ADB

Report and Recommendation of the President to the Board of Directors

Project Number: 47015-002
October 2015

Proposed Policy-Based Loans for Subprogram 2 Islamic Republic of Pakistan: Sustainable Energy Sector Reform Program

Asian Development Bank

CURRENCY EQUIVALENTS
(as of 15 October 2015)

Currency unit	–	Pakistan rupee/s (PRe/PRs)
PRe1.00	=	$0.0096
$1.00	=	PRs104.4500

ABBREVIATIONS

ADB	–	Asian Development Bank
CPPA	–	Central Power Purchasing Agency
CPPAG	–	CPPA Guarantee
CPS	–	country partnership strategy
DISCO	–	distribution company
ECC	–	Economic Coordination Committee
GENCO	–	generation company
IMF	–	International Monetary Fund
IPP	–	independent power producer
JICA	–	Japan International Cooperation Agency
MOWP	–	Ministry of Water and Power
MPNR	–	Ministry of Petroleum and Natural Resources
NEPRA	–	National Electric Power Regulatory Authority
NTDC	–	National Transmission and Despatch Company
PCU	–	program coordination unit
PHCL	–	Power Holding Company Limited

NOTES

(i) The fiscal year (FY) of the Government of Pakistan ends on 30 June. “FY” before a calendar year denotes the year in which the fiscal year ends, e.g., FY2014 ends on 30 June 2014.

(ii) In this report, “$” refers to US dollars.

Vice-President	W. Zhang, Operations 1
Director General	S. O'Sullivan, Central and West Asia Department (CWRD)
Director	F. Kawawaki, Energy Division, CWRD
Team leader	L. Mtchedlishvili, Senior Energy Specialist, CWRD
Team members	Z. Abbas, Senior Environment Specialist, CWRD
	S. Ali, Senior Project Officer (Financial Sector), CWRD
	S. Bhandari, Principal Economist, CWRD
	M. Endelman, Principal Financial Sector Specialist, CWRD
	F. Golez, Senior Operations Assistant, CWRD
	Y. Inoue, Finance Specialist (Energy), CWRD
	E. Khattak, Senior Project Officer (Energy), CWRD
	V. Medina, Social Development Specialist (Safeguards), CWRD
	D. Perkins, Senior Counsel, Office of the General Counsel
	A. Tareen, Senior Energy Specialist, CWRD
Peer reviewer	P. Wijayatunga, Principal Energy Specialist, South Asia Department

CONTENTS

PROGRAM AT A GLANCE

1. Basic Data

Project Number: 47015-002

Project Name	Sustainable Energy Sector Reform Program - Subprogram 2	**Department /Division**	CWRD/CWEN
Country	Pakistan	**Executing Agency**	Ministry of Finance
Borrower	Islamic Republic of Pakistan		

2. Sector

Sector	Subsector(s)	ADB Financing ($ million)
✓ **Energy**	Energy sector development and institutional reform	400.00
	Total	**400.00**

3. Strategic Agenda

Strategic Agenda	Subcomponents
Inclusive economic growth (IEG)	Pillar 1: Economic opportunities, including jobs, created and expanded

Climate Change Information

Climate Change impact on the Project	Low

4. Drivers of Change

Drivers of Change	Components
Governance and capacity development (GCD)	Anticorruption Client relations, network, and partnership development to partnership driver of change Institutional development Institutional systems and political economy Organizational development Public financial governance
Knowledge solutions (KNS)	Knowledge sharing activities
Partnerships (PAR)	International finance institutions (IFI) Official cofinancing
Private sector development (PSD)	Conducive policy and institutional environment

Gender Equity and Mainstreaming

No gender elements (NGE)	✓

5. Poverty Targeting

Project directly targets poverty	No

Location Impact

Nation-wide	High

6. Risk Categorization: Complex

7. Safeguard Categorization

Environment: C **Involuntary Resettlement:** C **Indigenous Peoples:** C

8. Financing

Modality and Sources	Amount ($ million)
ADB	**400.00**
Sovereign Programmatic Approach Policy-Based Lending (Loan): Asian Development Fund	300.00
Sovereign Programmatic Approach Policy-Based Lending (Loan): Ordinary capital resources	100.00
Cofinancing	**500.00**
World Bank	500.00
Counterpart	**0.00**
None	0.00
Total	**900.00**

9. Effective Development Cooperation

Use of country procurement systems	Yes
Use of country public financial management systems	Yes

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on proposed policy-based loans to the Islamic Republic of Pakistan for subprogram 2 of the Sustainable Energy Sector Reform Program.[1]

2. The programmatic approach and subprogram 1 were approved on 24 April 2014 in support of the 2013 National Power Policy of the Government of Pakistan, which seeks to build an affordable, reliable, sustainable, and secure energy sector to support the country's economic growth.[2] The programmatic approach, fully coordinated with the International Monetary Fund (IMF) under its extended fund facility,[3] takes a phased approach over 5 years to provide dynamic, long-term support to multidimensional reforms, with an annual subprogram that matches the budget cycle. Subprogram 1, cofinanced by the World Bank and the Japan International Cooperation Agency (JICA), established a solid foundation for implementation of reforms in subsequent subprograms. The proposed subprogram 2 will support the second year of the programmatic approach. The eighth review of IMF was completed in September 2015.[4]

II. THE PROGRAM

A. Rationale

3. In 2014, Pakistan's economy grew by 4.1%, above the forecasted global growth of 3.6%.[5] It is estimated that the country's growth rate could have been 2 percentage points higher given an adequate energy supply.[6] The gap between electricity demand and supply is expected to remain about 5,500 megawatts, or 20% of peak demand, until the end of 2017.[7] The average duration of load shedding in 2014 was around 8–10 hours a day in most areas, and up to 18–20 hours in rural areas.[8] The chronic energy shortage decreases business confidence and negatively affects manufacturing, trade, and consequently household income, often leading to social unrest.

4. Pakistan initiated a comprehensive energy sector reform program in the early 1990s, but the results have been mixed and expected efficiencies have not been fully achieved. The past reforms led to the unbundling of the Water and Power Development Authority into 15 corporatized entities: nine regional power distribution companies (DISCOs), four thermal power generation companies (GENCOs), the National Transmission and Despatch Company (NTDC), and the Water and Power Development Authority. The Central Power Purchasing Agency (CPPA), a unit within NTDC, was licensed to act as a single buyer and seller of electricity. All

---

1 The design and monitoring framework is in Appendix 1.

2 Government of Pakistan. 2013. *National Power Policy*. Islamabad; ADB. 2014. *Report and Recommendation of the President to the Board of Directors: Proposed Programmatic Approach and Policy-Based Lending for Subprogram 1 to the Islamic Republic of Pakistan for the Sustainable Energy Sector Reform Program*. Manila.

3 On 4 September 2013, the IMF board approved a $6.7 billion, 36-month program under the extended fund facility that aims to reduce inflation and lower the fiscal deficit to a sustainable level. http://www.imf.org/external/pubs/ft/scr/2013/cr13287.pdf

4 The eighth review was completed on 28 September 2015. https://www.imf.org/external/np/sec/pr/2015/pr15443.htm

5 IMF. 2014. *World Economic Outlook: Recovery Strengthens, Remains Uneven.* http://www.imf.org/external/pubs/ft/weo/2014/01/pdf/text.pdf

6 Government of Pakistan, Ministry of Finance. 2013. *Economic Survey 2012–2013*. Islamabad. The amount is also used as one of the assumptions for the macroeconomic framework for 2013–2014 in the Government of Pakistan, Planning Commission. 2013. *Annual Plan 2013–2014.* Islamabad.

7 NEPRA. 2015. *State of the Industry Report 2014*. Islamabad.

8 Captive power plants are used as backup supply. The installed capacity of licensed captive power alone is 847 megawatts, of which 476 megawatts uses oil or diesel fuel (footnote 7).

entities are still fully owned by the government except for the Karachi Electric Supply Company, which was privatized in 2005. Independent power producers (IPPs) generate 56% of the country's power. The National Electric Power Regulatory Authority (NEPRA), established in 1997, determines tariffs, issues licenses, and regulates the sector. About two-thirds of the population had access to grid electricity in 2014,[9] and electricity consumption has remained constrained at about 80 terawatt hours per year since 2009 despite the growth in demand (footnote 7).

5. Three key constraints to improved sector performance are (i) the gap between end-user and cost recovery tariffs,[10] (ii) insufficient investment and limited private sector participation due to concerns about electricity payments, and (iii) lack of transparency.[11]

6. **Tariff and subsidies.** A major goal of the overall program is improving the financial condition of the electricity sector through elimination of (i) the difference between the cost-recovery and end-user tariffs, and (ii) nonserviceable debts. Past governments have been reluctant to pass the total cost of electricity to customers, resulting in substantial government subsidies. There was a significant lag in determining the tariff, which consequently did not reflect the current cost. Costs that could not be recovered from consumers or subsidies were accumulated on the books of the DISCOs, which failed to pay fully for electricity purchases, giving rise to circular debt.[12] To address these issues, the Economic Coordination Committee (ECC) approved the National Power Tariff and Subsidy Policy Guidelines under subprogram 1, which set goals for (i) subsidy reduction, (ii) developing improved tariff determination processes, and (iii) a mechanism to cap the circular debt. Subprogram 2 was designed to detail and finalize these mechanisms (outputs are in paras. 18–20). Subsidies have decreased from 1.8% (FY2013) to 0.8% (FY2015) of gross domestic product and have been largely eliminated for industrial, commercial, and consumers using more than 300 kilowatt-hours per month.[13]

7. **Sector performance and private sector participation.** The performance of most public sector electricity companies is less than optimal, with low operational efficiency, poor service quality, and a weak financial position. Subprogram 1 resulted in instructions being given to four DISCOs to outsource collection to the private sector, and to all DISCOs to implement a revenue protection program. Two DISCOs have outsourced part of their collections, while two others are in the process of doing so. A detailed progress assessment will be made in subprogram 3. Losses have declined from 21.9% in 2013 to 18.7% in 2015, and collection has increased from 86% to 89% over the same period.

8. The overall program required the government to develop performance contracts with public power companies. In subprogram 1, the Ministry of Water and Power (MOWP) signed performance contracts with three DISCOs. Subprogram 2 is designed to complete signing of performance contracts with all DISCOs, GENCOs, and NTDC (delivered outputs are in para. 23).

---

[9] World Bank. 2014. *Reducing Poverty by Closing South Asia's Infrastructure Gap.* Washington, DC.

[10] The gap between the end-user and cost-recovery tariff consists of two factors: (i) the difference between cost-recovery and NEPRA-determined tariffs, and (ii) the difference between NEPRA-determined and government-notified tariffs, which are balanced through subsidies.

[11] The details of the sector problem is described in subprogram 1 (footnote 2).

[12] Circular Debt Impact on Power Sector Investment (accessible from the list of the linked documents in Appendix 2).

[13] Household customers accounted for 47% of total electricity consumption in Pakistan in 2013 (Government of Pakistan, Ministry of Finance. *Pakistan Economic Survey 2013–2014*. Islamabad). The World Bank considers 40% of households in Pakistan "poor" (T. Walker et al. 2014. Reforming Electricity Subsidies in Pakistan: Measures to Protect the Poor. *World Bank Policy Paper Series on Pakistan.* PK 24/12. Washington, DC: World Bank).

9. Although IPPs supply a significant portion of electricity in Pakistan, new private investments have failed to meet sector needs, primarily because of the lack of (i) clear demarcation between technical and commercial operations of the power grid, and (ii) a transparent system for settlement and payments. Subprogram 1 resulted in the amending of CPPA's articles of association to act as an agent for electricity procurement on behalf of DISCOs. CPPA signed agreements with GENCOs as the basis of new power purchase agreements under a future power market mechanism, with CPPA acting as the trading hub for bulk suppliers and buyers. Subprogram 2 was designed to complete the separation of CPPA from NTDC as another step towards a transparent market mechanism (delivered outputs are in para. 23).

10. The reliance on expensive fuel oil for power generation increased from 28% in FY2010 to 39% in FY2014, resulting in a rise in electricity cost (footnote 7). In the long term, the government is developing hydropower plants. In the short term, additional domestic gas production for existing gas-fired power plants would reduce electricity costs. The government has been slow to implement the 2012 Petroleum Exploration and Production Policy, which aimed to increase domestic gas production by raising selling prices for producers.[14] The overall program includes an action plan to increase gas production. In 2013, the Ministry of Petroleum and Natural Resources (MPNR) adopted a model petroleum concession agreement based on the policy, which is serving as the basis for awarding new concessions for exploration blocks. Subprogram 2 was designed to increase gas production from existing wells (delivered outputs are in para. 22).

11. There is low awareness in Pakistan of energy efficiency as the least costly means to increase consumable electricity. The overall program laid out a road map for adoption of fiscal incentives for energy conservation and mandatory application of the minimum energy performance standards for energy intensive technologies. Subsequent subprograms (beginning with 2) are designed to implement the road map (delivered outputs are in para. 22).

12. **Accountability and transparency.** Public disclosure of energy sector performance, which would enable stakeholder monitoring and action, was not a common practice in Pakistan. Subprogram 1 resulted in the implementation of web-based open access to NTDC operational information. DISCOs published monthly billing and collection data, but the degree of information disclosure varied. Public disclosure and monitoring will be strengthened by a separate Asian Development Bank (ADB) technical assistance (TA) loan.[15] Subprogram 1 resulted in the establishment of monitoring units within MOWP and the MPNR, and publishing of quarterly reports. Subprogram 2 was designed to expand the disclosure of sector performance and payments by NEPRA and CPPA (delivered outputs are in para. 25).

13. **Development coordination.** The proposed subprogram 2 has been prepared in coordination with the IMF, World Bank, JICA, and other development partners in order to increase the overall economic impact. Pakistan's macroeconomic indicators are improving and all IMF quantitative performance criteria were met by the end of 2014. Inflation eased in July 2015 to a 1.3% annual rate. Financial sector indicators remain sound and foreign exchange reserves reached $13.5 billion by the end of June 2015. The Fiscal Responsibility and Debt Limitation Act 2005 required the government to reduce the ratio of public debt to gross domestic product to 60% by June 2013 and maintain it below 60% from then on. The ratio was 63% for

---

[14] Government of Pakistan, Ministry of Petroleum and Natural Resources. 2012. *Petroleum Exploration and Production Policy 2012.* Islamabad.

[15] ADB. 2014. *Technical Assistance to the Islamic Republic of Pakistan for Public Sector Enterprise Reforms Project*. Manila.

FY2014, down from 63.6% in FY2013, mainly because of a lower fiscal deficit and appreciation of the Pakistan rupee against the US dollar.[16] Although challenges remain, the IMF believes that as structural reforms take hold, bottlenecks will ease, and growth will accelerate.

14. **Lessons.** The 2013 National Power Policy[17] and the programmatic approach follow the recommendations of the Friends of Democratic Pakistan Energy Sector Task Force, which ADB co-chaired with the government.[18] Through the Energy Sector Restructuring Program, ADB initiated key sector reforms in 2000. Power sector reforms were also part of the Accelerating Economic Transformation Program in 2008 and 2009.[19] The lessons from the Energy Sector Restructuring Program are to (i) focus on the program conditions where ADB has strong sector involvement, (ii) provide extensive long-term support for difficult reforms through TA and policy dialogue, (iii) privatize rather than just unbundle state-owned enterprises, (iv) reduce subsidies, (v) remain engaged, and (vi) reduce electricity theft.[20] These lessons have been reflected in the design of the overall program and subprogram 2.

15. **Link to country partnership strategy.** The program is aligned with the priorities of ADB's country partnership strategy (CPS), 2015–2019 for Pakistan—policy reforms and structural transformation in the energy sector.[21] The program is included in the country operations business plan, 2015–2017 for Pakistan.[22] ADB's CPS focuses on contributions that will strengthen the energy sector, consistent with ADB priorities such as inclusive growth. The underperforming energy sector is a barrier to economic growth, adequate job creation, and macroeconomic sustainability. The program will play a key role in the new CPS, supporting structural transformation of the energy sector. Reform policy actions will also contribute to knowledge-related issues, which align with the midterm review of ADB's Strategy 2020.[23]

B. Impact and Outcome

16. The impact of the overall program will be a sustainable energy sector that supports economic growth. The outcome will be a reliable and sustainable energy system.

C. Outputs

17. The overall program consists of five annual subprograms that support the government's reform initiatives, and the outputs identified in the programmatic approach remain valid. All ten policy conditions for subprogram 2, which reflect some amendments to the policy conditions originally contemplated for subprogram 2, were agreed with the government and met by 9 October 2015.[24] Outputs delivered under subprogram 2 are as follows:

---

[16] Government of Pakistan, Ministry of Finance. 2015. *Debt Policy Statement 2014–2015*. Islamabad.
[17] Footnote 2.
[18] Membership consists of the government and 26 donors, including the People's Republic of China, France, Germany, Japan, the United Kingdom, and the United States. Friends of Democratic Pakistan. 2010. *Integrated Energy Sector Recovery Report and Plan.* Islamabad.
[19] ADB. 2008. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Islamic Republic of Pakistan for the Accelerated Economic Transformation Program.* Manila.
[20] The program was rated *less than successful*, but was considered relevant as support to the economy. ADB. 2013. *Performance Evaluation Report: Energy Sector Restructuring Program in Pakistan.* Manila.
[21] ADB. 2015. *Country Partnership Strategy: Pakistan, 2015–2019*. Manila.
[22] ADB. 2015. *Country Operations Business Plan: Pakistan, 2015–2017.* Manila.
[23] ADB. 2014. *Midterm Review of Strategy 2020: Meeting the Challenges of a Transforming Asia and the Pacific.* Manila.
[24] For comparison of indicative triggers (planned at the time of subprogram 1) and the prior actions of subprogram 2, see Appendix 4-A: Comparison of Indicative Triggers and Prior Actions.

18. **Output 1: Managing tariffs and subsidies.** The objectives of this output are to have (i) clear policies on tariffs and subsidies targeted at low-income customers, (ii) policy implementation through NEPRA rules and guidelines, (iii) reduction of discretionary policy decisions and lags in tariff approval and implementation, and (iv) limits to power sector arrears. In subprogram 2, NEPRA finalized and published the Guidelines for Determination of Consumer End Tariff (Methodology and Process), including the timetable, multi-year tariff, and tariff petition forms and data requirements. The tariff petitions of all nine DISCOs for FY2015 included the corresponding forms and data requirements for the guidelines. Eight DISCOs have submitted 5-year investment plans to NEPRA for the multi-year tariff determination in the next fiscal year. Multi-year tariffs, which would eliminate the uncertainty and time lag for annual petitions, will be adopted for two DISCOs in the subsequent subprogram. Multi-year tariffs will facilitate privatization by providing certainty to investors and allowing for midterm planning.

19. In subprogram 2, the government analyzed the causes of the circular debt (footnote 12) and defined the cap of current and overdue payables as PRs314 billion.[25] However, additional policy-induced public sector borrowing through the Power Holding Company Limited (PHCL) was needed to maintain power supplies in the system, and the stock of PHCL debt increased from PRs239 billion in June 2014 to PRs335 billion by January 2015 and remained unchanged since then.[26] Servicing of this debt also contributes to the accumulation of circular debt. The government developed an action plan, agreed with IMF, to reduce the flow of circular debt to PRs39 billion by 2018 and consequently the stock of circular debt to PRs212 billion and PHCL debt to PRs220 billion (footnote 12).

20. The decline in oil prices since 2014 led to negative fuel price adjustments in monthly electricity tariffs. The government used this opportunity to introduce a surcharge in October 2014 to bring the customer tariff closer to cost recovery. A surcharge for servicing PHCL debt was also collected. All surcharges were challenged in court and suspended by the Lahore High Court. However, the Supreme Court has stayed the Lahore High Court's decision, and surcharges have been reinstated since June 2015. A final Supreme Court decision is pending, but if the court rules against the surcharges, the government will seek legislative changes to secure revenue sources for the sector.[27]

21. **Output 2: Improving sector performance and market access for private sector participation.** Market-oriented reforms will increase the efficiency of public sector power companies and encourage private sector participation. The objectives are (i) to reduce losses and improve tariff collection by DISCOs, (ii) improve demand-side efficiency and strengthen energy conservation, (iii) manage generation costs through least-cost plans and ensure their implementation, (iv) increase the gas supply and open the market to direct contracting between producers and large consumers, (v) commercialize public sector power companies,[28] and (vi) institutionalize CPPA's commercial operations.

22. Under subprogram 2, the minimum energy performance standards for compact fluorescent lamps, fans and motors, and appliance labeling standards have been prepared and approved by Pakistan Standards and Quality Control Authority. In March 2015, MOWP issued

[25] According to the Government of Pakistan, payables beyond 45-day payment periods are considered overdue.
[26] The government created PHCL in 2009 to take on the debt held by DISCOs, GENCOs, NTDC, and other power sector entities to clear circular debt. A total of PRs226 billion was transferred from these power sector entities to PHCL in 2009.
[27] Because of uncertainty regarding the time required for the legal process, a policy action of equalization surcharges is planned to be recognized in subprogram 3.
[28] Commercializing the DISCOs will help achieve the government's privatization targets.

an internal instruction to officially adopt the guidelines. A model supplementary agreement that gives better prices to existing gas concessions and encourages further exploration and production was approved in February 2015 under subprogram 2, and the conversion of existing gas concession agreements was initiated. A total of 66 supplementary agreements were signed with public and private gas companies by September 2015 to cover 92 applicants. In March 2015, the government also signed the first contract to import liquefied natural gas and the first shipment was delivered. ECC issued policy directives to ensure that liquefied natural gas is delivered to the customers who pay full cost-recovery prices. The supply will be allocated first to four efficient IPPs that otherwise use expensive high speed diesel.

23. MOWP has signed performance contracts with all GENCOs, DISCOs, and NTDC under subprogram 2. The contracts have performance indicators to ensure accountability and promote operational efficiency. The government also undertook actions to separate commercial functions from the grid's technical operator (NTDC). NTDC's petition to remove CPPA functions from its license was approved on 29 May 2015.[29] In parallel, on 3 June 2015, NTDC signed a business transfer agreement with CPPA Guarantee (CPPAG), and the commercial operations of CPPA were transferred to CPPAG. Power purchase agency agreements signed between CPPAG and DISCOs authorized CPPAG to act as a single buyer of electricity on behalf of DISCOs. Simultaneously, CPPAG signed power purchase agreements with all GENCOs and amended the existing power purchase agreement with Water and Power Development Authority. CPPAG commenced the issuance of invoices and payment transactions and its operational capability has thus been demonstrated.

24. In order to further promote operational efficiency and competition, the government launched an ambitious program to privatize DISCOs and GENCOs starting in FY2016. Transaction advisers have been recruited and are working at seven DISCOs, while the recruitment process is ongoing for the others.

25. **Output 3: Achieving accountability and transparency**. Better access to energy sector data will foster demand for information and a culture of transparency, which will lead to the monitoring of sector developments by stakeholders. Under subprogram 2, the last two annual reports (FY2013 and FY2014) published by NEPRA analyzed the performance of the DISCOs for the past 4 years. CPPAG also published on its website amounts due and payments made by each DISCO to CPPAG, and by CPPAG to each generator, including arrears.

26. **Subsequent subprograms.** Subprogram 3 has 14 indicative policy actions that cover all three reform areas and are to be completed by July 2016. Subprogram 3 is expected to include the following: (i) Output 1: multiyear tariff determination for two DISCOs and an enhancement and implementation mechanism to keep the level of payment arrears capped; (ii) Output 2: focus on future sector performance improvement through approvals of least-cost power generation plans, a restructuring plan for the mid- and down-stream gas sector, electricity market rules, fiscal incentives for energy conservation for at least one appliance or technology, and integration of NEPRA licensees into the supervisory control and data acquisition system;[30] and (iii) Output 3: information disclosure of key indicators from the power sector company's performance contracts, compliance with license provisions in the power sector, and sanction enforcements.

[29] IPPs subsequently requested a review of the license modification by NEPRA, and NEPRA confirmed on 4 September 2015 that no revision of the license modification was necessary.

[30] Integration of NEPRA licensees into the supervisory control and data acquisition system is a new policy action under subprogram 3.

27. Subprograms 4 and 5 are designed to continue the reforms begun under subprograms 1, 2, and 3, with indicative policy actions to be completed in 2017 and 2018. Indicative policy actions for subprograms 4 and 5 include the following: (i) Output 1: determination of multiyear tariffs; (ii) Output 2: implementation of least-cost power generation plans and gas sector restructuring plans, and energy conservation through mandatory minimum standards and fiscal incentives; and (iii) Output 3: disclosure of license provision compliance by IPPs.

D. Development Financing Needs

28. Subprogram 1 was approved and disbursed as a single-tranche loan of SDR257,443,000 ($400 million equivalent) in April 2014. Cofinancing for subprogram 1 was provided by the World Bank ($600 million) and JICA ($49 million equivalent). These loans were used to fund the government's budgetary needs for FY2014. The policy matrix (Appendix 4) lists actions taken prior to Board consideration for subprograms 1 and 2, and proposed policy actions for subsequent subprograms. The government has requested (i) a loan in various currencies equivalent to SDR213,543,000 from ADB's Special Funds resources, and (ii) a loan of $100 million from ADB's ordinary capital resources to help finance subprogram 2.[31] Both loans are single tranche loans. The Asian Development Fund loan will have a 25-year term, including a grace period of 5 years, an interest rate of 2.0% per annum during the grace period and thereafter, and such other terms and conditions as are set forth in the draft loan agreement. The ordinary capital resources loan will have a 15-year term, including a grace period of 3 years, a modified straight-line repayment method, an annual interest rate determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility, a commitment charge of 0.15% per year, and such other terms and conditions set forth in the draft loan agreement. Based on this, the average loan maturity is 9.95 years with no maturity premium payable to ADB. The World Bank will provide cofinancing for subprogram 2 in the form of a loan in the amount of $500 million.[32] The programmatic approach will support reforms outlined in the letter of development policy (Appendix 3) and the policy matrix (Appendix 4).

29. The amount of the loan for subprogram 2 is determined based on the government's request and development financing needs. The government estimates that fiscal deficit in FY2016 is about $12.7 billion, of which $3.3 billion is planned to be financed through external loans.[33] The government has further $3.9 billion of external financing needs for repayment of loans. In the energy sector, electricity subsidies for FY2015 totaled PRs221 billion, and are forecast to decrease to PRs118 billion in FY2016.[34] The sum of subprogram 2 and cofinancing by the World Bank is $900 million equivalent. This equals about PRs94.1 billion, or about 80% of the total electricity subsidy needs for FY2016.[35]

---

[31] The amount of loan has been increased from the originally programmed $150 million to $400 million based on the government's request and additional achievements in policy actions. Policy actions cannot be valued in monetary terms, but the additional achievements as justification of the increase in the loan amount is described in Appendix 4-A: Comparison of Indicative Triggers and Prior Actions.

[32] The development policy letter is consistent for all cofinancing institutions. The policy matrix may differ because of the different duration of support and timing of prior actions for each of the subprograms. The policy matrix was developed through joint missions by cofinancing institutions to ensure consistency in policy advice and to avoid partial implementation of reforms by dividing the prior conditions between the institutions.

[33] Government of Pakistan, Ministry of Finance. 2015. *Federal Budget 2015–2016: Budget in Brief.* Islamabad.

[34] Details on development financing needs are in Fiscal Analysis (accessible from the list of the linked documents in Appendix 2).

[35] Subprograms 3, with a loan of $150 million equivalent, and subprograms 4 and 5, with loans of $250 million equivalent each, are all subject to further discussions between ADB and the government, and to the availability of resources. Subprograms 3, 4, and 5 will be submitted for ADB Board consideration upon completion of the policy triggers. Financing from ordinary capital resources and from cofinanciers on a parallel cofinancing basis may be considered.

E. Implementation Arrangements

30. The ECC will oversee and is the final government authority on the reforms. The Ministry of Finance will be the program's executing agency, supported by the program coordination unit (PCU). The PCU will have overall responsibility for coordinating program monitoring and reporting. The MPNR and the MOWP will be the implementing agencies, supported by their monitoring units. Each monitoring unit will be responsible for program reporting and discussing implementation issues with the PCU. The monitoring units will submit quarterly reports to the ECC. The report will be provided to ADB and cofinanciers.[36] The Technical Assistance to support the program will be provided by ADB, JICA, the United States Agency for International Development, the World Bank, and other development partners through their ongoing and new initiatives. ADB approved a Technical Assistance loan for state-owned enterprise reforms, which provides analytical, technical, legal, regulatory, and communications support for the PCU and the monitoring units for the program's duration (footnote 15). The proceeds of the policy-based loan will be disbursed to Pakistan in accordance with ADB guidelines.[37] The loan proceeds will be used to finance the cost (excluding local taxes and duties) of items produced and procured in ADB member countries, excluding ineligible items and imports financed by other bilateral and multilateral sources.

III. DUE DILIGENCE

A. Economic and Financial

31. The proposed policy reforms under the program will contribute to the national economy by (i) reducing the subsidies for the power sector; (ii) increasing investment, production, and employment as a result of more reliable electricity; and (iii) lowering production and distribution costs. As of the end of June 2015, current and overdue payments equaled PRs314 billion. This represents an increase of about 51% from FY2013. The collection and losses have improved and the government has provided timely equity injection and tariff differential subsidies to DISCOs during the program period.[38] However, the gap between NEPRA-determined tariffs and actual cost-recovery levels continues to hamper the ability of DISCOs to make power purchase payments, contributing to a large portion of the new accumulation of circular debt. The government's plan to reallocate PRs335 billion of electricity sector debt held by PHCL to DISCOs will create further liquidity challenges for the DISCOs. Therefore, securing funds to provide electricity subsidies and remedies to decrease the PHCL debt burden is critical to sustaining electricity sector operations in the country.

32. The government is also implementing measures (e.g., tariff increases and infrastructure investments) to reduce technical and nontechnical losses and thus limit the total amount of subsidies. Based on the projected electricity sales and determined tariff levels, the government estimates that it needs to provide PRs118 billion in electricity subsidies in FY2016, significantly less than PRs292 billion in FY2014 or PRs221 billion in FY2015 (footnote 33).

33. As part of subprogram 2, the government has also developed an action plan to reduce the further accumulation of debt for each contributing factor and will now keep total payables below PRs314 billion, and reduce the flow and stock of circular debt in the next 3 years.

---

[36] Technical Memorandum (accessible from the list of linked documents in Appendix 2).
[37] ADB. 1998. *Simplification of Disbursement Procedures and Related Requirements for Program Loans.* Manila.
[38] The government provided PRs342 billion of liquidity injection to DISCOs in June 2013 to clear outstanding subsidy balances to DISCOs and some outstanding payables to generators and fuel suppliers.

B. Governance

34. In line with the ADB Second Governance and Anticorruption Action Plan,[39] a governance, institutional, and corruption risk assessment has been conducted as part of the preparation of the CPS for Pakistan in 2015. In the assessment, Pakistan's score for various governance indicators fell below the regional average in 2012. However, the country has made progress in improving accountability, increasing transparency, and raising efficiency. The government has embarked on several reforms to strengthen the institutional framework, including budget management, financial accounting, and reporting and expenditure controls. As part of the IMF extended fund facility, the government has changed its tax policy to increase transparency. The recent focus has been on capacity building and training at the federal and provincial levels. A fiduciary risk assessment found that overall fiduciary risk at the federal level remains medium to high despite progress observed in individual areas with regard to public expenditure and financial accountability assessment. Internal control and audit remain weak, as does the legislative oversight of budget formulation and execution. Although the institutional setup for public procurement has been established, insufficient effort has been made to augment the capacity and budgets of the procurement authorities. To support government public financial management reforms, ongoing initiatives financed by various development partners should be coordinated and complementary.

35. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government. The government is acting against corruption, which includes ongoing monitoring and reporting work by the public accounts committee of the Parliament.

C. Poverty and Social

36. The reforms supported under the program will accelerate economic growth and help create jobs, which are key to reducing poverty. Reliable power will benefit poor and vulnerable consumers, including hospitals and schools, who are hard hit by inadequate power supply, load shedding, and poor power quality. Small industries will be able to operate for more hours per day and thereby increase productivity, which in turn will create more work opportunities for the poor. Increases in the Human Development Index are strongly correlated with access to commercial electricity supplies. The indirect benefits of a reliable energy supply include reduced work time and better health of household members through reduction of fume-related indoor pollution, and water and food-borne diseases through refrigeration and boiling of water and food.

D. Safeguards

37. The subprogram has been assessed as category C for involuntary resettlement and indigenous peoples. In the case of environmental safeguards, the subprogram was initially classified as category B, because indirect environmental impacts were expected. However, it has become clear that the policy actions under this subprogram will not result in any direct or indirect impacts, and it has therefore been reclassified as category C for the environment.

E. Risks and Mitigating Measures

38. Major risks and mitigating measures are summarized in Table 1 and described in detail in the risk assessment and risk management plan.[40] The integrated benefits and impacts are expected to outweigh the costs.

---

[39] ADB. 2006. *Second Governance and Anticorruption Action Plan*. Manila.
[40] Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

Table 1: Summary of Risks and Mitigating Measures

Risks	Mitigating Measures
An economic downturn prompts less investment, limits fiscal revenue growth, and thereby risks breaching the ratio of public debt to gross domestic product. [a]	The government has developed a macroeconomic reform plan, agreed with the International Monetary Fund under the extended fund facility program, which will remove economic constraints; this and other reforms (including the proposed program) are expected to strengthen the fiscal position.
Lack of coordination in policy formulation and implementation by government ministries and agencies.	The Economic Coordination Committee oversees the reforms and receives quarterly reports. The Ministry of Finance will act to coordinate various government entities and transparency measures.
Lack of accountability because of weak corporate governance among energy sector public sector enterprise.	The government's commitment to further strengthen the regulator's capacity and to continue monitoring the performance of public sector enterprise will increase accountability in the sector and improve overall governance.
Reforms stall because of reluctance of stakeholders.	Transparency measures and information and education campaigns will help stakeholders understand how reforms benefit them.
Legislative process may be slow and face resistance by vested interests, and legislation may not be promulgated.	The program is based on government's own policy and reform initiative and is backed by a strong political will and commitment, supported by the donor community through technical assistance where needed.

[a] The level of the public debt to gross domestic product ratio is stipulated under the Fiscal Responsibility and Debt Limitation Act 2005.

Source: Asian Development Bank.

IV. ASSURANCES AND CONDITIONS

39. The government has assured ADB that implementation of subprogram 2 shall conform to all applicable ADB policies including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the loan agreements.

V. RECOMMENDATION

40. I am satisfied that the proposed policy-based loans would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve

(i) the loan in various currencies equivalent to SDR213,543,000 to the Islamic Republic of Pakistan for subprogram 2 of the Sustainable Energy Sector Reform Program, from ADB's Special Funds resources, with an interest charge at the rate of 2.0% per annum during the grace period and thereafter; for a term of 25 years, including a grace period of 5 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board; and

(ii) the loan of $100 million to the Islamic Republic of Pakistan for subprogram 2 of the Sustainable Energy Sector Reform Program, from ADB's ordinary capital resources, with interest to be determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; for a term of 15 years, including a grace period of 3 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board.

Takehiko Nakao
President

27 October 2015

DESIGN AND MONITORING FRAMEWORK

Impacts the Program is Aligned with Economic growth through sustainable energy sector (National Power Policy, 2013)			
Program Results Chain	**Performance Indicators with Targets and Baselines**	**Data Sources and Reporting**	**Risks**
Outcome Reliability, sustainability, and affordability of the energy system improved	a. Gas supply increased to 5 billion scfd by June 2017 (2013 baseline: 3.8 billion scfd) b. Private investment as a share of total investments in the power sector increased to 23% by June 2018 (2012 baseline: 19%) c. Average power distribution and transmission system losses reduced to 17.86% by June 2017 for all DISCOs and NTDC (2013 baseline: 21.86%) d. Unaccounted for gas reduced to 8% by June 2018 (2013 baseline: 11%) e. Subsidy to the power sector reduced to 0.3%–0.4% of GDP by June 2016 (2013 baseline: 1.8%)	a. OGRA report b. NEPRA state of industry report c. NEPRA state of industry report d. OGRA report e. Ministry of Finance data	Lack of coordination in policy formulation and implementation between government ministries and agencies
Outputs 1. Tariffs and subsidies managed a. Clear policies on tariffs and subsidies that are targeted at low-income customers b. Policy implementation through NEPRA rules and guidelines ensured c. Discretionary policy decisions and lag in tariff approval and	Tariff determination for all DISCOs reduced to within 4 months of submission of petition by June 2017 (2013 baseline: more than 7 months) Guidelines for DISCO tariff determination covering methodologies, timetable, formula, and procedures for both annual and multiyear tariffs, procedure for earlier submission on investment costs by DISCOs, and forward-	a. NEPRA website b. NEPRA website	Necessary legislation not promulgated

Program Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting	Risks
implementation reduced	looking automatic FPA notified by NEPRA by January 2015 and implemented (baseline: not applicable)		
2. Sector performance and market access for private sector participation improved. a. Losses reduced and collection rate of DISCOs improved b. Demand-side efficiency improved and energy conservation strengthened c. Generation costs managed through least-cost planning, and following of the plan for new power generation plants ensured d. Gas supply increased and gas market opened to direct contracting between producers and large-volume gas consumers e Performance of public sector power companies commercialized and improved f. Commercial operations of the CPPA institutionalized	Collection rate of DISCOs improved to 94% of total billing by 2017 (2014 baseline: 89%) Age of government receivables reduced to 90 days by June 2016 (2013 baseline: 410 days for provincial and 180 days for federal) Energy efficiency labeling of the 20 most energy-intensive appliances issued by June 2018 (baseline: not applicable) Payment arrears maintained below PRs314 billion starting from 2015 (2013 baseline: PRs503 billion) Long-term, least-cost generation and transmission expansion plan issued, and bidding for additions to three new power generation plants based on LCP completed by January 2018 (baseline: not applicable) At least 5% of new gas supply contracted directly to large gas customers and producers by January 2018 (baseline: not applicable) Performance targets set in the executed performance contracts met by all DISCOs by December 2017 (baseline: not applicable) CPPA becomes	a. NEPRA state of industry report b. Annual audited financial statements of the DISCOs c. Energy efficiency standards d. MOWP website e. Government official gazette f. Government official gazette g. NEPRA state of industry report h. Amended NTDC	

Program Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting	Risks
	operational as an independent agency by October 2015 and starts bulk customer trading by December 2017 (baseline: not applicable)	license	
3. Accountability and transparency in the power sector achieved	All key operational and payment information of the power sector published on CPPA's and DISCOs' websites by January 2016 (baseline: not applicable) Licensees' performance information published on NEPRA website and updated monthly by January 2018 (baseline: not applicable) Timely and continued issuance of quarterly report on the implementation status of the National Power Policy 2013; report includes review and recommendations by international experts (baseline: not applicable)	a. CPPA and DISCOs websites b. NEPRA website c. MOWP website	
Key Activities with Milestones Not applicable.			
Inputs ADB (ADF): $300 million (loan) ADB (OCR): $100 million (loan) World Bank: $500 million			
Assumptions for Partner Financing Not applicable.			

ADB = Asian Development Bank, ADF = Asian Development Fund, CPPA = Central Power Purchasing Agency, DISCO = distribution company, FPA = fuel price adjustment, GDP = gross domestic product, LCP = least-cost generation plan, MOWP = Ministry of Water and Power, NEPRA = National Electric Power Regulatory Authority, NTDC = National Transmission and Despatch Company, OGRA = Oil and Gas Regulatory Authority, OCR = ordinary capital resources, scfd = standard cubic feet per day.
Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

http://www.adb.org/Documents/RRPs/?id=47015-002-3

1. Loan Agreement
2. Sector Assessment (Summary): Energy
3. Contribution to the ADB Results Framework
4. Development Coordination
5. Economic Analysis
6. Country Economic Indicators
7. International Monetary Fund Assessment Letter
8. Summary Poverty Reduction and Social Strategy
9. Risk Assessment and Risk Management Plan
10. List of Ineligible Items

Supplementary Documents

11. Fiscal Analysis
12. Technical Memorandum
13. Fiduciary Risk Assessment
14. Circular Debt Impact on Power Sector Investment

DEVELOPMENT POLICY LETTER

No. 1(4)EFC/2014

Senator Mohammad Ishaq Dar
Minister for Finance, Revenue,
Economic Affairs, Statistics and
Privatization

ISLAMABAD
8th October, 2015

Dear President Nakao,

The government continues to pursue its long term strategy to restore macro-economic stability to Pakistan and improve its economic growth. This foundation of the government's effort has begun to bear fruit and we wish to maintain the momentum of the programme especially with respect to:

- Fiscal consolidation and stability;
- Rebuilding foreign exchange reserves; and
- Structural reforms.

Our efforts in the energy sector remain central to this programme, and its reform will directly impact the overall economic growth of Pakistan. Through this letter we wish to inform you of the progress of the Government of Pakistan's energy sector reform programme and our plans for the future. Our focus has been the development of a credible and actionable programme which can be supported over the medium term by the Asian Development Bank (ADB), the World Bank (WB) and the Government of Japan acting through the Japan International Cooperation Agency (JICA).

I. RECENT DEVELOPMENTS

We inherited severe economic imbalances and vulnerabilities in May 2013. In the previous five years, economic growth had averaged 3 percent, well below potential and about half its average of past decades, and inflation was running at about 11.8 percent. By end-June 2013, State Bank of Pakistan's (SBP's) international reserves had dropped to around 1.5 months of imports; investment to GDP ratio had fallen to 15.0 percent; tax to GDP ratio had declined to 9.8 percent while the fiscal deficit was 8.8 percent of GDP. Public debt was well above the 60 percent advised by Pakistani legislation, with some international analysts even suggesting Pakistan would default.

Our democratic transition in May 2013 went a long way to support the implementation of effective measures to address Pakistan's challenging economic situation. As a result of our reform efforts and initiatives, we have been able to make considerable progress in restoring macroeconomic stability. During the fiscal year ending June 30, 2015 (FY15), growth continued to pick up and reached 4.24 percent.

Favoured by low international oil prices, inflation ended last year at 4.53 percent; the fiscal deficit was contained at 5.37 percent; public debt declined; and the external current account deficit was below one percent, while international reserves stood at 3.4 months of imports in June 2015.

The results that have been achieved include:

- Pakistan has successfully completed eight reviews under the $6.64 billion Extended Fund Facility (EFF) Program of the International Monetary Fund.
- Pakistan successfully re-entered international capital markets after an absence of seven years by issuing Euro Bonds worth $2 billion and issued Islamic paper, Sukuk, for $ 1 billion. Recently, Pakistan has successfully issued Euro Bonds worth $500 million in difficult market conditions.
- We have resumed the privatisation programme, and have already divested the shares of United Bank Limited (about $400 million), Pakistan Petroleum Limited (subscription of PKR 30 billion, the highest in our stock market's history) and Habib Bank Limited, raising over $ 1 billion (the largest ever equity offering in an Asian frontier market). We have also completed the first strategic sale, of 88% percent of the shares in National Power Construction Company, raising $ 25 million.
- We have auctioned 3G-4G spectrum licenses. Against the target of PKR 50-79 billion set during the last five years, we aimed to raise PKR 120 billion from auctions in our government's first full financial year, FY14, and our target was achieved.
- Moody's and Standard and Poor's (S&P) have both raised their outlook on Pakistan's dollar bond from stable to positive. Likewise, Fitch also rated Pakistan for the first time and assigned a rating of B, which is a notch higher than the equivalent rating of S&P and Moody's.

We are improving tax compliance and enforcement to bring more people into the net and also broadening the coverage of other taxes, including General Sales Tax. We have circumscribed the Federal Board of Revenue and government's ability to issue Statutory Regulatory Orders (SROs) to grant tax exemptions and concessions. We are also collaborating closely with the provinces to ensure their contribution to improved fiscal management. We have curtailed government borrowing from SBP and remain within targets agreed with IMF and, as noted above, have diversified our financing in the domestic and international financial markets.

Pakistan's electricity sector, which is a pivotal contributor to the overall economic situation, was facing a severe crisis in June 2013. Despite tariff increases revenues were still falling short of costs, and the Government subsidized electricity to the tune of about 1.8 percent of GDP in FY13. Chronic electricity shortages, peaking at an estimated level of over 7,000MW in 2013 contributed to reduced economic output. The circular debt had reached PKR 503 billion in mid-2013. The underlying cause of this problem was, and to a large extent remains, our over-dependence on the expensive imported heavy fuel oil and diesel used for generation. Additional factors that affected the availability of electricity for consumption were high levels of losses and theft, and poor equipment maintenance.

In the past two years we have overseen significant improvements in the financial and technical performance of the electricity sector. By virtue of significant tariff increases in August and October 2013, subsidies were substantially reduced for industrial, commercial and bulk consumers and households using more than 300 kilowatt hours (kWh) per month. With the introduction of surcharges aimed at recovering some costs disallowed from the tariff, we further reduced subsidies in FY15 to 0.8 percent of GDP. We introduced performance contracts for the Boards and management of the distribution companies (Discos) and enforced the targets contained in them. At the end of FY15, losses had stabilized at around 18.7 percent, and collections had edged up to 89.2 percent. We have enforced merit order dispatch of power generation plants, pushing down the cost of generation and the increased generation thus enabled, plus new plant additions, means that we have been able to keep up with demand growth: last year the average daily shortfall was 2,900MW compared with 3,800MW in FY14 and 4,000MW in the year before that. This has allowed us to reduce load shedding to six hours in urban areas and eight in rural areas, while also supplying more electricity to industry.

There is still more to do. Technical losses and theft remain higher than acceptable. The circular debt has re-emerged despite our payment of PKR 480 billion in June and July 2013, because revenues from sales to consumers and subsidies from government do not cover the full cost of supply. Load shedding needs to be further brought down by making sufficient inroads into the generation deficit and strengthening transmission system. We continue to bring significant additional finance from private and public sources to support the much-needed investment in electricity infrastructure that will improve supply and bring down costs.

II. OUR PROGRAMME

Let me start this section on our programme by reiterating the basic tenets of our government's vision for Pakistan. First, we want to build an economy that is not dependent on others except through trade and investment, and based on competitive advantage and market considerations. This can only be achieved with rapid and sustained growth. Second, the private sector has to be the lynchpin of economic activity. Third, the only areas where the government's presence in economic affairs can be justified are where investments are too large or too risky for the private sector to undertake, or where markets are unlikely to function, or both. Fourth, everyone must share the burdens of revenue mobilization and enjoy the benefits of reforms. The distortive and inequitable culture of exemptions and concessions must end, and provinces should also be encouraged to participate in this effort. Fifth, government must limit itself to the resources available, aiming for their efficient use and respecting fiscal discipline. Last, we must protect the poor and vulnerable with an accessible and reliable social safety net.

A. Macroeconomic Stabilization

Pakistan was unfortunately unable to introduce structural reforms for macroeconomic stability and growth during the last one decade, which led to macroeconomic instability when the present government took office. However, since the government took office in June 2013, we have introduced a number of deep-rooted and comprehensive structural reforms and undertaken numerous stabilization measures while protecting vulnerable segments of the society. As a result, Pakistan not only averted the predicted default but is now firmly on the path of stability and growth.

Improvements in Pakistan's economy are manifested by an overall improvement in macroeconomic indicators. In FY14, Pakistan achieved, as mentioned above, GDP growth of 4.02 percent - the highest in six years - and increased it further to 4.24 percent in FY15, reaching the highest level in seven years. The fiscal deficit which stood at 8.2 percent (8.8 percent when the government took office) at the end of FY13 has been brought down to 5.37 percent in FY15. There has also been a significant increase in Pakistan's foreign exchange reserves in the past 18 months. Having touched the predicted low level of less than $8 billion in February 2014, Pakistan's reserves have continued to grow due to our serious efforts and have now reached the record level of over $20 billion. Positive macroeconomic performance has resulted in a soaring stock market and increased investment.

Going forward, we will continue to make serious efforts to further consolidate the macroeconomic gains. As committed under the IMF EFF programme, our monetary and exchange rate policies will continue to reduce external vulnerabilities by building foreign exchange reserves. We will maintain a prudent monetary stance, to meet continued expectations of low inflation. Improving monetary operations will help make our policy tools more effective, including enhancing SBP independence.

In this present fiscal year, FY16, we strive for 5.5 percent growth. The current account deficit is expected to narrow to about 0.5 percent of GDP, and inflation is expected to stay contained at under six percent. We continue to work to improve tax collection and aim to achieve a tax to GDP ratio of 12.0 percent this year. We are working to strengthen financial stability through various measures including the introduction of deposit protection, introduction of improved capital and liquidity standards in banks and by strengthening regulatory powers. Our privatisation programme will further build our reserves, with a particular concentration on strategic sales of electricity generation and distribution companies, scheduled for FY16 and beyond.

The banking sector remains sound, and we are committed to ensuring financial stability. We are introducing deposit insurance and strengthening measures to prevent money laundering and the financing of terrorism. We are reinforcing the regulatory and supervisory framework through a strong legislative agenda that will see the introduction of a Securities Bill, the Securities and Exchange Commission of Pakistan Act and a Futures Trading Bill as well as improvements to existing legislation to help improve recovery of non-performing loans.

The energy sector, by virtue of its influence on Pakistan's economic performance, has been identified as one which can significantly affect macroeconomic stability and fiscal performance. Our plans for the sector are discussed further in subsequent sections.

B. The Government's Vision and Objectives for the Energy Sector

In July 2013, within three months of taking office, we announced a National Power Policy, 2013.

The key goals and targets envisioned under the Policy include:

Goals	To enhance generation capacity in a sustainable manner Promote and ensure a culture of conservation and responsibility Ensure affordable electricity, based (where possible) on indigenous fuels Minimize losses (technical, financial) and inefficiency Control pilferage and theft, and Align the sector ministries, provincial and federal authorities, regulators, and implementing entities, to coordinate activities, and strengthen governance
Targets – to be achieved by 2017	Decrease/eliminate the demand/supply gap – 4500 - 5000 MW today to 0 by end 2017 Decrease weighted average generation cost from about USc 12/kWh today, to below 10 USc per kWh Reduce transmission and distribution losses from 23-25% today to about 16% Increase collection rates from 85% (system wide) to above 95%, and Reduce decision times for the Government, related departments, regulators, etc.

In September 2013, the Government prepared a detailed plan aimed at turning this vision into an actionable programme. Subsequently, the programme was discussed with stakeholders, including the private sector, academia and civil society, donor agencies, the utility providers, and bilateral governments, and their respective role in support of the programme was identified, i.e.

- Supporting the implementation of the Government's policies;
- Ensuring that public sector counterparts and utilities meet their obligations for various projects and programmes; and
- Enabling the Government to monitor the progress in achieving the objectives and targets set out in the Government's policies, and take corrective actions where required.

The proposed policy actions, and for which we seek support from WB, JICA, and ADB, are discussed in more detail below.

C. Structural Reform of the Energy Sector

We attribute the positive results in the sector that we have described above in large part to the reform programme which was supported under the first phase of programme lending approved in April and May 2014. We wish to maintain this program and look to the continued support of the three institutions (WB, ADB and JICA) through the proposed second phase of programme lending. In this next phase, the reform programme is aimed at continuing to improve the financial viability of the power sector but also in bringing about lasting structural reform that will encourage improved service and additional investment. It involves a three pronged strategy, i.e.

- To manage better tariffs and subsidies;
- To improve sector performance and open the market to private participation; and
- To improve the transparency and accountability of sector institutions.

Managing Tariffs and Subsidies

We decreased government subsidies for electricity consumption from 1.8 percent of GDP in FY13 to 1.3 percent in FY14 and to 0.8 percent in FY15, slightly above our original target of 0.7 percent. Subsidies remain now only for households which use less than 300 kWh/month, certain classes of consumers including those in Federally Administered Tribal Areas (FATA), Balochistan and some bulk power consumers. We have also eliminated the subsidy mechanism that was used to finance the uniform tariff policy through the introduction of a surcharge as permitted under the Regulation of Electricity Generation, Transmission and Distribution Act of 1997. The government's right to raise surcharges has been challenged in the Courts, but we are confident that we will be able to continue to raise surcharges in the future. We will further reduce subsidies to the electricity sector to 0.4 percent in FY16, as committed to in the IMF programme. We will also take steps to ensure that the remaining subsidies are focused on the poor.

Following the policy issued by government in early 2014, the National Electric Power Regulatory Authority (NEPRA) introduced guidelines for determination of tariffs which sets out the methodology and timetable for the introduction of multiyear tariffs (MYTs). We will stage the introduction of MYTs for all Discos over the coming three years. Because MYTs are a pre-requisite for their privatisation, we are taking steps to ensure that those Discos which are at the top of the government's list submit MYT petitions as soon as possible. Faisalabad and Peshawar Electric Supply Companies (FESCO and PESCO respectively) have already done so, and NEPRA has held its hearing for the FESCO petition. Islamabad and Lahore Electric Supply Companies (IESCO and LESCO respectively) will submit [five year] MYTs in FY16. The MYT will bring stability to tariff determination and in the five year tariff period, adjustment will be formula-based and therefore much quicker.

Despite our efforts to improve financial viability of the Discos, there is still a shortfall between the combination of revenues from sales to consumers and subsidies provided by the government on the one hand, and the cost of running the system on the other. The shortfall gives rise to the circular debt and is caused by a number of factors, including:

- Sector inefficiencies arising from Discos having higher levels of losses and lower levels of collections than those allowed by the Regulator;
- Discrepancies in the tariff regime that does not recognize some costs, including the cost of delays in determination of new tariffs;
- Some costs are imposed on the Discos by virtue of government policy, including subsidies, and failure by Federal and Provincial government departments to pay their bills.

In consequence, the circular debt – defined as the aggregate amount of payables owed by the Discos on the last day of any given month – started to re-emerge from August 2013. It had reached PKR 314 billion at the end of FY15, and experience indicates that beyond this level the ability of the sector to produce electricity is reduced. We have, therefore, imposed a cap on the circular debt and prepared a plan to manage it, which we have published on the Ministry of Water and Power web site. The three-year plan has been endorsed by the Economic Committee of the Cabinet (ECC) which will also monitor it, and publish the findings of the monitoring. The plan and our monitoring is also an important part of maintaining our commitment to IMF under the EFF programme.

Our circular debt management plan is fully funded to allow the reduction of the flows to PKR 39 billion by the end of FY18, and to manage the stock from its current level down to PKR 212 billion by the same date. In addition, we have also introduced a surcharge to cover the cost of servicing historic circular debt held in the Power Holding Company which currently amounts to PKR 335 billion. We rely on privatization proceeds to reduce the stocks of both current and historic circular debt. We will monitor the progress of the plan and provide support as required to cover the costs of the management plan throughout the remainder of this Parliament.

Improving Sector Performance and Opening the Market to Private Participation

We have identified three areas of action on which our program efforts will focus to improve the performance of the sector. The first is to address efficiency of machinery and appliances, on both the supply and the demand side, and thus ensure we extract maximum value from our investments in the electricity sector. To that end, after approval from the Council of Common Interest (CCI), we have placed the Energy Efficiency and Conservation Bill before Parliament and expect it to become law in early 2016. We have issued the guidelines on minimum energy performance standards, and energy labelling requirements for three consumption intensive appliances and in the near future we will introduce a fiscal incentive to promote energy efficiency and conservation.

On the supply side, the lack of focus on selection of least cost generation projects, and the failure to optimize generation and transmission investments has contributed toward the high cost of supply. We are well advanced in the preparation of a generation and transmission long-term least-cost plan to ensure that only those projects are considered for implementation which take into account considerations of location, fuel choice, and economic cost of power to be produced over the lifetime of the project, as well as making explicit social, environmental and other associated safeguard costs. We will ensure that least-cost plan is submitted to NEPRA during FY16. Thereafter we will ensure rigorous implementation of the plan and will not finance in the public sector, or approve investments by the private sector that does not feature in the least cost plan. We will also adhere to the retirement schedule in the plan, so that old and inefficient plants are taken out of service and replaced with modern, efficient and reliable plants.

The second area where we are focusing our efforts is in the gas sector. We recognize the importance of natural gas to the power sector as well as to other key industries. Domestically-produced gas is a readily-available, comparatively inexpensive and environmentally-friendly fuel for electricity generators. We are making efforts to ensure that exploration and production of gas in Pakistan have adequate incentives, and have awarded 46 new concessions for exploration and production of domestic gas in August 2013. Simultaneously, we adopted a model supplementary agreement that gives better prices to existing concessions. Since completing the DPC prior action in June 2015, we have converted a further two gas concessions bringing the total to 94 existing agreements of 120 that applied and were eligible for the new prices under the 2012 Petroleum Policy. In the coming year we will start amendments to the concession agreements to provide 2012 policy prices to incremental gas produced from existing concessions. In the medium term we will review the results achieved under the 2012 policy with a view to making the domestic gas sector more attractive to private capital.

To supplement our domestic supplies, we started importing liquefied natural gas (LNG) in April 2015 and have adopted a policy of cost recovery in the gas sector. We have defined those consumers who are eligible to receive LNG, namely power generation, bulk consumers, fertilizer production and compressed natural gas, since these are the ones that are able to extract the maximum economic value from gas. We have also mandated that these users of LNG will pay the full cost of the gas. No LNG will be added to the pool of domestic production and no consumer which does not pay the full cost of LNG will be supplied it.

In the medium term we intend to move towards a more market-oriented gas sector and away from the administrative allocations of gas and controlled pricing of today. This will be essential if we are to be able to attract further imports, whether via LNG or pipeline from our neighbours. As a first step in this direction, we have started a review of the structure of the middle and downstream gas sector and will adopt a restructuring plan in FY16. With the restructuring plan we will also prepare for the privatization of the gas distribution segment.

It is to the third area of power sector reform that we have devoted our largest effort and achieved the most significant change. We are poised for a significant transition, which has evaded previous governments for the past 15 years. We have set up the Central Power Purchasing Agency Guarantee (CPPA-G) independent from NTDC. Although initially CPPA-G will act as an agent of Discos, it is intended to develop competitive markets following policies set by government and requirements set by NEPRA. To make CPPA-G operational, NEPRA has approved the modification of NTDC license so that it can no longer buy or sell power. The Market Operator Registration Standards and Procedures Rules have been notified. CPPA-G has prepared a Commercial Code which has been approved by NEPRA and has put in place standard operating procedures that will allow billing and settlement. CPPA-G is charged with market development and as a first step will implement the market for direct contracting between electricity generators and bulk power consumers.

On behalf of the Discos, CPPA-G has signed PPAs with the Gencos. The power purchase agreements (PPAs) with the independent power producers (IPPs) whose agreements fall under the 2002 Power Policy remain to be novated from NTDC to CPPA-G and a new PPA has yet to be agreed between WAPDA Hydel and CPPA-G. We are committed to completing these actions in line with the legally-binding Economic Coordination Committee of the Cabinet's decision of September 4th, 2015 which provides for a transition period after the signing of the Business Transfer Agreement of two years for the 2002 Power Policy IPPs and six months for the WAPDA Hydel PPA. Thereafter we will be in a position to implement the bulk supply market.

In parallel, we are also pressing ahead with the privatisation of the publicly owned Discos and thermal generation companies (Gencos). Privatisation is a key part of our strategy to limit the government's financial liabilities in the electric power sector, including to address the stock of circular debt, and to improve technical performance. Consequently we are working to privatise Discos and Gencos, and have developed a plan to sequence the capital market and pre-privatisation restructuring for these firms. We have already recruited financial advisors for all companies and we expect to close the first transaction within FY16 and expect to complete the privatization of all Discos and Gencos within the term of the current government.

We recognize that during the remaining period in public ownership, and to make the power companies more attractive, we have introduced performance driven contracts for the public sector utilities, signed by the Board and management of each company and Ministry of Water and Power. The Discos are being instructed to implement the requirements of the Companies' Ordinance 1984. We have introduced a mechanism to monitor the utilities' performance under these contracts with reporting to the Economic Coordination Committee of the Cabinet on performance. NEPRA has signalled its intention to ensure implementation and compliance with the Grid Code.

Improving Accountability and Transparency

The status of follow up actions under the Petroleum Exploration and Production Policy 2012 actions under the National Power Policy, 2013 are being monitored regularly by the ECC of the Federal Cabinet. Review at the highest level demonstrates the importance which the government attaches to implementing the energy sector reform plan.

We have established a mechanism for quarterly monitoring of the power and petroleum policies set out in this letter. We have established monitoring units in Ministry of Water and Power and Ministry of Petroleum and Natural Resources charged with monitoring of the progress of the reforms, reporting to the ECC on a quarterly basis, and disseminating energy sector information to the public. We will also hire monitoring consultants to work with the units in MWP and MPNR through donor funding. We will ensure reporting of the results through web-based forums which allow all stakeholders (including citizens) to review progress and contribute their views. The proposed culture of monitoring and transparency will also require enhanced regulatory capacity, for which, bilateral/multilateral assistance is also being sought. As a first step we have appointed a new Chairman of NEPRA and a Member with financial skills. We will also establish a government-wide communications program, and will seek assistance from our partners to help in its establishment.

Further measures to promote transparency, some of which have already been initiated, will increase access to information in the energy sector through implementing web-based access to operational information on electricity generation, including the merit order dispatch. We have also publicly made available on the CPPA-G website the monthly amounts due and payments made by Discos and to generators.

We will implement public web-based information about the performance of Discos, Gencos and NTDC against the benchmarks set in their contracts. NEPRA has published its review of the performance of Discos on its website; Discos have published their own annual performance reports on their websites. We will further strengthen the two monitoring units at MWP and MPNR and upgrade their outreach capacity to move beyond passive publication and towards a more proactive approach to communications with the public. We are strongly committed to ensuring that all the information we publish is kept up to date: quarterly reports will be available within one month of the end of the quarter, and annual reports within six months of the end of the year.

III. GOVERNMENT COMMITMENT

We take this opportunity to reiterate our commitment to reforms and dealing with the policy issues. We have already taken some difficult decisions including substantial tariff increases and the settlement to the power sector circular debt which are already yielding positive results. We are committed to continue to make the necessary decisions to improve the power sector's financial viability.

You will appreciate that the measures described above to reform the energy sector constitute the strongest efforts yet undertaken for many years. Notwithstanding, we recognize that bringing the energy sector back on track requires continued efforts. The government's plan to deal with the structural impediments to the performance of the energy sector is matched by our commitment for improving the quantity and quality of physical investment in the sector, wherever possible with private sector investment participation.

In closing, we would like to express our continued appreciation of ADB, JICA and the World Bank for working with the government in the development of a single programme for the energy sector that is closely integrated with that of the IMF. We look forward to continuing to work closely with your institutions in our common purpose of improving Pakistan's economic prospects.

Kind regards,

Sincerely,

Mr. Takehiko Nakao,
President,
Asian Development Bank,
Manila.

Policy Matrix

Objective	Subprogram 1 Prior Actions completed by 31 March 2014	Prior Actions completed in Subprogram 2	Indicative triggers to be supported through Subprogram 3	Indicative triggers to be supported through Subprogram 4	Indicative triggers to be supported through subprogram 5	Results
Policy Area A: Managing Tariff and Subsidy						
Adoption of clear policies on tariffs and subsidies to target low-income consumers; ensuring policy implementation through NEPRA rules and regulations; and reduction of discretionary policy decisions and lag in tariff approval and implementation.	1. The ECC approved the Tariff and Subsidy Policy Guidelines covering: (i) subsidy policy for low-income residential customers; (ii) multi-year tariffs; (iii) guidance for tariff setting as envisaged in the NEPRA Act, including forward-looking fuel price adjustment through NEPRA proceedings; and (iv) guidance for circular debt management: (a) monthly accounting for arrears of payment by DISCOs to CPPA, and (b) mechanism to cap the overdue payables to the power generators. 2. NEPRA published on its website for consultation draft guidelines for DISCOs tariff determination covering principles, methodologies, timetable, formula and procedures for annual tariffs and MYTs, including: (a) a procedure for DISCOs to submit investment costs prior to filing of petition; and (b) adjustment mechanisms during the year, including formula-based forward-looking automatic FPA.	1. Nine DISCOs submitted tariff petitions to NEPRA for FY2015, including forms and data requirements stipulated in the NEPRA Guidelines for Determination of Consumer End Tariff, in order for NEPRA to start tariff determination; and 8 DISCOs submitted 5-year investment plans in order for NEPRA to start the determination of MYTs in FY2016. 2. MOWP has published on its website a cap for total due and overdue payables to generators not to exceed PRs314 billion and a plan to reduce the flow of new overdue payables to PRs39 billion by FY2018.	1. NEPRA issues determination on MYT for at least 2 DISCOs. 2. The flow of overdue payables is reduced to PRs[92] billion based on the action plan. 3. The government implements a mechanism based on tariff surcharges and the Universal Obligation Fund to maintain national uniform tariffs in DISCOs while ensuring cost recovery.	1. NEPRA issues determination on MYTs for at least 3 additional DISCOs. 2. The flow of overdue payables is brought down to PRs[57] billion based on the action plan.	1. NEPRA issues determination on MYT for at least 4 additional DISCOs. 2. The flow of overdue payables is brought down to PRs[39] billion based on the action plan. 3. NEPRA Act amended for NEPRA to notify tariff determination.	*Result Indicator A1: Time taken for DISCOS tariff determination.* • Baseline (FY2013): more than 7 months after admission of petition for all DISCOs. • Target (FY2017): within 4 months admission of petition for all DISCOS. *Result Indicator A2: Regulation for DISCOs tariff determination covering methodologies, timetable, formula, and procedures for both annual and MYT, procedure for earlier submission of investment costs by DISCOs, and forward-looking automatic FPA.* • Baseline (FY2012): not notified. • Target: notified by January 2015 *Result Indicator A3: Subsidies reduced.* • Baseline (FY2013): 1.8% of GDP. • Target (FY2017): 0.3%–0.4% of GDP.

Objective	Subprogram 1 Prior Actions completed by 31 March 2014	Prior Actions completed in Subprogram 2	Indicative triggers to be supported through Subprogram 3	Indicative triggers to be supported through Subprogram 4	Indicative triggers to be supported through subprogram 5	Results
Policy Area B: Improving Sector Performance and Opening the Market to Private Participation						
Reducing losses and improving collections in DISCOs.	3. (i) MOWP instructed PESCO, HESCO, SEPCO, and MEPCO to outsource to the private sector collection of their respective feeders with losses of 50% or above; (ii) MOWP instructed all DISCOs to implement revenue protection programs that ensure correct billing; reduce losses (and in particular theft) and improve collections; (iii) the Council of Common Interests initiated discussion on a mechanism to automatically adjust the amount of receivables owed by provincial governments and agencies; and (iv) the federal government adjusted receivables of federal agencies or entities to not exceed 90 days of billing by DISCOs.		4. Each DISCO provides information regarding current revenue protection initiatives, and their plans to comply with a full revenue protection program as instructed in subprogram 1. Outsourcing implemented in 5 DISCOs.			*Result Indicator B1: Reduction in distribution and transmission losses.* • Baseline (FY2013): 21.86% for DISCOs and NTDC. • Target (FY2017): 17.86% for DISCOs and NTDC. *Result Indicator B2: Increase collection in DISCOs.* • Baseline (FY2013): 86% of bills collected by DISCOs. • Target (FY2017): 94% of bills collected by DISCOs. *Results Indicator B3: Reduction of government receivables.* • Baseline (FY2013): provincial 410 days, federal 180 days.

Objective	Subprogram 1 Prior Actions completed by 31 March 2014	Prior Actions completed in Subprogram 2	Indicative triggers to be supported through Subprogram 3	Indicative triggers to be supported through Subprogram 4	Indicative triggers to be supported through subprogram 5	Results
Improving demand-side efficiency and strengthening energy conservation.		3. MOWP issued guidelines on MEPS and appliance labeling for at least 3 energy consumption-intensive appliances or technologies	5. Fiscal incentives and/or disincentives are put in place to promote MEPS for at least one energy-intensive technology or appliances.	3. {Analysis and review of the effectiveness of building codes revised in 2014 for revision in 2017}	4.MEP standards become mandatory for at least 3 energy-intensive consuming appliances or technologies 5. Building codes are reviewed and revised.	• [Target (FY2016): 90 days.] *Result Indicator B4: Notification of energy efficiency standards.* • Baseline (FY2013): no MOWP issued MEPS. • Target (FY2017): at least five MEPS issued by MOWP.
Managing generation cost through the LCP, and ensuring new generation follows the LCP.	4. MOWP issued an instruction establishing the principles and process for NTDC to prepare and periodically update the long-term least-cost generation and transmission expansion plan.		6. NTDC submits and NEPRA approves long-term least-cost generation and transmission expansion plan. 7. PPIB updates procedures and documentation for the 2002 IPP policy to ensure consistency with the LCP for competitive and unsolicited bids from IPPs for new capacity.			*Results Indicator B5: Introduce LCP and entry of new generation based on LCP.* • Baseline: no approved LCP. • Target (FY2017): LCP issued and additions to new generation capacity based on LCP.

Objective	Subprogram 1 Prior Actions completed by 31 March 2014	Prior Actions completed in Subprogram 2	Indicative triggers to be supported through Subprogram 3	Indicative triggers to be supported through Subprogram 4	Indicative triggers to be supported through subprogram 5	Results
Increasing gas supply and opening the gas market to direct contracting sales to large gas consumers.	5. (i) MPNR disclosed the 2013 Model Petroleum Concession Agreement on its website, (ii) MPNR announced the award of petroleum exploration blocks for the 2013 bidding round, and (iii) OGRA issued at least 3 pricing notifications under the 2012 Petroleum Policy.	4. MPNR has signed supplemental agreements agreeing to revised prices for 92 exploration concessions and production leases at the levels set out in the 2012 Petroleum Policy, including 26 from the private sector. 5. The Economic Coordination Committee has approved policy directives stating that LNG will be provided to consumers who pay its full cost through the tariff.	8. Government approves a restructuring plan for the midstream and downstream gas sector. 9. MPNR reviews and notifies enhanced/revised 2012 Petroleum Policy to promote additional gas production from domestic onshore and offshore areas.	4. MPNR has begun to implement a restructuring plan for the midstream and downstream gas sector.		*Result Indicator B6: Increasing gas supply.* • Baseline (FY2013): 3.8 billion scfd. • Target (FY2017): 5 billion scfd.

Objective	Subprogram 1 Prior Actions completed by 31 March 2014	Prior Actions completed in Subprogram 2	Indicative triggers to be supported through Subprogram 3	Indicative triggers to be supported through Subprogram 4	Indicative triggers to be supported through subprogram 5	Results
Commercialization and improvement of the performance of public companies in the power sector.	6. MOWP signed a performance contract, including operational and financial performance indicators and a monitoring framework, with at least 3 DISCOs.	6. MOWP signed performance contracts, including operational and financial performance indicators and a monitoring framework, with all remaining DISCOs, GENCOs, and NTDC. 7. Roadmap for privatization was developed and implementation started.	10. NEPRA ensures either that (i) all NEPRA licensees (Grid Code participants) are fully integrated into SCADA system, and are reporting to NPCC in real time in accordance with Grid Code requirements; or (ii) if any NEPRA licensees are not in compliance with the foregoing, administrative action has been initiated by NEPRA against such licensee in accordance with the provisions of the NEPRA's rules and regulations. NTDC ensures that the SCADA System under the Load Dispatch Center Phase 2 Project is fully implemented.	5. Implementation of the Privatization Roadmap through offering for sale or completion of contract. 6. Generation plant privatization including efficiency improvement and investment obligations. 7. MOWP signs enhanced performance contracts with DISCOs, GENCOs, and NTDC, taking into account the results of the audit referred to in Indicative Trigger 15 of Operation 3.	6. All remaining DISCOs have developed and started implementation of their revenue protection programs.	*Result Indicator B7: DISCOs meet key targets in performance contracts.* • Baseline (FY2013): 3 DISCOs signed performance contracts. • Target (FY2017): DISCOs meet set performance targets.

Objective	Subprogram 1 Prior Actions completed by 31 March 2014	Prior Actions completed in Subprogram 2	Indicative triggers to be supported through Subprogram 3	Indicative triggers to be supported through Subprogram 4	Indicative triggers to be supported through subprogram 5	Results
Commercial Operation of CPPA as an independent agency to buy power on behalf of DISCOs, and implementation of a multiple buyers market by allowing generators to contract sales directly with large consumers.	7. (i) The Memorandum and Articles of Association of CPPA amended to establish CPPA as an agent to purchase electricity on behalf of distribution companies (including DISCOs); and (ii) CPPA signed on behalf of DISCOs with GENCO's Holding Company on behalf of GENCO, HoAs reflecting key principles for power purchase agreements for existing thermal plants, with the energy price based on heat rate testing; HoAs have been endorsed by the respective board of directors.	8. (i) CPPAG has demonstrated the operational capability to handle all steps in the billing and settlement cycle of electricity sales by generators and purchases by DISCOs, and (ii) NEPRA has granted an amendment to the NTDC license to eliminate CPPA functions.	11. CPPA submits and NEPRA approves the market rules, allowing generators direct contract sales to bulk power consumers, and covering market registration, balancing operations, and settlement and billing among market participants.	8. CPPA implements approved market rules allowing direct contracting with bulk power consumers.		*Result Indicator B8: CPPA legally, institutionally and operationally independent from NTDC.* • Baseline (FY2013): CPPA is still a unit within NTDC. • Target (FY2016): All contracted power generated by IPPs, GENCOs and WAPDA are traded through an independent CPPA.
Policy Area C: Accountability and Transparency						
Increasing access to information in the energy sector.	8. NTDC implemented web-based open access to operational information, including merit order, and daily payment instructions to generators. 9. Each DISCO (i) included the subsidy amount in their customer's bills; and (ii) published on its website monthly billing and collection data aggregated by consumer category.	9. CPPAG publicly disclosed on its website the monthly amounts due, and payments made, by each DISCO to CPPAG, and by CPPAG to generators, including arrears.	12. MOWP implements public web-based access to monthly information results of performance contract, provided by DISCOs, NTDC, and GENCOs.			*Result Indicator C1: Access to operational and payment information publicly available from website.* • Baseline (FY2013): information not available on website. • Target (FY2017): information available on CPPA and DISCOs websites. *Result Indicator C2:*

Objective	Subprogram 1 Prior Actions completed by 31 March 2014	Prior Actions completed in Subprogram 2	Indicative triggers to be supported through Subprogram 3	Indicative triggers to be supported through Subprogram 4	Indicative triggers to be supported through subprogram 5	Results
Strengthening NEPRA.		10. NEPRA has disclosed the annual performance and evaluation report of DISCOs, and has initiated outreach actions to consumers regarding the content; DISCOs have disclosed on their respective websites their annual performance reports, including their plans to improve service delivery.	13. NEPRA publishes review of WAPDA, GENCOs, DISCOs, K-Electric, and NTDC compliance with license provisions. 14. NEPRA notifies licensees who have not provided adequate information and sanctions them if not provided by [December 2015].	9. NEPRA publishes review for at least 30 IPPs on compliance with license provisions.	7. NEPRA publishes review for all remaining IPPs on compliance with license provisions.	*Access to licensees' performance available on NEPRA website.* • Baseline (FY2013): information available only in NEPRA annual State of Industry Report. • Target (FY2017): information available on NEPRA website and updated monthly.
Monitoring and Surveillance.	10. ECC approved establishment of monitoring units within both MOWP and MPNR with responsibility for monitoring the energy sector, reporting on a quarterly basis, and publicly disclosing the report; and MOWP and MPNR formulated the scope of work for advisors to review quarterly monitoring reports and provide advice and recommendations on the implementation of the reforms, which will be made public.		15. MOWP discloses on its website annual operational audit reports provided in accordance with the signed performance contracts.	10. Based on a qualitative assessment of progress, revise the implementation of the outreach program		*Result Indicator C3: Quarterly reporting and public disclosure on the implementation status of the energy sector reforms.* • Baseline (FY2013): not available. • The reports are published quarterly.

CPPA = Central Power Purchasing Agency, DISCOs = distribution companies, ECC = Economic Coordination Committee, FPA = fuel price adjustment, GENCOs = Power Generation Companies, GDP = gross domestic product, HESCO = Hyderabad Electric Service Company, HOAs = Heads of Agreement, IPP = Independent Power Producer, LCP = least-cost generation plan, LNG = liquefied natural gas, MEPCO = Multan Electric Power Company, MEPS = minimum energy performance standards, MOWP = Ministry of Water and Power, MPNR = Ministry of Petroleum and Natural Resources, MYT = multi-year tariff, NEPRA = National Electric Power Regulatory Authority, NPCC = National Power Construction Corporation, NTDC = National Transmission and Despatch Company, PESCO = Peshawar Electric Supply Company, PPIB = Private Power Infrastructure Board, SCADA = supervisory control and data acquisition, SCFD = standard cubic feet per day, SEPCO = Sukkur Electric Power Company, WAPDA = Water and Power Development Authority.

Comparison of Indicative Triggers and Prior Actions of Subprogram 2

Original Indicative Triggers for Subprogram 2 (as of Subprogram 1 approval)	Prior Actions in Subprogram 2	Reasons for the change
1. Further to consultation referred to in prior action 2 of subprogram 1, NEPRA [notifies] guidelines for DISCO tariff determination covering principles, methodologies, timetable, formula and procedures for both annual and multi-year tariff (MYT), and including (a) procedure for DISCO to submit investment costs prior to filing of petition; and (b) adjustment mechanisms during the year including a formula-based forward-looking automatic fuel price adjustment (FPA).	1. Nine DISCOs submitted tariff petitions to NEPRA for FY2015, including forms and data requirements stipulated in the NEPRA Guidelines for Determination of Consumer End Tariff, in order for NEPRA to start tariff determination; and 8 DISCOs submitted 5-year investment plans in order for NEPRA to start the determination of MYTs in FY2016.	The contents of the action have not been changed substantially. The action was revised to reflect the number of DISCOs that have complied with the new guidelines for new petitions.
2. Further to the Tariff and Policy Guidelines 2014, the government (i) publishes on the CPPA website monthly overdue payables to the power generators disaggregated to DISCO level; and (ii) MOWP (a) publishes a cap for overdue payments not to exceed [PRs220 billion], and (b) maintains overdue payments below the cap for at least [3] months.	2. MOWP has published on its website a cap for total due and overdue payables to generators not to exceed PRs314 billion and a plan to reduce the flow of new overdue payables to PRs39 billion by FY2018	**The achievement from this action exceeded the expectations in the original indicative trigger.** During subprogram 2 monitoring, agreement has been reached with the government that the cap will not exceed PRs314 billion, including both current and overdue payables. The government has made further commitments and developed an action plan to reduce future payables. The wording of the action is revised to recognize this progress. The action on publishing monthly overdue payables is covered by Prior Action 9.
3. Each DISCO identifies and assesses existing consumer receivables and their respective recoverability to reflect, in accordance with the Companies Ordinance and the General Accounting Practices, re-classification and provisioning of the qualified receivables in its audited financial statements for FY2014.	Deleted.	This action was fulfilled. However, the government announced an ambitious privatization plan for DISCOs (see Prior Action 8), which requires further improvements to DISCOs than planned at the time of Subprogram 1.
3. MOWP issues regulation(s) on (i) minimum energy performance standards (MEPS) for at least 3 energy-intensive consuming appliances or technologies, and (ii) appliance labeling.	3. MOWP issued guidelines on MEPS and appliance labeling for at least 3 energy consumption-intensive appliances or technologies	MOWP has issued an official memo to adopt the guidelines, which were sufficient, because the guidelines are voluntary as of Subprogram 2.

4. MPNR notifies rules for enhancing gas production from producing, dormant or under-producing concessions.	4. MPNR has signed supplemental agreements agreeing to revised prices for 92 exploration concessions production leases at levels set out in the 2012 Petroleum Policy, including 26 from the private sector.	While the original action was going to impact the operations of a limited number of gas concessions, the new prior action addresses gas exploration and production companies and is expected to more rapidly increase domestic gas production.
No equivalent action	5. The Economic Coordination Committee has approved policy directives stating that LNG will be provided to consumers who pay its full cost through the tariff.	**This action is an additional achievement to the original policy matrix during Subprogram 2.** The action is based on the government's plans to import significant quantities of LNG. The action supports adoption of a full cost-recovery policy for imported LNG, which will improve investor confidence and avoid the risk of supplying LNG to non-cost recovery customer segments.
5. MOWP signs performance contracts, including operational and financial performance indicators and a monitoring framework, with all GENCOs, NTDC and all remaining DISCOs.	6. MOWP signed performance contracts, including operational and financial performance indicators and a monitoring framework, with all remaining DISCOs, GENCOs, and NTDC.	No substantial changes (only minor rewording).
No equivalent action.	7. Roadmap for privatization was developed and implementation was started	**This action is an additional achievement to the original policy matrix during Subprogram 2.** The government plans to privatize all DISCOs and GENCOs by 2017. While the completion of the program may face challenges, this action is recognized as the program accelerated the appointment of financial advisors for the first batch of privatization.
6. (i) NTDC files request and NEPRA amends NTDC license to remove CPPA functions, and NTDC's authority to purchase or sell electricity; and (ii) CPPA signs an energy supply agreement with each DISCO to procure power on their behalf.	8. (i) CPPAG has demonstrated the operational capability to handle all steps in the billing and settlement cycle of electricity sales by generators, and purchases by DISCOs; and (ii) NEPRA has granted an amendment to the NTDC license to eliminate CPPA functions.	**The revision highlights the increased irreversibility of the improvements in billing and settlement structure resulting from the action.** The two actions are also combined to focus on the outcome of the original two triggers.
7. (i) CPPA signs PPAs with WAPDA on behalf of DISCOs, and PPAs with all GENCOs (one PPA for each GENCO operational thermal plant); and (ii) WAPDA enters into an agreement with CPPA for administration of IPP PPAs under the 1994 policy.		

8. CPPA implements web-based access to monthly amount due and payments made by DISCOs to CPPA, and by CPPA to generators.	9. CPPAG publicly disclosed on its website the monthly amounts due, and payments made, by each DISCO to CPPAG, and by CPPAG to generators, including arrears.	No substantial change is made. The action was reworded to clarify the details of the information disclosure.
9. NEPRA publishes (at least monthly) on its website the information provided by all licensees on selected performance standards results and indicators.	10. NEPRA has disclosed the annual DISCO performance and evaluation reports, and initiated outreach action to consumers regarding the content; DISCOs have disclosed on their respective websites their annual performance reports, including their plans to improve service delivery.	The action was reworded to clarify the specific method of information disclosure and to add actions by DISCOs.

CPPA = Central Power Purchasing Agency, CPPAG = CPPA Guarantee, DISCOs = distribution companies, GENCOs = power generation companies, IPP = independent power producer, LNG = liquefied natural gas, MEPS = minimum energy performance standards, MPNR = Ministry of Petroleum and Natural Resources, MOWP = Ministry of Water and Power , MYT = multi-year tariff, NEPRA = National Electric Power Regulatory Authority, NTDC = National Transmission and Despatch Company, PPA = power purchasing agency, WAPDA = Water and Power Development Authority.