

# PROJECT INFORMATION DOCUMENT (PID) CONCEPT STAGE

Report No.: PIDC1283

<b>Project Name</b>	PK Sindh Public Sector Management Reform Project (P145617)
<b>Region</b>	SOUTH ASIA
<b>Country</b>	Pakistan
<b>Sector(s)</b>	Sub-national government administration (50%), General public administration sector (50%)
<b>Theme(s)</b>	Public expenditure, financial management and procurement (45%), Tax policy and administration (45%), Other accountability/anti-corruption (10%)
<b>Lending Instrument</b>	Investment Project Financing
<b>Project ID</b>	P145617
<b>Borrower(s)</b>	Finance Department, Govt of Sindh
<b>Implementing Agency</b>	Sindh Revenue Board
<b>Environmental Category</b>	C-Not Required
<b>Date PID Prepared/ Updated</b>	01-Jun-2014
<b>Date PID Approved/ Disclosed</b>	02-Jun-2014
<b>Estimated Date of Appraisal Completion</b>	30-May-2014
<b>Estimated Date of Board Approval</b>	15-Sep-2014
<b>Concept Review Decision</b>	Track II - The review did authorize the preparation to continue

## I. Introduction and Context

### Country Context

In spite of Sindh Province's enormous economic, geographic, and resource advantages, recent growth and social development trends indicate that the province is not realizing its full potential. Over the last decade growth has been erratic and declining and real incomes have declined since 2005/06. Several deep-seated structural problems underlie this continuous decline in Sindh's economic growth including: (i) a stark urban-rural bifurcation of the province which limits economic and social cohesion; (ii) an adverse law and order situation, especially in Karachi; (iii) vested interest groups which have undermined the cost effectiveness and quality of the public service delivery system; (iv) revenue collection which despite some success has remained relatively static; (v) continued reliance upon federal transfers; and (vi) increasingly binding skills, factors and input constraints impacting production and incomes in the province.

While federal transfers, which constitute 70% of the revenues of the province, provide a significant base for provincial expenditure, the total quantum of federal transfer revenues is not adequate to finance development needs of the province. To meet these needs, Sindh has to raise its own tax revenues through better structuring of its taxes and greater efficiency in their administration. In addition, Sindh must improve its public financial management (“PFM”) performance in order to achieve efficient and effective delivery of programs and services. Until Sindh is able to improve its own revenue mobilization and PFM performance, economic and social growth will continue to be a challenge for the province.

Deterioration in performance of public financial management systems is constraining economic and social performance. A Public Expenditure and Financial Accountability (PEFA) assessment was conducted for the province of Sindh in 2009 and a 2013 update is underway for completion within FY14. These assessments identify a range of weaknesses in the PFM systems, including critical shortcomings in budget execution processes as well as in internal and external controls. While the scope, nature, and follow up of external audits are adequate, significant efforts are required to clear the backlog of review of audit reports by the Sindh Provincial Assembly and to prevent the build-up of any new backlogs. Formal Coordination of PFM Reforms also needs to be improved.

Expenditure management is further constrained by inefficiencies in provincial procurement processes. Improvements in the provincial public procurement system could offer significant fiscal savings. E-Government procurement offers a viable solution for improving procurement transparency and increasing competition. An e-procurement (e-Government Procurement “e-GP”) system in Sindh Province would incorporate the tendering process into the procurement system - integrating transparency and competition into the procurement process, and creating a reliable source of data which can be used to improve procurement performance and inform the public about results.

Fiscal revenue is a critical challenge for provincial public finance. The low tax-to-GDP ratio in Pakistan, currently less than 10%, is widely recognized as a major policy concern. Own-source revenues of the Sindh Province are a small fraction of the total budget of the province, and even a smaller fraction of its needs. The province is highly dependent on federal transfers which have been erratic in recent years due to weak enforcement in tax collection by the federal government. Further, tax administration in the province is fragmented among three separate entities – the Sindh Revenue Board, the Board of Revenue, and Excise and Taxation.

Broadening the tax base and reforming tax administration is critical for generating a sustainable fiscal platform for the Government’s key development priorities. The under-performance of the provincial tax system reflects both weaknesses in policy (narrow tax base, undervaluation, exemptions and incentives) as well as inefficiencies of administration and enforcement. In particular, significant challenges exist related to provincial taxation. Provinces have limited authority to tax and, even in authorized areas of taxation, significant obstacles exist.

The opportunity for revenue growth associated with the Services General Sales Tax is substantial. While most provincial tax collection has been stagnant, the Sindh Revenue Board (“SRB”) which administers the Services General Sales Tax (SGST) stands out as an exception, doubling its revenues from approximately Pakistan rupees 15 to 34 billion from fiscal year 2010/11 to 2012/13. Based upon the current forecast for FY 2013-2014, Sindh anticipates a 20% SGST growth rate. By

strengthening the government's analytical capacity to develop and assess tax policy options and bolstering administrative initiatives, the SGST tax base can be broadened, catalyzing ongoing tax reform and increased revenue mobilization in the province.

### **Sectoral and Institutional Context**

#### **Government Program**

Led by the Finance Department, the Government of Sindh is developing a Provincial Tax and PFM Reform Plan to provide a roadmap for fiscal and financial reform. Specifically, the plan will focus on public financial management, tax and procurement reform, and it will provide a foundation for ongoing donor engagement and provincial implementation. The PFM reforms will use the PEFA findings as a foundation, and the government will prioritize areas of PFM reform among short, medium and long term horizons. Bank engagement in Sindh Province is premised upon this Provincial Reform Plan, and the development of political consensus required to support its implementation

#### **Other Development Partners**

In addition to the proposed Bank support, the European Union has committed approximately Euro 9 million of technical assistance to PFM reform in Sindh Province over a five year period. The EU Technical Assistance will provide training, capacity building, and analysis related to the achievement of three key Public Financial Management objectives: (i) establishing strategic budgeting in Sindh Province, (ii) enhancing the credibility of budget execution and reporting, and (iii) improving accountability.

#### **Relationship to CAS**

The proposed operation has direct relevance to the Pakistan CPS. One of the pillars of the Country Partnership Strategy for FY 2015-2019 is accelerating improvements in services. Improved services in Pakistan focuses on multiple strategies including: (i) increasing revenues to fund services, (ii) improve public financial management, (iii) improve development expenditures, and (vi) setting more ambitious stretch targets for areas that are not producing change fast enough (especially education and health). The scope of the proposed project touches upon all of the aforementioned areas of focus. The project will also support large Bank investments in education, nutrition, irrigation and agriculture sectors in the province.

## **II. Proposed Development Objective(s)**

### **Proposed Development Objective(s) (From PCN)**

19. The development objective of the project is to strengthen accountability and performance of public finance in Sindh Province.

### **Key Results (From PCN)**

20. The success of the project is to be measured by the following outcomes:

- Result 1: Improved budget execution to enable service delivery
- Result 2: Increased transparency and oversight in budget management practices
- Result 3: Increased Services General Sales Tax (SGST) collection
- Result 4: Increased transparency in the procurement process through the provision of timely and accessible procurement information

21. Indicators for measurement are as follows:

- Indicator 1: Variance in expenditures composition during the financial year
- Indicator 2: Number of internal audit reports
- Indicator 3: Percentage increase in collection from Services General Sales Tax (SGST) per annum
- Indicator 4: Key procurement documents made available in the public domain

PDO indicators and intermediate indicators are provided in Annex IV, the Preliminary Results Framework.

### III. Preliminary Description

#### Concept Description

##### Lending Instrument and Components

Loan amount, lending instrument and project duration. The proposed operation will be financed by an Investment Project Financing (IPF) loan of US\$50 million to the Government of Sindh Province in Pakistan and will use a results-based financing modality to support project implementation. The Project consists of two complementary components: (i) results-based financing to provide an incentive for achieving eligible public sector management (“PSM”) reforms (US\$45 million, and (ii) technical assistance to support activities for achieving DLIs (US\$5 million).

Results-based financing will disburse against agreed-to eligible expenditure programs in three reform areas: enhancing performance of public financial management systems; strengthening public procurement performance, and increasing revenue mobilization through tax policy reforms and increased administrative efficiency in tax collection.

##### Project Description

Component 1: Results-based financing to provide an incentive for achieving eligible public sector management (“PSM”) reforms (US\$45 million). The results-based component will include the following 3 focus areas for which DLIs will be developed.

Enhancing Performance of PFM Systems. The objective of this sub-component will be to strengthen PFM systems by improving budget execution processes and oversight mechanisms. The project will also strengthen accountability and oversight systems by (i) establishing budgetary information disclosure mechanisms to strengthen citizen input into the budget process; and (ii) improving the capacity of the Sindh Provincial Assembly to clear the backlog of review of audit reports and prevent the build-up of any new backlogs. The Sindh Finance Department will be supported to publicly disclose all the elements of financial information listed in PEFA such as annual budget documentation, in-year budget execution reports, year-end financial statements, external audit reports, contract awards and resources availability at primary service units.

Strengthening of Public Procurement Performance. This program is designed to create better data and more transparency and competition in procurement processes through the establishment of an e-Government Procurement (“EGP”) system. Toward this end, this project component involves the

necessary analysis and planning to identify required changes for the new technology to be effective, and the implementation of an e-GP Strategy.

**Increasing Revenue Mobilization.** This area of reform is designed to increase revenues associated with collection of the Services General Sales Tax (SGST) through broadening of the tax base and improving administrative inefficiencies. The Services General Sales Tax has been targeted for reform because it has an up-to-date tax structure (more than any other provincial tax) and it is highly automated. Further, the Sindh Revenue Board (“SRB”) is a new entity, and does not have the challenges of legacy institutions.

Component 2: This technical assistance component, worth 5 million dollars, will provide consultancy, communication and related support to the component 1.

#### IV. Safeguard Policies that might apply

Safeguard Policies Triggered by the Project	Yes	No	TBD
Environmental Assessment OP/BP 4.01		×	
Natural Habitats OP/BP 4.04		×	
Forests OP/BP 4.36		×	
Pest Management OP 4.09		×	
Physical Cultural Resources OP/BP 4.11		×	
Indigenous Peoples OP/BP 4.10		×	
Involuntary Resettlement OP/BP 4.12		×	
Safety of Dams OP/BP 4.37		×	
Projects on International Waterways OP/BP 7.50		×	
Projects in Disputed Areas OP/BP 7.60		×	

#### V. Financing (in USD Million)

Total Project Cost:	279.00	Total Bank Financing:	50.00
Financing Gap:	0.00		
<b>Financing Source</b>			<b>Amount</b>
BORROWER/RECIPIENT			217.00
International Development Association (IDA)			50.00
EC European Commission			12.00
Total			279.00

#### VI. Contact point

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