PROGRAM INFORMATION DOCUMENT (PID)
CONCEPT STAGE

Report No.: 95435

Operation Name	Second Power Sector Reform Development Policy Credit
Region	SOUTH ASIA
Country	Pakistan
Sector	General Energy Sector (100%)
Operation ID	P152021
Borrower(s)	ISLAMIC REPUBLIC OF PAKISTAN
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Implementing Agency	
Date PID Prepared	January 19, 2015
Estimated Date of Appraisal	March 30, 2015
Estimated Date of Board Approval	April 28, 2015

I. Key development issues and rationale for Bank involvement

1. This proposed second credit in a programmatic series of two single tranche operations continues IDA's support for Pakistan's goal of developing an efficient and consumer oriented electric power system that meets the needs of its people and economy sustainably and affordably. The proposed operation is aimed at improving financial viability and thus reducing the burden of public financing to support operations and investment in the sector. IDA financing would provide US$500 million equivalent. The proposed operation is part of a wide program of reforms aimed at lifting Pakistan's growth potential. It is at the core of the Country Partnership Strategy (CPS) for 2015-2019 and supports the World Bank's twin goals of poverty reduction and shared prosperity.

2. Pakistan's economic performance is improving. For the first time in many years, Pakistan's GDP growth was over four percent in fiscal year 2012-2013 (FY 13/14), despite the aftermath of floods in 2010 and 2011 and a difficult security situation. The threat of a foreign

exchange crisis, severe a year ago, has receded. At 5.5 percent of GDP, the fiscal deficit was less than forecast, and inflation, though above the previous year, remained in single digits. Nevertheless, the economy is still vulnerable to shortages of energy, particularly electricity, natural disasters such as the floods experienced in 2014, and to lower than expected inflows of remittances, foreign direct investment (FDI) and taxes.

3. Poverty is declining. Despite falling and increasingly volatile per capita growth, poverty has declined over the last decade, and Pakistan's poverty rate broadly followed the per capita growth trend. The share of the population below the national poverty line fell from 34.7 percent in FY01/02 to an estimated 13.6 percent in FY10/11. Real per capita consumption growth of the bottom 40 percent of the population – a measure of shared prosperity – also exceeded that of the top 60 percent in the same period. Growth has been broadly inclusive, with the national Gini coefficient falling from 0.34 to 0.29 between FY98/99 and FY10/11. Social safety nets such as the Benazir Income Support Program (BISP) have redistributed wealth to the poor and vulnerable and have become especially important as growth has become more volatile. BISP has achieved high efficiency, with 73.5 percent of the program budget reaching the poor.

4. Energy sector performance has improved but challenges remain. Subsidies to the sector were reduced in FY13/14 to about 1.2 percent of GDP, down from 1.5 percent the previous year. Falling oil prices have reduced input costs for electricity generation and as tariffs have been adjusted downwards, the government has introduced surcharges which have further reduced the gap between cost of supply and sector revenues. A gap of about PKR 2/kWh remains, however, and the sector continues to suffer acute liquidity shortages. As a result, accumulated arrears of payment by the public electricity distribution companies (Discos) to their suppliers, commonly known as the circular debt, has started to re-emerge and currently stand at about PKR xx billion, or xx percent of FY13/14 GDP. Targeting of subsidies towards the poorest remains an issue, as does the need to ensure that the sector develops in a socially and environmentally sustainable way.

5. The government is staying the course but needs to increase its focus on structural issues. Distractions on the political and security front slowed the pace of reform in the latter part of 2014, but momentum is again picking up. The government has developed an ambitious power sector privatization program, which underlines the need for further structural reforms which in turn will improve sector performance, particularly by reducing losses, raising collections, bringing down the cost of supply and encouraging investment. The Extended Fund Facility (EFF) agreed with the IMF early in the government's term, and complementary work by a significant group of donors has underpinned the authorities' resolve, but long outstanding issues need to be addressed.

6. The proposed operations will support the key challenge of restoring financial viability to the electric power sector. In addition the operations are expected to support faster economic growth, improve the business environment and attract greater private investment, focus government subsidies on the poor and help set the sector onto a more environmentally sustainable path.

7. The operation faces high risks. Past efforts at reform of the power sector have stalled in the face of vested interests within the sector and government interference from outside it. The government has done well so far, but there remains a risk of slowing down or reversal of reforms, especially if public fatigue or resentment sets in when shortages mount in the critical

summer months. Resistance to change within the sector, especially if it increases individual accountability in companies and among consumers who benefit from the current weak governance present a major risk to achieving the operation's objectives.

II. Proposed objectives

8. Pakistan's goal is to develop an efficient and consumer oriented electric power system that meets the needs of its people and economy sustainably and affordably. The three guiding principles of the 2013 National Power Policy are efficiency, competition and sustainability, and it focuses on five main targets set out in Table 1 below.

Table 1: The Five Main Targets of the National Power Policy (July 2013)

Target	Current Situation	Goal and date
Decrease gap between supply and demand	4,500 – 5,000 MW shortfall	Reduce to zero by 2017
Improve affordability by decreasing cost of generation	Average generation cost 12 US¢/kWh	Reduce average generation cost to 10 US¢/kWh by 2017
Decrease aggregate technical and commercial transmission and distribution (T&D) losses	T&D losses currently about 23-25 percent	Reduce T&D losses to about 16 percent by 2017
Improve collection of billed electricity	Collections are currently about 85 percent of billing	Increase collections to 95 percent of billing
Improve governance by decreasing decision making times at Ministries, related departments and regulators	Slow decision making	Shorter processing times (goal yet to be established)

9. The government has developed an Action Plan to implement the National Power Policy over the next 3 to 5 years. The action plan ties together the policies and actions required to implement the specific strategies of the 2013 National Power Policy. The strategies are closely interlinked. Achieving financial sustainability requires improving cash flows through tariffs reflective of efficient costs, promoting efficiency and performance of the companies through commercialization, and reducing losses, in particular theft. The government also considers that privatization of the Discos will help improve performance. Reductions in the cost of generation will come from increasing hydropower and gas in the generation mix and better efficiency, promoted through least cost planning. Subsidies must increasingly be targeted only to low-income households. Creating awareness and consensus for the policy implementation requires increasing transparency through greater access to information, strengthening the capacity of NEPRA and improving its accountability.

10. This is the second in a proposed series of two development policy credits (DPCs) supporting Pakistan's goal of developing an efficient and consumer oriented electric power system that meets the needs of its people and economy sustainably and affordably. The DPC focuses particularly on policy and institutional actions that will improve financial viability and thus reduce the burden of public financing for the sector.

11. Description of Prior Actions:

- Following the mechanism in 2014 Tariff and Subsidy Policy Guidelines, MWP has informed NEPRA of the FY14/15 subsidies by consumer category to incorporate in the tariff determination of each Disco, to apply in FY14/15 expected to result in electricity subsidies to be reduced to 0.7% of GDP.

- MWP has published in its website a cap for total overdue payables to power generators not to exceed PKR 250 billion and a time bound action plan for bringing them down to zero.
- The Government has implemented a mechanism based on tariff surcharges and Universal Obligation Fund to maintain national uniform tariffs in Discos while ensuring cost recovery.
- MPNR has signed supplemental agreements agreeing revised prices for [120] exploration concessions at the levels set out in the 2012 Petroleum Policy, including at least [20] from the private sector.
- Cabinet Committee On Energy has approved a policy directive that LNG will be provided to consumers who pay its full cost through the tariff.
- (i) CPPA (G) has demonstrated 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 NTDC license to eliminate CPPA functions.
- CPPA (G) publicly disclosed on its website the monthly amounts due, and payments made, by each Disco to CPPA (G), and by CPPA (G) to Generators, including arrears.
- NEPRA has disclosed the annual Discos performance and evaluation report, and has initiated outreach action to consumers on the content thereof; and Discos have disclosed on their respective websites their annual performance reports, including their plans to improve service delivery.

12. The following results indicators are selected for the project:

(i) Reduced subsidies allocated in the federal budget from a baseline of 1.8 percent of GDP in FY12/13 to 0.7 percent by the end of FY14/15;

(ii) Increased bill collection in Discos from a baseline of 86 percent of bills collected in FY12/13 to 94 percent of bills collected in FY15/16;

(iii) Increased domestic gas supply from 3.8 billion standard cubic feet per day in FY12/13 to 5 billion standard cubic feet per day in FY 15/16;

(iv) Separation of market operation and transmission system operation, with contracted power generated by IPPs, Gencos and WAPDA Hydel traded through an independent Central Power Purchasing Agency acting on behalf of Discos by the end of FY 15/16;

(v) Disco performance reports and NEPRA review published by FY14/15.

III. Preliminary description

13. The proposed operation continues support for the government's Action Plan to implement the 2013 National Power Policy. The first operation reflected prior actions taken by the government to support the most pressing needs to stabilize the sector. This second operation in the series has a bias towards longer term structural reform. Combined, the series have the particular aim of restoring the sector's financial viability and reducing the burden of public financing for it. It is centered around three policy aims:

(A) *Reducing subsidies and improving tariff policy.* Reducing, making more transparent and better targeting subsidies is essential if the sector is to become financially viable and the government's fiscal position is to improve. Measures in this area will further limit government subsidies, including through the Universal Service Obligation which will shift the cost of the uniform tariff policy on to consumers and start active management of the circular debt.

(B) *Improving sector performance and opening the market to private participation.* Actions to be supported will increase the supply of gas through better and more transparent pricing, and move the electricity sector towards market oriented operation, thus opening it up for privatization.

(C) *Ensuring accountability and transparency.* Better monitoring, governance, transparency and rigor in reporting of results in the energy sector is important for implementation of reform and to ensure government and broader stakeholder support. Actions include monitoring and self-reporting mechanisms for sector entities, and publication of performance against benchmarks.

14. There are synergies between the three policy aims, shared prosperity and poverty reduction. Addressing subsidies and ensuring that the efficient costs of providing electricity services are reflected in tariffs will provide strong signals to Discos and their owners that they must improve performance. Increasing the supply of gas and opening the sector to private participation will reduce the subsidy burden. More transparency and accountability will improve governance and give more information to potential investors in the privatization process, while also promoting demand for an efficient and well run sector, helping to reduce subsidies.

IV. Environment Aspects

15. An environment analysis was prepared during the first operation in the series. There are no changes to the operation that are expected to require re-analysis.

16. During preparation we will continue discussions with the Department of Climate Change in the Cabinet Secretariat on its monitoring of climate change impacts of the power sector which it is currently studying.

V. Tentative financing

Source:		($m.)
International Development Association (IDA)		500
	Total	500

VI. Contact point

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