Report Number : ICRR0022026

1. Project Data

Operation ID P161136	**Operation Name** Pakistan: Finance for Growth DPC	
Country Pakistan	**Practice Area(Lead)** Finance, Competitiveness and Innovation	
L/C/TF Number(s) IDA-59750,IDA-59760,IDA-59770	**Closing Date (Original)** 30-Jun-2018	**Total Financing (USD)** 301,376,429.30
Bank Approval Date 15-Mar-2017	**Closing Date (Actual)** 30-Jun-2018	

	IBRD/IDA (USD)	**Co-financing (USD)**
Original Commitment	301,600,000.00	0.00
Revised Commitment	301,600,000.00	0.00
Actual	301,376,429.30	0.00

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2. Project Objectives and Policy Areas

a. Objectives

According to the Program Document (page 1), the program development objective of the Pakistan Finance for Growth Development Policy Credit was to support the government's efforts "to promote an inclusive and transparent financial sector that was able to better intermediate resources including for long-term finance."

b. Pillars/Policy Areas

The program had three policy areas:

Improving Access to Finance and Enhancing Financial Inclusion aimed to promote a more diverse and inclusive financial sector and to improve access to credit to support private sector-led growth by: (a) advancing the digitization of financial transactions; (b) linking investments in Pakistan's National Savings Scheme (NSS) --- the public sector savings program that accounts for a significant portion of savings in the country --- to the banking system; (c) improving corporate creditworthiness; and (d) increasing consumer confidence in bank deposits.

Fostering Long-Term Finance supported strengthening the regulatory framework and the enabling environment for long-term finance, by: (a) mobilizing finance for infrastructure; and (b) mitigating the risks to long-term lending through prudential regulation.

Enhancing Transparency of the Financial Sector aimed to address remaining gaps in transparency and market integrity in the financial sector by: (a) prohibiting Benami transactions --- i.e., holding property and assets in the name of one person for the benefit of another; (b) curbing money laundering and terrorist financing; (c) formalizing new offerings of prize bonds; and (d) improving governance in the insurance sector, which remained dominated by state-owned insurers.

c. Comments on Program Cost, Financing, and Dates

Program Cost: The program was estimated to cost SDR 222.1 million (US$301.6 million equivalent) at appraisal.

Financing: The program was financed with two IDA credits: (a) an SDR 185.3 million credit covered with a Financing Agreement (portion A of the credit, SDR 178.7 million, carried an interest of 1.25 percent per annum, while portion B, SDR 6.6 million, 1.13 percent); and, (b) an SDR 36.8 million credit covered by a Scale-Up Financing Agreement (this credit carried an interest of 3.2 percent per annum). Both credits were fully disbursed in single tranches, totaling SDR 222.1 million (US$301.4 million equivalent).

Dates: The program was approved on March 15, 2017, became effective on April 5, 2017, and closed as scheduled on June 30, 2018.

3. Relevance of Objectives & Design

a. Relevance of Objectives

The program objective was relevant to the development priorities of the government at the time of program appraisal and closing. The "11th Five-Year Plan for 2013-18" aimed to implement Pakistan's "Vision 2025" for "balanced human, social, and economic progress" through seven pillars: (a) developing human and social capital; (b) achieving sustained, indigenous and inclusive growth; (c) achieving democratic governance, institutional reform, and modernization of the public sector; (d) achieving energy, water and food security; (e) advancing private sector and entrepreneurship-led growth; (f) developing a competitive knowledge economy; and, (g) modernizing transportation infrastructure and regional connectivity. The program objective was relevant to the second pillar, achieving inclusive growth, and the fifth pillar, advancing private sector and entrepreneurship-led growth.

The program objective was aligned with the Bank Group strategy at the time of program appraisal and closing. The Bank Group "Country Partnership Strategy for the Islamic Republic of Pakistan for the Period FY2015-19" (CPS) supported the country's overarching goals of poverty reduction and shared prosperity, organized around four strategic areas: (a) energy security; (b) greater private sector development; (c) inclusion for vulnerable groups, including the poor, women, the youth, and those in conflict areas; and, (d) improved delivery of government services. The program objective was aligned with the second pillar, private sector development, which among others, supported "improvements to the financial infrastructure", the "deepening of financial markets", "long-term market development, and "enhanced financial intermediation to the private sector" (CPS, page 18), and with the third pillar, inclusion, which supported "financial inclusion" for households in the poorest districts, for women, and for MSMEs (CPS, page 20).

Rating

Substantial

b. Relevance of Design

The policy areas were consistent with the program objective.

- Improving Access to Finance was directed at problems with financial inclusion, which remained low in Pakistan: (a) 100 million remain unbanked --- only 13 percent of adults had a formal account, including less than 5 percent of women (compared to an average 37 percent in the South Asia region); (b) the financing needs of micro, small, and medium enterprises were largely unmet by the formal sector --- 3.2 million MSMEs received only 7 percent of bank credit to the private sector; (c) overall, financial intermediation remained low --- credit to the private sector stood at just about 15 percent of GDP, half the average in middle-income countries; (d) some 7 million retail savers, saving through NSS certificates (national savings was 13 percent of GDP, with the NSS at 10 percent of GDP) transact in cash at the Central Directorate for National Savings (CDNS), the Ministry of Finance department which acts as the custodian of the NSS, and not through banks, with little automation; (e) the regulatory framework for companies was outdated; and, (f) Pakistan had no explicit system or fund for deposit protection.
- Fostering Long-Term Finance would help develop the infrastructure finance market: (a) Pakistan ranked poorly on infrastructure competitiveness (117th of 140 countries) --- investment in energy, transport, and communications fell from around 4 percent of GDP in 2005-06 to around 2 percent in 2014-15, and infrastructure project finance averaged just 0.1 percent of GDP (compared to 1.5 percent in Indonesia and 3.5 percent in Malaysia); (b) to address the infrastructure deficit, Pakistan needed to raise infrastructure investment to 10 percent of GDP annually, but the infrastructure financing market remained under-

developed; and, (c) banks faced maturity and liquidity mismatches and other complex risks in participating in long-term lending for infrastructure.

- Enhancing Transparency in the Financial Sector would address gaps with financial market integrity: (a) Benami --- the practice of holding property and assets in the name of one person for the benefit of another --- had been abused to conceal ownership of assets acquired through illegal means, to defraud creditors, and to evade payments of government fees, charges, and taxes; (b) the Financial Action Task Force (FATF), the inter-governmental organization founded in 2009 to combat money laundering, listed Pakistan in its "grey list", reflecting "strategic deficiencies" with the country's anti-money laundering and combating the financing of terrorism (AML/CFT) framework; (c) prize bonds --- open-ended certificates that awarded lottery prizes were useful instruments for retail savings, but, as unregistered certificates, were susceptible to money laundering and tax avoidance; and, (d) there were corporate governance issues with the three state-owned enterprise (SOE) insurers that dominated the insurance market --- the State Life Insurance Corporation (SLIC), which controlled 50 percent of the life insurance market, the National Insurance Company Limited, which enjoyed a statutory monopoly over the insurance of public property, and the Pakistan Reinsurance Company Limited, which was the only reinsurance company in the country.

The prior actions were supportive of the policy areas and were linked with expected results.

- On Improving Access to Finance: (a) approval of the Digital Transactions Account (DTA) scheme designed by the State Bank of Pakistan, the central bank, to provide for the interoperability of platforms across service providers would advance early gains made by Pakistan in mobile banking (5.8 percent of the adult population had mobile accounts, compared to an average 1.9 percent in the South Asia region); (b) granting the CDNS with clearinghouse membership in the National Institutional Facilitations Technologies (NIFT), the body managing automated clearinghouse facilities in Pakistan, would enable the CDNS to transact in the NSS products (e.g. distribute interest on NSS certificates) with savers through their bank accounts, thereby motivating savers to obtain and use bank accounts; (c) approval by the National Assembly, the lower legislative house, of a new Companies Act (amending the 1984 Companies Ordinance) would --- by encouraging electronic business registration, streamlining company procedures, and enhancing corporate reporting --- promote formality and increase firm access to credit; (d) passage of the Deposit Protection Corporation Act by Parliament (the National Assembly and the Senate, the upper legislative body) and the creation of a Deposit Protection Corporation, would, if international experience were any guide, raise consumer confidence in the banking system and hence foster financial inclusion. These prior actions were drawn from Pakistan's National Financial Inclusion Strategy (NFIS) of 2015, according to the ICR (page 14).
- On Fostering Long-Term Finance: (a) approval by the Cabinet's Economic Coordination Committee of the National Policy on Infrastructure Finance, prepared with the assistance of the Bank, would create synergies between local and international financial sources to fund investment in infrastructure, including those listed in the China-Pakistan Economic Corridor investment plan; and, (b) issuance by the State Bank of Pakistan of prudential regulations for long-term finance consistent

with Basel III requirements would encourage bank participation in infrastructure finance. These prior actions were drawn from the Pakistan Financial Sector Assessment Program (FSAP) Update of 2016, according to the ICR (page 14).

- On Enhancing Financial Sector Transparency: (a) passage by Parliament of the Benami Transactions Prohibition Act would help curb money laundering and tax avoidance associated with Benami transactions, and creating an Adjudicating Authority for Benami Transactions would help implement the new law, which placed the onus on proving ultimate ownership of a property on the owner of record (failure to prove ownership would lead to confiscation of the property, with possible criminal charges); (b) completion by the Ministry of Finance of the AML/CFT National Risk Assessment would determine Pakistan's compliance with FATF Recommendation 1 (that countries required financial institutions and certain non-financial businesses and professions to identify, assess, and take effective action to mitigate money laundering and terrorist financing risks), a determination of which would help strengthen the country's AML/CFT controls; (c) approval by the Cabinet of new rules for registered prize bonds would curb money laundering and tax avoidance associated with unregistered prize bonds; and, (d) an endorsement by the Ministry of Commerce of the International Finance Corporation's (IFC's) assessment of the SLIC's compliance with the Public Sector Companies Rules of 2013 should lead to the implementation of the remedial actions recommended by the assessment. These prior actions were drawn from the Pakistan FSAP Update of 2016, according to the ICR (page 16).

The choice of lending instrument was appropriate. The government faced a gross financing requirement of Pakistani Rupees (PKR) 9.3 trillion (US$88.5 billion) in fiscal year (FY) 2016/17, which was expected to rise to PKR 12 trillion (US$107 billion) by FY2019/20. Multilateral official assistance and domestic credits were to be the main sources of long-term financing. This operation would provide budget support to the government. At the same time, this operation would advance policy and structural reforms to promote financial inclusion, develop long-term finance in Pakistan, and enhance transparency in the financial sector.

The macroeconomic framework, which had been adequate as the operation was prepared, had started to deteriorate soon after the operation was approved and became effective.

- According to the International Monetary Fund (IMF) Staff Report on the Pakistan 2017 Article IV Consultation, macroeconomic stability gains had been made with the implementation of the Extended Fund Facility (EFF) program in 2013-16, with inflation contained and the financial sector sound. The outlook for economic growth was favorable and had strengthened to around 6 percent annually in the medium-term (FY2017/18 to FY2021/22). Medium-term growth would be supported by investments under the China-Pakistan Economic Corridor plan, improved availability of energy, and growth-supporting structural reforms.
- However, macroeconomic stability gains made under the EFF program had begun to erode --- fiscal consolidation slowed, the current account deficit widened, and foreign exchange reserves declined --- and posed risks to the economic outlook. Risks stemmed, internally, from recent weaker implementation of policy reforms, a deterioration in security conditions, and pressures on policy implementation ahead of

the 2018 general elections, and externally, from lower trading partner growth, tighter international financial conditions, a faster rise in international oil prices, and failure to generate sufficient exports to meet rising external obligations from large-scale foreign-financed investments. The IMF recommended stronger fiscal consolidation, the maintenance of a prudent monetary policy stance to preserve low inflation, and advanced financial sector reforms to continue strengthening resilience and support financial deepening.

Rating
Substantial

4. Achievement of Objectives (Efficacy)

Objective 1

Objective
To promote an inclusive and transparent financial sector that was able to better intermediate resources including for long-term finance.

Rationale
The degree of achievement of the program development objective is assessed as moderately unsatisfactory.

The program achieved three of the four results targets for improving access to finance and enhancing financial inclusion, but there are attribution problems for at least two of these results.

- The number of digital transaction accounts increased from 45 million in the baseline (July 2016) to 53 million by the program closing date (end-June 2018), exceeding the target of 50 million. Of these, the number of transaction accounts for women rose from 7 million in the baseline to 15.2 million by the closing date, more than doubling the target of 7.5 million. The increase in the number of digital transaction accounts was envisioned as the result of the approval by the NFIS Council of the DTA scheme (prior action 1), which would provide an integrated platform for digital transactions delivered through mobile accounts. According to the ICR (page 23), this result may not be entirely attributed to the prior action, however, as the first pilot of the DTA scheme was launched only in January 2018, six months before the program closing date. The ICR explains that private sector fintech activity and even the Bank's Financial Infrastructure and Inclusion Project and other technical assistance (TA) operations could have materially contributed to the rise in the number of digital transaction accounts.
- The percentage of NSS returns distributed through bank accounts rose from zero percent in the baseline to 2.8 percent (on a base of 2.4 million NSS accounts) by the program closing date. The achievement fell short of the target to have 5 percent of NSS returns (on a base of 7 million NSS accounts) distributed through bank accounts. This target required the State Bank of Pakistan to grant the CDNS clearinghouse membership in the NIFT to enable the distribution of NSS returns through bank accounts (prior action

2). The ICR (page 23) clarifies that the Program Document had inaccurately estimated that there were 7 million NSS accounts; rather, there were 7 million investment items in 2.4 million accounts.

- The number of registered companies increased from 65,735 in the baseline to 85,401 by the program closing date, exceeding the target of 70,000. The increase in the number of registered companies was a result expected from the approval by the National Assembly of the new Companies Act to modernize the regulatory framework for firms (prior action 3).
- The deposit base of the banking sector rose from PKR 11 trillion (US$105 billion equivalent) in the baseline to PKR 12.5 trillion (US$121 billion equivalent) by the program closing date, meeting the target of PKR 12.5 trillion. This result was expected to follow from the approval by Parliament of the Deposit Protection Corporation Act of 2016 (prior action 4). The ICR (page 23) argues that there is also an issue of attribution with this result: while the Deposit Protection Corporation Act was passed in 2016, the Deposit Protection Corporation was not established until the beginning of June 2018, a month before the program closing date. However, the ICR also concedes that the mere passage of the law could have strengthened consumer confidence in the banking system.

The program did not achieve the sole results target for fostering long-term finance.

- The percentage of long-term loans (loans with maturity of five years or more) in total bank loans increased only marginally from 8.8 percent in June 2015 to 8.9 percent by the program closing date, below the target of 10 percent. The Economic Coordination Committee had previously approved the National Policy on Infrastructure Finance in 2017 (prior action 5) and the State Bank of Pakistan had issued prudential regulations for long-term finance in line with Basel III requirements (prior action 6). These actions, together with the rise of public-private partnerships and energy project finance in recent years, were thought to contribute to an increase in long-term lending in the country. However, the effects of the policy and regulatory initiatives on long-term lending were yet to be realized by the program closing date. The ICR (page 24) lists continuing challenges to the development of the market for long-term finance in Pakistan: (a) on the demand side, the lack of bankable projects; (b) on the supply side, problems of asset (long-term loans) and liability (short-term deposits) mismatches; (c) limited buy-in of the new policy, across other agencies of government, even after its formal launch; and, (d) lack of, or poor quality of, data on the sources and uses of funds in the system.

The program partially met only one of four targets set for enhancing transparency in the financial sector.

- Pakistan did not have an adjudication body for Benami accounts by the program closing date, contrary to the target that an adjudicating authority for Benami accounts be appointed and made operational. Pakistan enacted the Benami Transactions Prohibition Act in 2017 (prior action 7) to criminalize Benami transactions in property and to stop the conduct of transactions through Benami bank accounts, but the rules and regulations to implement the law were not issued by the Federal Board of Revenue until March 2019, nine months after the program closing date. The issuance of the rules and regulations was necessary before an adjudicating authority could be appointed and made operational.

- Whether Pakistan remained in compliance with Recommendation 1 of the FATF, a status that held in the baseline, could not be confirmed by the program closing date. Only a Mutual Evaluation Report (an in-depth country report analyzing the implementation and effectiveness of measures to combat money laundering and terrorist financing) could determine whether a country followed FATF recommendations. The Mutual Evaluation Report for Pakistan was still under preparation by the program closing date, although the National Risk Assessment, the first step in assessing compliance with FATF recommendations, had been completed earlier in 2017 (prior action 8). The Mutual Evaluation Report, subsequently published in October 2019, determined Pakistan to be "partially compliant" with Recommendation 1. Meanwhile, the FATF kept Pakistan in its "grey list", indicating the presence of "strategic AML deficiencies", and urged Pakistan to complete its action plan by February 2020.
- The value of registered prize bonds as a percentage of the value of all outstanding prize bonds increased marginally from zero percent in the baseline to 0.7 percent by the program closing date, below the target of 2 percent. The Cabinet had previously approved the rules for new registered prize bonds in February 2017 (prior action 9). Prize bonds do not offer premium or profit and do not pay interest but rather offer lottery prize money to holders in lucky draws conducted throughout the year. They had been issued beginning in 1960 as central government debt and the new prize bonds come in denominations of PKR 40,000 and higher.
- The roles of chairman and chief executive officer (CEO) of the SLIC remained merged at program closing, the same status that held in the baseline, thus failing achieve the results target that the positions of chairman and CEO meet the "fit and proper" criteria (the test for evaluating managers, directors, and shareholders that references their ability to fulfill their duties --- "fitness" --- as well as their integrity and suitability --- "propriety"). Previously, the Ministry of Commerce endorsed the corporate governance assessment of the SLIC to monitor the SLIC's compliance with the Public Sector Companies Rules of 2013 (prior action 10), which decreed, among others, that the offices and roles of chairman and CEO be separate at all public sector companies.

Rating
Modest

5. Outcome

The outcome of the program is assessed as moderately unsatisfactory. The program objective was highly relevant to the development priorities of Pakistan and highly aligned with the country partnership strategy of the Bank Group: part of a larger set of macroeconomic reforms, the operation was directed at addressing low savings and investment --- by broadening (increasing access to finance) and deepening (developing capital markets and infrastructure finance) the financial sector while promoting the financial market integrity and stability (enhancing transparency and governance). The program design was substantially relevant: the policy areas were consistent with the program objectives; the prior actions were supportive of the policy areas and linked to expected results, although there were attribution problems with at least two indicators; and, the instrument was appropriate. However, the macroeconomic framework, which had been adequate with the implementation with the IMF EFF program in 2013-16, saw policy reform slippages as the IMF program ended and soon after this Bank operation was approved. The efficacy of the program was modest: three of the nine target results were either exceeded or met, albeit with questions about the direct attribution of at least two of these to the prior actions; two were partially achieved, with the results greater than the baseline but short of the target; and, four were not met.

a. Outcome Rating

Moderately Unsatisfactory

6. Rationale for Risk to Development Outcome Rating

Risks to the sustainability of the development outcomes of the operation are assessed to be substantial, overall.

Political risk is substantial. Political risk could arise from: (a) opposition by vested groups to institutional reforms, for example, to governance reform in the SOE-dominated insurance industry; (b) the absence of a majority by the ruling political party in the upper house of Parliament, which could weaken political commitment to reforms that support the macroeconomic framework; and, (c) an under-delivery by the provinces on their commitments to the budget parameters, which could also weaken the macroeconomic framework.

Macroeconomic risk is high. In its first review, in December 2019, of the current 39-month SDR 4.3 billion (US$6 billion) Extended Fund Facility for Pakistan (Pakistan requested and obtained approval of the new EFF in July 2019, after the previous EFF was completed in 2016), the IMF determined that while the program "was on track and has started to bear fruit", the "risks to the [economic] outlook remained high". The risks include: (a) fiscal slippages that could undermine fiscal consolidation and put debt sustainability at risk; (b) lukewarm progress on structural reforms especially those strengthening governance of economic institutions that could result in stagnant economic activity; (c) a potential blacklisting by the FATF that could result in a freeze of capital flows and lower investment to Pakistan; and, (d) global economic shocks that could weaken economic activity and affect growth prospects and current account deficit projections.

Financial sector policy risks appear to have moderated, in view of recent progress with policy reform. On improving financial access: (a) the NFIS targets have been made more ambitious, with ramped-up efforts at digitizing financial transactions; (b) the Financial Infrastructure and Inclusion Project is advancing the digitization agenda; and, (c) the Deposit Insurance Corporation is operational. On fostering long-term finance: the government and the Bank are building a capital market development program that focuses on the demand side in long-term finance, tackling issues pertaining to the bankability and profitability of infrastructure projects. And, on improving transparency in the financial sector: (a) the rules and regulations to implement the Benami

Transactions Prohibition Act were issued by the Federal Board of Revenue in March 2019; (b) the Mutual Evaluation Report of the AML/CFT regime was completed under the auspices of the FATF in October 2019; (c) the government started a program to register all outstanding prize bonds, and discontinued the issuance of the PKR 40,000 bond in February 2019 (over concerns with AML risk); and, (d) the government has placed the SLIC on the privatization list.

a. Risk to Development Outcome Rating

Substantial

7. Assessment of Bank Performance

a. Quality-at-Entry

The program design was underpinned by analytical work produced by the government, the Bank, and the IMF. According to the Program Document (page 41) and the ICR (pages 35 and 37):

- The first policy area was informed by: the government's "Investment Climate - Business Registration Diagnostic" (2014), "National Financial Inclusion Strategy Pakistan (NFIS)" (2015), and "Doing Business Reform Strategy 2016 - Smart Regulations, Simplified Procedures, Competitive Costs" (2016); the Bank's "Pakistan Financial Sector Assessment Program (FSAP) Update" (2016) and "Pakistan FSAP Update: Debt Capital Markets Technical Note" (2016); and the joint Bank-IMF "Pakistan - Report on the Observance of Standards and Codes (ROSC), Accounting and Auditing (A&A)" (2017).
- The second policy area by: the Bank's "Pakistan FSAP Update: Infrastructure Finance Technical Note" (2016).
- Third policy area by: the government's "NFIS" (2015), "NFIS: Insurance Technical Note (2015), and "AML/CFT National Risk Assessment" (2016).

The program was aligned with other Bank structural reform programs in Pakistan, particularly reforms in recent years that aimed to strengthen the policy, institutional, legal and regulatory framework for financial intermediation. The operation followed the First and Second Fiscally Sustainable and Inclusive Growth Development Policy Credits (FSIG I, 2014-15, and FSIG-II, 2015-16) which aimed "to foster private and financial sector development to bolster economic growth, and mobilize revenue while expanding fiscal space to priority social needs" and the Competitiveness and Growth Development Policy Credit (CGDPC, 2016-17) which aimed "to improve the business environment, and enhance fiscal management by improving revenue management and making spending more pro-poor". The operation would, in turn, be followed by the Financial Inclusion and Infrastructure Project (2018-22) which aimed "to increase access and usage of digital payments and other financial services for households and businesses in Pakistan." The reforms measures were complementary and progressive among the successive development policy operations. Moreover, according to the Program Document (page 14), the design of this program benefitted from the experience gained and the lessons learned from FSIG-I, FSIG-II and the

CGDPC, which included the extensive stakeholder consultations required for legal and regulatory reforms and vital technical assistance to support reform measures.

The Bank coordinated the design and preparation of the program with Pakistan's development partners.

- The FSAPs of 2010 and 2016 (Update), which informed the policy reform plans, were jointly conducted with the IMF. The reform measures were complementary to the structural reform agenda, including in the financial sector, of the IMF's Three-Year SDR 4.4 billion (US$6.6 billion) Extended Fund Facility for Pakistan approved in 2013.
- According to the Program Document (page 24), the Bank collaborated with the Consultative Group to Assist the Poor (CGAP) to help the government develop and launched the NFIS in 2015.
- The Bank and the United Kingdom's Department for International Development (DFID) coordinated the extension of technical assistance to the State Bank of Pakistan to support the implementation of the NFIS.
- The Bank also collaborated with DFID and the Gates Foundation on the DTA scheme, and with the U.S. Agency for International Development (USAID) on access to finance for SMEs.

The Bank provided technical assistance for program design and preparation. The ICR (page 18) lists TA operations over FY2014/15 to FY2017/18 to support the development and reform of the financial sector, principally TA: to develop the NFIS; to support the AML/CFT framework, including preparation of the AML/CFT National Risk Assessment; and, to revamp the legal and regulatory framework of the insurance sector. The design of the third pillar also benefitted from technical assistance provided by the IMF, the Trust Fund for Accelerating Growth and Reform (TAGR), and the Financial Sector Strengthening Initiative (FIRST).

The Bank secured adequate government commitment to the program objectives, the scale and scope of which was aligned with the government's implementation capacity. The set of prior actions for this operation --- new legislation by Parliament, policy decisions by the Cabinet, and regulatory and administrative actions by the State Bank of Pakistan, the Securities and Exchange Commission of Pakistan, the Ministry of Finance, and the Ministry of Commerce --- were all completed as planned. Moreover, according to the Program Document (page 13), the government had demonstrated a strong commitment to financial sector reforms over the preceding years, as evidenced by: amendments to the Financial Institutions Ordinance of 2001 to improve the recovery of bank non-performing loans without court intervention; the enactment of a new law on secured transactions; the passage of the Securities and Exchange Commission of Pakistan Act; and, the enhancement of the Credit Bureau Act.

The Bank identified risks to the implementation of the reform plan and advanced mitigation measures. Political risk was considered high, and macroeconomic risk, substantial. To mitigate political risk, which could arise opposition by vested interests to the reform measures, the Bank recommended extensive consultations with various stakeholders and across political affiliations. To mitigate macroeconomic risk that could arise from internal and external shocks, the Bank urged the government to pursue prudent fiscal and monetary policies and build a large reserve position to cushion the economy from shocks. The Bank also committed its support, in tandem with the IMF's, for the government's effort to maintain an appropriate macroeconomic policy framework for the operation.

There were moderate deficiencies with quality at entry however.

- Follow-up steps to the prior actions that were necessary to achieve the targeted results were not made explicit in the Program Document: the full operationalization of the DTA scheme; and, the issuance of the rules and regulations to implement the Benami Transactions Prohibition Act.
- The Program Document erred in assuming that an AML/CFT National Risk Assessment (NRA) was sufficient to determine Pakistan's compliance with FATF recommendations. A Mutual Evaluation Report (MER) was necessary.
- The Program Document also erred in its count of the number of NSS accounts. There were 2.4 million NSS accounts, not 7 million. The target of 5 percent of NSS accounts for which NSS returns were distributed through banks was calculated on the basis of 7 million accounts.

Quality-at-Entry Rating

Moderately Satisfactory

b. Quality of supervision

According to the ICR (page 28), the Bank sustained its policy dialogue with the government even as adverse political developments (the removal of the Prime Minister and the resignation of the Finance Minister in mid-2017) risked delaying progress with the operation.

There was a moderate deficiency with supervision:

- The Bank did not remedy the deficiencies at entry (see Section 7.A) during the period between effectiveness and closing.

Quality of Supervision Rating

Moderately Satisfactory

Overall Bank Performance Rating

Moderately Satisfactory

8. Assessment of Borrower Performance

a. Government Performance

The government was strongly committed to the objectives of the program, completing all nine prior actions required for the effectiveness of the operation.

However, the government did not complete in time (before program closing) many follow-up steps to the prior actions that were necessary to achieve many results targets: (a) full operationalization, and not just a pilot, of the DTA scheme; (b) operationalization of the Deposit Protection Corporation; (c) issuance of the rules and regulations to implement the Benami Transactions Prohibition Act; and, (d) completion of the AML/CFT Mutual Evaluation Report.

The government also failed to maintain the adequacy of macroeconomic framework for the operation. According to the ICR (pages 12 and 29): (a) fiscal discipline started to slip at the end of the IMF program in late 2016, and the exchange rate, already overvalued, did not adjust in line with changing economic conditions; (b) the momentum in support of privatization and tariff reform weakened; (c) by mid-2017, as elections approached, the government reduced income tax thresholds in the FY2018 Budget, increased fiscal exemptions, raised import tariffs, and kept the exchange rate overvalued; and, (d) after the Prime Minister was removed from office in July 2017 (the Supreme Court disqualified the incumbent Prime Minister from holding office for failure to fulfill the eligibility requirements decreed in the Constitution) and Finance Minister resigned, the political priorities of the government changed. For this reason, it can be argued that certain program results --- the size of the deposit base of the banking system, the percentage of long-term loans among all bank loans --- could have been better had macroeconomic policy and performance been more supportive of growth.

Government Performance Rating

Moderately Unsatisfactory

b. Implementing Agency Performance

The Ministry of Finance was the lead implementing agency, responsible for "overall oversight and implementation" of the operation.

Considering the satisfactory completion by Parliament, the Cabinet, the State Bank of Pakistan, the Securities and Exchange Commission of Pakistan, the Ministry of Finance, and the Ministry of Commerce of all the prior actions required for the effectiveness of the operation, the performance of the Ministry of Finance as lead implementing agency is deemed satisfactory.

Certain results, however, fell below target, and the Ministry of Finance, as lead implementing agency, could have worked better to attain the program targets. The Federal Board of Revenue did not issue the rules and regulations to implement the Benami Transactions Prohibition Act of 2017 until nine months after the program closing date, in March 2019; hence, there was no adjudication body for Benami transactions by the program closing date as planned. The positions of chairman and CEO of the SLIC remained one in mid-2018, hence, the government-owned insurer did not meet the "fit and proper" criteria for its managers as expected.

Implementing Agency Performance Rating

Moderately Unsatisfactory

Overall Borrower Performance Rating

Moderately Unsatisfactory

9. M&E Design, Implementation, & Utilization

a. M&E Design

The M&E plan for the program defined nine results indicators to comprise the evidence for achievement of the program objective, four for the first policy area, one for the second, and four for the third (see Sections 3.B and Section 4). The results indicators for the program were specific, well-defined, and measurable. However, there were moderate deficiencies with the results indicators:

- Because some of the indicators were headline macroeconomic variables, their attribution exclusively to the prior actions could not established. The increase in the size of the deposit base in the banking system could also be attributed to economic growth (GDP grew 5.8 percent in FY2017/18 from 5.5 percent in FY2016/17).
- The Bank's Financial Inclusion and Infrastructure Project, which aimed to increase the access to and use of digital payments, overlapped with this program, being approved in June 2017 and becoming effective in March 2018. The increase in number of digital transaction accounts could also be attributed to this project.

The M&E plan also called for the Ministry of Finance, the lead implementing agency of the program, to assume responsibility for the overall M&E function, in collaboration with the State Bank of Pakistan, the Securities and Exchange Commission of Pakistan, the Ministry of Commerce, the Planning Commission and the Fiscal Revenue Board.

b. M&E Implementation

The ICR reported all the program results, indicating that the Ministry of Finance performed its M&E functions as designed (the Bank did not file any Implementation Status and Results Reports (ISRs), which would have cited the program results in the interim).

According to the ICR (page 21), it grappled with the problem that the results for some of the indicators "did not match the timeline of the operation". For example, the DTA was not fully operational by the target date (the first pilot had only been launched in January 2018); yet, the associated result --- the increase in the number of digital transaction accounts by end-June 2018 --- was to be attributed to the DTA scheme. There is no information to indicate that the Ministry of Finance flagged this issue during M&E implementation.

c. M&E Utilization

According to the Program Document (page 14), the reforms supported by the operation were "medium term in nature" and, hence, the full results would "materialize in the medium term". The program results indicators and M&E data would, therefore, be useful for measuring and understanding the impact of the reform program over time.

M&E Quality Rating

Substantial

10. Other Issues

a. Environmental and Social Effects

Environmental Effects: The Program Document (pages 26 and 38) stated that the reform program supported by the operation either had no negative or some positive effects on the environment. Specifically, actions to improve access to finance and to enhance financial sector transparency had no negative environmental effects. Meanwhile, actions to foster long-term finance were expected to have positive environmental effects: the approval of the National Infrastructure Finance Policy (prior action 5) and the issuance of prudential regulations for long-term finance (prior action 6) called for considering environmental impacts in decisions to approve and finance infrastructure projects. The document noted than an advisory team from the IFC had engaged the State Bank of Pakistan in developing policies, guidelines, and best practices for financial institutions to implement "green financing" initiatives. The ICR does not cite any environmental issues with the operation.

Social Effects: The Program Document (pages 26 and 38) stated that actions to improve access to finance and to enhance transparency in the financial sector had positive poverty and social impacts. Improving access to finance would support poverty reduction and shared prosperity, as access to finance was low in Pakistan, particularly among the poor (only 4.2 percent of poor households had bank deposits, compared to 12.1 percent among the non-poor), women (only 4.8 percent had access to the formal financial sector, compared to an average 37.4 percent elsewhere in South Asia), and micro, small- and medium-scale enterprises. Enhancing transparency in the financial sector would also have positive welfare effects, specifically: (a) implementation of the DTA scheme would offer financial products through convenient access points; (b) allowing NSS returns to be coursed through bank accounts would integrate the NSS with the formal financial sector; and, (c) fulfilling the FATF recommendations on financial market integrity would help contain the cost of remittances to Pakistan. The ICR (pages 26-27) reiterates these claims: increasing digital financial services, providing deposit protection, and linking the NSS to the banking system would foster financial inclusion, which remained important for poverty reduction, and for gender and social development. The ICR does not quantify these impacts resulting from the operation, however.

b. Fiduciary Compliance

Public Financial Management: According to the Program Document (pages 26-27), the government had prepared a Public Financial Management (PFM) reform strategy focused on mitigation PFM risks, which for the operation was deemed "substantial". The Pakistan Federal Government Public Expenditure and Financial Accountability (PEFA) Update of 2012 had identified weaknesses in PFM, although it noted that recent changes had been positive, with the country's PEFA scores comparing favorably with those of other countries in the South Asia region. Moreover, recent actions by the federal and provincial governments reflected strong overall commitment to PFM reform. The ICR does not cite any PFM issues with the operation. The operation followed standard Bank agreements, funds flow arrangements, and disbursement procedures for development policy credits.

c. Unintended impacts (Positive or Negative)

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d. Other

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11. Ratings

Ratings	ICR	IEG	Reason for Disagreements/Comment
Outcome	Moderately Unsatisfactory	Moderately Unsatisfactory	---
Risk to Development Outcome	Substantial	Substantial	---
Bank Performance	Moderately Satisfactory	Moderately Satisfactory	---
Borrower Performance	Moderately Unsatisfactory	Moderately Unsatisfactory	---
Quality of ICR		Substantial	---

Note

When insufficient information is provided by the Bank for IEG to arrive at a clear rating, IEG will downgrade the relevant ratings as warranted beginning July 1, 2006.
The "Reason for Disagreement/Comments" column could cross-reference other sections of the ICR Review, as appropriate.

12. Lessons

Three lessons are drawn from the ICR (page 30), with some adaptation.

Follow-on steps to prior actions of a development policy operation (DPO) should be made explicit in the

Program Document and agreement for their effective and timely implementation should be secured from the government. In this operation, the Federal Board of Revenue needed to issue the rules and regulations (a follow-on step) to implement the Benami Transactions Prohibition Act which was passed by Parliament in 2017 (a prior action), before the government could establish an adjudication authority for Benami transactions (a results target). The Federal Board of Revenue did not issue the implementing rules and regulations until after the program closing date. Pakistan's compliance with FATF Recommendation 1 (a results target) required not just the conduct of a AML/CFT National Risk Assessment (a prior action) but the completion of an AML/CFT Mutual Evaluation Report (a follow-on step), which was not delivered until after the program closing date.

The Bank should be cognizant of the risks of undertaking DPO actions close to an election date and devise better mitigation measures to address political risk. In this operation, general elections (for all members of the National Assembly in 272 constituencies and for all members of the provincial assemblies in 4 provinces) were held in July 2017, three months after the operation became effective, which meant that preparations for the elections diverted the government's focus on completing the follow-on steps to the program's prior actions. Political exigencies also appear to have led the government to slacken on policy reforms that would have maintained the adequacy of the macroeconomic framework for the operation.

Results indicators should be designed more robustly, with attribution issues explicitly considered in the choice of targets. In this operation, the increase in the size of the deposit base was to be attributed purely to the passage of the Deposit Protection Corporation Act, with the effects of other explanatory factors ignored in the calculation. A better attribution approach would have been: (a) forecast the increase in the size of the deposit base, with GDP growth as an explanatory variable, and (b) attribute only the deviation from trend (the difference between the actual size of the deposit base and the forecast size) to the policy action.

13. Assessment Recommended?

No

14. Comments on Quality of ICR

The ICR offers a comprehensive record of the program. It provides a succinct historical account of economic and financial sector reforms pursued by government since 2013, and Bank and IMF support for these efforts (paragraphs 1-5, pages 9-10 and Annex 1, page 32); clearly explains the macroeconomic context in which the financial sector reform program was set (paragraphs 6-9, pages 10-12, and Annex 5, page 36); details the problems with financial access, long-term finance, and financial market integrity at which the policy pillars were directed (paragraphs 11-23, pages 14-17); lists the analytic underpinnings of the policy actions (Annex 6, page 37, and Annex 4, page 35), and links the policy actions to their associated results and their respective targets (Table 2, pages 13-14), thus delineating the results chain for the operation.

The ICR is candid in its assessment of the outcome of the program. It raises questions about the attribution of at least two of the results targets to their associated prior actions (the increase in the number of digital transactions accounts and the approval of the DTA scheme, the increase in the deposit base of the banking system and the passage of the Deposit Protection Corporation Act). It also cites problems with the data used to cite baseline numbers (the number of NSS accounts) and to calculate quantitative targets (the percentage of NSS profits distributed through bank accounts). Moreover, it discusses at length outstanding issues, particularly with the targets that were not met by the program closing date (the increase in the percentage of long-term loans, the formation of an adjudicating body for Benami transactions, compliance with FATF Recommendation 1, and the division of the positions of chairman and CEO of the SLIC).

There are moderate deficiencies with the ICR, however.

- The ICR confines the rating and discussion of the government's performance to its actions on economic reform --- privatization, tariffs, the exchange rate, income tax thresholds, fiscal exemptions, the FY2018 Budget, and the IMF program. These are important for setting the macroeconomic framework for the operation, but the rating and the discussion ought to focus on government's performance relative to the objective and policy areas of the program --- access to finance, long-term finance, and financial sector transparency. No mention is made of the prior actions or the follow-up measures to the prior actions.
- The ICR (page 5) rates the performance of the implementing agency, the Ministry of Finance, as moderately unsatisfactory, but offers no discussion to justify this rating.
- The ICR (pages 22-25) uses rating terminologies for relevance and efficacy (e.g. satisfactory, moderately satisfactory, …, highly unsatisfactory) that do not follow OPCS guidelines (should be: high, substantial, …, negligible).

a. Quality of ICR Rating

Substantial