

**PAKISTAN**  
**COUNTRY PARTNERSHIP STRATEGY FY 2010-2013**

**EXECUTIVE SUMMARY**

i. During the previous CAS period strong growth and rapid poverty reduction through 2007 stalled as the economy faced crisis in 2008. An ambitious reform program of the government elected in 2008 has reduced the fiscal and, in particular, the external current account deficit, increased GDP growth, restored foreign exchange reserves, and reduced inflation. The reforms have also resulted in a significant increase in power tariffs along with an automatic pass through of international fuel prices. The government still has more work to do in a difficult security environment to further reduce inflation and the fiscal deficit, particularly to eliminate the large losses of public sector entities in the power, transport and manufacturing industries, and increase public revenues through the introduction of a value added tax and better tax administration. The country's top leadership is cognizant of this and is committed to continue spearheading reforms in these areas.

ii. The Government's strategy focuses on regaining macroeconomic stability after the economic crisis and on structural reforms required to support the recovery of strong and sustainable growth. The overall vision of PRSP-II is to steer Pakistan's economic growth back to the range of 5-7 percent per year by stimulating growth in the production sector; creating adequate employment opportunities; improving income distribution; and harnessing the country's economic competitiveness through economic liberalization, deregulation and transparent privatization. The strategy recognizes that to steer Pakistan back on a path of broad-based growth, create jobs, and reduce poverty, a prolonged period of macroeconomic stability, financial discipline and sound policies is required.

iii. **Lessons Learned from the Previous CAS.** The CPS reflects lessons learned from the Bank's past engagement in Pakistan. In particular, the need to adapt to a rapidly changing political and security environment during implementation of the FY06-09 CAS highlights the need for flexibility. In addition, the proposed CPS will focus more on the longstanding structural problems (like tax revenue mobilization and power) that contributed to the rapid erosion in growth and stability during 2007 and 2008. Reflecting the need for greater realism, the proposed CPS outlines a less ambitious priority IBRD/IDA lending program while leaving open the possibility of doing more should conditions permit. Finally, given Pakistan's unique development and geopolitical challenges, enhanced partnership arrangements are critical.

**Bank Group Assistance Strategy**

iv. This CPS seeks to support Pakistan to address some of the major institutional, policy and financing constraints on its capacity to achieve and sustain high economic growth rates, to manage conflict and to improve the social indicators and capacity of its population. The World Bank Group's support to Pakistan will be organized around four pillars: (i) improving economic governance; (ii) improving human development and social protection; (iii) improving infrastructure to support growth; and (iv) improving security and reducing the risk of conflict.

v. **Improving Economic Governance.** Addressing the shortcomings of Pakistan's economic management is critical not only for restoring macroeconomic stability but also for reducing the likelihood of reversals leading to another cycle of growth giving way to stagnation. Enhancing domestic revenue mobilization will be the urgent priority during the CPS period. Strengthening public expenditure management at all levels of government will complement this focus. The strategy also focuses on governance of markets with a view to strengthening Pakistan's competitiveness by addressing barriers to competition, and factor market rigidities (including constraints in access to finance). The World Bank will support improvements in the legal and policy framework for growth through a analytical work and

policy-based lending. Through A AA and policy dialogue the Bank will support increased efficiency, competition and broadening of financial markets as well as improvements in financial infrastructure. An integral part of IFC's strategy in Pakistan is to increase access to finance to underserved groups, especially micro, small, and medium enterprises (MSMEs) by strengthening financial intermediation and business management and corporate governance practices at enterprise level.

vi. ***Improving Human Development and Social Protection.*** Improvement in human development, including social protection, is critical to the goal of building resilience at the level of families and individuals. The focus of Bank Group efforts will be to support increased spending on human development along with reforms to improve governance and accountability in the provision of services with the level of Bank closely tied to the achievement of agreed results under specific programs. There will be enhanced attention to assessing and addressing the needs of vulnerable groups among the poor, such as women and displaced people. In education, the CPS will support government programs that combine supply side interventions and demand-side measures to improve access to education with a focus on equity to address regional and gender imbalances. In social protection, the Bank will sustain its partnership with the Government in establishing the Benazir Income Support Program (BISP) as the country's national safety net program with a focus on increasing its targeting efficiency and strengthening its operation. IFC will continue to explore opportunities for investment in private health and education sectors. Particular emphasis will be given to promoting public-private partnerships, wholesaling through financial intermediaries, and technical and vocational education.

vii. ***Improving Infrastructure to Support Growth.*** At present, power is the most pressing need in infrastructure and the Bank Group will support adoption of policies to bring about financial sustainability, expansion of generation in a least cost manner, and improvement in the efficiency of transmission and distribution. A significant increase in IBRD lending is envisioned to support enhanced power generation. IFC will support development of the power sector with a focus on supporting privatization of utility and distribution companies, improving of utility efficiency and promoting energy efficiency, as well as development of renewable power generation (hydro and wind generation). IFC will be a significant investor in transport and logistics. In agriculture, the strategy envisions technical assistance to help Pakistan in agricultural policy analysis and design with a view to increasing agricultural competitiveness and expanding rural livelihoods. IFC will explore investment opportunities in agribusiness (including warehousing and logistics), and support agribusiness SMEs through financial intermediaries.

viii. ***Improving Security and Reducing the Risk of Conflict.*** The persistence of conflict in KP and FATA poses a threat to some of the most vulnerable and marginalized populations in Pakistan, while also challenging economic stability across the country. The absence of employment opportunities and inadequate livelihoods in FATA and KP has created a favorable environment for militant groups whose economic incentives for potential recruits greatly outweigh available opportunities while political and governance deficits, including weaknesses in the justice system, perpetuate a historical experience of disenfranchisement, alienation, corruption, poverty and underdevelopment that have fuelled the crisis. Bank support will be guided by the results of a Post Crisis Needs Assessment (PCNA) which is now underway. This is a highly complex area, and the Bank's knowledge is evolving but limited. We will, however, make this a major thrust of our work. Support under the CPS may include support for agricultural/livestock-linked employment and livelihoods, expansion of general and technical/vocational education, investment in energy and transport, and social protection. In addition, the strengthening of local government will also be a focus to enhance the legitimacy of the state and counter the claim to legitimacy by militant groups as a viable alternative to the state.

## **Implementing the Strategy**

ix. Recognizing the challenges and uncertainties facing Pakistan in the coming few years, the strategy emphasizes a more focused prioritization on key outcomes with flexibility to enable the Bank

Group to meet emerging challenges and opportunities. Hence within the overall strategic framework outlined above, the strategy will prioritize Bank support as follows: First, the CPS gives special focus to the achievement of those outcomes that have the potential to be truly transformational. These outcomes are deemed to be pivotal to the sustained achievement of most of the rest of PRSP-II objectives and CPS outcomes and will be the areas where the Bank Group will concentrate much of its efforts. Pakistan cannot effectively build the foundation to make headway on exploiting its strategic advantages and endowments in the medium to long-term without successfully addressing these very basic issues. These objectives are by no means easy – indeed, many of them represent longstanding challenges where progress has been incremental, at best. In these areas the CPS envisions a full range of services including AAA, IBRD/IDA financing and, where appropriate, MDTF resources for the conflict affected region. These transformational outcomes are:

- ***Strengthening Tax Policy and Administration:*** raising the ratio of tax to GDP (currently only 10.2 percent of GDP) is absolutely essential if Pakistan is to have the resources to invest in human development and infrastructure, and if it is to build resilience to future shocks and guard against costly and disruptive growth reversals.
- ***Expanding Power Provision:*** reforming the power sector and ensuring sustainable expansion of supplies is absolutely essential if industrial and service activity is to be increased and productivity raised.
- ***Addressing Security:*** coping with the consequence of conflict while reducing the prospects of future conflict is essential for long term growth. This is a highly complex area, and the Bank's competence and knowledge is evolving but limited. We will, however, make this a major thrust of our work, giving emphasis to service provision and job creation in highly vulnerable areas, (and drawing upon emerging findings from the WDR and from work in Pakistan).

x. Second, in addition to these transformational priorities, the strategy identifies a core program of support to improve educational and health outcomes, strengthen the potential for increased and more productive labor force participation, reinforce safety net systems and enhance the earning capacity of the poor and vulnerable. These objectives relate directly to key elements of the MDGs and related social outcomes and indicators. The core program also includes selected investments in ports, water management and financial management.

xi. These two areas comprise the priority lending program to be financed during the CPS. Finally, the CPS envisages the potential for the program to expand beyond this priority program to address key challenges which do not meet all of the selectivity criteria but where the Bank would like to support the government to lay the basis for interventions to successfully address significant development challenges. Such challenges include fostering livability and economic growth and dynamism within Pakistan's major cities and rapidly growing urban settlements, and strengthening fiscal management in Pakistan's provinces. The CPS will support such activities where the individual programs are ready and the prospects for success and results are strong. We will also link expansion of the overall lending program beyond the priority program to progress being made against the objectives of the transformational activities. The above approach to engagement with Government under the CPS emphasizes exercising selectivity in what we can firmly undertake to do effectively while not foregoing the option to do more, if conditions permit. It should allow for more effective use of our resources under the uncertain conditions we expect to continue to face in Pakistan.

xii. In line with the need for selectivity, the proposed CPS also identifies sub sectors and thematic areas where the Bank will not lend. In the energy sector, given our limited resources and capacity, the Bank will not engage in coal. On governance, the Bank will play only a supporting role with partners

leading in the areas of civil service and judicial reforms. In agriculture, the strategy envisages providing analytical support to formulate strategies and policies to increase value-added in the sector. We may extend this role to supporting the government to develop program platforms that may serve as vehicles for other development partners to provide financing to the sector, subject to demand from government and partners. Finally there are sectors, like highways, where risks are such that the Bank Group will not engage pending significant improvement in institutional governance or strong measures being taken by Government to mitigate risks, including fraud and corruption risks.

xiii. The priority lending program amounts to an estimated \$3.7 billion (IBRD/IDA) through FY12, equivalent to about 60 percent of a total potential lending envelope of up to \$6.0 billion during the 4 year CPS period (FY10-13). IFC intends to invest between \$1.3 and \$1.5 billion provided that the economic and security situations do not deteriorate significantly, and will continue with its robust program of Advisory activities. The Bank on behalf of development partners will administer complementary grant financing of at least \$100 million for the MDTF for the Northwest Border Region. This amount may increase depending on developments in the region and results achieved.

### **Risks and Mitigation**

xiv. Given the serious and multifaceted challenges that Pakistan faces, this CPS poses greater than normal risks. The FY10-13 CPS will be implemented in the context of economic austerity with the potential for policy reversal as well as other uncertainties. Notably, although Pakistan has made much progress in stabilizing the economy, reviving growth of GDP, exports and foreign exchange reserves and reducing inflation and the current account deficit, the fiscal situation remains vulnerable and inflation high and hence there is a risk of macroeconomic slippage. In addition, ongoing conflict within Pakistan and in Afghanistan poses a risk to stability while proposed Bank Group activities in the conflict-affected northwest greatly increase the Bank's exposure to such risks. Finally, there are implementation risks which impact the Bank Group's program. The Bank Group will seek to mitigate these risks through proactive measures to reduce exposure of staff to security risks and through alternative means of supervision along with continued attention to capacity building and robust fiduciary arrangements such as those involving third-party monitoring. By design, the Bank program is largely structured to be dependent on results, with disbursements for a significant part of priority program and commitments against the contingent part of the overall program firmly dependent on program and results achieved during implementation.