory Authority will have completed the revision and amended [as needed] all rules, regulations, and administrative orders pertaining to procurement at the federal level. A new Procurement Law will have been submitted to Parliament. • 33 percent of national procurement being carried out under modern rules and regulations starting in fiscal year 2003/04 (all federal government procurement). In addition defense procurement is also expected to be subject to these rules. • 50 percent of national procurement being carried out under revised modern rules and regulations a new Procurement Law in fiscal year 2004/05 (all federal government and semi-autonomous federal agencies).

OBJECTIVES	ACTIONS		
	SAC I – Prior Actions (Board June 2001)	SAC II – Prior Actions (Board June 2002)	Follow-up Actions (Fiscal Years 2003-2005)
			In addition defense procurement is also expected to be subject to these rules.
CIVIL SERVICE REFORM To improve the performance of the civil service by restoring integrity, autonomy, and adoption of modern personnel and management practices.	• The government amended the Federal Public Service Commission (FPSC) Ordinance, so as to enhance FPSC's independence, increase its financial autonomy, expand its role in the recruitment of public servants, and limit and define the posts which are outside its purview. • The FPSC has initiated review of all appointments made in contravention with established procedures. Unqualified appointments are being terminated. • To improve performance and reduce corruption the Civil Service Act has been amended to enable the government to prematurely retire civil servants who are found to be inefficient and have completed 25 years of service. A Removal from Service (Special Powers) Ordinance has been issued to expeditiously remove from the service officers involved in corruption. • The government has established a Committee to review Pay and Benefits Reforms. The Committee has completed analysis and recommendations leading to broad based civil service reforms.	• To improve performance and reduce corruption the Civil Service Act has been amended to enable the government to prematurely retire civil servants who are found to be inefficient and have completed 20 years of service. • To improve the quality and performance of higher level staff, examination requirements have been established as a prerequisite for promotions [to grades 17, 19 and 20]. • The government has implemented initial phase of right-sizing program of the Federal Secretariat by eliminating vacant posts and placing redundant personnel in a surplus pool. • The first phase of the Borrower's pay and pension reform scheme for civilian and military personnel has been implemented through: (a) the revision of pay scales; and (b) the rationalization of pension benefits	• The government will have continued with the implementation of its program of civil service reforms by: (a) continued implementation of the Cabinet-approved program to right-size and improve the skill-mix of the federal civil service; (b) carrying out the second phase of pay and pension reforms. As a part of this program the Cabinet will have approved the establishment of a contributory pension fund for new entrants; and the monetization of a number of allowances into salaries. • The provincial and district governments will have defined arrangements for transferring responsibilities for staff recruitment and personnel management from the provinces to the district level. • The government will have continued the implementation of programs to strengthen merit-based recruitment, and promotions and revamp training programs. • A strategy to strengthen the professionalism of the civil service in key areas of economic and financial management will have been agreed and implementation started by creation of Economist Cadre.
DEVOLUTION Implement devolution to improve governance in service delivery	• Following a consultation process launched in April 2000, the Devolution Plan was promulgated on August 14, 2000.	• The Local Government Ordinances to reconstruct and regulate local governments were promulgated on August 2001 in each of the four provinces. • The local governments have started their functions with their own budget under transition arrangements with the provincial governments.	• The government will have carried through with the continued implementation of programs of capacity building. Programs with a focus on establishing clear budgetary procedure and financial management will have been implemented. • Provincial Finance Awards (one per province) defining

OBJECTIVES	ACTIONS		
	SAC I – Prior Actions (Board June 2001)	SAC II – Prior Actions (Board June 2002)	Follow-up Actions (Fiscal Years 2003-2005)
			rules for inter-governmental fiscal relations will have been established. • The local government will have started preparing and implementing their own budgets from fiscal year 2002/03. • The federal, provincial, and district governments will have agreed and defined measurable indicators to monitor the performance of local governments and their effectiveness in service delivery.
PILLAR 3: IMPROVING HUMAN DEVELOPMENT			
POLICY, FISCAL, AND MONITORING FRAMEWORK Increase the share of pro-poor expenditures with monitoring and evaluation mechanisms to track progress	• The government has launched a small-works program (*Kushal Pakistan*) to provide employment and basic services to the poor. • The government has launched a direct cash-transfer program ("Food Support Program") targeted to 200,000 poor families –1.2 million people. • The government has strengthened the Islamic-based *Zakat* charity program that provides cash transfers to the most vulnerable groups in society.	• The FY 2001/2002 budget allocations of the Borrower's federal, provincial and territorial governments for human development and pro-poor expenditures under the I-PRSP have been increased, in the aggregate, to one hundred sixty-four billion rupees (Rs. 164 billion) or four and four-tenths of one percent (4.4 percent) of the Gross Domestic Product (GDP). • A National PRSP Implementation Committee has been established in the Borrower's Ministry of Finance (MOF) to oversee the implementation of the Borrower's anti-poverty strategy as reflected in the I-PRSP and to help build consensus in support of the full PRSP under preparation, together with a PRSP Secretariat to coordinate the actions directed by the National PRSP Implementation Committee, and as part of this process: (a) a national poverty line and methodology have been established; and (b) intermediate health and education outcome indicators have been formulated and are being evaluated, with a view to preparing an action plan not later than September 2002 to improve the monitoring tools established therefore • The government has established as a part of the I-PRSP an expenditure tracking mechanism for pro-poor (or I-PRSP expenditures). Quarterly expenditure reports are being prepared and disseminated to the public.	• The federal and provincial governments will have established a clear fiscal framework to finance the district government and ensure the regular flow of funds. • In the area of monitoring and evaluation of the PRSP: (a) the government will have completed the action plan and initiated implementation of the program to establish (or improve) the baseline data and improved monitoring of its health and education intermediate outcome indicators; and (b) improve the quarterly analyses of performance in I-PRSP expenditures in conjunction with the provincial governments.
EDUCATION	• The federal government with the participation of the provinces has	• The consolidated budget allocations of the federal, provincial, and district government budgets for education	• The consolidated federal, provincial, and district governments budgets would have increased the share

OBJECTIVES	ACTIONS		
	SAC I – Prior Actions (Board June 2001)	SAC II – Prior Actions (Board June 2002)	Follow-up Actions (Fiscal Years 2003-2005)
Increase enrollments, narrow gender gaps, and increase quality of education.	developed a comprehensive Education Sector Reform Strategy. • To improve the delivery of services and the use of scarce resources the Provinces and territories are undertaking the following actions: ♦ systems for teacher absenteeism and enforcement of sanctions. The second largest province (Sindh) has initiated program to re-certify workers to identify those hired without the necessary qualifications. ♦ Hiring of new teachers largely being conducted through contract hiring. ♦ Intensified efforts to devolve management of non-salary budgets to the school level through parent-teacher associations or teachers. ♦ Rationalizing of investment programs in all provinces. Focus in finishing ongoing school-building programs before initiating new ones.	have increased to Rs 72.5 billion or 2.0 percent of GDP. • Pursuant to the Borrower's Education Sector Reform Program: (a) additional budgetary resources for education have been directed at the Borrower's provincial, territorial and district government; (b) a National Education Assessment Initiative has been launched; and (c) school rehabilitation, teacher training and girls schooling and feeding programs in the Borrower's provinces, territories and districts have been expanded. • To increase public financing of private education, the federal government has approved a new charter for the National Education Foundation. • The Cabinet has approved a national strategy to promote private sector participation in education.	of education expenditures in the fiscal year 2002/03 budget and beyond in line with recommendations from Public Expenditure Review and costing of reforms under the PRSP. • The government will have expanded public-private partnerships through restructuring of the National Education Foundation. • The government will have established a system for collecting reliable data, including outcome-based indicators, at the national, provincial and district levels. • Continued implementation of the Education Reform Strategy and monitoring of education outcomes. • The government will have completed the development of the National Education Assessment Initiative at the federal and provincial level. The first assessment will have been conducted in fiscal year 2004/05.
HEALTH Improve the health status of the population through the expansion and improved quality of preventive and public health systems.	• Family Planning and maternal and child health care programs has been strengthened through increases in female health staff mostly through the Lady Health Workers. To reduce maternal morbidity and mortality, targeted programs in 20 rural districts are underway. • Immunization programs have been strengthened to achieve specific targets	• Pursuant to the Borrower's National Health Policy: (a) an Expanded Immunization Program for children has been launched by the Borrower; (b) the Borrower's Lady Health Workers Program has been strengthened through the appointment of an additional 10,000 Lady Health Workers; (c) the Borrower's Tuberculosis Control Program has been expanded; and (d) a national strategic HIV/AIDS prevention program has been formulated by the Borrower for imminent launching.	• The consolidated federal, provincial, and district governments budgets will have increased the share of health and population expenditures in the FY 2002/03 budget and beyond in line with recommendations from Public Expenditure Review. • The accelerated implementation of the Expanded Program of Immunization for children will have yielded an increase in the coverage rate of at least 5 percent per year through fiscal year 2004/05. • The government will have hired about 10,000 new

OBJECTIVES	ACTIONS		
	SAC I – Prior Actions (Board June 2001)	SAC II – Prior Actions (Board June 2002)	Follow-up Actions (Fiscal Years 2003-2005)
	over the next two years for (a) increase coverage of expanded immunization program (EPI) for children 12-23 months from 56 percent in 1999/00 to 75 percent in 2003/04, (b) increase in population with access to tuberculosis control from 12 percent to 30 percent, (c) eliminate confirmed polio cases by the end of 2002.		Lady Health Workers per year to reach its target of 78,000 workers in fiscal year 2002/03 and 100,00 workers reaching 100 million women and children by fiscal year 2004/05. • The government will have launched the implementation of the expanded HIV/AIDS prevention program. Continued implementation of the National Health Policy and monitoring of health outcomes.
PILLAR 4: IMPROVING INCOME GENERATING OPPORTUNITIES AND SOCIAL PROTECTION			
SOCIAL PROTECTION To help reduce poverty, develop human capital, and reduce gender imbalances through more active public policies. To develop the government's capacity to prepare and implement these policies.	• Implementation of small-works program (*Kushal Pakistan*)) to provide employment and basic services to the poor. • Launching of a direct cash-transfer program ("Food Support Program") targeted to 200,000 poor families –1.2 million people. • Strengthening of the Islamic-based *Zakat* charity program that provides cash transfers to the most vulnerable groups in society. • Establishment of a Micro-Credit Bank to service the poor, especially in rural areas.	• The financing of the off-budget Zakat program has been increased from Rs. 8 billion to Rs. 10 billion to reach more than 2 million beneficiaries. • The government has initiated the monitoring and evaluation of the Food Support Program through third party surveys. The first survey has been conducted on a pilot basis by the University of Punjab. • The Pakistan Kushal program has been strengthened and it s budget allocation increased to Rs. 15 billion or about 12 percent of the country's public investment program. • The -credit program of the Micro-Credit Bank has been strengthened. Branches have been expanded to 30 (out of 100) districts.	• The government will have established monitoring and evaluation system fro Zakat and strengthened the monitoring system for the Food Support Program. Expansion of program based on lessons learned from evaluation. • The government will have established monitoring and evaluation systems for the Kushal program. Expansion of program based on lessons learned from evaluation. • The government will have strengthened the legal and regulatory environment for micro-finance institutions and expansion of coverage of successful existing programs.

Annex G: List of Persons Met

Federal Government
Mr. Ahmed Jawad, Sr. Joint Secretary, Economic Affairs Division, Ministry of Finance
Mr. M. Abdullah Yusuf, Chairman and Secretary of Revenue, Central Board of Revenue
Dr. Ather Maqsood Ahmed, Member, Central Board of Revenue
Mr. Muhammad Yunis Khan, Auditor General (former Secretary of Finance)
Dr. Parvez Tahir, Chief Economist, Ministry of Planning and Development
Dr. Addas Kazmi, Chief (Macro), Ministry of Planning and Development
Mr. Muhammad Asif Sheikh, Chief (Public Investment), Ministry of Planning & Development
Mr. Muhammad Yunus, Joint Chief Economist (Operations), Ministry of Planning & Development
Mr. Sajid Hassan, Secretary, Ministry of Education

State Bank of Pakistan
Dr. Ishrat Husain, Governor
Dr. Riaz Riazuddin, Director of Research
Dr. Abdul Naseer, Economic Advisor

Banking Sector
Mr. Shaukat Tarin, President and CEO, Union Bank
Mr. Asif R. Sana, Executive Vice-President, Union Bank
Mr. R. Zakir Mahmood, President and CEO, Habib Bank
Mr. S Ali Raza, Chairman and President, National Bank of Pakistan
Mr. Mirza Abrar Baig, Executive Vice-President, National Bank of Pakistan

IMF
Henri Lori, Resident Representative in Pakistan

World Bank
John Wall, Country Director
Amer Z. Durrani, Sr. Transport Specialist
Tahseen Sayed, Sr. Social Sector Specialist
Ahmad Ahsan, Lead Economist
Hanid Mukhtar, Sr. Economist
Rashid Aziz, Sr.Energy Specialist
Zahid Hasnain, Economist
Zareen Naqvi, Sr. Economist
Mudassir Khan, Sr.Financial Sector Specialist
Sadiq Ahmed, Sector Director
Sharokh Fardoust, Sr. Economic Adviser
John Panzer, Sector Manager
Manuela Ferro, Lead Economist

Others
Brig. Tariq Saddozai, Managing Director, Karachi Electric Supply Company
Mr. Jalaluddin Qureshi, Chief Financial Officer, Karachi Electric Supply Company
Mr. Riaz Malik, former Chairman, Central Board of Revenue
Mr. Riaz Naqvi, former Chairman, Central Board of Revenue