Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 16-Dec-2020 | Report No: PIDC237119

BASIC INFORMATION

A. Basic Program Data

Country	Project ID	Parent Project ID (if any)	Program Name
Pakistan	P175727		KP- Spending Efficiently for Enhanced Development
Region	**Estimated Appraisal Date**	**Estimated Board Date**	**Does this operation have an IPF component?**
SOUTH ASIA	12-Feb-2021	22-Apr-2021	Yes
Financing Instrument	**Borrower(s)**	**Implementing Agency**	**Practice Area (Lead)**
Program-for-Results Financing	Islamic Republic of Pakistan	Finance Department, Government of Khyber Pakhtunkhwa	Governance

Proposed Program Development Objective(s)

To strengthen KP's capacity to manage public resources, and improve resource availability and accountability for delivery of education and health services.

COST & FINANCING

SUMMARY (USD Millions)

Government program Cost	1,000.00
Total Operation Cost	625.00
Total Program Cost	600.00
IPF Component	25.00
Total Financing	625.00
Financing Gap	0.00

FINANCING (USD Millions)

Total World Bank Group Financing	400.00
World Bank Lending	400.00

Total Government Contribution	225.00

Concept Review Decision

The review did authorize the preparation to continue

B. Introduction and Context

Country Context

1. **Pakistan is at a crossroads as it deals with the coronavirus (COVID-19) pandemic.** Periodic macroeconomic crises and a low human capital basis have constrained the country's growth prospects. Between FY2000–FY19, annual economic growth in Pakistan averaged around 4.3 percent, below the South Asian annual average of 6.2 percent. Low investment in human capital, slow progress of structural reforms, low private investment, and slow export growth, among others, have hindered growth prospects. The country was making good progress in stabilizing its economy and implementing much needed structural reforms. However, the COVID-19 pandemic has had significant negative impacts on the economy. Real GDP growth (at factor cost) is estimated to have declined from 1.9 percent in FY2019 to -1.5 percent in FY2020, the first contraction in decades, reflecting the effects of COVID-19 containment measures that followed monetary and fiscal tightening prior to the outbreak. Due to significant uncertainty over the evolution of the pandemic, demand compression measures to curb imbalances, along with unfavorable external conditions, Pakistan's near-term economic prospects are subdued. Economic growth is projected to remain below potential, averaging 1.3 percent for FY2021–22.

2. **In response to the outbreak of COVID-19 in Pakistan, the government announced a fiscal stimulus package of approximately US$7.5 billion[1] (equivalent to 2.6 percent of GDP).** This aims to: (a) support the medical health sector in combatting the spread of the virus and providing relief to those affected; (b) implement social welfare measures to support the poor and vulnerable whose livelihoods have been affected by the economic slowdown and partial lockdowns across the country; and (c) provide stimulus to businesses and industries to protect productive assets during the economic downturn. The financing of the response package comprises approximately US$2.5 billion of additional resources and a re-appropriation from the existing budget. Pakistan has also availed of the Debt Service Suspension Initiative (DSSI) and expects US$1.8 billion to US$2.4 billion in temporary fiscal space due to the debt service standstill during the period May 1 to December 31, 2020 from bilateral creditors, including the G20, and its extension through 2021. The country has committed to use the created fiscal space for additional social, health, or economic spending and follow the disclosure and other requirements of the DSSI.

3. **Human capital accumulation is low, and the impact of COVID-19 pandemic puts at risk some of the gains made in recent years.** According to the World Bank Human Capital Index (HCI), if no improvements in health and education service delivery take place, a Pakistani child born today is expected to be only 40 percent as productive as s/he could be by age 18. With a large share of births taking place outside health facilities (33.8 percent), and low immunization rates (65.6 percent) children are deprived of a strong start to life. High rates of malnutrition and low learning outcomes contribute to the country's low HCI: 37.6 percent of Pakistani children under age five are stunted; and learning poverty is

[1] Estimated USD equivalent for PKR 1.2 trillion stimulus package.

very high with 75 percent of Pakistani children not being able to read and understand a short age-appropriate text by age 10.

4. **Khyber Pakhtunkhwa (KP) province has made progress in transitioning out of vulnerability and crises, leading to substantial poverty reduction.** KP's incidence of poverty fell from 73.8 percent in FY02 to 27 percent in FY14, the largest decrease in any province in Pakistan. The province still faces service delivery challenges in both health and education despite recent improvements. It is also one the most affected by the COVID-19 pandemic with over 1000 pandemic related deaths (as of November 2020) and close to 1.2 million pushed out of employment.

Sectoral (or multi-sectoral) and Institutional Context of the Program

5. **The GoKP has made progress in revenue mobilization and management of public finances, but several challenges remain to be addressed**: policy-driven planning and budgeting; comprehensive, credible, and transparent budget; predictability and control in budget execution; resource mobilization; asset and liability management; and accountability for results. The GoKP is already taking steps to address issues related to mobilizing resources and managing public resources through both legislation (for example, the Local Government Act 2013) and policy (for example, through a notification requiring the consolidation of Government funds into the TSA). The GoKP intends to deepen these successes through additional investment to address three recurring problems. These problems include <u>poor quality of spending related to weak fiscal management;</u> <u>increased fiscal risks associated with large pension spending and subvention to autonomous bodies and Public Sector Enterprises(PSEs);</u> and <u>unattractive investment climate and business environment resulting from regulations and procedural bottlenecks.</u> The immediate result of these problems is poor service delivery and low sector outcomes, a shrinking fiscal space, and an unattractive investment climate.

6. **A large and increasing pension bill poses a considerable fiscal challenge for the Government of Khyber Pakhtunkhwa as will likely crowd out public investment and other necessary public expenditure.** Civil Service pension expenditures increased from about 3.2 percent of provincial fiscal revenues in 2009-10 to 20.6 percent in 2017-2018. While KP government increased the retirement age in 2019 (from 60 years to 63 years) to defer pension costs to the medium-term, this decision was overruled by the courts. The authorities are considering parametric reforms (e.g. automatic inflation indexation instead of ad hoc wage indexation, gradually extending the wage base from the current final wage, and requiring workers with 25 years of service to reach age 55 to retire). The authorities are also considering the pros and cons as well as the institutional requirements for establishing a contributory defined contribution scheme to mitigate long-run pension payments.

7. **Fiscal risks also materialize through unbudgeted in-year payments to autonomous bodies and Public Sector Enterprises (PSEs) annually. Overall, subventions to PSEs accounted for [10] percent of the GoKP's 2020/21 budget**. KP does not have a policy to guide expenditure and injections to autonomous bodies and PSEs, which can help mitigate some of the fiscal risks over the medium-term and allow for better budgeting for the payments made to these organizations and institutions. Regulatory framework for monitoring and oversight of these bodies and companies is weak due to a lack of a legal framework, and absence of institutional framework to oversee performance and financial compliance, particularly of Section 42 companies and autonomous bodies and authorities. Many such bodies and companies do not regularly prepare their annual financial statements and there is no oversight mechanism on the budgetary performance, including for development schemes managed by public sector enterprises. The lack of transparency and accountability in the governance of these bodies and PSEs is further compounded by the weak corporate governance arrangements within these institutions.

8. **Business regulation in KP, as in much of Pakistan is complex and presents substantial regulatory risks to investment.** One of the biggest cross-cutting constraints in the provincial regulatory governance is the lack of automation and transparency of compliance. It causes inconsistent interpretation and application of regulation. The resultant onerous

and discretionary enforcement not only increases administrative burden on compliant firms but also compounds regulatory risks and incentives to avoid and evade compliance. However, KP is first province in Pakistan to have already made impressive strides in regulatory reforms by revamping the municipal licenses adopting a risk management approach and reducing cost of compliance by waiving off application fees. This effort can be readily expanded to modernize and automate all entry and operational level business registrations, licenses, no-objection certificates and permits which will contribute to transparency in regulatory governance. It will also require institutionalization of the reform effort for sustainability.

9. To address these problems, the GoKP has prepared a strategic framework aligned with the themes of its Economic Recovery Plan (ERP), *Azm-e-Nau* (Spirit of Khyber Pakhtunkhwa).[1] The ERP designed to respond to the COVID 19 pandemic is supported by the revised *PFM Reforms Strategy* and the *Good Governance Strategy*. This strategic framework is designed to tackle the upstream structural weaknesses in the management of public resources as well as the downstream operational issues in PFM to achieve efficiency savings, timely budget execution, and accountability mechanisms to reduce the risk of mismanagement of funds. In addition, the strategy envisions accelerated digitization of business processes, including e-procurement, and delivery of e-services to citizens and firms to ensure business continuity during emergencies. Sector level strategic documents also provide a roadmap for addressing service delivery deficiencies in the education sector (KP Education Blue Print 2018-2023) and the health sector (KP public health forecasting and supply chain strategy 2017-2022).

Relationship to CAS/CPF

10. The Program supports the twin goals by helping KP to increase efficiency in its public expenditure, close its large tax gap and create fiscal space for growth-enhancing expenditures on infrastructure and human capital. It supports CPS Results Area 4 on *Service Delivery*, and specifically Objective 4.1: *Improved Public Resources Management*, which aims to help the Government mobilize revenue and improve public expenditure to create fiscal space for spending on public services and infrastructure.[2] Additionally, it complements the Country Private Sector Diagnostic (2020) and Country Private Sector Diagnostic (2020) which aims to address complex and non-transparent regulatory regime for improving sector level investment competitiveness for which provincial level business environment reforms are vital. Pakistan Systematic Country Diagnostic (2020) identified these reforms as essential for improving the quality of provincial level investment climate. The Program is also aligned with the key IDA 18 theme on Governance, and the Sustainable Development Goal 16 on governance and institutions. The Program also directly contributes to two of the five key priorities of the flagship report *Pakistan @ 100,* namely (i) better governance, transparency and accountability to provide enabling environment for growth and reforms through PFM, service delivery, use of information communication and technology (ICT) skills and human resource management in the public sector, and devolution to local governments; and (ii) [3]tax revenue generation to finance public investment and minimize borrowing from commercial banks. Finally, the Program is consistent with the WBG's response to the COVID-19 crisis. In the wake of COVID-19, the Program has incorporated the use of ICT to support service delivery during the pre and post recovery while also supporting reforms to improve the management of emergencies.

Rationale for Bank Engagement and Choice of Financing Instrument

[1] Government of Khyber Pakhtunkhwa (2020). *The Spirit of Khyber-Pakhtunkhwa-Economic Recovery Plan*. Peshawar: Planning & Development Department.

[2] World Bank Group (2014). *Islamic Republic of Pakistan: Country Partnership Strategy, 2015-2020* (Report No. 84645-PK), discussed by the Executive Directors on May 1, 2014, and extended by the Performance and Learning Review (Report No. 113574) distributed to the Executive Directors on an absence-of-objection basis with a closing date of June 15, 2017.

[3] World Bank (2019). *Pakistan@100: Shaping the Future.* Washington, DC: World Bank.

11. **The proposed operation is an integral part of the World Bank's whole-of-country approach to strengthen PFM systems at the federal and provincial levels.** The Bank will support the GoKP's ambitious efforts to improve its PFM system as part of KP's Public Financial Management Strategy. This project advances some of the areas supported under the Multi-Donor Trust Funded Governance and Policy Project which closes in 2022. Under this project, the Bank is already providing technical assistance in preparation of the PFM law, pension forecasting, revenue mobilization, public investment management and citizen engagement. The Bank's global knowledge in public expenditure management, including pension management, will provide the much-needed expertise that GoKP requires to address systemic public expenditure inefficiencies that undermine its fiscal strategy. Through the proposed operation the GoKP intends to improve its spending quality by sealing the administrative and policy loopholes that undermine sector level performance, and to create fiscal space by tackling long standing fiscal problems arising from pension costs and subvention to public sector enterprises. Moreover, engagement of the Bank under this project also leverages the Bank's existing engagements in health and education to improve KP's human capital under the Human Capital Project. This is even more urgent now given the need to efficiently channel resources to address the COVID 19 pandemic. The proposed operation focuses largely on PFM related bottlenecks that undermine health and education sector performance. Collaboration with the IFC brings additional expertise in areas of business regulation and investment climate reforms as KP gears itself to increase its own source revenue, another important elements of KP's PFM reforms that the Bank currently supports.

12. **The proposed Program will utilize the Program for Results (PforR) instrument with a Technical Assistance (TA) component.** Lesson learnt from a similar PforR – KP Revenue Mobilization and Public Resource Management Program – show that this is the most suitable instrument to reinforce the strong government ownership and sustain implementation momentum. The instrument also reinforces the results orientation of the GoKP's program which requires milestones for timely and consistent implementation, and provides incentives for behavioral change, institutional strengthening, and flexibility in undertaking complex tasks such as redesign of business processes. The proposed instrument also takes account of KP's experience in implementing results-based operations including the KP Revenue Mobilization and Public Resource Management Program, which became effective in 2019. The use of this instrument will facilitate sustained dialogue and coordination of support by development partners active in PFM and related areas while also enhancing collaboration of various stakeholders in KP. The proposed TA component is needed to finance specific expenditures for ICT investments and institutional capacity building in challenging areas such as business process re-engineering and database integration.

Program Development Objective(s)

To strengthen KP's capacity to manage public resources for improved delivery of selected services to citizens and firms.

PDO Level Results Indicators

13. **The following results indicators will measure the achievement of the PDO (PDO indicators):**

a. Reduction in proportion of government schools without basic facilities (%)
b. Average availability of selected essential medicines in primary health care facilities (%)
c. Reduction in combined budget allocation for pension and subsidies to PSEs as a share of provincial fiscal revenues (%)
d. Reduction in time for complying with business regulations (%)

e. Increase in citizens reporting satisfaction with delivery of health and education services in public facilities (%)

PforR Program Boundary

14. The Government program supported by the proposed project is drawn from following strategic documents: Economic Recovery Plan (ERP); Good Governance Strategy; Public Financial Management Reform Strategy; KP- Public Health Forecasting and Supply Chain Strategy and KP Education Sector Plan. These activities are to be implemented during the period 2021-2026. The Program for Results ("big P") comprises elements drawn from these strategic documents to be implemented during the period 2021-2026 amounting to US$ 600million. The Bank will finance a portion of the Program (big P") to the tune of US$375million or 63 %, and the GoKP will finance the balance.

15. The corresponding Result Areas under the proposed Program are as follows:

- **Result Area 1: Spending better and transparently for improved service delivery:** This RA will support better allocation and execution of the budget in education and health sectors with a focus on improving facilities for service delivery.
- **Result Area 2: Managing fiscal risks for increased fiscal space:** The RA will support management of fiscal risks associated with PSEs in the province as well as the cost of pensions for provincial civil servants.
- **Result Area 3: Facilitating citizens and firms for improved business environment:** The RA will support improvements in business regulations and digital payments for ease of doing business between citizens and governments and within government.

16. An Investment Project Financing (IPF) component will provide inputs designed to advance implementation of several activities by the GoKP through Technical Assistance (TA). The TA will be provided in three sub-components as follows:

- **Digitizing government for business continuity—**support digitization and e-solutions for payment, procurement, and supply chain management. TA will also support establishment of business portal and investor information system.
- **Strengthening systems for public expenditure management—**support capacity for public expenditure management, including strengthening internal audit, pension management, corporate governance of Public Sector Enterprises; and citizen engagement.
- **Program Implementation—** support coordination for implementation, including Third Party Verification as well as staffing and equipment for the Shared Services Unit for Program Management.

E. Initial Environmental and Social Screening

17. Preliminary environmental risk assessment of the TA interventions indicates that environmental impact are mostly related to e-waste generated at the end of the useful life of electric and IT equipment and its subsequent recycling and disposal of the equipment purchased under the project. These impacts will be mitigated by developing and adopting an E- Waste Management Plan applicable throughout this ITC life cycle. Besides these, the project does not involve any civil works nor operations in protected areas. Consequently, the project environmental risk rating is proposed as Low. The environmental and social systems assessment (ESSA) including consultation on and disclosure of the draft systems assessment will be conducted before Appraisal.

Legal Operational Policies	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Areas OP 7.60	No

Summary of Screening of Environmental and Social Risks and Impacts of the IPF Component

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