

**PROGRAM INFORMATION DOCUMENT (PID)
CONCEPT STAGE**

December 14, 2015

Report No.: AB7814

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Operation Name	Pakistan Equitable Growth Development Policy Credit
Region	SOUTH ASIA
Country	Pakistan
Sector	General finance sector (10%);General industry and trade sector (30%);General public administration sector (60%)
Operation ID	P157207
Lending Instrument	Development Policy Lending
Borrower(s)	GOVERNMENT OF PAKISTAN
Implementing Agency	Ministry of Finance (MoF)
Date PID Prepared	December 14, 2015
Estimated Date of Appraisal	March 24, 2016
Estimated Date of Board Approval	June 21, 2016
Corporate Review Decision	Following the concept review, the decision was taken to proceed with the preparation of the operation.

I. Key development issues and rationale for Bank involvement

Pakistan has seen a turnaround in terms of macroeconomic stability – creating the conditions for renewed efforts to achieve higher, sustainable and inclusive growth. Until mid-2013 the economy was suffering from significant external and domestic imbalances. The new government in 2013 elaborated a program of reforms to stabilize the economy. This reform program was supported by the IMF through an Extended Fund Facility (EFF) and a number of development partners. The previous Fiscally Sustainable and Inclusive Growth DPC series as well as this proposed DPC are supporting the government's economic reforms program. Over the past few years Pakistan has been successfully implementing its economic reform program, with macroeconomic stability largely restored and a mild growth acceleration. The Government's stabilization program has been aided by declining oil prices, which came as a windfall for a net oil-importing country like Pakistan.

Growth has maintained its upward momentum, but remains below required levels to accelerate job creation and significantly improve living standards. GDP grew by 4.2 percent in FY14/15 compared to 4.0 percent last year, driven mainly by services and supported by agriculture. External risks have declined and official foreign exchange reserves reached US\$13.6 billion on June 30, 2015, equivalent to 3.2 months of projected imports, and well above the low of US\$3.0 billion in November 2013. The current account deficit remained modest, at 1.0 percent of GDP during FY14/15. The Real Effective Exchange Rate (REER) appreciated in FY14/15 year on year by 8.8 percent. This may be affecting competitiveness of exports, which contracted by 3.9 percent compared with import contraction of 0.9 percent in FY14/15.

Fiscal consolidation has continued, but important challenges remain. During FY14/15, the

fiscal deficit (excluding grants) declined from 5.7 percent to 5.4 percent of GDP: revenue declined marginally by 0.1 percent of GDP and expenditures decreased by 0.4 percent of GDP. Spending on subsidies fell from 1.3 to 1.0 percent of GDP. The public debt to GDP ratio decreased to 64.6 percent in FY14/15, but it remains above the 60 percent limit stipulated in the Fiscal Responsibility and Debt Limitation Act (FRDLA) 2005.

Prices have stabilized due to fiscal consolidation and low oil prices. For a third year in a row, headline CPI inflation is in single digits. In June 2015 it was 3.2 percent, although core inflation stood at 4.6 percent. Year-on-year, food inflation declined to 3.2 percent. Falling oil prices have not only contributed directly through reductions in petroleum product prices and electricity tariffs but also indirectly through reduced service and manufacturing costs. Supported by low inflation and to foster private sector credit, the State Bank of Pakistan (SBP) cut its key policy rate by a cumulative 300 basis points (bps) in FY14/15, owing to favorable trends in oil prices and falling inflation.

II. Proposed Objective(s)

The proposed loan is a single-tranche stand-alone operation with two broad development objectives: (i) attracting private sector investment through an improved business environment and (ii) improving fiscal management to maintain macroeconomic stability and create the necessary fiscal space. The operation contributes to the government's strategy for accelerating economic growth, ensuring fiscal consolidation, increasing investment, and enhancing the openness of the economy to domestic and external competition. A stand-alone operation is being proposed to support a selected number of discrete reforms that the Government of Pakistan wants to implement before entering the electoral cycle in 2017.

The operation will contribute to accelerating growth and fostering an inclusive growth pattern. This operation supports higher and inclusive growth through several channels. First, by supporting measures to enhance the investment climate and develop capital markets, the operation aims to contribute to the creation of more and better jobs. Second, SOE reform and privatization will improve services delivery and limit the claims of loss-making state enterprises on the budget. Third, improved fiscal management that results in increased fiscal space will allow the authorities to allocate additional resources to public investment, while reducing financing from the commercial banking sector and private sector crowding out. Forth, measures to improve poverty measurement and the targeting of social safety net interventions will enhance the effectiveness of pro-poor policies. The proposed program builds on the success of the previous FSIG series and the ongoing IMF program, continuing with the implementation of unfinished reform efforts, deepens reforms where progress has been uneven, and brings in new crucial reform

III. Preliminary Description

The operation will support reforms in a number of areas through eleven prior actions. The actions represent significant continuity with the previous FSIG series, completing some of the longer term reforms initiated three years ago, deepening reforms in areas where results have been more uneven and incorporating some new crucial reforms areas. The policy actions are

structured around two development objectives and reform pillars: (i) attracting private sector investment and (ii) improving fiscal management.

Reform aims in the first pillar. Under the first pillar of attracting private sector investment, the operation will support reforms to improve the business environment in the area of getting credit and paying taxes, improve governance and transparency of capital markets, improve financial inclusion and support efforts in the privatization agenda, particularly in the insurance sector, and to improve transparency of federal state owned enterprises.

Reform aims in the second pillar. Under the second pillar of improved fiscal management, the operation will support reforms to broaden the tax base, by eliminating tax exemptions and enhancing audit policy and capacity, improving debt management coordination, strengthening targeting of safety net programs as well as improving poverty measurement and the publication of poverty data.

IV. Risks and Risk Mitigation

The overall risk rating level of the operation is high. Political risks to the operation are high, stemming from both the broader political and security situation in Pakistan which may distract policy makers, as well as from political resistance to the reform program itself. Macroeconomic risks are substantial, stemming from the possibility of domestic and external shocks. The depth of the reforms being supported requires several mitigation measures in favor of sustainability of reforms to address substantial risks regarding institutional capacity and stakeholders and high risks of judicial intervention. Mitigation measures including setting the reform pace in line with perceived potential political-economy constraints, continuation of the recent prudent macroeconomic policy mix. The World Bank and the IMF will continue to work in tandem and closely coordinated. Institutional and coordination risks are mitigated through the use of the permanent economic reform unit as the coordinating body at the MoF and regular meetings chaired by the Minister of Finance to assess progress in the reform program and the provision of technical assistance required to advancing reforms. Judicial challenges can be mitigated by strengthening the legal basis of the reforms being supported.

V. Poverty and Social Impacts and Environment Aspects

The operation supports sustained poverty reduction and shared prosperity. The proposed measures will contribute to higher and more inclusive growth. This operation supports reforms that are expected to improve the business environment, resulting in increased competitiveness and job creation. Efforts to enhance access to finance will address a key constrain for SME growth. Mobilizing revenue will create the fiscal space necessary to finance public expenditure to accelerate growth and limit government financing from commercial banks, resulting in increased credit to the private sector. The operation will also support reform efforts to improve the pro-poor orientation of government programs and policies as well as improved gender outcomes. More detailed assessment will be prepared for this operation.

VI. Environment Aspects

Pakistan has adequate legislative cover, policy guidelines, and institutional mechanisms in place for managing the environment. The Pakistan Environmental Protection Council, headed by the prime minister, is responsible for overall guidance on national environmental programs and policies. After devolution in 2010, provinces have been empowered to legislate and formulate policies. At the federal level, the Climate Change Division of the Cabinet Secretariat is responsible for environmental protection. The institutional arrangements for environmental management are quite elaborate at the provincial level, though implementation remains the key challenge across most of the country. This operation is likely not to cause any significant effect on Pakistan's environment, forests, and other natural resources, and there are systems in place for reducing any eventual adverse effect as described in paragraph of OP 8.60. A more detailed discussion of environmental aspects will be prepared for this operation.

VII. Tentative financing

Source:	(\$m.)
BORROWER/RECIPIENT	0
International Development Association (IDA)	500
Borrower/Recipient	
IBRD	
Others (specify)	
	Total
	500

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