

**Islamic Republic of Pakistan**

**Khyber Pakhtunkhwa Revenue Mobilization and Public Resource Management**

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**ABBREVIATIONS AND ACRONYMS**

|  |  |
| --- | --- |
| BPM | Business Process Mapping |
| BPR | Business Process Review |
| DLI | Disbursement-Linked Indicator |
| ESSA | Environmental and Social Systems Assessment |
| ETNCD | Excise, Taxation, and Narcotics Control Department |
| FATA | Federally Administered Tribal Areas |
| FBR | Federal Board of Revenue |
| FD | Finance Department |
| GDP | Gross Domestic Product |
| GoKP | Government of Khyber Pakhtunkhwa |
| GPIF | General Provident Investment Fund |
| GPP | Governance and Policy Project |
| GSTS | General Sales Tax on Services |
| HDF | Hydroelectricity Development Fund |
| ICT | Information and Communication Technology |
| IFSA | Integrated Fiduciary Systems Assessment |
| IPF | Investment Project Financing |
| KP | Khyber Pakhtunkhwa |
| KPITB | Khyber Pakhtunkhwa Information Technology Board |
| KPRA | KP Revenue Authority |
| MTEF | Medium-Term Expenditure Framework |
| NFC | National Finance Commission |
| NFMIS | National Financial Management Information System |
| OSR | Own-Source Revenue |
| P&DD | Planning and Development Department |
| PAP | Program Action Plan |
| PAS | Pakistan Administrative Service |
| PATA | Provincially Administered Tribal Areas |
| PCU | Program Coordination Unit |
| PDO | Program Development Objective |
| PEFA | Public Expenditure and Financial Accountability |
| PFM | Public Financial Management |
| PFMRS | Public Financial Management Reform Strategy |
| PforR | Program-for-Results |
| PPP | Public-Private Partnership |
| PRAL | Pakistan Revenue Automation Limited |
| SBP | State Bank of Pakistan |
| SECP | Securities and Exchange Commission of Pakistan |
| SRB | Sindh Revenue Board |
| ST&IT | Science Technology and Information Technology |
| TA | Technical Assistance |
| TMA | Tehsil Municipal Administration |
| TSA | Treasury Single Account |
| UIPT | Urban Immoveable Property Tax |

# Strategic Relevance and Technical Soundness

1. **The proposed Program is designed to support the Public Financial Management Reform Strategy (PFMRS) of the Government of Khyber Pakhtunkhwa (GoKP).** The PFMRS is based on sound diagnostics, most notably the Khyber Pakhtunkhwa (KP) Public Expenditure and Financial Accountability (PEFA) assessment of 2017. The recent subnational PEFA assessment shows progress on some indicators compared to the previous PEFA of 2007, but it also identifies several areas in need of improvement. The PFMRS provides for reform measures in all the areas for improvement that are within the province’s control (for example, excluding external audit, which lies within the federal domain). These areas include the following: fiscal strategy; revenue outturn and revenue administration; expenditure composition outturn, predictability of in-year resource allocation, and availability of funds for commitments; monitoring of expenditure arrears; unreported financial operations and fiscal risk reporting; public investment and asset management; and internal audit.
2. **The Program targets select reform measures under the PFMRS with the highest potential impact on the two main binding constraints to the GoKP’s development objectives:** (a) limited fiscal space to invest on narrowing the province’s infrastructure gaps and improving human development outcomes through better public service provision and (b) suboptimal utilization of the development budget, which is the vehicle for capital investment. The Program’s interventions and targeted results have been defined through extensive policy dialogue and operational engagement between the GoKP and the World Bank.
3. **The operation is a hybrid Program-for-Results (PforR), with US$100 million designated to the PforR and US$18 million allocated for the Technical Assistance (TA) and Capacity Building component that also caters to the Program Action Plan (PAP).** The PforR (results-based financing) component is expected to facilitate a strategic focus on the specific results that the GoKP aims to achieve in revenue mobilization and public resource management; strengthen the GoKP’s implementation systems without creating parallel systems and additional requirements; narrowly focus on results that are measurable over a specific duration; and build a strong government ownership for the reform agenda, with adequate flexibility for adjustment. The TA and Capacity Building component is to be delivered under two subcomponents: (a) foundations of e-government and (b) program coordination and support.

## Results-Based Component

### Results Area 1: Revenue Mobilization

1. **The Program’s first results area focuses on increasing own-source revenues (OSRs) to address the constraint of limited fiscal space for investment and public service provision.** OSRs are critically important to the GoKP’s ability to engage in meaningful fiscal planning and take on multiannual commitments—such as large infrastructure projects and new service delivery facilities—for two reasons. First, the province needs to expand its resource envelope to generate additional fiscal space to finance development priorities. Second, it needs to reduce its dependence on federal fiscal transfers. Even though the bulk of federal transfers are based on the National Finance Commission (NFC) formula, this revenue stream is not predictable due to volatility in the performance of federal revenues, which affects the size of actual transfers as well as the timing of fund releases to the provinces.

Table 1: KP OSRs and Federal Transfers (PKR, billions), FY2013–2017

|  | **FY2013** | **FY2014** | **FY2015** | **FY2016** | **FY2017** |
| --- | --- | --- | --- | --- | --- |
| 1. Federal transfers (divisible taxes, straight transfers) | 197 | 234 | 251 | 302 | 984 |
| 2. Province’s own-source tax and non-tax revenue (i + ii) | 11.7 | 20 | 22.7 | 25.6 | 80 |
| (i) Taxes (a + b) | 4.3 | 10.5 | 11.7 | 13.3 | 39.8 |
| a) Direct taxes | 2.2 | 2.5 | 3 | 3.4 | 11.1 |
| b) Indirect taxes | 2.2 | 8 | 8.6 | 9.9 | 28.7 |
| (ii) Non-tax revenues | 7.4 | 9.5 | 11 | 12.3 | 40.2 |
| Total revenue receipts (1 + 2) | 224.8 | 284.5 | 308 | 366.5 | 1183.8 |

*Sources*: KP Civil Accounts (June 2017 final) and Revised Budget Estimates, KP Finance Department (FD).

1. **Interventions in this results area are designed to capture more of the economy’s untapped tax potential and leverage the province’s capital assets to generate sustainable revenue streams.** The Program targets revenue sources with the largest revenue potential, economic efficiency, and prospects of delivering quick returns. Two provincial taxes fit this profile: (a) the General Sales Tax on Services (GSTS), which has the largest revenue potential, and (b) the Urban Immoveable Property Tax (UIPT), which has high growth potential (annual growth of 12 percent in the past five years) and a large tax gap, that is, difference between actual and potential receipts (Figures 1.B, 1.C, and 1.D). These taxes are also efficient from a tax policy perspective in the sense that increasing collection is not likely to dampen economic growth or give rise to perverse incentives for economic actors. The Program also targets revenue generation from commercial use of underutilized government real estate assets, an all but untapped source of non-tax revenue with a high revenue potential and relatively quick returns.

Figure 1: Composition of Own-Source Tax Revenue in KP



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**The World Bank staff calculations**

Note: CVT is Capital Value Tax; MVT is Motor Vehicle Tax; AIT is Agricultural Income Tax and STS is Sales Tax on Services

1. **The Program’s tax-related interventions focus on expanding the tax base without introducing any new taxes or raising tax rates.** This approach is known as the ‘Broad Base, Low Rate’ principle, which aims to minimize economic distortions. Broadening the tax base can be done by reducing tax exemptions (tax policy), bringing more taxpayers into the tax net (increasing registration of new taxpayers), and increasing taxpayer compliance (tax administration). The Program therefore focuses on the GSTS as the tax with the largest gains to be made from increased compliance. Services are the largest and fastest-growing sector of the KP economy, accounting for an estimated 64 percent of the province’s gross domestic product (GDP). In turn, the GSTS accounted for 64 percent of KP tax revenue and one-third of the total OSR receipts in FY2016/17 (Figure 1.B). Despite a rapid increase in GSTS receipts in the past three years, these receipts amounted to only 0.4 percent of the estimated output of the services sector. It is therefore evident that even a threefold increase in the GSTS receipts would amount to a low tax burden, especially considering that compliance improvement measures will focus primarily on large taxpayers.
2. **A recent World Bank analysis estimates that the GoKP is capturing about a quarter of the potential GSTS revenue due to low compliance and extensive exemptions.** The exemption of the eight districts designated as Provincially Administered Tribal Areas (PATA) and the Kohistan District from most taxes accounts for as much as 60 percent of the GSTS tax gap. Some of these districts have substantial services sectors, including tourism, which is a growing industry. GSTS compliance in the taxable districts of KP is estimated at 23 percent. Compliance rates vary across sectors, ranging from 48 percent in banking and telecom to 6 percent in transport (Figure 2.B). It therefore makes sense for the GoKP to concentrate its efforts and resources on increasing GSTS compliance—with a focus on large sectors (for example, telecom, banking, construction, and transport and logistics) and taxpayers. The Program’s interventions therefore aim to increase compliance by strengthening the capacity of the KP Revenue Authority (KPRA) to detect and deter tax evasion and by encouraging taxpayers’ compliance through facilitation measures.
3. **The Program also targets the UIPT because of its large tax gap, which is mainly due to the low valuations used for taxation purposes.** UIPT valuations are about 20 percent of current market values, resulting in comparatively low receipts that contribute 4.4 percent of KP OSR tax receipts in FY2016/17, compared to 6 percent in Punjab. Other reasons for the underperformance of UIPT revenues relate to incomplete tax records, large-scale exemptions, and a narrow delineation of city boundaries that exclude peri-urban areas. Bringing UIPT valuations closer to market values has several advantages. First, it would generate additional revenue for Tehsil Municipal Administrations (TMAs) to expand and improve municipal services such as waste collection, which are severely underfunded. Second, current exemptions for small properties ensure that the new valuations would not have a negative impact on low-income households or microbusinesses. Third, it would help counter distortions in economic incentives due to the under-taxation of property in Pakistan, which favor investment in real estate over other sectors. The Program will therefore support the initiative of the Excise, Taxation, and Narcotics Control Department (ETNCD) to revise valuation tables to bring them closer to market values (up to 40 percent of sale or rental values) in the province’s major urban centers.

Figure 2: Revenue Potential in KP’s GSTS, by Various Compliance Scenarios



1. **The Program’s design is informed by global experience of using information and communication technology (ICT) to facilitate taxpayer compliance, tackle tax evasion, and reduce the cost of tax collection.** Digitizing tax records, simplifying and automating business processes, and integrating databases to expand and cross-check taxpayer information are proven ways of improving the performance of tax administration. Taxpayers benefit from more convenient and cheaper ways to access information and file and pay their taxes. Tax authorities enhance their ability to compile and analyze taxpayer information while reducing their operational costs (for example, by undertaking fewer, better-targeted inspections). ICT is critical to the business intelligence function, which is very effective in increasing compliance. Business intelligence uses large datasets and algorithm-based systems to track the timeliness of tax declarations, detect cases of potential under-declaration, monitor tax arrears, identify potential taxpayers to be brought into the tax net, and select cases for tax audit. The Program therefore provides for the automation of key business processes and integration of datasets through a data warehouse solution for all three tax authorities.
2. **The Program’s interventions related to automation build on the KP tax authorities’ existing achievements, taking account of their constraints and priorities.** For core business processes, the KPRA uses the e-filing system provided by Pakistan Revenue Automation Limited (PRAL), a company administered by the Federal Board of Revenue (FBR) and used by all tax authorities that collect GSTS in Pakistan. This system enables automated processing of tax returns and flags registered taxpayers who have failed to file their returns (stop-filers) or pay within the deadlines (delinquent taxpayers). The system also allows taxpayers to register and file their taxes online. This system has recently enabled online payments to the FBR and the Sindh Revenue Board (SRB). This functionality is also available to the KPRA, but the authority still needs to conclude bilateral agreements with commercial banks to provide payment options to taxpayers (for example, payments at ATMs, online transfers, and so on). At present, taxpayers can pay only at branches of the National Bank of Pakistan or Bank of Khyber.
3. **The Program’s ICT interventions in tax administration also reflect lessons from the experience of other tax authorities in Pakistan.** One example is the automated issuance of invoices for the UIPT in Punjab, which has contributed to higher receipts and reduced taxpayer appeals, especially as taxpayers are able to review their properties’ data and tax liabilities online. The Punjab Excise and Taxation Department (ETD) also offers taxpayer facilitation services through a telephone hotline, which answers taxpayers’ queries. The SRB has established database links with other institutions such as the FBR and the Securities and Exchange Commission of Pakistan (SECP). These links have helped the SRB identify firms that provide services in the province without registering with the SRB.
4. **The Program also targets revenue generation from government-owned real estate.** The GoKP owns land and buildings, not all of which are used by government entities. Revenues from the lease of public properties amounted to PKR 0.4 billion in FY2016/17, which was only 3 percent of non-tax revenue. The Program’s targeted result is to consolidate these assets in a commercially managed portfolio. This approach has helped subnational governments around the world generate substantial and sustainable revenue streams, with annual yields ranging from 3 percent to over 10 percent of portfolio value. Program results relate to compiling an asset map with detailed profiles of each asset, including geo-tagging and market-based valuation, followed by the establishment of a government-owned asset management company. The company will have the mandate to invest revenue from mature assets with high rental value in developing other assets to increase the value and future yield of the portfolio. The company’s governance setup will exclude incumbent and retired public officials from the management and Board of Directors to ensure that business decisions are based on commercial criteria. This approach has been successfully implemented in many countries and has much potential for Maximizing Finance for Development by making public land available for development by private firms, thereby bringing investment and jobs in growth sectors such as logistics and hospitality.

### Results Area 2: Management of Public Resources

1. **The Program’s second results area targets the more efficient and strategic use of the province’s financial resources.** Interventions relate to four main results: cash management through regular consolidation of government cash balances, integration of local governments’ budgets in the National Financial Management Information System (NFMIS), improved management of KP special-purpose funds with calibrated investment strategies and associated risk management, and reorientation of development spending toward infrastructure investment. These results relate to large pools of funds that present opportunities for substantial efficiency gains through the Program’s interventions.
2. **Cash management is a critical public financial management (PFM) issue in Pakistan because substantial government funds remain outside the Treasury Single Account (TSA) at all levels of government, including in KP.** When the NFMIS was established, no legislation was adopted to require all government funds to be deposited in the TSA. Instead, the old practice of government entities putting budget funds in commercial bank accounts continued, especially for the execution of development budgets. This practice gives rise to several problems, most notably the following:
3. **The GoKP lacks accurate and timely information about its cash position, which hinders smooth budget execution.** This is because government entities’ bank accounts are not linked to the TSA, so their balances are not tracked through the NFMIS. Lack of timely and comprehensive information about cash availability compels the FD to take a cautious approach in releasing funds for budgeted expenditures to avoid a shortfall of funds. This is also necessary due to the non-recording of new commitments in the NFMIS at the time they are incurred, which makes it difficult for the FD to estimate the volume and timing of pending payments. In turn, however, this form of cash rationing holds back budget execution, especially on the development side and impairs the predictability of resource flows to service delivery entities.
4. **Government entities’ cash deposits are essentially idle funds that return miniscule interest.** This deprives the GoKP of the opportunity to invest surplus cash in revenue-generating instruments.
5. **The channeling of development funds deprives the GoKP of accurate information on budget execution.** Several government entities that have previously obtained FD authorization to open accounts in commercial banks routinely transfer funds from their development budgets to their bank accounts to facilitate project implementation. These transfers are recorded in the NFMIS as actual expenditures of specific development projects, though the funds may be spent later or not at all. This practice inflates the development expenditure reported in the NFMIS, thereby affecting the fiscal balance. Moreover, the large number of bank accounts makes it impossible for the GoKP and the Auditor General of Pakistan to ascertain whether the funds have been spent for the intended purpose.
6. **The GoKP is unable to track municipal governments’ expenditures in a reliable and timely manner.** Like in other provinces, local governments units below the district level (TMAs, Village and Neighborhood Councils) currently execute their budgets through accounts in commercial banks. Neither their budgets nor their expenditures are recorded in the NFMIS. This means that their cash balances do not show up as part of the consolidated balance of the KP Consolidated Fund. The NFMIS currently records only transfers from the provincial level to municipalities, which in turn are shown as spent.
7. **KP has been the first province to take steps to improve cash management by bringing deposits of government entities in commercial banks into the KP Consolidated Fund.** In 2017, the GoKP requested and obtained detailed information from the State Bank of Pakistan (SBP) on the accounts held by KP government entities, including local governments, in commercial banks. The FD subsequently analyzed this information and found that out of a total PKR 186 billion (around US$1.6 billion), PKR 89.4 billion belonged to the province’s special-purpose funds, while the remaining PKR 96.5 billion was held by various government entities, including provincial departments, authorities, and local governments. The GoKP therefore took immediate steps to address the problem. First, the GoKP issued a directive to all departments forbidding the transfer of funds from assignment accounts (under the TSA) to accounts in commercial banks. Second, the GoKP requested entities with accounts in commercial banks to submit monthly bank statements to the FD.
8. **The Program supports targeted results of the GoKP in improving cash management.** The main results in this area will include regular consolidation of the GoKP cash balances under the TSA, the adoption of a cash management policy and revised accounting rules, and the preparation of cash plans to inform the release of budget funds to spending entities. The consolidation of cash balances by all government entities (except those holding dedicated funds, endowment funds, and monies parked in courts as a result of disputes) is expected to proceed in phase-wise frequency, starting with monthly consolidation, followed by fortnightly, and leading to a weekly consolidation. This consolidation of accounts will require the closure of all but a few accounts in commercial banks (for example, those of special-purpose funds) so that government entities’ cash balances will be held in TSA-linked subaccounts. In turn, all expenditures from these accounts will have to be recorded in the NFMIS. The GoKP may maintain a few ‘zero balance’ bank accounts authorized for specific purposes such as the collection of revenue receipts to be transferred to the TSA.
9. **The Program also supports the plan of the GoKP to bring the accounts for municipal governments into the TSA and the NFMIS.** KP will be the first province to fully extend the NFMIS to city governments (TMAs) and bring their accounts under the TSA. This measure is especially relevant in KP, given that local governments receive substantial financing from the provincial budget equal to at least 30 percent of the development budget. Bringing the municipal accounts into the TSA will make them part of the province’s consolidated cash balance and allow the FD to monitor their budget execution to inform releases of budget funds. The subaccounts for TMAs will be held under a new TSA main account, Account- 5, and those for Village/Neighborhood Councils (VCs/NCs) in a new Account-6. The NFMIS is due to be gradually rolled out to TMAs, which will then be able to upload their budgets and make in-year re-appropriations in the NFMIS with support from the Accountant General’s office. The Accountant General’s office, through satellite district and/or TMA accounting units, will be able to record the TMAs’ expenditures in detail in the NFMIS, thereby providing much more granular information on the utilization of municipal budgets.
10. **The Program’s results also target improvements in the management of another important financial resource, the KP special-purpose funds.** These funds consist of the Hydroelectricity Development Fund (HDF, also known as the Hydel Fund), the Pension Fund, and the General Provident Investment Fund (GPIF). The purpose of the HDF is to finance new investments in hydropower, including as co-financing for potential public-private partnership (PPP) projects. At present, the HDF has no liabilities, though fiscal risks could arise from future PPPs. The main issue for the HDF is therefore to diversify its investment instruments to generate more income while managing portfolio risks. It is also important to increase transparency of the HDF through detailed financial reporting to build confidence among citizens and prospective investors. The Program will therefore support improved financial reporting and disclosure for these three funds.
11. **In the case of the Pension Fund, the main issue is to ensure adequate resources to match ballooning liabilities.** The policy framework on pension obligations is a federal responsibility. Provinces typically follow suit and, in some cases, announce generous increases in pension benefits (for example, the GoKP announced a 15 percent increase in FY2016/17 while the federal government had announced 10 percent). However, undertaking pension reforms is a larger subject and requires coordination across federating units. However, provinces are responsible for pension payments from their budgets. To effectively manage these liabilities, the GoKP established a Pension Fund in 1998. This fund is financed through equity injections from the GoKP budget, but these transfers have historically been miniscule and sporadic. Over the last five years, the GoKP has injected PKR 2.5 billion on average. The pension liabilities have, however, grown faster than the holding of the Pension Fund (estimated at PKR 40 billion as of end-June 2018) that is not enough to cover just an annual payout (PKR 60 billion estimated for FY2018/19). Moreover, the GoKP has followed a deliberately conservative investment policy to minimize the risk of principal losses by placing most of the funds’ resources in short-term instruments, notably government securities and deposits in the Bank of Khyber. As a result, the returns on these funds’ capital have been modest. At the same time, the reliance on short-term investments does not match these funds’ long-term obligations, and the concentration of investments is not optimal from a risk management perspective. In addition to strengthening institutional framework and improved reporting and disclosure, the Program will support an actuarial analysis of pension liabilities, which will inform a financing strategy to cover the Pension Fund’s future obligations and ensure a conservative level of equity injection during the life of the Program. Once the results of the actuarial analysis are out, the GoKP may consider revisiting these levels to adequately cover for the estimated pension liabilities.
12. **Finally, the Program targets improvements in the quality of development expenditure by increasing the focus on capital investment and strengthening planning and appraisal.** The World Bank has conducted an analysis of the province’s development expenditure, which shows that just under half of the Annual Development Plan (ADP) is spent on capital investment, that is, on new fixed assets such as new infrastructure, durable equipment, and ICT systems. Like in other provinces, the ADP also includes some recurrent expenditures such as social transfers (for example, subsidies to farmers, scholarships), repairs of existing infrastructure, and salary and operational costs of administrative units that are not part of approved organograms. While such expenditures may be well justified, their inclusion in the ADP makes it difficult to measure spending on new infrastructure—an important indicator of public expenditure’s potential contribution to economic growth. The Program’s main targeted result is therefore to increase the share of capital investment in the ADP, including by planning regular repairs and maintenance of infrastructure assets under the recurrent budget. Another important result targeted by the DLI is to strengthen the emphasis on planning and project preparation by minimizing budget allocations to projects that have not been adequately prepared and appraised before being included in the ADP.

## Technical Assistance and Capacity Building Component

1. **The TA component is to be delivered under two subcomponents:** (a) foundations of e-government and (b) program coordination and support. The first entails activities in relation to business process reviews (BPRs), e-archiving, indexing (document management), related change management, and website and email domain. The second involves capacity building, training, studies, and monitoring and evaluation. BPR, which is critical to simplification and acceleration of activities and functions in the public sector, has been designed for inclusion in the operation in line with the specifications and processes catering to the needs of the organizations through a Business Process Mapping (BPM) that will identify (a) critical business processes and vital business functions; (b) hidden processes; (c) potential problems caused by disruption; (d) possible escalations caused by problems; and (e) essential resources required to enable continuity of critical business processes, including resources and needs for future/further automation.

# Program Expenditure Framework and Boundary

1. **Government program:** The overall Government program cost for 2019–2023 is estimated at PKR 43.8 billion (US$330 million). The government program supported by this operation is implemented by the following key entities: the FD, ETNCD, Planning and Development Department (P&DD), Revenue and Estate Department, and Science Technology and Information Technology (ST&IT). The entities cover the full scope of core functions and activities needed to deliver on the outcomes of this operation. The IDA financing of US$118 million, out of the total US$330 million, represents 36 percent of the overall program cost (table 2).

Table 2: Government Program and Financing Sources

|  |  |  |
| --- | --- | --- |
| **Source**  | **Amount (US$, millions)** | **Percentage of Total** |
| Government | 212 | 64 |
| IDA | 118a | 36 |
| Other development partners | 0 | 0 |
| **Total Program financing** | 330 | **100** |

*Note:* a. This includes US$18 million for the TA and Capacity Building component.

1. **PforR (Program) Expenditure Boundary.** Implementation of the government program primarily requires compensation of staff, retirement benefits, and operating expenses of the entities as well as repairs and maintenance costs. These constitute recurrent spending. The Program expenditure boundary is, therefore, defined as the total estimated recurrent spending by the five entities over the Program duration of 2019–2023. This equates to a total amount of US$157 million. The expenditures are derived from the GoKP’s three-year Medium-Term Expenditure Framework (MTEF) projections plus two forward years. The IDA contribution (US$100 million) to this expenditure boundary constitutes 75 percent of the Program expenditure boundary (table 3).

Table 3: Program Expenditure Boundary and Financing Sources

|  |  |  |
| --- | --- | --- |
| **Source**  | **Amount (US$, millions)** | **Percentage of Total** |
| Government | 57 | 36 |
| IBRD/IDA | 100 | 64 |
| Other development partners | 0 | 0 |
| **Total Program financing** | 157 | **100** |

1. **The expenditure framework is defined in table 4 (by object classification) and in table 5 (by entities).** The government’s expenditure framework provides clarity regarding the specific Program expenditure (type and amount) to be incurred by the five core implementing entities (table 6).

Table 4: Overall Government Program Cost (by object classification)



Table 5: Overall Government Program Cost ( (by entities)

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Department** | **FY2018/19** | **FY2019/20** | **FY2020/21** | **FY2021/22** | **FY2022/23** | **Total** |
| Excise, Taxation, and Narcotics Control (KPRA)  | 1,339 | 1,425 | 1,372 | 1,455 | 1,560 | 7,151 |
| Finance | 3,676 | 4,003 | 4,426 | 4,944 | 2,051 | 19,100 |
| Planning and Development | 2,820 | 1,364 | 645 | 519 | 545 | 5,893 |
| Revenue and Estate  | 1,884 | 1,824 | 1,909 | 1,857 | 1,694 | 9,168 |
| ST&IT (KPITB) | 515 | 440 | 470 | 502 | 537 | 2,464 |
| **Grand Total (PKR, millions)** | **10,234** | **9,056** | **8,822** | **9,277** | **6,388** | **43,777** |
| **Grand Total (US$, millions)** | **77** | **68** | **67** | **70** | **48** | **330** |

*Note:*  KPITB = Khyber Pakhtunkhwa Information Technology Board.

Table 6: Program (PforR) Expenditure Boundary

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Major Object Description** | **FY2018/19** | **FY2019/20** | **FY2020/21** | **FY2021/22** | **FY2022/23** | **Total** |
| A01: Employee-related expenses | 2,529 | 2,584 | 2,644 | 2,707 | 2,771 | 13,235 |
| A03: Operating expenses | 1,088 | 1,218 | 1,364 | 1,527 | 1,682 | 6,879 |
| A04: Employees' retirement benefits | 70 | 78 | 87 | 98 | 109 | 442 |
| A13: Repairs and maintenance | 36 | 40 | 45 | 50 | 56 | 227 |
| **Grand Total (PKR, millions)** | **3,723** | **3,920** | **4,140** | **4,382** | **4,618** | **20,783** |
| **Grand Total (US$, millions)** | **28** | **30** | **31** | **33** | **35** | **157** |

# Results Chain and Selection of Disbursement-linked Indicators

Figure 3: Theory of Change



1. **The Disbursement-linked Indicators (DLIs) of the Program capture outputs or intermediate outcomes that are expected to directly contribute to the higher-level outcomes represented by the Program Development Objective (PDO) indicators.** The selection of DLIs is informed by two additional criteria: (a) challenging but attainable and within the control of the GoKP and (b) readily verifiable, measurable, and scalable. The rationale for the selection of DLIs is shown in table 7.

Table 7: DLIs - Rationale, Measurement, Verification, and Scalability

|  |  |
| --- | --- |
| **DLIs** | **Description** |
| **Results Area 1: Revenue Mobilization** |
| Registered Tax Payers who filed GSTS in previous year (DLI #1) | This intermediate outcome indicator is selected due to high revenue potential of the GSTS and the critical importance of taxpayer compliance in capturing this potential. It is scalable, easy to measure and verifiable. To incentivize full achievement, the target for year 1 will not be scalable. |
| Database integration in tax administration (DLI #2) | This output indicator is critical to the capacity of the tax authorities to broaden the tax bases and incentivize compliance. It is essential to the business intelligence function that increases productivity of tax authorities and reduces the cost of tax collection. The targets are discrete, clearly defined, and easy to verify. The indicator is not scalable. |
| Cities with UIPT survey, valuation and digitized records (DLI #3) | This output indicator captures the most important tool to increase UIPT receipts. The surveys have been shown to expand the tax base by adding new properties to the tax records, improving the accuracy and transparency of tax assessments, enabling digitization of tax records and issuance of automated invoices, and providing data on market values to inform valuations used to calculate UIPT liability. This indicator is quantitative, scalable and readily verifiable. |
| **Results Areas 2: Management of Public Resources** |
| Cash management with regular consolidation of cash balances and cash plans (DLI #4) | This indicator combines intermediate outcomes and outputs that represent critical milestones in achieving sound cash management. KP is the first province to prohibit the practice of government entities parking budget funds in commercial banks and to bring these funds into the TSA. This is a prior result under the Program. The targets require consolidating government cash balances as well as preparing cash plans by select GoKP departments to improve predictability of spending plans. This indicator is clearly defined and verifiable. The indicator is not scalable. |
| ADP allocations to unapproved projects (DLI #5) | This intermediate outcome indicator addresses a critical gap in the ADP process: unapproved projects included in the ADP. This indicator seeks to minimize budget allocations to unapproved projects, thereby allowing more funds for projects with higher implementation readiness. This indicator is quantitative, readily verifiable but not scalable.  |
| TMAs using the NFMIS (DLI #6) | This outcome indicator tracks the implementation progress of another groundbreaking reform. KP will be the first province to bring the accounts of municipalities into the NFMIS. This extension will help manage municipal budgets by making re-appropriations within their budgets, increase transparency of municipal financing and expenditures, and reinforce the cash management function. This indicator is quantitative, scalable and easy to verify. |

# Program Action Plan and Implementation Arrangements

1. **The PAP and legal covenants anchor the implementation arrangements and contain measures to mitigate fiduciary risks and strengthen environmental and social benefits.** The GoKP is required to assign officials to the Program Coordination Unit (PCU) to manage overall Program implementation, resolve any bottlenecks, keep senior officials informed about implementation progress, and seek their guidance as needed. All implementing entities are also required to designate a focal person to participate in the Reform Working Group and that the group convene on a quarterly basis or more frequently, as needed, to take stock of Program implementation and coordinate on the next steps. The PAP includes actions based on the findings and recommendations of the Integrated Fiduciary Systems Assessment (IFSA) and the Environmental and Social Systems Assessment (ESSA).
2. **The FSA finds that PFM practices in GoKP provide reasonable assurance that Program funds will be used for the intended purposes, but overall fiduciary risk remains substantial.** The PFM performance of the province has been improving as evidenced in the PEFA assessment of 2017. At the same time, significant risks arise from systemic weaknesses such as lack of commitment accounting (a country-wide issue) and limited scope of internal audit as well as insufficient staff capacity in PFM and procurement in some of the implementing entities. The Program Action Plan includes measures to mitigate these risks, including the requirement for internal audit in implementing entities and certification of relevant staff in financial management and procurement through the relevant training courses organized under the GPP.
3. **In addition, the Program Expenditure Framework (PEF) does not include major procurement activities, which limits associated fiduciary risks.** The PEF covers recurrent costs of the implementing entities, excluding those related to functions unrelated to the Program (e.g. narcotics control by the ETNCD), and does not include major procurements. ICT-related interventions such as establishing a data warehouse (DW) for the three tax authorities and extending selected NFMIS functionalities to TMAs may involve procurement of some hardware, whose cost is however likely to be modest given the cost efficiency of cloud-based DW solutions and online portals for access to NFMIS. Procurement spending on ICT consultancy services (e.g. for the integration of tax authorities’ databases) are also likely to be limited, as much of this work is expected to be performed by government entities.
4. **The ESSA indicates that the Program does not present significant environmental or social risks.** The Program does not involve land acquisition, resettlement, any activities affecting indigenous people. Suggested DLIs may have positive social impacts and have the potential to improve social service delivery by expanding fiscal space. The design of measures to expand the tax base and raise non-tax revenues ensures that measures have a low risk of any regressive impacts.

## Institutional and Implementation Arrangements

1. **The Finance Department (FD) will have the overall responsibility for Program coordination.** A specially designated team of government officials drawn from various departments, the Reform Working Group (RWG), has supported the preparation of this Program and will continue supporting its implementation. A Program Coordination Unit (PCU) staffed with key technical staff covering financial management, procurement, and monitoring and evaluation (M&E) will coordinate implementation. The RWG comprises 17 government officials from the implementing entities who are responsible for preparing the Program with the World Bank and will be overseeing program implementation in their respective agencies. The PCU will have the following responsibilities: coordinating among implementing agencies; monitoring progress towards the results indicators and the implementation of the Program Action Plan (PAP); ensuring timely reporting and third-party verification of annual DLI targets; submitting applications for withdrawal of program funds; and assuring compliance with fiduciary requirements. This coordination mechanism reflects the positive experience of Punjab province in managing PforR operations.
2. **Seven implementing entities will be responsible for specific DLIs, as reflected in the table below.**

Table 3: Entities responsible for specific DLIs

|  |  |
| --- | --- |
| **Entity** | **Responsibility** |
| FD | Responsible for DLIs 2, and the IRIs related to the mobilization of tax revenues through tax policy measures; the coordination of measures aimed at the harmonization of processes and integration of databases among the three tax authorities; and the generation of non-tax revenues from the effective management of government-owned real estate assets (results area 1). FD will also be responsible for DLIs 4 and 6 related to cash management and the use of FMIS to record transactions, as well as the IRI related to the strengthening of OBB practices (results area 2). |
| KPRA | Responsible for DLI 1 on STS taxpayer filing compliance and related measures including relevant tax administration and taxpayer facilitation measures and outputs, and will contribute to DLI 2 (database integration among tax authorities and with third parties). |
| KPITB | Responsible for DLI 2 on the integration of databases of the three tax authorities and also for the IRI related to the harmonization and automation of shared business processes among the three tax authorities. |
| ETNCD | Responsible for DLI 3 related to the collection of the UIPT and contribute to DLI 2 (results area 1). |
| P&DD | Responsible for DLI 5 related to the appraisal of ADP projects, and also for the IRIs related to public investment planning (results area 2). |
| Local Government Department | Responsible for DLI 6 on the decentralization of the NFMIS to the TMAs (results area 2). |
| BoR | Contribute to DLI 2 on database integration and the IRI on the consolidation/reduction of tax instruments (results area 1). |

# Risks and Mitigation Measures in the Program Action Plan

1. **The targeted results of the Program require consistent policies as well as institutional and behavioral changes, which present risks of partial or delayed implementation.** Improving revenue performance and public resource management requires decisive action from the political and administrative leadership, as well as consistent implementation efforts. For example, bringing urban property valuations closer to market values does not require legislation but cannot realistically proceed without endorsement from the political level. The same applies to stemming the outflow of budget funds into commercial banks. Risks related to the Program’s technical design are moderate given that the Program builds on the government’s own strategy, priorities, and initiatives.
2. **Institutional capacity in KP has improved in recent years but it varies across administrative departments and continuity is affected by the frequent turnover of senior officials.** Senior officials in the FD and other key departments have been prominent reform champions. Turnover at this level, however, tends to be higher than at the working level because, like in other provinces, most senior officials in KP come from the Pakistan Administrative Service (PAS) and are expected to serve in different provinces and the federal government. To mitigate this risk to implementation capacity, the GoKP and the World Bank have worked on the preparation of the Program with the working-level officials of the Reform Working Group. These officials belong to the provincial administrative service and are likely to stay in their departments and follow through on the implementation of Program activities.
3. **The limited experience of the GoKP in results-based operations poses a potential risk.** The proposed Program will be the first large operation to be financed by the World Bank in KP after a gap of several years. The only operation with DLIs to date is the KP Governance and Policy Project (KP GPP), which is an Investment Project Financing (IPF) with two DLIs that account for 20 percent of project funds. So far, the GoKP has met the first-year targets for both DLIs. Another positive aspect is that the implementing entities responsible for the DLIs of the KP GPP (KPRA and P&DD) are also among the implementing entities responsible for DLIs under the Program. In addition, the extensive engagement of the GoKP officials in formulating the results indicators of the Program, compiling data for the indicators’ baseline values, and setting targets has enabled them to familiarize themselves with the PforR instrument. Members of the Reform Working Group have also visited Punjab to learn from the province’s successful experience in implementing PforRs.
4. **Potential stakeholder risks could be significant, though to date, the GoKP measures in the Program’s results areas have not given rise to controversy.** For example, the gradual expansion of services subject to GSTS from 11 to 91 has broadened the tax base without eliciting complaints from businesses—largely because the associated tax burden remains low. Regarding the collection of the UIPT, the experience in Punjab is encouraging. The UIPT surveys and automation of tax records in Punjab have helped expand the tax base by 17 percent and more than double receipts within four years, while taxpayers’ complaints have declined. Tax-related results supported by the Program may be expected to benefit taxpayers by reducing the hassle involved in paying taxes. The prohibition on government entities keeping cash in commercial banks might encounter opposition from officials who are wary of losing discretion in using budget funds or from commercial banks that stand to lose these deposits. The GoKP has so far managed these risks by withholding development funds from entities with large cash balances in commercial banks, which will lead to a gradual reduction of these balances.
5. **The Program’s prospects of achieving its development objectives may be affected by country-level macro-fiscal risks.** Federal macro-fiscal policies have a direct impact on provincial finances. For example, new tax exemptions such as those granted in the federal budget of FY2018/19 could reduce the size of the divisible pool of revenues, which are the main source of budget financing for the provinces. In addition, the fiscal position of KP is exposed to risks arising from the approved merger of the province with Federally Administered Tribal Areas (FATA), a significantly poorer and less-developed region. The cost of bringing public services and infrastructure to similar levels as in KP will add to the expenditure of the enlarged province, though this cost is expected to be spread out over a period exceeding the duration of the Program. At the same time, this cost is likely to strengthen the resolve of the GoKP to increase OSR receipts and pursue efficiency gains in public expenditure.

# Economic Analysis

1. **The Program is expected to make a substantial contribution to the public finances of the GoKP as well as the province’s economic development.** The Program’s interventions under the first results area are expected to contribute to an increase in the province’s OSRs and those in the second results area to generate efficiency gains in public spending. The overall financial impact should be an increase in the fiscal space available to the GoKP. The record of the GoKP in using the additional resources from the 7th NFC Award to support economic and social goals indicates that a further increase in the province’s financial resources will enable the province to make necessary investments to improve human development outcomes and the physical capital of the province. In recent years, the province has made overall good use of its budgetary resources, which have financed a rapid expansion in public service provision, especially school education and health. The increased public spending on infrastructure and public services has been accompanied by faster-than-average economic growth and poverty reduction, as well as improved human development outcomes. The proposed Program is expected to enable the province to allocate more funds to growth-enhancing sectors.
2. **The expected net economic impact of the Program is positive.** While additions in revenue collection and the associated improvement in efficient and effective use of public investment envelope can be projected, improvements in other areas such as institutional performance, disclosure, monitoring in the case of Output Based Budgeting (OBB), and improvement in the management of funds are difficult to be identified with explicit economic gains. Nonetheless, based on certain assumptions, the expected benefits of the quantifiable proposed interventions have been estimated and the results show that the net impact is highly positive.
3. **The revenue mobilization measures are estimated to raise OSR tax receipts by at least 50 percent from the baseline.** Over the last five years, more than half of KP’s own-source tax revenue is contributed by the GSTS. Moreover, the revenue collected from this source has increased more than 12 times since FY2011/12. However, the estimated tax gap from this buoyant source is above 70 percent under ideal compliance rates. Three possible scenarios are assumed for the increase in OSR tax due to the first results area. These scenarios correspond to GSTS compliance. In a low-case scenario based on a rise in compliance to 60 percent, receipts from GSTS could more than double from PKR 10.2 billion to PKR 24.0 billion. In a medium (high)-case scenario with compliance reaching 75 percent (90 percent), these receipts can increase to PKR 30 billion (PKR 36 billion). The Pakistan rupee/U.S. dollar exchange rate is assumed constant because of purchasing power parity. The future values of the difference in revenues (with and without Program intervention) are discounted assuming a 5 percent discount rate. The cumulative benefits over the next five years, in present value terms, are estimated at US$654 million under the low-case scenario, US$940 million under the medium-case scenario, and US$1.23 billion under the high-case scenario (Table 8). In the light of these findings, the expected gains from the first results area alone far outweigh the Program cost. It is important to note that even the benefits of this single intervention are underestimated as purchasing power parity does not hold (at least in the short run). Furthermore, the total benefit of this results area could keep accruing as the GSTS, once the compliance reaches 75 percent, is expected to generate higher revenues over a long period beyond the life of the proposed Program.

Table 8: Expected Benefits of Program in Terms of Increased Own-Source Tax Revenue (US$, millions)

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Year** | **OSR without Program** | **OSR with Program** | **Difference** | **PV of Difference** | **Cumulative PV of Difference** |
| *Low-case scenario* |
| 1 | 151 | 280 | 129 | 123 | 123 |
| 5 | 206 | 381 | 176 | 138 | 654 |
| *Medium-case scenario* |
| 1 | 151 | 336 | 185 | 176 | 176 |
| 5 | 206 | 458 | 252 | 198 | 940 |
| *High-case scenario* |
| 1 | 151 | 392 | 241 | 230 | 230 |
| 5 | 206 | 535 | 329 | 258 | 1,225 |

*Note:* PV = Present value.

1. **The consolidation in government cash balance is expected to generate additional funds to better plan the fund release policy for spending entities, thereby improving the predictability of the province’s spending and its budget execution, particularly on public investment.** The elimination of outstanding cash deposits by select government departments (Law, Health, Higher Education, Elementary and Secondary Education, and Local Government) with commercial banks is expected to render PKR 34 billion in nominal terms by the end of the proposed Program. On the other hand, with the transformation of the province’s ADP toward 80 percent approved portfolio through the proposed Program, it is estimated that the expenditure on public investment will increase by 10 percent over the next five years, assuming that the transferred cash from bank deposits is channeled to this avenue. This analysis does not consider the economic growth, inflation, and the increase in development budget over the next five years.
2. **The increased focus of the ADP on capital investment and project selection is also expected to enhance the contribution of public expenditure to economic growth in the province.** Literature indicates that a rise in capital investment will have important effects on both the demand and supply side—including a positive multiplier effect on national income. Barro and Lee (1994) worked on a cross-country empirical analysis to isolate major determinants of growth, concluding that there are five important effects on growth, of which there is a positive effect from higher public investment on growth. A recent study conducted by Almsafir and Morzuki (2015) for Malaysia also shows that a 1 percent increase in public investment is associated with 1.007 percent increase in GDP. The results of many similar studies generally find that productivity growth results from a coordinated program of public investment in infrastructure, equipment, innovation, and human capital.
3. **Better management of funds would help mitigate fiscal risks emanating from future obligatory direct liabilities.** Pension payments have almost tripled in the last five years and constitute around 12 percent of the province’s recurrent spending on average over the last five years. On the other hand, the size of the Pension Fund is too meager to even cover for one annual pension payout fully. With the ongoing and expected exponential rise in pensions over the coming years, the Program intervention would give a critical start to the process of funding the pension liabilities through envisaged capitalization and a well-diversified investment policy for the Pension Fund. That would, in turn, allow the government to better manage the risk of these obligatory expenditures in the future.
4. **The implementation of the NFMIS decentralization plan in local governments as well as OBB in service delivery sectors would improve effectiveness, monitoring, and accountability.** The former will also stem the flow of unspent cash balances by local governments outside the provincial consolidated fund and improve service delivery.