EMERGENCY PROJECT PAPER

ON A

PROPOSED GRANT

IN THE AMOUNT OF US$ 20.0 MILLION

UNDER THE MULTI DONOR TRUST FUND FOR

KHYBER PAKHTUNKHWA, FEDERALLY ADMINISTERED TRIBAL

AREAS AND BALOCHISTAN

TO THE

ISLAMIC REPUBLIC OF PAKISTAN

FOR A

ECONOMIC REVITALIZATION OF KHYBER PAKHTUNKHWA AND FATA PROJECT

(ERKF)

August 22, 2011
CURRENCY EQUIVALENTS

(Exchange Rate Effective = October 01, 2010)

Currency Unit = Pakistan Rupees
85.50 = US $1

FISCAL YEAR
January 1 – December 31

ABBREVIATIONS AND ACRONYMS

AAA Analytical and Advisory Activities
ADB Asian Development Bank
AG Auditor General
AO Accounts Officer
BDS Business Development Services
BDSP Business Development Service Provider
BE Business Edge
BOI Board of Investment
CAS Country Assistance Strategy
CFC Common Facility Center
CGA Controller General of Accounts
CGS Credit Guarantee Scheme
CPS Country Partnership Strategy
CSO Civil Society Organization
DA Designated Accounts
DCO District Coordination Officer
DFID Department for International Development - UK
DG Director General
DNA Damage and Needs Assessment
ERP KP and FATA Emergency Recovery Project
ESFP Environmental and Social Focal Point
ESSAF Environmental and Social Screening and Assessment Framework
FATA Federally Administered Tribal Areas
FDMA FATA Disaster Management Authority
FIP Financial Inclusion Program
FM Financial Management
FY Financial Year
GDP Gross Domestic Product
GoKP Government of Khyber Pakhtunkhwa
GoP Government of Pakistan
GPS Global Positioning System
GRMC Grant Review and Monitoring Committee
ICR Implementation Completion Report
IFA Investment Facilitation Authority
IFC International Finance Corporation
IPSAS International Public Sector Accounting Standards
ISR Implementation Status and Results Report
IUFR Interim Unaudited Financial Report
KP Khyber Pakhtunkhwa
LG&RDD Local Government and Rural Development Department
M&E Monitoring and Evaluation
MDTF Multi Donor Trust Fund
NWFP North West Frontier Province (the old name of KP Province)
NGO Non-Governmental Organization
<table>
<thead>
<tr>
<th>Acronym</th>
<th>Full Form</th>
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<tr>
<td>NRSP</td>
<td>National Rural Support Program</td>
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<tr>
<td>ORAF</td>
<td>Operational Risk Assessment Framework</td>
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<td>PA</td>
<td>Political Agent</td>
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<tr>
<td>P&amp;D</td>
<td>Planning and Development</td>
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<td>PaRRSA</td>
<td>Provincial Reconstruction, Rehabilitation and Settlement Authority</td>
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<td>PCNA</td>
<td>Post Crisis Needs Assessment</td>
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<tr>
<td>PDMA</td>
<td>Provincial Disaster Management Authority</td>
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<tr>
<td>PIFRA</td>
<td>Project for Improvement of Financial Reporting and Auditing</td>
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<tr>
<td>PKR</td>
<td>Pakistan Rupee</td>
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<tr>
<td>PM</td>
<td>Prime Minister</td>
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<td>PMU</td>
<td>Project Management Unit</td>
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<tr>
<td>PPD</td>
<td>Public Private Dialogue</td>
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<td>PPP</td>
<td>Public Private Partnership</td>
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<td>PSC</td>
<td>Project Steering Committee</td>
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<td>PU</td>
<td>Project Unit</td>
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<tr>
<td>SAR</td>
<td>South Asia Region</td>
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<td>SBP</td>
<td>State Bank of Pakistan</td>
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<td>SCCI</td>
<td>Sarhad Chamber of Commerce and Industry</td>
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<td>SDA</td>
<td>Sarhad Development Authority</td>
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<tr>
<td>SME</td>
<td>Small and Medium Enterprise</td>
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<td>SMEDA</td>
<td>Small and Medium Enterprise Development Authority</td>
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<tr>
<td>TA</td>
<td>Technical Assistance</td>
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<td>UN</td>
<td>United Nations</td>
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<td>USAID</td>
<td>United States Agency for International Development</td>
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<td>WB</td>
<td>World Bank</td>
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PAKISTAN
ECONOMIC REVITALIZATION OF KP AND FATA PROJECT

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### Basic Information

Country Director: Rachid Benmessaoud  
Sector Manager/Director: Ivan Rossignol/Ernesto May  
Team Leader: Gabi George Afram  
Project ID: P124268  
Expected Effectiveness Date: August 15, 2011  
Lending Instrument: Multi Donor Trust Fund (MDTF)  
Sectors: Private Sector Development  
Themes: Private Sector (60%); Conflict Prevention and Post Conflict Reconstruction (20%), Public Private Partnership (20%)  
Environmental category: B  
Expected Closing Date: June 30, 2015

### Project Financing Data

- [ ] Loan  
- [ ] Credit  
- [X] Grant  
- [ ] Guarantee  
- [ ] Other: MDTF

### Financing Plan (US $m)

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<th>Source</th>
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<td><strong>Total Project Cost:</strong></td>
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<td>Borrower:</td>
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<tr>
<td><strong>Total Project Financing</strong></td>
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### Client Information

**Recipient:** Islamic Republic of Pakistan  
**Responsible Agencies:**  
1. Industries and Technical Education Department, Government of KP (GoKP), and  
2. FATA Secretariat  
**Contact Persons:**  
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   Telephone No.: 92-91-9211281, Fax No.: 92-91-9210896  
   Email: mkj68@msn.com
**Estimated disbursements (Bank FY/US $m)**

<table>
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<tr>
<th>FY</th>
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<td>8.1</td>
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<td>Cumulative</td>
<td>1.2</td>
<td>9.3</td>
<td>16.8</td>
<td>20</td>
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**Project Development Objective and Description**

**Project development objective:** To support the Government of Pakistan (GoP) in the economic recovery and revitalization of the crisis affected areas of Khyber Pakhtunkhwa (KP) province and Federally Administered Tribal Areas (FATA), by creating sustainable employment opportunities through rehabilitation of Small and Medium Enterprises (SMEs), investment mobilization, and institutional capacity building.

**Project description:** The Project aims to support creation of employment opportunities and sustainable jobs for the people of KP and FATA, thereby addressing the core strategic objective of stimulating employment and livelihood opportunities, as highlighted in the recently completed Post Crisis Needs Assessment (PCNA). The project has three broad components:

**Component 1: SME Development (US$ 14 million).** This component includes a matching grants program with technical assistance (TA) to support SMEs that have been adversely affected by the ongoing crisis in order to enhance their productive capacity and restore lost employment. This component will also promote economic empowerment of women by assigning priority to eligible enterprises owned and managed by women. Three types of support will be provided under this component:

(i) **SME Rehabilitation (US$ 9.80 million):** Matching grants to SMEs whose businesses have been affected due to direct damage to their buildings, machinery, equipment and stocks;

(ii) **SME Up-gradation (US$ 2.80 million):** Matching grants to SMEs to improve their productive capacity; and

(iii) **Business Development Services (US$ 1.40 million):** support to SMEs in areas such as accounting, financial and legal services, market development, project management etc.

**Component 2: Attracting Investments from the Diaspora (US$ 2 million).** The main objective of this component is to mobilize private investment to jumpstart the rehabilitation of businesses and reconstruction of infrastructure, thereby creating employment. There are two main activities under this component:

(i) Pre Feasibility Study for a Private/Public Sector Diaspora Bond for SMEs; and

(ii) Outreach Program for Mobilizing Diaspora Investment

**Component 3: Institution Building to Foster Investment and Implement Regulatory Reforms (US$ 4 million).** This component will support capacity building of both KP and FATA governments to improve the business climate and attract investment to the region. This will be accomplished through the following activities:

(i) Capacity building of governments of KP and FATA;
(ii) Development of a Public Private Dialogue (PPD) mechanism to promote reforms;
(iii) Institutionalizing investment promotion; and
(iv) Implementation Support

The SME Development component will be implemented by the KP office of Small and Medium Enterprise Development Authority (SMEDA), and the implementation of the second and third components will be done by the dedicated cells of KP and FATA authorities.

<table>
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<th>Safeguard Policies Triggered:</th>
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<tr>
<td>Environmental Assessment (OP/BP 4.01)</td>
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<td>Natural Habitats (OP/BP 4.04)</td>
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<td>Forests (OP/BP 4.36)</td>
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<td>Pest Management (OP 4.09)</td>
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<td>Physical Cultural Resources (OP/BP 4.11)</td>
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<td>Indigenous Peoples (OP/BP 4.10)</td>
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<td>Involuntary Resettlement (OP/BP 4.12)</td>
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<td>Safety of Dams (OP/BP 4.37)</td>
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<td>Projects on International Waters (OP/BP 7.50)</td>
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<td>Projects in Disputed Areas (OP/BP 7.60)</td>
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<th>Does the project require any exceptions from Bank policies?</th>
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<tr>
<td>Have these been approved by Bank management?</td>
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<tr>
<td>[x] Yes [ ] No</td>
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<th>Conditions and Legal Covenants:</th>
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<td><strong>Section in the Grant Agreement (GA)/Project Agreements (PAs)</strong></td>
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<tr>
<td>Section I.B.1(a) of Schedule 2 to the GA / Sections I.A.1 of the Schedules to the PAs</td>
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<td>II.B.4 of the Schedules to the PAs</td>
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<td>III.2 of the Schedules to the PAs</td>
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A. Introduction

1. This Project Paper seeks the approval of the Regional Vice President (RVP) to provide a GRANT under the KP/FATA/Balochistan Multi Donor Trust Fund (MDTF) in an amount of US$ 20.0 million to Pakistan for an Economic Revitalization of Khyber Pakhtunkhwa and FATA Project (ERKF).

2. This Project is designed to address the recovery and rehabilitation needs in the Khyber Pakhtunkhwa (KP) and Federally Administered Tribal Areas (FATA) as a result of the militancy crisis. The proposed Project will help in the revitalization of the private sector in the crisis-affected regions through direct support for the Small and Medium Enterprises (SMEs), attracting investments from the Diaspora, and institutional capacity building including regulatory reforms. The Project will be implemented by the Department of Industries, Government of Khyber Pakhtunkhwa (GoKP) and FATA Secretariat for KP and FATA components respectively in collaboration with the line departments and with the respective local administrations. The KP office of Small and Medium Enterprise Development Authority (SMEDA) will implement the Small and Medium Enterprise (SME) Development Component of the Project both in KP and FATA.

3. The ERKF is a joint initiative for both KP and FATA and the activities will cater to the economic rehabilitation needs identified for this region under the recently completed Post Crisis Needs Assessment (PCNA) supported by the Asian Development Bank (ADB), European Commission (EC), United Nations (UN) and World Bank (WB), that was formally issued in October 2010. The Bank is targeting its interventions through a MDTF established for KP, FATA and Balochistan. Given the geographical and administrative proximity of the crisis-affected areas of KP and FATA, the ERKF combines the response to SME needs of this region under one operation.


Country Context

4. The KP-FATA region has consistently been one of the poorest parts of Pakistan. Both areas lag behind other provinces across a wide range of social and economic indicators, with a lag even more pronounced when viewed through a gender lens. Estimated GDP growth for KP was already slowing in the period leading up to mid-2009, declining to around 3% in 2007/8, as compared to Pakistan’s GDP growth rate of 4.2% for the year 2007/8. Furthermore, KP has consistently experienced far higher rates of unemployment than the rest of Pakistan (see Figure 1). While FATA is not included in the surveys, the unemployment issue is likely to be

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1 SMEDA was established by the Federal Government of Pakistan in 1998 to take on the challenge of developing SMEs in Pakistan. With a futuristic approach and professional management structure it focuses on providing an enabling environment and business development services to SMEs. In KP, SMEDA has been the major focal point for SME development in the militancy hit areas

2 Illiteracy levels are as high as 97% for women in FATA compared to 71% for men; the comparative figures for KP are 68 % for women and 33% for men, respectively.
even more pronounced there. Moreover, unemployment is particularly high among young men aged 15-30 (the main resource pool for militant recruitment).

5. Furthermore, there is a broad-based awareness of the region’s acute development disparities with the rest of Pakistan. The absence of visible progress and the perceived lack of interest by both sub-national and federal governments in redressing these disparities contribute to a widely perceived lack of faith in the capacity of existing government institutions to meet the basic needs of the population.

6. The militancy crisis in KP and FATA is a key contributor to stagnant growth and high unemployment. The ranks of the unemployed have risen with the intensification of the crisis in 2009/10, and even are likely to continue rising. These conditions have created a conducive environment for opportunistic militant groups whose economic incentives for potential recruits greatly outweigh alternative available options. Many are dependent on the black economy, drug trafficking and criminal activity for survival. Over time, militant groups have become increasingly active in the region, and pushed further east across the settled districts of KP into Swat.

7. In early 2009, the Government of Pakistan (GoP) launched major military operations in the KP-FATA to eliminate the local pockets of militants. The conflict has imposed a huge economic cost, on top of the obvious human tragedy. The crisis affected areas constitute 15% of the combined area of KP and FATA, are home to about 18% of the population, and account for some 17% of the value added. The military operations led to significant damage to physical infrastructure and services while displacing some 3 million people. While the majority of the internally displaced persons (IDPs) have returned to their places of origin, many
have lost their homes and livelihoods. Those who stayed behind have suffered equally and tend to be just as poor and vulnerable as the IDPs.³

8. **Growth in the industrial sector has stagnated and tourism in Swat has ceased almost entirely** because of security concerns. One of the most important economic sectors of KP-FATA is the mining of gems and dimension stones, which is operating at less than 10% of previous output levels because of the deterioration in security condition and the ban on the use of explosives (dynamite), an essential mining input. Out of 250 mines, only 25 are operational in KP province. The experience in other sectors is similar, and overall, the economy of KP and FATA is likely to have contracted significantly in 2009/10.

9. **The ongoing crisis facing Pakistan has been amplified by the floods in July/August 2010**, resulting in enormous destruction, further internal migration/displacement, and massive loss of livelihoods. The adverse affects of these crises have been much more pronounced in KP and FATA than the rest of the country.

Government Response, Damage and Needs Assessment and Partnership Arrangements

10. In the face of the crises that have confronted KP and FATA, the federal and provincial governments have embarked on rapid post-crisis recovery and reconstruction efforts in collaboration with international and national humanitarian agencies. Since the beginning, donor support has been coordinated by the Planning Commission at the Federal Level, while, the Provincial Rehabilitation, Reconstruction and Settlement Authority (PaRRSA) was established to coordinate and implement these initiatives for both KP and FATA.

11. The GoP also has launched various assessments for strategic medium to long term support for the region. A **Damage and Needs Assessment (DNA)** was completed in 2009 with the WB and ADB support covering the areas first affected by the GoP’s action to combat the militants⁴ and a subsequent **PCNA** was completed in October 2010. The PCNA assessed and quantified the short and medium term social and economic needs of the region. Recognizing the need for a harmonized approach to respond to the crisis, the GoP has requested the Bank to administer the MDTF for the recovery and rehabilitation of the crisis affected areas of KP, FATA and Balochistan.

12. **The PCNA provides the underpinning for long term peace building in KP and FATA.** Drawing on extensive stakeholder consultations, the Report identifies key crisis drivers and the consequent priority areas that need to be addressed to support a coherent and durable peace-building strategy. These have been organized into four strategic objectives related to political and governance reform, employment and livelihood opportunities, provision of basic services, and efforts for counter-radicalization and reconciliation⁵. The ERKF builds on the Pillar 2 of the PCNA that recommends creation of employment generating opportunities in farm and

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³ Based on the household survey data analysis reported by ‘Food Security and Market Assessment in Crisis Affected Areas of KP and FATA’, World Food Program, 2010.
⁴ Swat, Upper and Lower Dir, Buner, Shangla, Mohmand, and Bajaur.
⁵ The key strategic objectives of the PCNA are: (i) enhance responsiveness and effectiveness of state to restore citizen trust; (ii) stimulate employment and livelihood opportunities; (iii) ensure provision of basic services; (iv) counter-radicalization and reconciliation
non-farm sectors, development of marketable skills, rehabilitation of enterprises and improving
the investment and business climate for medium to long term economic growth and peace
building in these areas. It also acknowledges the need for the project instruments to be flexible,
due to the continuing militancy and possible displacements as well as the high likelihood of
further natural disasters in the region such as landslides, floods, drought and earthquakes.

C. Bank Response: The Project

Brief description of Bank’s Strategy of Emergency Support

In order to respond to the KP-FATA 2009 DNA, and subsequent PCNA Report, the Bank has
established, with support from a variety of development partners, the MDTF for the crisis
affected areas of KP, FATA and Balochistan. The MDTF will mobilize donor support to finance
critical investments in support of reconstruction and peace building in these areas. It will provide
flexibility to finance stand-alone projects or program activities, including those co-financed by
the government, bilateral or multilateral agencies6. In the first phase, the MDTF has US$ 130
million in pledges from ten donors; Australia, Denmark, Finland, European Union, Germany,
Italy, Turkey, UK, USA and Sweden.

13. The GoP, GoKP and FATA authorities have requested the Bank to allocate US$ 20
million from the MDTF to support the economic revitalization of the crisis affected areas of KP
and FATA, through employment generating activities. This request is consistent with the
Financing Strategy approved by the MDTF Steering Committee.

14. In addition to administering the MDTF, the Bank is also preparing a series of projects to
respond to the key strategic objectives of the PCNA. This will also provide the basis for
additional funding by the MDTF. The KP and FATA governments have already requested for a
value chains Project in KP-FATA region with possible additional funding from MDTF

15. In parallel, the Bank has also approved a KP-FATA Emergency Recovery Project (ERP),
which will provide safety net support grants to poor and vulnerable households affected by
militancy in the crisis areas. The ERP is funded from IDA (US$ 250 m) and MDTF (US$ 35 m)
resources.

16. Finally, the Bank will continue to provide advisory support, critical for the success and
sustainability of the overall response to the crisis. This includes sharing best practices in terms of
institutional arrangements to ensure the best possible delivery mechanisms and sound
governance arrangements including tracking of fund flows, procurement practices, grievance
mechanisms, and monitoring and evaluation systems, to ensure accountability and transparency.

Rationale for Proposed Bank Emergency Project

17. The GoP has requested Bank’s assistance to help respond to the emergency situation
resulting from the militancy and exacerbated by the floods. The challenges of the dual

6 The priority financing areas of the MDTF are (i) restoration of damaged infrastructure and disrupted services; (ii)
local service delivery; (iii) provincial governance and service delivery; (iv) livelihoods; (v) capacity building and
institutional strengthening.
emergency require mobilization of a significant amount of resources in a timely manner to limit
the negative effects of the shock and to immediately revive economic activities in the crisis-
affected areas.

18. The GoP has initiated a multi pronged strategy to deal with the emergency situation, i.e.
by addressing the immediate needs with safety net support including cash grants, public work
programs and rehabilitation of basic services; alongside efforts that build a sustainable economic
base for job creation. The government realizes the huge challenge of creating sustainable long
term employment, especially for the most sensitive segments of society, including young men
aged 15-29 years, as well as women and other vulnerable groups.

19. The proposed ERKF will provide immediate support to crisis-affected SMEs to facilitate
the creation of new jobs or restore jobs that have been lost during the crisis, facilitate domestic
and international investments in KP and FATA, and help improve the overall business
environment in these regions.

20. International experience suggests that such initiatives are a crucial element in a post
conflict response. There is a growing recognition that any post crisis program needs to have a
specific focus on sustainable job creation. Often times the lack of employment opportunities is a
key driver of conflict. Such programs need to develop on three broad pillars: (i) mobilizing
private sector and quasi-private sector investment, (ii) directly supporting firms in their up-
gradation and/or rehabilitation, and (iii) addressing the constraints to enabling environment,
which is essentially a complex coordination exercise involving the public sector service
providers, regulators and the private sector. In most post crisis responses, the World Bank Group
has been engaged in providing support to some or all of the above mentioned efforts.

21. As an administrator of the MDTF, the Bank is well placed to help Pakistan cope with
these challenges due to its substantial international and regional experience (including in post
conflict situation response) in generating immediate and long term sustainable job opportunities
through economic growth initiatives. The World Bank has designed economic revitalization
projects and non-lending technical assistance (NLTA) in fragile states and conflict affected areas
in the region and globally. For example, in Timor-L’este (Enterprise Rehabilitation Project),
Afghanistan (Economic Growth), Sri Lanka (Small and Medium Enterprise Development),
Bosnia-Herzegovina (Access to Finance), and Kosovo (Local Economic Development), these are
all examples where the Bank Group has quickly responded to the needs of the economic and
private sectors in recovering and developing the foundations for sustained growth in a
conflict/post conflict environment.

22. The Project activities will complement the activities being carried out under the economic
growth agenda of the United States Agency for International Development (USAID). Its SME
grant program will also be implemented by SMEDA in Malakand Division. The Project activities
will ensure that there are synergies between the ERKF and USAID’s project, and that there is no
multiple lending to SMEs.

23. In addition, the ERKF will complement the on-going initiatives in the financial sector for
the crisis affected areas of KP and FATA. This includes a Credit Guarantee Scheme (CGS) of £8
million (around US$ 12 million) for commercial banks to finance Small and Rural Enterprises,
and a £50 million (US$ 78 million) DFID’s Financial Inclusion Program. Of this, £4 million (US$ 6.2 million) has been allocated specifically for KP/FATA to enable the banks to extend short, medium and long term credit to SMEs. The banking sector in Pakistan has mainly focused on large corporate sector, while smaller firms across the country have traditionally relied on retained earnings or informal modes of financing to fund their working capital and investment needs (only 1.6% of working capital needs of SMEs are financed by commercial banks). The overall financing to SMEs has further contracted between 2008 and 2009 due to the overall weak macroeconomic situation in the country which resulted in high non-performing loans (NPLs) in the banking sector and the share of SME lending has fallen from 11.75% to 10.27% of total lending. While the CGS would encourage the banks to downscale and increase their lending to SMEs, the ERKF project will address the demand side by providing business development and enhancement support to SMEs in addition to providing matching grants.

**Project Development Objectives (PDO)**

24. To support the GoP in the economic recovery and revitalization of the crisis affected areas of KP province and FATA, by creating sustainable employment opportunities through rehabilitation of SMEs, investment mobilization, and institutional capacity building.

**Key Performance Indicators:** The following set of indicators will be used to assess the Project’s performance, which includes both quantitative and qualitative indicators:

- 850 SMEs directly/indirectly benefited from the grants program, of which 2-3% businesses owned/managed by women entrepreneurs
- 8,000 jobs/employment (direct and indirect) generated in enterprises supported by the project
- 500 SMEs access business development services offered under the Project
- US$ 10 million attracted for KP-FATA from Diaspora and migrant workers settled across the country
- Investment facilitation authorities established in FATA and KP

**Summary of Project Components**

25. The proposed Project has three components; (1) SME Development; (2) Attracting investments from the Diaspora; and (3) Institution building to foster investment and implement regulatory reforms.

**Component 1: SME Development (US$ 14 million):**

26. This component will provide direct support to the crisis-affected SMEs in KP and FATA, through a matching grants program that will be managed and administered by the KP office of the SMEDA. Preference will be assigned to eligible businesses owned and managed by women entrepreneurs. This activity has following three subcomponents:

27. **Subcomponent 1.1 SME Rehabilitation (US$ 9.80 million):** This subcomponent will provide direct support to the affected SMEs. A large number of the affected enterprises have not been able to continue normal business operations and were forced either to shut down or operate
inefficiently, therefore the ERKF offers support in the form of matching grants to enterprises meeting the eligibility criteria which will be detailed in the Operations Manual for this Project. These grants may be used as working capital, for reconstruction of basic infrastructure, acquiring/repairing machinery and equipment for productive activities, etc.

28. **Subcomponent 1.2 SME Up-gradation (US$ 2.80 million):** This support will be provided to eligible individual SMEs for up-gradation, as well as to a group of SMEs for cluster development programs. Some potential uses of these grants include technological innovation, product development, adopting new packaging/labeling requirements, establishing common facility centers (CFCs), etc. Funds may be used for both capital investment and working capital.

29. **Subcomponent 1.3 Business Development Services (US$ 1.40 million):** This subcomponent supports procurement of business development services (BDS) and capacity building of SMEs through service providers including the International Finance Corporation (IFC)’s Business Edge (BE) Program\(^7\). Implementation of this subcomponent will rely on the findings from an upfront rapid needs assessment to identify market demand for training programs and BDS to make the interventions directly focused on these needs.

30. The SME Development component will initially focus on all sectors and SMEs in the crisis-affected areas identified in the PCNA. However, as project implementation proceeds support will also be given to SMEs operating in key economic sectors where value chains have been adversely affected, including horticulture, marble, gemstones, tourism and furniture.

31. The Project Unit (PU) of the implementing partner, SMEDA-KP, will assess the needs of the SMEs while working in coordination with the Department of Industries in KP, and the FATA Secretariat through their Project Management Units (PMUs). Detailed project description and implementation arrangements are outlined in Annexes-1 and 7 respectively.

32. This component will complement similar activities, such as the proposed USAID’s US$ 10 million *SME Revitalization Program* for Malakand Division (KP). By engaging SMEDA as one of the implementation partners under the ERKF project, the Bank will ensure consistency of project activities, utilize existing expertise and avoid duplication.

**Component 2: Attracting Investments from the Diaspora (US$ 2.0 million):**

33. This component aims to attract private investments for KP and FATA. The Project will provide financial and technical support to the governments of KP and FATA for attracting investment from Diaspora and immigrant workers with an objective to generate economic activities and link the two economies to domestic and international markets. Activities proposed under this component will complement the SME Development component of the Project by highlighting investment opportunities to overseas Pakistanis. Support will be provided for Business to Business (B2B) matchmaking for SMEs in specific sectors. There are two main activities under this component:

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\(^7\) IFC’s Business Edge (BE) aims at improving the business performance and competitiveness of firms and creating jobs in developing countries. This is achieved by strengthening the management skills of SMEs and middle managers of larger firms, providing them access to BE practical training solutions.
34. **Pre-Feasibility Study for a Private/Public Sector Diaspora Bond for SMEs:** This activity entails undertaking a pre-feasibility study for the suggested Diaspora bond to establish the need, justification, mechanics and structure of the financial instrument.

35. **Outreach Program for Mobilizing Diaspora Investment:** An outreach program to mobilize Diaspora investment envisages activities such as (i) Investment Road Shows, (ii) Annual Pakistan Diaspora conference titled ‘Khushamdid’ (Welcome) Pakistan and (iii) Re-Connect Pakistan (A web tool for Diaspora). The outreach program with focus on KP and FATA is planned domestically for Karachi in the first year; whereas international events to mobilize Diaspora are designed for the second and the following years. These efforts will also benefit from the networking opportunities through the MDTF partners.

**Component 3: Institution Building to Foster Investment and Implement Regulatory Reforms. (US$ 4.0 million):**

36. This component will provide support to create an alluring business climate and attract investments to KP and FATA by building the capacity to undertake regulatory reforms and promote investment. This will be accomplished through: (i) Capacity building of counterpart institutions; (ii) the development of a Public Private Dialogue (PPD) mechanism to promote reforms; (iii) Investment promotion; and (iv) Implementation Support.

37. **Capacity Building of Governments of KP and FATA:** The ERKF Project will support the governments of KP and FATA to build their capacities for implementation of reforms. The Industries Department in KP specifically lacks the technical capacity and resources to implement economic programs and projects. Building the capacity of the department is also consistent with the KP’s Comprehensive Development Strategy (CDS), which highlights the need for technical support to the public sector to ensure mainstreaming of development work through relevant government departments.

38. In FATA, this support will center around assisting the Government to develop appropriate data collection and M&E methodologies, as well as undertaking diagnostic work on many of the challenges unique to the FATA region. This specific activity envisages an online portal facilitating the business community and contributing to the overall transparency of the project.

39. **Development of a Public-Private Dialogue (PPD) Mechanism to Promote Reforms:** This activity will bring together the KP and FATA governments, along with the private sector, civil society, and other key development partners to identify, and implement policy reforms, with the ultimate goal of improving the investment climate and enhancing productivity and competitiveness of local enterprises and workforce. The actual process of policy reforms will be grounded in a formal PPD mechanism, which entails the public sector, business and non-governmental sector partners working collectively to create better conditions for economic growth and employment generation.

40. **Institutionalizing Investment Promotion:** This activity addresses the specific needs of both regions to institutionalize investments facilitation and undertake regulatory reforms through
dedicated bodies. In the case of FATA, the Investment Facilitation Authority (IFA) will serve as a dedicated unit to improve the investment climate in the region. For KP, there may be various options under the Industries Department. Of these options, the Investment Facilitation Centre (IFC) at the Sarhad Development Authority may produce the desired investment facilitation outcomes.

41. **Implementation Support:** In view of the limited capacities within KP and FATA, the ERKF Project will provide this support to the Project counterparts of KP, FATA and SMEDA-KP for effective implementation of the Project. Details of implementation costs and arrangements are given in Annex 3 and 7 respectively.

D. **Implementation Arrangements:**

42. The existing administrative structures and service providers in FATA and KP will mostly be used for project implementation.

43. There are two counterparts of the Project, the GoKP and FATA Secretariat who will each manage implementation of their parts of the Project through independent Project Steering Committees (PSCs) for strategy and policy formulation and overall supervision. The PSCs will be headed by respective Additional Chief Secretaries (ACS) and its core members will comprise: the Secretary of the counterpart department, the Provincial Chief of SMEDA-KP, two private sector representatives (KP/FATA Chamber of Commerce and Industry), and the Director General of Provincial/FATA Disaster Management Authority (PDMA/FDMA). Other members will be co-opted for discussing/addressing issues as needed. The PSCs will meet on quarterly basis.

44. In view of the existing institutional capacity of KP, a dedicated PMU has been set up under the Industries and Technical Education Department. In FATA, the implementation will be managed by the FATA Secretariat’s PMU, which is already in place and recently completed work on a USAID funded project. The PMUs will be headed by Project Directors and assisted by Project Officers (Technical Specialists), dedicated Finance/Admin officers, procurement specialists, safeguards and M&E focal points. The project officers, once appointed, will be provided the required fiduciary training by the Bank. The PMUs will coordinate overall project implementation and reporting.

45. The implementation of the first component on SME Development will be done through SMEDA by a PU for both KP and FATA. SMEDA will hire the necessary experts to staff its PU. Details of implementation structure, financial management and disbursement arrangements are provided in Annexes 5, 6 and 7.

46. The respective PMUs in KP and FATA will implement component two and three, through specific technical assistance (TA) provided under the Project.

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8 Investment Facilitation Authority (IFA) has been recently notified by the FATA government with the objective of promoting investment and private sector development in FATA.
Eligibility for Processing under OP/BP 8.00

47. ERKF is in line with the guiding principles under the Bank’s operational policy OP/BP 8.00 and addresses adverse economic impact on KP and FATA resulting from the crisis. The project is adapted to the emergency's particular circumstances and takes into account the Bank’s assistance strategy for the country, which highlights increasing employment and livelihood opportunities in conflict-affected areas. Moreover, the ERKF Project is in line with the core development and economic mandate, including peace-building objectives and reconstruction and rehabilitation activities. For the overall MDTF, there is close coordination and establishment of appropriate partnership arrangements with other development partners in line with the comparative advantage and core competencies of each such partner. Additionally, there are appropriate oversight arrangements, including governance and fiduciary oversight.

Consistency with the MDTF Administration Agreement

48. The ERKF is supporting the counterparts in executing activities outlined in the MDTF Administration Agreement, such as restoring livelihoods of local communities through increased access to productive assets and market opportunities in order to facilitate income generating activities, e.g. providing skills development and business development training to communities to foster new business ventures and promoting women’s greater involvement and decision-making in income generating activities. It will also address the objective of strengthening the technical capacity, and institutional arrangements and coordination, of KP’s line department (Industries), as well as the FATA Secretariat, in order to carry out the post-crisis reconstruction efforts. As an administrator of the Trust Fund, the Bank, through ERKF, is providing technical advice to, and coordinating capacity building activities for, the GoKP and FATA Secretariat’s officials.

Consistency with Country Partnership Strategy (CPS)

49. The Pakistan CPS for FY10-13 recognizes that conflict and insecurity represent major obstacles to economic development and poverty reduction. The operation is fully aligned with the CPS, falling under Pillar 4 titled ‘improving security and reducing the risk of conflict’; and more specifically ‘Increased Employment and Livelihood Opportunities in Conflict-Affected Areas’. Under this Pillar, the CPS considers that addressing the longstanding economic deprivation and social inequities among the population in the North West Frontier Province (now Khyber Pakhtunkhwa) region is critical to dealing with conflict. The operation, therefore, has a strong focus on SME development to enable income generation and revival of economic activities in the crisis-affected areas. The capacity building of various public sector departments within KP and FATA will directly contribute to one of the expected outcomes of CPS, i.e. ‘Strengthened capacity and strategic reform of governance institutions in KP and FATA’ under Pillar 4.

Expected Outcomes

50. The overall project outcome is to create employment opportunities for the local population. The ERKF will support this outcome through providing immediate rehabilitation support to the SMEs, affected and damaged by the conflict, to enable these enterprises to restart
their businesses. The support will further enhance the production capacity of the SMEs and increase their competitiveness. The project is also likely to generate investment in the KP and FATA regions, especially through the Diaspora outreach program. A major contribution of project activities will be establishment of an active mechanism for PPD to take the reforms forward in the long run and on a sustainable basis.

51. The ERKF, as a whole, will enhance the capacity of the provincial and local administration to take on economic reforms in KP and FATA, and address issues of business environment and investment climate. The PDO, the anticipated results and intermediate outcomes and proposed monitoring mechanisms are detailed in the ‘Results Framework and Monitoring’ in Annex 2.

E. Appraisal of Project Activities

52. The preparation and appraisal of this project has relied heavily on Bank’s international and national experience of implementing similar programs in crisis affected areas. The learning from these programs has helped in formulating the contents of the proposed project. The Bank team has already helped GoKP and FATA Secretariat in the preparation of a draft Operations Manual along with some of its Technical Annexes (Beneficiary Eligibility Criteria and Communications Campaign). The remaining elements related to M&E, Project Oversight, data verification through third party monitoring, managements of PMUs, etc will also draw from this experience.

Technical

53. The technical design of the specific interventions under each component of the project builds on the economic recovery efforts of KP and FATA in the post-crisis areas, through the delivery of rehabilitation grants and institutional capacity building. The authorities of FATA in particular, are seeking immediate support for creating employment opportunities for the youth, thereby discouraging its involvement in illicit activities and thus restoring peace in the region. The GoKP and FATA Secretariat are not familiar with the Bank’s implementation procedures for such projects. The Project recognizes this and addresses this constraint through project design and capacity building, and will work to ensure continued technical inputs in selection, design and implementation of Project activities. The PMU at FATA Secretariat has already started work, such as the development of a detailed implementation plan and preparation of TORs for hiring technical specialists (Project Officers). The IFA has already been notified which is an important institutional mechanism as it will take over the Project’s activities beyond completion of the operation. Similarly the GoKP collaborated with SMEDA-KP for putting together its implementation plan for the SME Development.

Economic and Financial Analysis

54. Measuring the economic benefits of SME Development Component is not a simple proposition. The absence of any baseline information on the SMEs in KP and FATA poses difficulty in exactly quantifying the expected impact of the Project investment on the local economies. It is expected that the proposed grants program will act as a catalyst to revive and upgrade the local SMEs. About 850 SMEs will be directly supported through matching
grants under various subcomponents of the SME Development Component over four years. Impact of rehabilitation of the closed businesses will also generate a multiplier effect. The revived enterprises will also benefit the suppliers and vendors across the value chains.

55. One of the key benefits of the proposed Project is the expected increase in employment opportunities. Direct increase in the number of jobs will be achieved with the rehabilitation and up-gradation of the local SMEs. The revived SMEs can immediately re-employ at least the core/essential staff. Similarly, the beneficiaries of up-gradation grants and BDS support will also play a role in creating employment opportunities. The project expects to directly revive/create about 8,000 new jobs through the proposed interventions.

56. The grants for SME up-gradation will increase the firms’ efficiency and capacity utilization which in turn can yield an increase in output. The Cluster development interventions proposed in the Project design will bring about long range benefits to the local SMEs; such as the use of improved technologies, possibilities for new products development, achieving increased business volumes, etc. These activities will not only offer direct benefits to the participating SMEs but will also act as demonstration projects for other SMEs to copy. The intervention is thus expected to support long term sustainable SME development in the two regions.

57. The BDS management training will fine tune business management skills of the SMEs; thereby supporting sustainable development of the SME sector. The project aims to enhance the management capacity of about 500 SMEs. Lending support for BDS procurement will also enhance the capacity of the BDS Providers.

58. The component on Investment Mobilizations will induce economic gains for the two regions by attracting US$ 10 million from the Diaspora, provided the macro stability is restored and that the security conditions remain stable.

Fiduciary Aspects and Arrangements

59. An assessment of the FM arrangements has been done for the project. The overall FM risk is assessed as High. This will be revisited once proposed mitigating actions have been put in place. The PMU for KP was notified during March 2011, while FATA will be using an existing PMU that was established back in year 2010 for implementing an ADB funded project.

60. Three segregated designated accounts (DAs), in US Dollars will be established, one each for KP and FATA PMUs and one for SMEDA. Government procedures will apply for budgeting. Disbursements will follow the ‘report-based’ principle whereby funds will be front-loaded to the DAs based on cash forecasts for the following two quarters provided in Interim Un-audited Financial Reports (IUFRs). Separate project financial statements shall be prepared for KP and FATA using cash basis IPSAS including details of expenditures by components and activities. These will be audited by the Auditor General (AG) of Pakistan and must be submitted to the Bank no later than 6 months after the year-end. SMEDA will submit entity financial statements with disclosure of operations, resources and expenditures related to the project which will be audited by private sector auditors, acceptable to the Bank. These will be submitted within 6 months of the close of the financial year. The KP Department of Industries, FATA Secretariat
and SMEDA are not currently implementing any Bank-financed projects and as such there are no unsettled ineligible expenditures and overdue audit reports.

61. Two staff dedicated for FM will be appointed at each PMU and accounting procedures applicable to the project will be approved by the Office of CGA prior to Disbursement. These procedures will embody a comprehensive internal control framework, including service standards. At SMEDA, initially existing staff will be assigned additional responsibilities for the FM activities related to the Project and as implementation commences, dedicated FM staff will be added. The Operations Manual, under preparation, will include relevant guidance on FM, including internal controls, funds flow and financial reporting for activities at SMEDA funded by the Grant. An Internal Auditor will be appointed by the Office of Accountant General-KP whose scope of work will include the entire project activities. To ensure his independence, the Internal Auditor shall report to the Project Steering Committees. Further, the project shall prepare an action plan with the Project for Improvement of Financial Reporting and Auditing (PIFRA) directorate for inclusion in the national Financial Management Information System (FMIS) which target shall be met within 6 months of the Effectiveness, unless otherwise agreed with the World Bank.

62. There are nine IDA-financed projects in Pakistan which have not refunded or provided documentation on the use of Designated Accounts/Special Accounts (DA/SA) after the deadline of two months after the end of the “grace period” (i.e., the “lapsed loan” date, normally six months after the Closing Date). Under Bank policy (OP 12.00, disbursement paragraph 12), failure to refund unused Designated Accounts/Special Accounts balances results in the Bank not permitting the use of DA under new loans, which term includes recipient-executed grants financed from trust funds. Management endorsement for a waiver of the requirements of OP 12.00 has been secured for a period of 12 months ending on October 31, 2011 to allow for continued use of DAs for loans and credits to Pakistan.

63. Based on the implementation of the proposed actions, the FM arrangements, as designed and proposed are considered adequate and there will be reasonable assurance that funds are used for intended purposes with economy and efficiency and that the requirements of OP/BP 10.02 will be met. The implementing entities will ensure that the Bank’s guidelines on Preventing and Combating Fraud and Corruption in Bank Financed Projects are followed in the project.

64. **Procurement Arrangements**: The Bank guidelines for procurement will be followed for the implementation of this Project. Project procurements would largely cover selection of consultancies, both firms and individuals, besides some goods. Hiring of procurement staff would be a condition of disbursement for the TA components for both KP and FATA. The capacity assessment for KP will be done as its PMU has been notified only recently. KP’s PMU shall not do any procurement of goods and services unless the procurement staff is on-board and trained by the Bank’s procurement team.

65. Implementing agency for the FATA component is the already established PMU. The present Project Director has considerable experience of selection of firms on Bank funded and other development projects. It was agreed that Project Officers for component three shall be the procurement focal point. As soon as the project officer is hired, capacity assessment will be
done. In FATA component, procurements are expected to include procurement of goods, selection of individuals and possibly some firms.

66. SMEDA shall be responsible for some minor procurements i.e. individual consultants and goods for operational purposes for implementation of SME component. Manager SMEDA assisted by the assistant manager will be the procurement focal point of SMEDA.

67. The support provided to SMEs under subcomponents 1.1 and 1.2, shall be considered as grants for which selection procedures, contract forms, and performance monitoring system have been agreed and will be documented in the Project’s Operations Manual. The beneficiaries will be required to follow accepted commercial practices. Overall procurement risk is *High*.

68. **Environmental and Social Aspects:** The construction activities, and operation of, some of the SMEs to be supported by the Project under its Component 1 may potentially cause negative environmental and/or social impacts, such as contamination of soil and water, air quality deterioration, and safety hazards for workers and surrounding population. **As the rehabilitation and reconstruction of SMEs will be limited to existing buildings, on existing land owned by SMEs within existing premises, no land will be acquired for expansion of existing physical infrastructure. Therefore, none of the social safeguard policies will be triggered.**

69. To address these potentially negative impacts, the task team has prepared an Environmental and Social Screening and Assessment Framework (ESSAF), in accordance with the OP/BP 8.00 for emergency operations. The ESSAF\(^9\) specifies the environmental and social assessment requirements the implementing agencies of KP and FATA will need to fulfill before any component under the ERKF Project can be implemented. The Framework describes the monitoring and reporting requirements to be fulfilled during the Project implementation, in addition to defining the institutional setup required for ESSAF implementation. The ESSAF has been shared with the implementing agencies in KP and FATA. It has been disclosed locally by the implementing agencies on December 15, 2010, and also at the InfoShop on January 10, 2011.

70. In accordance with ESSAF requirements, the PMUs of GoKP and FATA Secretariat, and SMEDA’s PU will designate appropriate officers as their respective Environmental and Social Focal Points (ESFPs), to ensure the effective implementation of ESSAF during the Project implementation, and also to coordinate with the Bank and other stakeholders, such as Environment Protection Agents (EPAs), on matters relevant to environmental and social management of the Project. Capacity building of these ESFPs and other related project personnel (such as the field officers), as well as awareness raising of the remaining Project and SMEDA staff will be done by the Bank team for better management of environmental aspects of the Project, particularly for the effective implementation of ESSAF.

**Lessons Learned and Reflected in the Project Design**

71. The Bank Group has a long history of similar projects in places like Aceh (Indonesia), Afghanistan, Congo, South Eastern Europe, and West Bank Gaza, often in close cooperation

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\(^9\) ESSAF is applicable to all projects under the MDTF.
with other parts of the Bank Group (IDA, IFC and MIGA) and donors. This rich history of projects provides many valuable design and implementation lessons.

- **The most critical factor for success is government commitment and ownership.** Activities proposed under the project have been identified in the PCNA, but at the same time were separately identified by the KP and FATA authorities as initiatives they wanted to undertake as part of their development strategies.\(^\text{10}\)

- **In post crisis situations, grant financing tends to be more successful than credits.** With grant financing it is possible to align incentives and outcomes, particularly when done in a "matching" way to facilitate risk-sharing. Conversely, credit financing requires firms to be willing to assume all the risk, in an environment that is highly uncertain.

- **The project design must be simple and flexible:** Too many components can overwhelm the client and their ability to implement the Project, and the Bank's ability to support project implementation can be challenged, particularly in an insecure environment. This Project exclude many proposals such as assistance with industrial estates, value chain financing (which are left for a follow on projects), financial sector support, etc and focused on the minimum needed to take initial steps at addressing only the most critical priorities.

- **PPD is** essential to managing the huge coordination challenge inherent in any effort to improve the enabling economic environment.

- **Diaspora have typically been the first investors in post crisis situations**, so there is often a focus on attracting this type of investor.

- **Implementation capacity is often limited in post crisis scenario.** This Project addresses capacity challenges by working through existing service providers; i.e. SMEDA, and focuses on capacity building of the main counterparts in KP and FATA.

- **Collaboration with the IFC, other donors, and federal level capabilities is essential.** This Project collaborated with IFC and donors at the design stage. During the implementation, the Bank can assist in attracting the UK Diaspora to invest in KP and FATA. Since DFID’s own rules of business prohibit it from doing this, the Department appreciated the component on Diaspora investment during Project consultations. Similarly, synergies with USAID’s sponsored SME grant program will be sought.

**Alternative Implementation Arrangements Considered and Proposed Arrangements:**

72. The proposed design was based on proposals of the GoKP, FATA Secretariat, and PCNA Report which highlights the importance of addressing the reconstruction needs for long-term economic development and employment creation in KP and FATA regions. Options for simultaneously financing economic revitalization projects are limited especially in FATA. However, the following approaches were considered:

73. *(a) Seeking multilateral and bilateral support* specifically for economic development in KP and FATA. This Project seeks funding under the MDTF and is different from other

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operations being pursued under the MDTF since it focuses on the private sector development and institutional capacity building for implementing economic and regulatory reforms. Therefore, there will be no duplication with other projects that will provide cash grants under safety nets programs or will support infrastructure development in the affected areas of KP, FATA and Balochistan. The Project also addresses the gaps identified in the PCNA as well as those mentioned by the FATA authorities.

74. **(b) Third Party Implementation.** Concern over the capacity of counterparts and pace of implementation resulted in using a third party i.e. SMEDA to implement the SME Development component of the Project. While there are considerable advantages to this, it was decided that for the overall long term development of KP and FATA, it is important to have the local government in the lead role. To address this, Component 3 will focus on institutional capacity building.

**Bank Supervision, Monitoring, and Evaluation Arrangements:**

75. The Project’s supervision plan has been developed considering the limitation of Bank staffs’ access to the Project area, especially in FATA, in light of gradual deterioration in the law and order situation in these parts of Pakistan. Increased challenges for the Bank’s task team requires alternative ways for field supervision and monitoring of ongoing operations, while there is limitation in supervision budget. The CPS (FY 2010-2013) also recognizes this challenge and emphasizes that the Bank needs to find ways to enhance supervision while mitigating the risks associated with a challenging security environment. Following the UN’s decision to raise its security risk levels to Phase III for Balochistan and KP, the Bank teams have adopted several innovative measures to continue supervision and monitoring of projects in these areas.

76. For the ERKF Project, proposed supervision mechanisms include;

(a) **Project M&E system:** The progress in achieving the Project's objectives against the performance indicators will be measured through a comprehensive M&E system (details are provided in Annex 2).

(b) **Locally based technical experts** to assist the respective governments in day to day project management. The Bank plans to engage local experts as part of supervision team to assist with ongoing management especially during the first year of implementation. Some of these experts will be housed within the PMUs for the first six months of the Project to ensure intensive hand-holding of the counterparts.

(c) **Third Party Monitoring.** For quality assurance and cross verification, a third party monitoring team will be hired within a year of implementation for an independent assessment of the reported progress. The experience of employing third party monitoring and the promotion of sustained beneficiary participation in projects, in collaboration with civil society organizations, offers a viable alternative and necessary complement to Bank’s supervision.

(d) **Review by the High Level PSCs at the KP/FATA level:** The KP and FATA Project Steering Committees will initially meet as and when required, but at least once every quarter during the first year to oversee ERKF’s progress. Following that, the PSCs will meet every six months or as required.
(e) **Possible innovative measures**\(^{11}\): The recently initiated pilots of the SAR Innovation Team funded by the Governance Partnership Facility grant, concluded that in the face of emerging security conditions in several SAR countries, the Bank task teams need to find creative ways to address challenges of field supervision. The ERKF will therefore consider using technology such as geo-referencing through GPS enabled cameras for physical verification and mobile phones based voice messaging for beneficiary participation, tracking and verification. While these measures cannot fully replace the utility of actual field visits, they provide a useful alternative in crisis affected areas where access is an issue.

(f) **Financing for the supervision:** To ensure the availability of sufficient resources for implementation support, the MDTF has committed sufficient resources (about US$ 600,000) for project preparation and supervision over four years. The Bank’s supervision team will be led by a Senior Specialist, based in the local office, and supported by local and international technical specialists to oversee implementation of respective components. A full time local expert based in Peshawar will work closely with SMEDA, and the respective counterparts of KP and FATA.

**Communications Strategy:**

77. Communication with stakeholders has been strongly emphasized while designing the ERKF. The communication campaign will provide stakeholders with relevant project design information; bring transparency to the process; and develop a close link with, and understanding of the targeted beneficiaries especially the SMEs. The strategy will be jointly implemented by both the governments of KP and FATA, and SMEDA, and will categorize direct (target beneficiaries, sponsors, partners, implementing staff, GoP) and indirect stakeholders (media, academia, donors, politicians, opinion makers and the civil society).

78. A **Grievance Redressal Mechanism** will also be established, using technology as much as possible. Considering the deep penetration of mobile phones in the KP and FATA regions, both beneficiaries and Bank project team members can use a mobile telephone-based system to register grievances and complaints. Monitoring of such complaints would also become simplified and those who register complaints will find this system to be easy and hassle-free. A detailed communications strategy for ERKF is attached as Annex 8.

**F. Project Risks and Mitigating Measures**

79. The **ERKF Project faces significant reputational, implementation and operational risks**, which could be aggravated by volatile country (including macroeconomic and security) situation. The Bank team rates the overall risks as high, and therefore, the Bank team and counterparts have incorporated mitigation measures in the Project design. The Operational Risk Assessment Framework (ORAF), analyzes major risks and outlines mitigation measures, and is attached as Annex 4. The following summarizes key risks and its mitigation measures derived from ORAF:

\(^{11}\) Similar measures are being tried out by DFID for its ongoing projects in KP and FATA.
80. **The Project is vulnerable to attract applications from ineligible SMEs.** This can create resentment amongst the rejected applicants. Therefore, the eligibility criteria will be published in print/electronic media and will also be posted on the websites of the FATA Secretariat and Industries Department of KP to ensure wide dissemination and proper resolution of this issue.

81. **There are significant project implementation risks as two independent PMUs will be managing the Project.** The PMUs have limited capacity to deal with the technical components, and this risk is exacerbated by the outreach issues within various agencies of FATA. This risk is being mitigated by working with SMEDA that will hire field officers to enhance Project’s outreach to SMEs. Both PMUs and SMEDA will receive TA under the Project to ensure smooth implementation.

82. **There is lack of experienced and qualified staff in GoKP and FATA for the FM of ERKF.** FATA will be using staff (Accounts Officer) from an existing PMU who has experience of donor-funded projects. An additional position will be created for support since one person is not considered sufficient to manage the recording and reporting. GoKP will appoint two staff for FM in the PMU. Bank staff will provide training on reporting requirements and close supervision will be done, particularly in the initial stages of the project.

### A Framework to Address Key Governance Challenges

The Bank recognizes the significant governance challenges which Pakistan faces in the present environment. Due to the absence of strong institutional mechanisms within KP and FATA, this Project is subject to significant risks especially in the first component which will hand out grants for immediate rehabilitation and upgradation of SMEs. Considering this, the Bank team has incorporated mechanisms within the Project design to ensure strong governance and accountability in the Project implementation so that the intended results and benefits of the Project are not comprised. These measures build upon the experience of the recent Bank-financed and other donor supported emergency Projects in Pakistan, including the proposed USAID’s Malakand SME Revitalization Project and DFID’s CGS for SMEs. The key governance challenges specific to the Project are explained below in terms of (1) transparency and outreach, (2) fiduciary risks, and (3) M&E of the Project’s activities.

**Transparency and Outreach** in this demand-driven Project necessitates an effective public information campaign to explicitly disseminate the messages containing the objectives and various features of the program. Dissemination of the eligibility criteria for the selection of grant beneficiaries under the SME Development component will be communicated to address any resentment.

**Fiduciary risks** in financial and procurement management were identified during the Project appraisal missions. Given the importance of these fiduciary aspects the task team has determined that; (1) placement of two adequately qualified and experienced FM staff in each PMU; (2) issuance of accounting procedures (embodying internal controls); and (3) placement of procurement staff/focal point in each PMU will be the disbursement conditions of the Project.
A diligent M&E system is vital for this Project and requires careful planning to address the issue of limited mobility and access of the Bank teams to the Project sites beyond Peshawar. The Project, will therefore, employ various supervision tools for third party monitoring such as, spot checks, process evaluation, and beneficiary assessments to evaluate the level of satisfaction with the Project implementation including selection of beneficiaries, disbursements and grievance systems.

G. Terms and Conditions for Project Financing

83. The proposed project will be financed by US$ 20 million MDTF grant. The project would be implemented over a three-to-four year period, with a closing date of June 30, 2015.
Annex 1: Detailed Description of Project Components

PAKISTAN: ECONOMIC REVITALIZATION OF KP AND FATA PROJECT (ERKF)

Component 1: SME Development (US$ 14 million)

Background

84. The SME Development Component provides direct support to SMEs to accelerate economic recovery in the two regions affected by the conflict, crisis and recent floods. The component specifically focuses on the SME sector since it is the most important driver of economic growth in a region. In Pakistan, enterprises employing up to 99 persons constitute over 90% of all the private enterprises in the industrial sector and employ 78% of the non agriculture labor force. They contribute over 30% to GDP and account for 25% of the exports of manufactured goods. For KP and FATA, the importance of SME sector is even higher since the share of SMEs in the total private sector is higher in these two regions compared to the national average.

85. The project’s approach of focusing on SMEs is in line with the recent policy of the Government of Pakistan (GoP). During the past several years, the GoP has taken a number of steps to support the SME sector. Some of these initiatives include the establishment of SMEDA and the SME Bank, the formulation of a national SME Policy, and the issuance of separate prudential regulations for SMEs.

86. In KP and FATA, majority of the businesses are small or medium. In KP, important SME sectors include marble processing, flour mills, wood & furniture manufacturing, pharmaceutical, footwear, cement products manufacturing and mines & minerals. In services, tourism and transport are the two most important sectors. A large number of SMEs also belong to wholesale/retail trading sectors. Important agro-based sectors in KP include horticulture, livestock, fisheries and beekeeping.

87. FATA has a very small industrial base. SMEs in FATA are mostly from marble mining & processing, food, light engineering and furniture sectors. For the service sector, transport and construction are the two most important sectors. Trading is also an important activity and trading enterprises exist in all the major urban centers of FATA. Anecdotal evidence suggests that the average size of a SME in FATA is smaller than that in KP.

88. Looking at the diversified needs of the SMEs of KP and FATA, different types of products have been offered under SME Development Component. These products have been organized as three subcomponents:

1.1 – SME Rehabilitation
1.2 – SME Up-gradation
1.3 – Business Development Services (BDS)

\[12 \text{ SME Policy 2007, Ministry of Industries & Production, Government of Pakistan}\]
89. For the implementation of these subcomponents, SMEDA will establish a Project Unit (PU) and will hire eight field officers to ensure component’s outreach to the affected areas of KP and FATA. The implementation arrangements are outlined in Annex-7, and will be provided in detail in the Operational Manual, to be prepared by the GoKP and FATA Authorities.

**Subcomponent 1.1 – SME Rehabilitation (US$ 9.80 million)**

90. The first subcomponent will provide direct support to the SMEs affected by crisis, where a large number of private sector enterprises in the affected areas have been damaged. Much of that has revolved around the destruction of buildings and infrastructure, machinery, equipment, and stocks. Along with these physical losses, businesses have also suffered in the form of lost revenues. A large number of the affected enterprises have not been able to continue their normal business operations and had either to shut down their operations or operate inefficiently. This has resulted in huge loss of employment opportunities for the local people. Discontinuity in routine business operations has eroded the capital base of the affected enterprises and currently, it is very difficult for most of them to restart their business operations without an external support. This particular need is being taken care of by the Rehabilitation subcomponent. The Project offers this support in the form of grants which will be provided to the SMEs meeting the eligibility and approval criteria. The program provides the flexibility of using these grants either for capital expenditures or for working capital. Some uses of grants during project implementation could include (i) reconstruction of damaged buildings and infrastructure; such as manufacturing halls, shops, hotels, mines, etc.; (ii) replacing or repairing/maintaining their damaged machinery and equipment; and (iii) for working capital needs of the business. Some possible uses in this regard may be for buying raw material, for paying staff salaries, paying utility bills, etc. Trading enterprises may use this grant for restocking of goods.

**Subcomponent 1.2 – SME Up-gradation (US$ 2.80 million)**

91. Subcomponent 2 offers support for up-gradation of the SMEs of KP and FATA for improving their business productivity and efficiency, without limiting support to only crisis-affected SMEs. This support will be provided in the form of matching grants to the eligible SMEs, at the individual and cluster level. Grants classified under this second subcomponent will be available to all the SMEs that meet the defined eligibility criteria. The Project will give priority to businesses which are located in more marginalized areas (list of those areas will be provided by the government counterparts).

92. The first type of grants will be available to those SMEs which have an existing business and they need some support to upgrade their business processes for improving their productivity and efficiency. Some possible uses of this grant may include:

- Technological innovation by acquiring better machinery and equipment; for achieving efficiency through cost reduction, quality improvement, increased production volumes, etc.
- New product development; for which support may be provided for research and development
- Support for developing/adopting new packaging/labeling requirements for some new products/markets
93. The second type of matching grant will be for supporting clusters. Preference will be assigned to those projects which have a strong public good element for the cluster or the geographical area. Some potential uses for this grant include:

- Establishing Common Facility Centers (CFCs) to fulfill a joint need of the cluster,
- Building market infrastructures for supporting the marketing of the products of certain SMEs clusters,
- Developing joint marketing/branding projects.

94. Grant support for this type of projects will be available for establishing new ventures. However, the SMEs participating in this project must have existing business enterprises as mentioned in the eligibility criteria. The grant money may be used for capital investment or for working capital for initial period following the startup (duration varying with the nature of the project). For such projects, it will be very important to assess the commercial viability of the project as one of the eligibility criteria.

Subcomponent 1.3 – Business Development Services (BDS) (US$ 1.40 million)

95. Along with providing direct support for immediate rehabilitation and up-gradation, the project design also takes into consideration the long term sustainable development of SMEs. Subcomponent 3 specifically focuses on this particular aspect. There are two products offered in this regard:

- Capacity Building of SMEs; and
- Support for Procuring Business Development Services (BDS)

Capacity Building of SMEs

96. Capacity building of SMEs of KP and FATA will be carried out for developing their business management skills so as to enable them run their businesses in a better manner. Most of the training programs in this regard will be carried out under the umbrella of ‘Business Edge’; which is an internationally recognized program of International Finance Corporation (IFC), designed specifically for SMEs. The Business Edge training program’s modules have been customized to the local environment and are conducted in local languages. Business Edge certified trainers will conduct capacity building programs of the selected SME groups; mainly in five business management areas:

a. Marketing Management
b. Human Resource Management
c. Financial Management and Accounting
d. General and Operations Management
e. Personal Productivity Skills
The program will be carried out in two phases:

- The first phase will focus on training of SMEs by the existing Business Edge Trainers. This will start immediately as the project is launched.
- The second phase will also include Training of Business Development Service Providers (BDSPs); along with the training of SMEs. Under this program, local people from KP and FATA will be trained by Business Edge to expand the pool of local trainers

**Support for Procuring BDS**

97. Business Development Services (BDS) are needed by the business enterprises for managing their businesses in a professional manner. Requirements for these services fall under multiple functions. BDS benefits the business enterprises mostly in the long term; and are therefore not considered to be a preferable area of investment by the SMEs. The option of utilizing these services is considered to be costly; and consequently, majority of the SMEs do not avail these services. The project offers to provide support for procuring these services by providing matching grants to SMEs. These matching grants will only be available for soft services and will not be utilized for physical support, such as for buying machinery and equipment, etc.

Some more commonly required BDS are listed below:

- Accounting/Financial Management
- Product development
- Productivity/Process improvement
- Certifications
- Market research
- Market linkages
- Legal/Regulatory/Tax advice

98. Prior to launch of subcomponent 3, a rapid need assessment exercise will be carried out to make the interventions more focused. The exercise will identify training areas and the types of BDS which are more commonly demanded by the SMEs. Training programs for SMEs and for BDSPs will be aligned with the results of the need assessment exercise.

**SME Eligibility Criteria**

99. The Economic Revitalization Project covers all districts of KP and all Agencies and Frontier Regions of FATA. There will be no pre-allocation of project funds (in any of the three subcomponents) on a geographical basis. While the project does not exclude any particular region or assigns mandatory disbursement for any region, it does prioritize SMEs in crisis affected districts/agencies as identified in the PCNA Report.
Enterprise Size

100. As per the SME Policy prepared by SMEDA, SME is defined in terms of three different criteria:

Table: A1.1

<table>
<thead>
<tr>
<th>Employment</th>
<th>Paid Up Capital</th>
<th>Annual Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to 250</td>
<td>Up to Rs. 25 Million</td>
<td>Up to Rs. 250 Million</td>
</tr>
</tbody>
</table>

101. The above-mentioned SME definition applies to whole of Pakistan and is more close to the SME environment in Punjab and Sindh. The SME environment in KP and FATA is different as discussed with stakeholders and it was deemed appropriate to tailor this definition to cater for SME needs in the region. Following guiding principles have been kept in view while defining SME eligibility with respect to its size:

a. The number of employees is chosen as the criterion for determining SME size.

b. The overall approach of the project is to provide more benefits to relatively smaller enterprises. Therefore, the upper limit of the number of employees has been decreased; compared to the standard definition; so as to accommodate maximum number of smaller enterprises.

c. It was also deemed necessary to put a lower limit on the number of employees; so as to avoid project activities getting into the domain of microenterprise sector.

102. Based on these factors, recommended eligibility criterion for this grant program includes SMEs which have employees between 3 and 100.

Sector

103. Enterprises from all broader categories of manufacturing, trading, services and mining are covered under the scope of this project. The manufacturing sector also covers SMEs engaged in agro processing such as small dairy processing, fruits and vegetables processing, etc. Enterprises which are strictly engaged in on-farm activities are not covered by the Project. However, the possibility of including livestock farming (only for FATA) may be considered. Including livestock in the project scope is also important from the perspective of improving gender balance in the project; since most of the livestock activities in rural areas are carried out by women. A decision on this may be taken by the FATA’s Project’s Steering Committee, after the Project’s launch.

104. There will be no pre-allocation of funds for any sector; in any of the three subcomponents. Entire funds will be disbursed with a demand driven approach. This will ensure effective utilization of the funds; without any risk of underutilization. Some priority may be attached to some sectors during the application assessment/approval process by assigning some extra points to SMEs coming from those sectors; such as marble & granite, gems, horticulture, furniture and construction. Final list of these sectors will be developed by SMEDA during the project implementation phase.
Registration of the Enterprise

105. Pakistan is not considered to be an effectively documented economy. KP and FATA are considered to be relatively less developed areas and consequently, the level of documentation is further lower in these two areas. The applicant SME has to be registered, however that registration can be with any government department. Including this condition in the eligibility criteria will help in registering and formalizing the SME businesses. In FATA, registration authorities may be the offices of Political Agent (PA), Assistant Political Agent (APA), Tehsil Municipal Administrator (TMA) or any other government organization. In KP, it may be the Provincial Industries department or any other government department.

New versus Existing Businesses

106. All types of grants for individual SMEs will be available only to those SMEs businesses which exist for at least one year. No grant will be available for new business. Grants offered to a group of SMEs for a cluster development program under subcomponent 2 may be allowed for establishing a new venture. However, the SMEs participating in this cluster development program cannot be new and will have to meet the standard criterion of being in existence for at least two years.

Grant Size and Share

107. Grant size will vary for the three subcomponents. Since MDTF Project has been designed to support SMEs affected by crisis situation, for individual SME, the size of the rehabilitation grants has been kept higher than the grant sizes for Up-gradation and BDS components. The size of the cluster development program by a group of SMEs will generally be higher, so the grant size has been kept higher. Maximum limits of grants for different subcomponents are shown in the following table:

<table>
<thead>
<tr>
<th>Subcomponent</th>
<th>Maximum Grant Size (PKR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rehabilitation</td>
<td>1.0 - 2.5 million</td>
</tr>
<tr>
<td>Up-gradation (individual SME)</td>
<td>0.75 - 1.0 million</td>
</tr>
<tr>
<td>Up-gradation (cluster development program)</td>
<td>5.0 million</td>
</tr>
<tr>
<td>BDS support</td>
<td>0.3 million</td>
</tr>
</tbody>
</table>

SME Share in the Matching Grant

108. For ensuring the ownership of SMEs in the interventions, it is important to have the share of the beneficiary SME in the required support. For Rehabilitation subcomponent, the project offers a higher share of support than that for the subcomponents of Up-gradation and Capacity building. The proposed shares of the Project and the matching shares by the SME in the matching grants in the three subcomponents are shown in the following table:
<table>
<thead>
<tr>
<th>Subcomponent</th>
<th>Project Share</th>
<th>SME share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rehabilitation</td>
<td>60%</td>
<td>40%</td>
</tr>
<tr>
<td>Up-gradation</td>
<td>50%</td>
<td>50%</td>
</tr>
<tr>
<td>Capacity Building</td>
<td>50%</td>
<td>50%</td>
</tr>
</tbody>
</table>

109. For the Up-gradation and BDS components, the beneficiary SME will have to contribute its share in cash; while for Rehabilitation subcomponent, the matching contribution may also be considered in-kind.

**Other Design Factors**

**Preference for Women Entrepreneurs**

110. For promoting gender balance, women entrepreneurs will be given a preferential treatment by awarding additional points during the application evaluation process.

**Reimbursement versus Direct Disbursement of Grant Money**

111. It will not be practical for the SMEs applying under Rehabilitation subcomponent to get grant money on a reimbursement basis. Most of the SMEs which have been affected by the crisis exist in a shut down condition. There is very low probability that such SMEs will have the cash available with them to first spend for rehabilitation and later get that amount reimbursed through grants. Therefore, rehabilitation grants will be given on direct disbursement basis and not on reimbursement basis. Another possible option in this regard is that the project makes direct payment to the suppliers of machinery, raw material, utility companies, etc. This approach will eliminate the risk of inappropriate use of funds.

112. Grants for up-gradation and procurement of BDS will be provided only on reimbursement basis; since these will be availed by those SMEs which are already running their businesses and thus have cash flows available with them for getting this support.

**Grants in Multiple Tranches**

113. Grants will be given in multiple tranches. Disbursement of next tranche will be contingent upon meeting the milestones set for the previous tranche; and showing the value added by the previous tranche. This will maintain a pressure on the beneficiary SME to spend the grant money for the purpose for which it is approved.
Component 2: Attracting Investments from the Diaspora (US$ 2 million)

114. This component will provide financial and technical support to governments of KP and FATA for attracting investment from the Diaspora with an objective to generate economic activities and develop links with domestic and international markets. Activities undertaken under this Component will provide momentum to catalyze a Diaspora investment agenda. Support will be provided for Business to Business (B2B) matchmaking for SMEs in specific sectors through activities such as Investment road shows (IRS) and Khushamdid (Welcome) Pakistan.

115. The main objective of this component is mobilizing Diaspora to amplify private investments and knowledge gains for KP and FATA in an effort to attain long term employment generation for sustainable economic growth. The Pakistani Diaspora (Overseas Pakistanis) is significant, around 7 million people that contributed almost US$ 8.9 billion in terms of foreign remittances to country’s economy during the fiscal year of 2010.

116. Diaspora plays a crucial role in contributing to the economic development in various ways including:
   a. Building business networks and social capital
   b. Mobilizing Foreign Direct Investments (FDI)
   c. Sending money to relatives and friends in terms of foreign remittances
   d. Developing market linkages for products from home country
   e. Promoting tourism and home country’s culture
   f. Engaging actively in philanthropy

117. For a country like Pakistan which has very few avenues to earn foreign exchange, remittances play a significant role in sustaining the economy, especially considering that 4 to 5 % of the GDP can be attributed to remittances. A recent World Bank (2010) report shows that remittances by Pakistanis abroad have played a significant role in Pakistan's economic development. Foreign remittances have contributed to noteworthy poverty reduction in Pakistan "by an impressive 17.3 percentage points between 2001 and 2008 (from 34.5 percent in 2001-02 to 17.2 percent in 2007-08)". Furthermore, the region has a history of Diaspora support following conflicts and crises. Above all, the Diaspora could play a significant role in Pakistan’s economy in the area of trade and investment. A possible close working relationship between the Diaspora and SMEs can therefore yield economic benefits such as facilitating economic growth in the non-farm sector and could play a role in marketing of Pakistani products abroad and attracting investments into the SMEs from the domestic and international markets.

118. Diaspora also can support home governments by helping them to bridge financing gaps through portfolio investments. Countries with infant debt markets resort to borrowing from the Diaspora communities, securitizing future revenues, and issuing bonds indexed to growth. World Bank estimates suggest that the Sub-Saharan African countries could raise US$ 5–10 billion by

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13 A Diaspora is the movement or migration of a group of people, such as those sharing a national and/or ethnic identity, away from an established or ancestral homeland.
14 Ministry for Overseas Pakistani (http://www.opf.org.pk)
issuing Diaspora bonds and US$ 17 billion by securitizing future remittances and other future receivables \(^{17}\). In a very recent development, The United States of America has signed separate MoUs with El Salvador and Honduras \(^{18}\) to assist them in securitizing their future remittance receipts to raise financing for infrastructure and development projects. Israel, India, Sri Lanka, Liberia etc. have been on the forefront in arranging financing from their respective Diaspora. The State Bank of India (SBI) has raised Diaspora bonds over US$ 14 billion. Similarly, the Government of Sri Lanka has repeatedly sold Sri Lanka Development Bonds (SLDBs) since 2001 to several investor categories including non-resident Sri Lankans raising over US$ 700 million.

119. This operation will support two activities:
(i) Pre Feasibility for a Private/Public Sector Diaspora Bond for SMEs; and
(ii) Outreach Program for Mobilizing Diaspora Investment

(i) Pre Feasibility Study for a Private/Public Sector Diaspora Bond for SMEs

120. This activity will undertake a feasibility study for a Diaspora bond to establish the need, justification, mechanics and structure of the financial instrument. Launching a Public Sector Pakistani Diaspora bond has the potential to generate ample financial resources and effectively fill up the gap for investment appetite of KP and FATA. Similar to all other provincial governments of Pakistan, KP and FATA faces operational challenges rather legal restriction to deal with issues related to sovereign debt. To avoid complexities of processes involved at the federal and provincial levels, a private sector Diaspora bond supporting SMEs financing gap in the provinces could also be a viable option. These challenges have made a strong case for a pre-feasibility study for a Diaspora bond.

121. The study will also review the existing remittance networks (payment systems, branch networks, mobile phone payments, money transfer agents etc.) available in the target areas. It is important to explore options for enhancing access such as cost sharing with the private sector for setting up new outlets in the region.

(ii) Outreach Program for Mobilizing Diaspora Investment

122. The outreach program will target the domestic and overseas migrant workers, and other groups of Diaspora. This entails an effective promotion campaign of products from KP and FATA, investment opportunities in various SME sectors and infrastructure, and a strong marketing of Pakistan as credible brand representing quality and diversi-ty. These national and international events spread over 4 years, and will be built on the success of each other.

123. During the first year the Project, focus will mainly be on the domestic migrant workers from KP and FATA (mostly settled in Karachi). For instance, investment road shows with focus on KP and FATA is planned for Karachi; whereas international events to attract Diaspora investments will be in the second and following years of the Project. The international events


(conferences and road shows) are dependent on the overall security environment, and ownership of the local authorities, private sector (Chambers and Associations) and investment facilitation institutions (e.g. Board of Investment) in KP and FATA.

124. This particular subcomponent entails an outreach program to attract Diaspora investment that involves:

(i) Investment road shows (IRS);
(ii) ‘Khushamdid (Welcome) Pakistan’ (Annual ‘Pakistan Diaspora’ conferences in KP and FATA); and
(iii) ‘ReConnect Pakistan’

125. The investment road shows (IRS) will be designed to attract foreign investments. IRS are proposed in pre-select geographical destinations hosting large Diaspora and migrant workers from KP and FATA.

126. An annual Pakistan Diaspora conference ‘Khushamdid Pakistan’ in Peshawar is another potential activity. This can facilitate Diaspora’s visit to home to revitalize and strengthen linkages and also provide better understanding of opportunities to engage with local businesses. Such an event will also provide a platform for policy dialogue, industry roundtables, networking opportunities for Diaspora with the highest government functionaries, special visits to historical and cultural attractions, and special exhibitions to showcase products of KP and FATA.

127. The ReConnect Pakistan will be an open membership website dedicated to Pakistani Diaspora across national and international boundaries. It would be packed with up to date and essential information on Diaspora linkages, investments and business opportunities back home and facilities offered by GoP to Diaspora communities. The ReConnect Pakistan will share Diaspora success stories and serve as a window of information and promotional tool for the component of investment mobilization.
Component 3: Institution Building to Foster Investment and Implement Regulatory Reforms (US$ 4 million)

128. This component will provide support to the Governments of KP and FATA to create a more attractive business climate and attract investments to the region by building capacity to undertake regulatory reforms and promote investments. The recently concluded PCNA exercise highlights how stakeholders have overwhelmingly pointed out that a deficit of individual and institutional capacity is a crisis driver. The PCNA findings confirm that capacity constraints in the provision of public services, the governance structures, civil society, and the private sector to create jobs must be tackled to fully address the crisis.

129. The project will accomplish this objective through the development of four main activities:

(i) Capacity building of governments of KP and FATA;
(ii) Development of a Public Private Dialogue (PPD) Mechanism to Promote Reform;
(iii) Institutionalizing Investment Promotion; and
(iv) Implementation Support

130. Complimentary to supporting SMEs directly and to attract investment in the region, is the need to create conducive business environment and the local capacity to sustain such an environment in the medium and long term. In KP and FATA, this is particularly important, given that there is significant room for improvement on the business environment. For example, the Doing Business in Pakistan 2010 report shows that Peshawar ranks 8th out of 13 districts on the ease of doing business in Pakistan. Furthermore, there is no local, provincial, or federal capacity dedicated to promoting investment in the region. Only recently, an Investment Facilitation Authority (IFA) in FATA has been notified, details of which follow in this section.

131. Table A1.3 below summarizes the broad areas of support under each activity for both KP and FATA:
Table A1.3: Summary of Activities

<table>
<thead>
<tr>
<th>Activities</th>
<th>KP</th>
<th>Rationale</th>
<th>FATA</th>
<th>Rationale</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Capacity building of governments of KP and FATA</td>
<td>Capacity assessment and involving the right mix of directorates to achieve Component’s objectives</td>
<td>The Industries Department has explicitly requested Bank’s support for capacity building.</td>
<td>Data collection on SME sector and online gateway for Knowledge management on FATA</td>
<td>There is dearth of basic economic data on FATA.</td>
</tr>
<tr>
<td>(ii) Development of a Public Private Dialogue (PPD) mechanism to promote reforms</td>
<td>PPD mechanism structured to promote business environment and sector specific reforms</td>
<td>A formal structured partnership mechanism that helps identify, prioritize and resolve key constraints to private sector development is an important part of sustained growth in the medium term</td>
<td>PPD mechanism structured to promote business environment and sector specific reforms</td>
<td>A formal structured partnership mechanism that helps identify, prioritize and resolve key constraints to private sector development is an important part of sustained growth in the medium term</td>
</tr>
<tr>
<td>(iii) Institutionalizing Investment Promotion</td>
<td>Supporting the PMU to build capacities of its attached department Sarhad Development Authority (SDA) and its affiliate, the Investment Facilitation Centre (IFC)</td>
<td>IFC’s mandate is to promote investments in the province</td>
<td>Supporting the already notified Investment Facilitation Authority (IFA) or a new entity specifically mandated to promote investments in FATA</td>
<td>The ToRs for IFA closely matches what the Project sets out to achieve and FATA secretariat sees a role for IFA in investments promotion in the region</td>
</tr>
<tr>
<td>(iv) Implementation Support</td>
<td>Technical Assistance (TA) to both PMUs and SMEDA’s PU</td>
<td>Industries department’s PMU and SMEDA’s PU need TA in setting up and running the project’s operations. PMU at FATA also needs strengthening.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Capacity building of governments of KP and FATA

132. There is limited capacity for the Project implementation in KP, as the Industries Department has few resources for staffing and minimal experience in managing donor projects.  

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19 The Industries Department at KP is an administrative department of the Provincial Government which is responsible for the promotion, planning and development of Industries, Trade, Commerce, among other areas. The Department works through its
Building capacities of the Department is consistent with the KP’s Comprehensive Development Strategy (CDS) which highlights as key priorities employment generation through opportunities for private sector development, and technical support to the public sector to ensure that the rapid increase in activity can be implemented. Among directorates of the Industries Department are the Small Industrial Development Board (SIDB) and the Sarhad Development Authority (SDA), both of which will also be key players in developing a reform agenda and in promoting investment in the region.

133. The PCNA correctly highlights that capacity development is far more important than trainings. It will be critical to conduct a capacity gap assessment to design appropriate capacity development strategies at the industries department. In the short term capacity can be augmented by technical assistance and/or support structures. However, over the medium to long term such parallel systems deplete capacity and this would be a guiding principal in supporting the PMU at KP.

134. In FATA, on the other hand, the capacity building needs are more focused on the need to collect and disseminate basic economic data to guide policymakers and key stakeholders in identifying and prioritizing a reform agenda. There is limited information, much of which is neither current nor accurate, that can guide regulators, investors, donors, and businesses on opportunities and constraints to starting, expanding, supporting or investing in the private sector. Even basic statistics, such as the number of operating businesses, key sectors and opportunities for investment are missing. The Project will assist FATA in filling this gap by providing support and technical assistance in identifying key gaps in private sector data that can be collected, developing appropriate methodologies.

135. The Project will support a range of approaches to be implemented through partner organizations to assist the FATA Secretariat with vital data collection and analysis for policy decisions. The project will support the government to identify key priority statistical areas. A factor in the decision of how, when, and from where to collect data will hinge on understanding key constraints, including inaccessibility, areas of conflict, cultural norms, etc. Therefore, the project will support the government to develop appropriate data collection methodologies, given many of the challenges unique to the region. Furthermore, the project will support FATA in developing a monitoring and evaluation methodology, so that mechanisms are in place for the sustainable collection and dissemination of information relevant to economic growth.

136. In addition, there will be a focus on transparency and accountability by ensuring that data and policy-based information are widely distributed to the public. This will be accomplished by assisting FATA in developing a gateway/portal that will display and update information, and be progressively built into possibly GIS enabled mechanism.

attached units (or directorates) including the technical education and manpower training, workers welfare board, Industries, commerce and labor, Small Industrial Development Board (SIDB), and Sarhad Development Authority (SDA).

20 The GoKP and FATA Secretariat are faced with the difficult task of building public trust from a very low base. The foremost strategic objective as enunciated by PCNA also points to this urgent need by calling for greater government openness to citizen scrutiny, far greater citizen participation in local government and a dramatic increase in responsiveness of community concerns.
Data collection may be considered for the following:

a. SME surveys;
b. Overview of business environment and constraints;
c. Priority sectors and profiles (some are available and needs consolidation from bodies such as SMEDA, FDA, and the secretariat); and
d. Other areas to be identified

**Development of a Public Private Dialogue (PPD) Mechanism to Promote Reforms**

137. Promoting growth and revitalizing enterprises requires an integrated approach including the need to create a facilitative business environment and the local capacity to sustain such an environment in the medium and long term. Therefore, activity two is designed to address and build capacity within the governments of KP and FATA to undertake, identify, and implement policy reforms, and to promote investment within the region, with the ultimate goal of improving the investment climate and improving productivity and competitiveness of local businesses, entrepreneurs and workers.

138. The actual process of policy reforms will be grounded in a formal *Public Private Dialogue* (PPD) mechanism, which entails the public sector, business and non-governmental sector partners working collectively to create better conditions for economic growth and employment generation. PPD is particularly valuable in post-conflict and crisis environments to consolidate peace and rebuild the economy through private sector development. Structures and instruments for dialogue need to be adapted to any conflict or crisis environment, and to take into account the inherent informality of the economic actors and the potential role of customary systems in establishing the rule of law. Localizing this PPD initiative to take account of issues and specific challenges to KP and FATA respectively will be a guiding principle in the design and implementation of this component.

139. The governing body of the PPD could take the shape of a business forum or a secretariat depending on what makes the most sense in the current context of the each of the two regions. Before embarking on setting up a PPD mechanism, an initial diagnostic would be undertaken to best identify which institutions can be best harnessed, as well as to identify which sectors, reforms, and stakeholders will be best suited to include in the design and implementation of the initiative.

140. The diagnostic will be the first and one of the most important steps of the process. It will provide solid reasoning behind the decision to launch a dialogue process in one area rather than another, and will justify the amount of human and capital investment needed to support it. It will also create a baseline against which the PPD can be measured over time and can flag potential obstacles, thus enabling better strategic management decisions. Finally, the diagnostic will provide a concrete action plan and blueprint for organizing, staffing, resourcing, monitoring, and prioritizing so that the governments of both KP and FATA will have complete clarity on the objectives, the process, and the expected outcome of this investment. The diagnostic and action plan are likely to be quite different for each of the regions, given differences in local governance,
organization of local governments, and key constraints facing the private sector. When the initiative transforms into the implementation phase, one of the most important elements of effectiveness and success will depend on the degree to which the institution has a formal mandate and support of key decision makers. Without the blessing of key decision makers, the dialogue may not be as effective or achieve initial objectives.

141. Outputs from the PPD can be varied, and include analytical outputs (e.g. think pieces, surveys, policy papers, assessments), specific reform recommendations (including suggested texts for draft laws or amendments), structure and process outputs such as conferences meetings, information dissemination programs, and soft outputs such as increased trust, building of social capital, etc.

142. Finally, the PPD mechanism will also need to be monitored and evaluated by the Project. The M&E framework will provide stakeholders the ability to monitor internal processes and encourage transparency and accountability. The definition of inputs, outputs, outcomes and impacts will be matched with key indicators and subject to periodic review from stakeholders. The first step in this process will be to develop a baseline assessment to measure effectiveness in order to enable the partnership to best measure how it will achieve goals over time.

Institutionalizing Investment Promotion

143. More than 70 percent of investment promotion intermediaries may be missing out on foreign investment by failing to provide investors with accurate and timely information, according to the Global Investment Promotion Benchmarking 2009 report. This function, known as “investment facilitation,” is one of the simplest and most cost effective, yet it is neglected at many agencies.

144. There is a lack of active institutional structures in promoting investment in KP. This need was stated by stakeholders in the recent PCNA exercise who recommended establishing a “promotion and investment facilitation unit” in the Province. Such an institution is envisaged to achieve investment promotion in KP the outcome of which will be improved investment climate, growth and employment. The Investment Facilitation Centre (IFC) (housed under the SDA) is mandated to promote investment by providing a platform to the local and foreign investors, and disseminates investment databases to the prospective investors. In consultation with the Secretary Industries, the project will support building the capacity of IFC and/or other attached departments to better respond to the needs of private investors.

145. Similarly, there is presently limited capacity in FATA to market the region to potential investors. The promotion agenda supported by the Project will focus on identifying and

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21 The action plan from the diagnostic will include identifying for each region a) Roles of stakeholders, including principles for selection of participants, and optimal functions of donors, b) Functions of a secretariat – who should organize meetings, circulate information, organize external resources, etc. as well as location and composition, c) Proposal for organizing working groups, e.g. by issues, sectors, locality, d) Agenda of initial key issues, based on consultations with both public and private sectors, and proposed mechanisms for introducing new agenda items in the future, e) Operating guidelines for dialogue – how often stakeholders meet, process for reaching consensus, feedback mechanisms, degree of openness, relationship with government, etc, and f) Support services that may be required, such as technical assistance, research, communications and outreach strategies.
marketing the advantages and opportunities that FATA investment provides. For example, the relative ease of establishing businesses will be promoted, and key sectors and industries will be highlighted and marketed. As mentioned above, FATA’s Investment Facilitation Authority will attract membership from the highest level; Governor KP and FATA as the Chairman and ACS FATA as the vice chairman and having representation from elected representatives, State Bank of Pakistan, Securities and Exchange Commission, Board of Investment, SMEDA, and FATA Chamber of Commerce etc. Major tasks assigned to the Authority includes regulatory framework for investment, encouragement and facilitations to banks and other financial institutions and services, development of policy for PPPs, advocacy and lobbying for private sector development in FATA. IFA will assume a long term investment facilitation role under the project.

146. The PCNA points out that one major driver of conflict in KP and FATA is a weak regulatory environment and lack of enforcement that discourages investment and adversely impact economic growth and employment generation. The Project will focus specifically on building the capacity to attract investment to the FATA and KP region. While this will be linked to the PPD mechanism, through the identification of sector specific and business environment reforms whose goal is to attract domestic and foreign investment to the region. However, this activity will focus specifically on building the capacity of an investment promotion institution (new or existing).

Implementation Support

147. In view of the limited capacities within KP and FATA, the ERKF Project will provide this support to the Project counterparts of KP, FATA and SMEDA-KP for effective implementation of the Project. Details of implementation costs and arrangements are given in Annex 3 and 7 respectively.
### Annex 2: Results Framework and Monitoring

**PAKISTAN: ECONOMIC REVITALIZATION OF KP AND FATA PROJECT (ERKF)**

<table>
<thead>
<tr>
<th>PDO</th>
<th>Project Results Indicators</th>
<th>Monitoring Mechanism</th>
<th>Key Assumptions</th>
</tr>
</thead>
<tbody>
<tr>
<td>To support the Government of Pakistan (GoP) in the economic recovery and revitalization of the crisis affected areas of Khyber Pakhtunkhwa (KP) province and Federally Administered Tribal Areas (FATA), by creating sustainable employment opportunities through rehabilitation of Small and Medium Enterprises (SMEs), investment mobilization, and institutional capacity building.</td>
<td>1. <strong>Business rehabilitation:</strong> 850 SMEs use matching grants for rehabilitation and up-gradation 2. <strong>Jobs:</strong> 8,000 jobs restored/created 3. <strong>Sustainability:</strong> 60% of all assisted SMEs operational and productive at the completion of the project 4. <strong>Investments:</strong> US$ 10m attracted from Diaspora and migrant workers from KP and FATA 5. Investment Facilitation Authority (IFA), FATA and Investment Facilitation Center (IFC), KP established and operationalized</td>
<td>Beneficiary surveys, PMUs and PMUs reports, SMEDA’s PU reports, Media Files</td>
<td></td>
</tr>
</tbody>
</table>

### Table: A2.1

<table>
<thead>
<tr>
<th>Intermediate Results (Outputs)</th>
<th>Intermediate Results Indicators</th>
<th>Monitoring Mechanism</th>
<th>Key Assumptions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Output #1:</strong> SME Development &amp; Support Program established.</td>
<td>1.1 SME Rehabilitation Support provided: 600 matching grants provided to SMEs meeting criteria 1.2 Up-gradation Support: 250 SMEs benefit from the up-gradation grants 1.3 Capacity Building &amp; BDS Support: BDS provided to 500 SMEs/clusters 1.4 11 machinery pools/common facilities centers operational</td>
<td>Field Visits reports and Third Party Monitoring (TPM), PMU Reports, Final assessment on completion of Project</td>
<td>1.1 USAID US$ 10m SME Revitalization Program for Malakand Division (KP) implementation began 1.2. DFID Credit Guarantee Scheme (CGS) of US$ 12m implemented on schedule 2.1 US$ 10m of Diaspora investment pledges.</td>
</tr>
<tr>
<td><strong>Output #2:</strong> ‘Attracting Investments from the Diaspora’ Program implemented.</td>
<td>2.1 Diaspora Outreach program implemented: At least 7 to 10 outreach activities/events successfully organized 2.2 Re-connect Pakistan (web tools for Diaspora) operational</td>
<td>Commercial Bank reports, FATA Secretariat, Industries Department Final assessment.</td>
<td>3.1 Regulatory Reforms</td>
</tr>
</tbody>
</table>

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44
| **Output #3:** Institution Building to Foster Investment and Implement Reforms | 3.1 Recommended regulatory/institutional reforms introduced/notified by Industries Department for private sector development in KP.  
3.2 PPD mechanisms established in KP/FATA; defining economic growth and employment generation policy reforms; proposals for implementation submitted. | SMEDA reports/ newsletters, Economic Survey of Pakistan, PMU, Media Coverage, GoKP and FATA Secretariat, Final Assessment. | implemented/Investment Climate improved (see rating) |
PDO: To support the Government of Pakistan (GoP) in the economic recovery and revitalization of the crisis affected areas of Khyber Pakhtunkhwa (KP) province and Federally Administered Tribal Areas (FATA), by creating sustainable employment opportunities through rehabilitation of Small and Medium Enterprises (SMEs), investment mobilization, and institutional capacity building.

Project Results Indicator

<table>
<thead>
<tr>
<th>Project Results Indicator</th>
<th>Target Values</th>
<th>Data Collection and Reporting</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Number of SMEs using matching grants for rehabilitation and upgradation (at least 2-3% awarded to enterprises owned and managed by women)</td>
<td>850</td>
<td>Bi Annually, and End of Project captured in ISRs and ICR</td>
</tr>
<tr>
<td>2. Number of jobs restored/created (direct and indirect)</td>
<td>8,000</td>
<td>Annually, End of Project captured in ISR and ICR</td>
</tr>
<tr>
<td>3. X% of all assisted SMEs operational and productive at the completion of the project</td>
<td>60%</td>
<td>End of Project captured in ISR and ICR</td>
</tr>
<tr>
<td>4. X $ of million investments attracted from Diaspora and migrant workers from KP and FATA</td>
<td>10</td>
<td>Annually, End of Project captured in ISR and ICR</td>
</tr>
<tr>
<td>5. Investment Facilitation Authority (IFA), FATA and Investment Facilitation Centre (IFC), KP established and operationalized (%) completed</td>
<td>100</td>
<td>Annually and End of Project captured in ISR and ICR</td>
</tr>
</tbody>
</table>

Responsibility for Data Collection:

1. PMUs and SMEDA-PU
2. Third Party (Independent Firm)
### Table: A2.3

<table>
<thead>
<tr>
<th>Table: A2.3</th>
<th>Target Values</th>
<th>Data Collection and Reporting</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Baseline</td>
<td>Yr 1</td>
</tr>
<tr>
<td><strong>Baseline</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Intermediate Outcome Indicator</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Output 1: SME Development Program Implemented</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Number of matching grants provided for rehabilitation of SMEs, meeting criteria (direct and indirect beneficiaries)</td>
<td>180</td>
<td>220</td>
</tr>
<tr>
<td>2. Number of matching grants provided for upgradation (direct and indirect beneficiaries)</td>
<td>60</td>
<td>100</td>
</tr>
<tr>
<td>3. BDS provided to SMEs/ clusters</td>
<td>100</td>
<td>150</td>
</tr>
<tr>
<td>4. Number of machinery pools/common facilities centers operational</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td><strong>Output 2: ‘Attracting Investment from Diaspora’ Program Implemented</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Number of outreach activities/events successfully organized</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>2. Re-connect Pakistan (web tool for Diaspora) operational (Number of hits on website)</td>
<td>200</td>
<td>1,500</td>
</tr>
<tr>
<td><strong>Output 3: ‘Institution Building to foster investment and implement regulatory reforms’ Program implemented</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Recommended regulatory/institutional reforms introduced/notified by Industries Department for private sector development in KP.</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>2. Number of PPD platforms established in KP and FATA</td>
<td>0</td>
<td>2</td>
</tr>
</tbody>
</table>
In view of the existing institutional capacity of KP, a dedicated PMU has been established by the KP’s Industries and Technical Education Department. In FATA, the implementation will be managed by a PMU already in place. The implementation of the first component on SME development will be done by SMEDA for both KP and FATA through a dedicated PU. Details for financial management (FM) and procurement arrangements are available in Annexes 5 and 6.
ANNEX 4
OPERATIONAL RISK ASSESSMENT FRAMEWORK (ORAF)

Negotiation to Approval Package Version

Project Development Objective(s)

To support the Government of Pakistan (GoP) in the economic recovery and revitalization of the crisis affected areas of Khyber Pakhtunkhwa (KP) province and Federally Administered Tribal Areas (FATA), by creating sustainable employment opportunities through rehabilitation of Small and Medium Enterprises (SMEs), investment mobilization, and institutional capacity building.

PDO Level Results Indicators:

1. 850 SME/businesses benefited by the grants program
2. 8,000 jobs (direct and indirect) generated in enterprises supported by ERKF
3. 500 SMEs that access business development services offered under the project
4. US$ 10 million in investments attracted from Diaspora and migrant workers from KP and FATA
5. Investment Facilitation Authority (IFA), FATA and Investment Facilitation Center (IFC), KP established and operationalized

<table>
<thead>
<tr>
<th>Risk Category</th>
<th>Risk Rating</th>
<th>Risk Description</th>
<th>Proposed Mitigation Measure</th>
</tr>
</thead>
</table>
| 1. Stakeholders Risk   | Medium-I    | 1.1 There could be a negative perception of Bank’s project if the ineligible enterprises are denied assistance.  
  1.2 USAID has plans to initiate economic growth work in Malakand and could expand into other areas resulting in a duplication of efforts.  
  1.3 The recent floods have exacerbated the economic turmoil being faced by KP and FATA, as it devastated the agricultural sector and destroyed the infrastructure critical for | 1.1 (a) **Transparent criteria** for the selection of crisis affected SMEs agreed with the implementing counterparts and Small and Medium Enterprise Development Authority (SMEDA) which will be made public through a focused communication campaign.  
(b) **A Grievance Redressal Mechanism** will be put in place to respond to complaints raised by the rejected applicants. (c) Additionally, the SME component beneficiaries will be selected by a **Grant Review and Monitoring Committee (GRMC)** comprising two reps each from KP and FATA, one each from KP and FATA private sectors, one from banking sector and one from SMEDA.  
1.2 Regular interaction with the development partners periodically to avoid possible duplication. The Project’s |

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22 This is the version that should be used for Negotiations and submission for Board Approval.
the Industrial Activity. The Damage and Needs Assessment (DNA) of WB and ADB estimates the cost of reconstruction to be around US $ 6-7 billion. A communication campaign will also support team’s efforts.

1.3 Depending upon the Project outcomes and its overall success, additional funding may be sought from the MDTF and/or IDA sources.

2. Implementing Agency Risk

<table>
<thead>
<tr>
<th>2.1</th>
<th>There will be issues with the implementation of the Project at the agency level within FATA as the presence and capacity of the local government and SMEDA are limited in remote areas of FATA.</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.2</td>
<td>Bank’s past experiences with GoKP have highlighted the shortage of qualified procurement staff. Hence, efficiency and robustness of the evaluation and processes could be compromised.</td>
</tr>
<tr>
<td>2.3</td>
<td>There could be political pressures on PMUs and PU officials for grants disbursements. There could also be interference from the local chambers of commerce and SME associations in the selection of ERKF’s beneficiaries.</td>
</tr>
<tr>
<td>2.4</td>
<td>Absence of key counterparts or appointment of unresponsive counterparts in key positions can delay Project’s activities and can also reduce the frequency and effectiveness of the Steering Committees.</td>
</tr>
<tr>
<td>2.5</td>
<td>The Project could suffer from misallocation of funds and delayed disbursements plus there may be serious issues around establishing PMUs’ transparency.</td>
</tr>
</tbody>
</table>

2.1 FATA Secretariat and KP’s Industries and Technical Education Department will address the capacity constraints by hiring technical consultants/staff for the PMUs before ERKF’s commencement. To enhance the outreach, eight field officers will be hired by SMEDA’s PU. Market based salaries with incentives aligned to results would be offered to attract talented individuals.

2.2. Recruitment/placement of adequately qualified FM and procurement staff and documentation of basic internal controls and payment processes is a pre-condition for disbursement. Bank staff will provide training on procurement and FM requirements to the designated PMU staff. Close supervision will be done by Bank teams throughout Project’s life. Also, KP-FATA will upload procurement disclosures on ERKF’s website. An independent complaint redressal mechanism will also be established.

2.3. (a) A separate Project Steering Committee for KP and FATA, comprising the ACS, Director General P/FDMA, SMEDA and private sector representatives will be established. It will oversee Project’s performance and make policy decisions as and when required. (b) The GRMC will provide an additional layer of verifications and monitoring of the process.

2.4 It is difficult to mitigate this risk at the provincial level and for FATA Secretariat. However, as these positions are always occupied by trained public sector officials, the Project’s continuity should not suffer.

2.5.(a) There will be direct transfer of funds to PMUs with timely reporting of expenses along with independent
verification of payments to beneficiaries by SMEDA and third party monitoring arrangements.
(b) FATA Secretariat’s and GoKP’s mechanism for internal reviews will be extended to the PMUs. In FATA, the corruption cases are reviewed by the Governor’s Inspection Team which also reviews public complaints.

### 3. Project Risk

<table>
<thead>
<tr>
<th>3.1 Design</th>
<th>High</th>
<th>3.1.1. Absence of baseline information will affect the process of Project preparation especially the designing of interventions.</th>
<th>3.1.1. Initially the Project will work with sectors on which data is available. As for other sectors, baseline information will be gathered after six months of Project commencement date.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>3.1.2. There is a possibility that only few sectors are organized in associations/clusters and thereby benefiting disproportionately from the Project. It is also important to note that Bank policies restrict Bank projects from supporting sectors such as tobacco and arms.</td>
<td>3.1.2. There will be a provision in the Implementation Manual to revise the criteria after the interim review of the Project by the Steering Committees, if this concern is verified. Prior to the Project’s commencement, SMEDA will be asked to complete a mapping of the local SME and Traders associations to determine the possibility of outreach and collaboration with the local networks.</td>
</tr>
<tr>
<td>3.2 Social &amp; Environmental (SASDI and SASDS)</td>
<td>Medium-L</td>
<td>3.2.1. The construction activities and operation of the SMEs supported by the Project may potentially cause negative environmental and social impacts. The nature and significance of these negative impacts will depend upon the type, size and location of these SMEs.</td>
<td>3.2.1. To assess the nature and significance of the potentially negative environmental and social impacts, and to determine appropriate mitigation measures, the Project will carry out environmental and social assessment of each component (e.g., rehabilitation of an SME) during the Project implementation. The Project ESSAF defines the environmental and social assessment requirements which the implementing agencies will need to fulfill.</td>
</tr>
<tr>
<td>3.3 Program &amp; Donor</td>
<td>Medium – I</td>
<td>3.3.1. There could be delays in seeking approvals from the GoP and MDTF Secretariat on various actions including release of funds and clearance of requests necessary for the commencement of certain activities under the Project.</td>
<td>3.3.1. MDTF Secretariat is housed in the Bank’s Country Office in Islamabad. The services of the same Secretariat will be requested to pursue desired approvals and actions from the GoP on fast track basis. Bank’s internal procedures have already been streamlined under OP 8.0 to enable Project Preparation and approval on fast track basis.</td>
</tr>
<tr>
<td>3.4 Delivery Quality</td>
<td>3.4.1. Industries and Technical</td>
<td>3.4.1. Before Project’s completion, institutional</td>
<td></td>
</tr>
</tbody>
</table>
Education Department of KP and FATA Secretariat may not be able to sustain Project activities after the PMUs are dismantled. This can hamper the extension of economic activities beyond Project’s life. Arrangements will be in place within KP and FATA to take over PMU’s relevant staff and Project activities. An Investment Facilitation Act (IFA) has already been notified by FATA which will be a permanent set up.

<table>
<thead>
<tr>
<th>Overall Risk Rating at Preparation</th>
<th>Overall Risk Rating During Implementation</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>High</td>
<td></td>
</tr>
</tbody>
</table>
Annex 5: Financial Management and Disbursement Arrangements

PAKISTAN: ECONOMIC REVITALIZATION OF KP AND FATA PROJECT (ERKF)

Country Issues

148. The Bank has carried out extensive analytical work on public financial management (PFM) systems in the country, both at national and sub-national levels. In May 2007, Public Financial Management and Accountability Assessments (PFMAA), using the PEFA 23 PFM Performance Measurement Framework, were completed for Balochistan, Punjab, and KP and a Federal level PFMAA using the same framework was delivered in June 2009. It noted that reforms underway have contributed towards improvements in PFM systems. Most notable are the ones initiated under the Bank-funded Project for Improvement of Financial Reporting and Auditing (PIFRA) and the implementation of a Medium Term Budgetary Framework (MTBF) which is supported by DFID. Donor-funded projects and a number of self accounting entities remain outside the government FMIS. The government is yet to develop an effective internal audit function and continuing efforts are needed to improve effectiveness of tax collection and the management of cash balances impacting the predictability in availability of funds. Specific diagnostic and analytical work has not been done for FATA where Federal PFM systems are applicable.

149. **Inherent risk**: The inherent risk is “High”. Country level risk is Moderate and the implementation done by specially created PMUs, is subject to the country PFM processes and controls. However, due to weak / absent capacity at the implementation level and the nature of the transactions i.e. grants to multiple recipients, the inherent risk of the project is higher.

150. **Control risk**: The control risk is “High”. Keeping in view the nature of transactions under the project, particularly numerous grants to SMEs and the lack of existing systems and procedures in place the Control risk is originally assessed as “High” but with staffing in place and sufficiently rigorous mechanisms for the grant process, it is anticipated that there will be adequate assurance that project funds will be used for intended purposes, economically and efficiently.

151. **Residual risk**: The residual risk rating of the project is considered “High”.

Risk rating summary is present in the working papers file.

**Strengths**

- Implementing unit in FATA has prior experience of donor-funded projects;
- SMEDA, which will be processing the SME grants, has experience of implementing similar programs, both donor-funded as well as government initiatives.

**Weaknesses**

- Implementing unit in KP to be put in place. Existing capacity is lacking;

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23 Public Expenditure and Financial Accountability
• Department of Industries, the implementing department in KP, does not have any experience in donor-funded projects;
• Delays in issuance of audited financial statements of SMEDA in past years.

Staffing

152. At each PMU there will be at least two dedicated individuals for FM, one of whom shall be an Accounts Officer and the other should be at the Assistant Accounts Officer or Cashier level. The officers may be deputed from the Accountant General (AG) or otherwise hired from the market against terms of reference acceptable to the Bank. These staff must be on-board prior to the first disbursement.

153. In FATA, an Accounts Officer deputed from the Office of AG is already in place. He is currently working on USAID funded projects and has previously worked on a Bank-funded project as well. He is well versed with governmental accounting systems and procedures. However, he requires additional support to manage the accounting and reporting requirements of the project.

154. For the SMEDA PU, Finance and Admin Officer will be hired at the later stages of the Project, if deemed necessary by the Bank team. Until such person is hired, SMEDA KP Office and SMEDA Head Office (Lahore) shall provide support to ensure that proper records are maintained and FM arrangements are adequate to meet all reporting requirements.

155. To strengthen the internal controls, an internal auditor will be required to be deputed from the Office of AG to cover the entire project activities. Such person should be appointed within three months of the project’s Effectiveness.

Budgeting

156. Normal GoP rules and procedures will apply. One hundred percent of Project activities will be financed through the Grant and there shall be no counterpart funds. Annual budget for the project will be prepared and submitted on the basis of planned activities.

Accounting

157. Separate books of account, on cash basis, will be maintained by each PMU for the Project activities using the Chart of Accounts under the New Accounting Model (NAM). SMEDA will make necessary arrangements for capturing project related resources and expenditures in its books. The annual audited financial statements shall also provide, by way of notes to the accounts, material financial commitments at each year end. Sufficient subsidiary records will be kept to facilitate preparation of quarterly reports and annual financial statements providing details of receipts and expenditures by Project components and activities.

158. Currently the PMU at FATA is using Excel spreadsheets to maintain accounts. Complete manual books will be maintained. Within one month of Effectiveness, both the PMUs will start working with the PIFRA Directorate for incorporation of the project in the national Financial
Management Information System (FMIS) and shall prepare an action plan to ensure that the same is completed within 6 months of Project effectiveness, unless otherwise agreed with the World Bank. Once the PMUs have live access to the national FMIS, complete manual books will be discontinued and only a Cash Book will be maintained.

159. The SMEDA PU will make use of the FMIS being used in SMEDA. This is specially developed software. The comprehensiveness and adequacy of this system will be assessed once amendments / additions have been made for the Project.

160. Additional resources dedicated for the Project from SMEDA offices shall be billed to the Project along with necessary supporting documents. Such billing may include costs for travelling, stationary, a percentage of salary of staff working for the project based on actual time spent etc.

Internal controls

161. Prior to the first disbursement, each PMU shall prepare a set of basic accounting rules and procedures including for example, payment processing, fixed assets, cash and bank management etc. which shall also define service standards. The same will require approval from the Office of Controller General of Accounts. These procedures will embody a strong and comprehensive internal control framework for activities under all 3 components. Further, the use of the national FMIS will include defined user profiles with strict security protocols to ensure segregation of duties

162. SMEDA has detailed accounting procedures and guidelines in place. The same will be applied to the Project. Approval and authorization processes within the PU as well as internal controls ensuring segregation of duties and guidance on financial reporting and funds flow will be included in the afore mentioned Operations Manual.

163. The grants to SMEs will be processed by an independent Grant Review and Monitoring Committee (GRMC) supported by the PU in SMEDA. The payment of grants under component 1 will however be made by the PMUs in FATA and KP. Payments will be made directly by the PMUs to the bank accounts of SMEs. No cash payments will be made. Payments made from the PMUs to the SMEs and/or on behalf of the SMEs by the PMUs will be treated as eligible expenditures for reporting purposes. If the Bank determines any ineligible expenses, the amounts should be refunded to the Bank.

164. The Operations Manual prepared for component 1 shall clearly specify eligibility and approval criteria for grant support under component 1 and the payment guidelines. Each grant proposal shall include a disbursement schedule. The concerned PMU will make payments in accordance with this schedule. The GRMC with the support of the PU will carry out an upfront FM assessment of the eligible SMEs as specified in the manual. The disbursement methods (direct payments to suppliers by the PMUs, reimbursement of expenditure to SMEs, advances to SMEs) and payment schedules will be determined in line with the FM capacity of the SMEs and the nature of the activities. The manual shall also specify the periodic SOEs, other financial progress reports, annual financial statements and statutory audit reports that the SMEs should
furnish to the PMU. In the case of advances, evidence of expenditures there-against must be documented no later than 60 days after the disbursement. The manual shall specify the supporting documentation and other records/books of accounts to be maintained at the SMEs for component 1 under different disbursement methods. The PMUs will monitor the use of funds by SMEs via its monitoring officers in the field and third party monitoring (TPM) to ensure that the funds are used for approved and intended purposes.

165. An Internal Auditor will be engaged to cover the entire project activities including the SMEs. This position will report to the project Steering Committees. The Internal Auditor will be deputed for this purpose from the Office of the AG for all the components of the Project. He/she shall regularly review the transactions, processes, procedures and performance as well as any other aspects of the project activities as may be considered necessary to provide assurance to the Steering Committees regarding the fiduciary controls, risk management and monitoring mechanisms in place. The Internal Auditor shall regularly review the transactions, processes, procedures and performance as well as any other aspects of the project activities as may be considered necessary to provide assurance to the Steering Committees regarding the fiduciary controls, risk management and monitoring mechanisms in place. The Internal Auditor shall prepare a work plan and submit reports to the Steering Committees at least half-yearly. A detailed internal audit TOR, acceptable to the Bank, will be developed once the Internal Auditor is on board.

**Fund Flow Arrangements**

166. In accordance with agreed procedures for operation and maintenance of the Designated Accounts, circulated by the Finance Division, Government of Pakistan; relating to the maintenance and operation of Revolving Fund Accounts of loans/credits/grants, three Segregated Designated Accounts (DA) in US Dollars, will be established for the receipt of funds from the Bank; one each for KP and FATA PMUs and one for SMEDA PU. Each DA will be operated by joint signatories ensuring segregation of duties. Funds will be front-loaded using a report-based system. Each PMU and the PU will submit quarterly Interim Un-audited Financial Reports (IUFRs) providing six monthly cash forecasts. Initial advance into the DAs will be provided by the Bank on the basis of projections for the first two quarters, which will be replenished quarterly on the basis of actual expenditures incurred and forecast for the following two quarters. The funds provided into the DA would be used to meet the project’s eligible share of financing of expenditures.
### Allocation of Grant Proceeds

<table>
<thead>
<tr>
<th>Disbursement Category</th>
<th>Amount of Credit (expressed in USD)</th>
<th>Percentage of Expenditures to be Financed</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Rehabilitation Sub-grants; Up-gradation Sub-grants; and BDS Sub-grants for:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) SMEs in FATA; and</td>
<td>4,900,000</td>
<td>100% of amount of Matching Grant</td>
</tr>
<tr>
<td>(b) SMEs in KP</td>
<td>9,100,000</td>
<td></td>
</tr>
<tr>
<td>(2) Goods, non-consultant services, consultant services, Training and Workshops and Incremental Operating Costs:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) For activities under Parts B and C of the Project carried out by FATA;</td>
<td>1,700,000</td>
<td>100%</td>
</tr>
<tr>
<td>(b) For activities under Parts B and C of the Project carried out by KP; and</td>
<td>3,300,000</td>
<td>100%</td>
</tr>
<tr>
<td>(c) For activities under Part A of the Project carried out by SMEDA.</td>
<td>1,000,000</td>
<td>100%</td>
</tr>
</tbody>
</table>

**TOTAL AMOUNT** 20,000,000

The MDTF financing is inclusive of import duties and taxes.

**Incremental Operating Costs:**

167. Incremental operating costs will cover incremental staff salaries, per diem and allowances, office rent, office supplies, utilities, conveyance, travel and boarding/lodging allowances, operating and maintenance expenditures of office equipment and vehicles, bank charges, insurance, advertising, media projections, newspaper subscriptions, periodicals, printing and stationary costs incurred for the purposes of Project activities, which expenditures would not have been incurred in the absence of the Project.

**Retroactive financing**

168. The Project requires retroactive financing to meet eligible expenditures incurred since November 1, 2010 up to the signing of the Grant Agreement. The retroactive financing of up to an aggregate amount of US$150,000 (US$50,000 each for KP, FATA and SMEDA) is for costs incurred to start-up the implementation related activities under all three sub-categories in disbursement category 2.
Financial reporting

169. Interim Unaudited Financial Reports (IUFRs) will be submitted within 45 days of the end of each calendar quarter separately for KP and FATA PMUs and the SMEDA PU. The format and content of these reports will be agreed during Negotiations.

170. Annual financial statements for the Project will be prepared separately for KP and FATA in accordance with cash basis international public sector accounting standards. These financial statements will include details of expenditure incurred by Project components and activities. SMEDA will include disclosure of the operations, resources and expenditures related to the project in its entity financial statements. SMEDA annual financial statements are prepared in accordance with Accounting and Financial Reporting Standard for Small and Medium Sized entities, issued by the Institute of Chartered Accountants of Pakistan. This is acceptable to the Bank.

Auditing

171. SMEDA is audited by private sector auditors as well as DG Commercial Audit, who carries out a limited scope review. However, the last audited financial statements available are for FY 2007-08. Audited financial statements for FY 2006-07 and FY 2007-08 were issued 15 and 22 months after the close of the financial year respectively. Audits for FY 2008-09 and FY 2009-10 were completed in March 2011 i.e. after 21 months (for FY 2008-09) and 9 months (for FY 2009-10) of the close of the financial year. These were delayed due to administrative reasons, mainly delays in appointment of auditors by the Board of Directors.

172. External audit of the project for KP and FATA PMUs will be conducted by the Supreme Audit Institution, i.e., the Office of the Auditor General of Pakistan which is acceptable to the Bank. Entity financial statements of SMEDA will be audited by a firm of Chartered Accountants, in accordance with SMEDA Ordinance 2002. Acceptable audited financial statements will be submitted within 6 months of the close of each financial year.

<table>
<thead>
<tr>
<th>Audit Report Type</th>
<th>Due Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Project Financial Statements for Financial Year ended June 30 each year – KP</td>
<td>December 31 each year.</td>
</tr>
<tr>
<td>Project Financial Statements for Financial Year ended June 30 each year – FATA</td>
<td>December 31 each year.</td>
</tr>
<tr>
<td>Entity Financial Statements for Financial Year ended June 30 each year – SMEDA (including disclosure of operations, resources and expenditures of the project)</td>
<td>December 31 each year.</td>
</tr>
</tbody>
</table>
**Supervision plan**

173. Considering the risk ratings for the project, intensive supervision will be required. This will include capacity building support and training in Bank requirements as well. Access to project implementation areas is restricted due to security concerns. As part of the task team, efforts will be made to use alternative mechanisms including innovative approaches for supervision for example GIS mapping to review physical progress, use of TPVs and locally based consultants etc. A substantial portion of the FM supervision activities would consist of desk reviews of internal and external audit reports and follow-up on audit paras/recommendations in respect thereof, quarterly financial reports, and fixed assets physical verifications reports supplemented by dialogue with the project staff. Other financial management supervision tools such as expenditure reviews, site visits, etc., would be used to the extent practical and possible in an effort to periodically monitor the adequacy of financial management systems.

**Conditionality**

- Issuance of Project Operations Manual prior to disbursement under any category;
- Persons of AO and AAO/Cashier level to be in place at each PMU prior to Disbursement to relevant PMU;
- Accounting procedures for the project to be prepared and approved by the Office of CGA prior to Disbursement to relevant PMU;
- Internal Auditor to be appointed within 3 months of Effectiveness;
- Project to be live in the national FMIS within 6 months of Effectiveness, unless otherwise agreed with the World Bank.
Annex 6: Procurement Arrangements

PAKISTAN: ECONOMIC REVITALIZATION OF KP AND FATA PROJECT (ERKF)

174. Procurement for the proposed Project would be carried out in accordance with the World Bank’s “Guidelines: Procurement Under IBRD Loans and IDA Credits” dated May 2004, revised October 2006, May 1, 2010, and January 2011; and “Guidelines: Selection and Employment of Consultants by World Bank Borrowers” dated May 2004, revised October 2006, May 1, 2010, and January 2011 as well as the provisions stipulated in the Financing Agreement. The general description of various items under different expenditure categories are described below. For each contract to be financed by the Grant, the different procurement methods or consultant selection methods, estimated costs, prior review requirements, and time frame are to be agreed between the Borrower and the Bank Project team in the Procurement Plan. This plan is yet to be developed. The Procurement Plan will be updated at least annually or as required to reflect the actual Project implementation needs and improvements in institutional capacity. A General Procurement Notice shall be published by mid March 2011.

Procurement of Works

175. No works are envisaged in this project.

Procurement of Goods

176. There could be some requirements of office equipment (furniture, and computers) and field vehicles for Project cell in KP and SMEDA. There is no other requirement envisaged so far.

177. Contracts for goods under ICB are not expected at this stage. Procurement methods for goods under the Project will consist of shopping for contracts costing up to US$ 200,000, NCB for contracts up to US$ 300,000, and ICB for contract costing more than US$ 300,000. Direct contracting may be used for any urgently required goods after prior approval of the Bank.

Procurement of non-consulting services

178. Some training institutes may be hired under the project for training of SMEDA staff, and the participating/prospective entrepreneurs. Selection of such service providers shall be made as non consultancy services based on Section 3.16 of the Procurement Guidelines following criteria and procedures acceptable to the Bank as described in the Procurement Section of the Operational Manual. Based on similar experience in other regions, it is determined that QCBS is not the best method to follow for selecting such service providers. A simple RFP shall be used for such contracts, with a sample contract for small lump sum consultancy, which has been proven to be implementation friendly for these unique non-consultancy services. The procurement process shall basically be a quality based selection comprising the following steps:

a. Advertisement to invite interested parties for submitting technical and financial proposals on the formats agreed with the Bank and annexed with the procurement section of the operational manual.
b. Evaluation of technical proposals and selection of qualified firms for each category of services. There could be a number of firms qualified in one sub-category.

c. Opening of financial proposals and negotiating a contract with them on a unit rate basis.

d. Bank’s NOL shall be required before entering into a contract with any of these entities.

e. All advertisements shall be placed in nationally circulated newspapers, as well as project web-site and a minimum of 15 days response time shall be mandatory.

179. Component 1 comprises selection of various SMEs which shall be selected to be provided with grants for revitalization/expansion. The Bank team will agree with KP and FATA on the selection procedure including dissemination, eligibility, selection procedure, evaluation method, contract formats and performance indicators. The grantees shall be required to follow accepted commercial practices Samples of these documents are included in the Project Operations Manual.

Selection of Consultants

180. The major consultancy assignments would be identified under component 2 and 3 for various regulatory reviews, initial assessments and M&E. Contracts with consulting firms will be procured in accordance with Quality and Cost Based Selection procedures or other methods given in Section III of the Consultants’ Guidelines. Consulting services selection would be carried out through Quality and Cost Based Selection (QCBS) for contracts with consulting firms costing more than US$ 200,000 equivalent, and through Consultants Qualification (CQ) for contracts costing up to US$ 200,000. Other methods as mentioned in Section III of Consultants’ Guidelines shall be used as required.

Individual Consultants

181. This is envisaged to include any full-time or part-time technical assistance required for the Project. Services for assignments that meet the requirements set forth in paragraph 5.1 of the Consultant Guidelines may be procured under contracts awarded to individual consultants in accordance with the provisions of paragraphs 5.2 through 5.3 of the Consultant Guidelines, which stipulate that the selection should be made through comparison of at least 3 CVs that meet the requirements of the Terms of Reference including those for qualifications and experience. Under the circumstances described in paragraph 5.4 of the Consultant Guidelines, such contracts may be awarded to individual consultants on a sole-source basis.

Operational Costs

182. Costs related to the implementation of the Project will be financed by the Grant.

Assessment of the Agency’s Capacity to Implement Procurement

183. The PMUs established at the Industries and Technical Education Department in KP and FATA Secretariat are responsible for the overall project implementation at KP and FATA
respectively, whereas project manager PU SMEDA shall be responsible for procurements in SMEDA pertaining to component 1. There shall be a dedicated procurement staff in PMU KP and one of the project officers in PMU FATA shall be the procurement focal point. Hiring of these staff is a condition of disbursement for the respective TA components for KP and FATA. Procurement capacity assessment shall be done once the staff is hired.

184. The identified risks for procurement and contract implementation and mitigation measures are provided below. Given the readiness status of the project the overall Project risk for procurement is High.

**Capacity of PMU**

185. The Project Director of PMU FATA has relevant experience of consultancy selection on several projects. Manager SMEDA and assistant managers have procurement experience, although not on the Bank projects. Capacity of PMU for KP is not known at this point in time, as it was notified only on March 8, 2011. The Bank will conduct a training workshop for the project staff soon after identification/hiring of KP and FATA procurement staff.

**Procedural Clarity**

186. Given the emergency nature of the project, quick turnaround in procurement decisions is essential. There shall be agreement with KP, FATA and SMEDA that the respective implementing entities shall be empowered to take procurement decisions. Such agreements shall be documented in the project manual.

**Market Constraints**

187. Consulting firms may be reluctant to participate in the project given the law and order situation. The assignments shall be developed in a manner that local as well as external participation is encouraged and the contract sizes are large enough to solicit good response. There shall be adequate dissemination of the opportunities.

**Transparency**

188. The official websites of the project in KP, FATA and SMEDA shall be developed for adequate dissemination. All procurement notices, bid documents /RFPs, evaluation reports, and award data shall be posted on the website. Bank’s guidelines on publication of award paragraph 2.28 of consultancy guidelines and 2.60 of the procurement guidelines shall be followed for disclosure. These websites shall also be used for posting of grant evaluations, awards, and performances.

**Complaints**

The PMUs would manage the complaint handling system. This system would include documentation and addressing of complaints within a period of 7 days. Monitoring Directorate FATA/Governor’s inspection team shall be the forum for appeals for the complainant in FATA, if the redressal by PMU is not deemed sufficient. PMU shall keep the Bank informed by
forwarding to it any complaints within 3 days of the receipt. Arrangements for KP are yet to be identified. For ICB/international selection of consultants the Bank-prescribed complaint redressal mechanism will apply.

Table 1: Procurement Actions (Summary of the above identified issues and agreed actions)

<table>
<thead>
<tr>
<th>Issues</th>
<th>Action</th>
<th>Timeline</th>
<th>Responsibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>i. Capacity of PMU and Project Unit (PU)</td>
<td>Hiring of respective Procurement Focal points</td>
<td>Disbursement Condition</td>
<td>KP/FATA/SMEDA</td>
</tr>
<tr>
<td></td>
<td>Training session</td>
<td>After hiring of staff</td>
<td>Bank</td>
</tr>
<tr>
<td>ii. Procedural clarity</td>
<td>Agreement on Recipients’ internal approval procedures</td>
<td>August 22, 2011</td>
<td>PMU/PU</td>
</tr>
<tr>
<td>iii. Market Constraints</td>
<td>Adequate packaging</td>
<td>August 22, 2011</td>
<td>PMU/PU</td>
</tr>
<tr>
<td></td>
<td>Wide circulation</td>
<td>Ongoing</td>
<td>PMU/PU</td>
</tr>
<tr>
<td>v. Transparency</td>
<td>Functional website</td>
<td>Within a month of Project’s Effectiveness</td>
<td>PMU/PU</td>
</tr>
<tr>
<td></td>
<td>Disclosure on website</td>
<td>Ongoing</td>
<td>PMU/PU</td>
</tr>
<tr>
<td>vi. Complaints</td>
<td>Independent complaint redressal mechanism</td>
<td>Within a month as of Project’s Effectiveness</td>
<td>PMU/PU</td>
</tr>
</tbody>
</table>

Procurement Plan

189. The Recipient has developed a Procurement Plan for Project implementation which provides the basis for the procurement methods. This plan will be made available in the Project’s database, Project website, and the Bank’s external website. The Procurement Plan will be updated in agreement with the Project Team annually or as required to reflect the actual Project implementation needs and improvements in institutional capacity Frequency of Procurement Supervision

190. In addition to the prior review supervision to be carried out from Bank offices, the capacity assessment of the Implementing Agency has recommended frequent supervision missions to visit the field to carry out post review of procurement actions.

Review of Procurement by the Bank
Thresholds for prior review of contracts under eligible expenditures are given in the table below. All other contracts will be subject to Post-Review by the Bank. PMU will send to the Bank a list of all contracts for post-review on a quarterly basis. Post-reviews as well as the implementation reviews would be done six monthly. Such review of contracts below threshold will constitute a sample of about 15-20 percent of the contracts.

Table 2: Thresholds for Procurement Methods and Prior Review
Aligned with The Rapid Response to Crisis and Emergencies: Streamlined Procurement Procedures.
Prior Reviews Identified in Approved Procurement Plan

<table>
<thead>
<tr>
<th>Expenditure Category</th>
<th>Contract Value (Threshold) US $</th>
<th>Procurement Method</th>
<th>Contracts Subject to Prior Review US$ thousand</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Civil Works</td>
<td>Not applicable</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Goods</td>
<td>&gt;300,000</td>
<td>ICB</td>
<td>All</td>
</tr>
<tr>
<td></td>
<td>&lt;300,000</td>
<td>NCB</td>
<td>First Contract by all entities</td>
</tr>
<tr>
<td></td>
<td>&lt;200,000</td>
<td>Shopping</td>
<td>First contract by all entities</td>
</tr>
<tr>
<td></td>
<td>Regardless of value</td>
<td>Direct Contracting</td>
<td>All</td>
</tr>
<tr>
<td>3. Consulting Services</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>-3.A Firms</td>
<td>&gt;200</td>
<td>QCBS,CQS, QBS,FBS,LCS</td>
<td>First contract by any process and thereafter as provided in Proc. Plan</td>
</tr>
<tr>
<td>Individual Consultants</td>
<td>Regardless of value</td>
<td>Single Source</td>
<td>All</td>
</tr>
<tr>
<td></td>
<td>Comparison of 3 CVs</td>
<td></td>
<td>None</td>
</tr>
</tbody>
</table>

Note: ICB = International Competitive Bidding; NCB = National Competitive Bidding; QCBS = Quality- and Cost-Based Selection; QBS = Quality-Based Selection; FBS = Fixed Budget Selection; LCS = Least-Cost Selection; CQS = Selection Based on Consultants' Qualifications; TOR = Terms of Reference.

There are no ICBs involved in the Project implementation.
Annex 7: Implementation and Monitoring Arrangements

PAKISTAN: ECONOMIC REVITALIZATION OF KP AND FATA PROJECT (ERKF)

192. KP-FATA’s existing administrative structures and service providers will be utilized for ERKF’s implementation. Coordination and creation of linkages with provincial and federal agencies will be ensured to avoid duplication of efforts. The key strategic partners include local Chambers of Commerce and Industry, Small and Medium Enterprise Development Authority (SMEDA), Investment Facilitation Authority (IFA), and Board of Investment. The Project is closely aligned with the Post Crisis Needs Assessment (PCNA) Report and the development plans of FATA and KP. SMEDA’s office in KP is already working in the crisis affected areas and has the requisite local knowledge and relevant experience that will go a long way in the effective implementation of this Project.

Table A7.1: Project Implementation – Roles and Responsibilities of Counterparts

<table>
<thead>
<tr>
<th>Component</th>
<th>Implementing Partner</th>
<th>Reporting Line</th>
<th>Overseeing Entity</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. SME Development</td>
<td>SMEDA through PU</td>
<td>GRMC and PMU</td>
<td>KP and FATA Project Steering Committees, headed by the respective ACS</td>
</tr>
<tr>
<td>2. Attracting Investments from the Diaspora</td>
<td>Project PMU in KP and FATA Secretariat</td>
<td>Project Director</td>
<td></td>
</tr>
<tr>
<td>3. Institution Building to Foster Investment and Implement Regulatory Reforms</td>
<td>Project PMU in KP and FATA Secretariat</td>
<td>Project Director</td>
<td></td>
</tr>
</tbody>
</table>

Project Steering Committees

193. Steering Committees for KP and FATA headed by the respective Additional Chief Secretary (ACS) will be notified for overall policy formulation and strategic management of the ERKF. Membership will include Secretary Industries of KP, DG Projects of FATA, Provincial Chief SMEDA, Director General (DG) FATA/Provincial Disaster Management Authority (F/PDMA), and two private sector representatives (KP/Tribal Chambers and Associations). Other members will be co-opted for discussing/addressing issues of concerned project components/sectors.

Project Management Units (PMUs)

194. A PMU, each for KP and FATA will be used for implementing and overseeing project activities. FATA has already established a PMU with a dedicated Project Director in place. This PMU will be further strengthened with TA provided under the project for hiring professional Project Officers/Technical Specialists, with additional responsibilities as M&E, procurement and safeguards focal persons. Two staff dedicated for Financial Management (FM) will be appointed at FATA’s PMU.
For KP, the Industries Department has notified a PMU along the same lines as FATA. However, instead of a focal point for procurement, it will hire a dedicated procurement staff.

The FM, procurement and safeguards staff of the PMUs will be provided with training by the Bank to ensure smooth implementation and compliance. The figure A7.1 below summarizes the overall implementation and coordination structure.

**Figure: A7.1 (Structure and Composition of PMUs)**

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**Role of SMEDA: Implementation Partner for Component 1**

The governments of KP and FATA have agreed to partner with SMEDA-KP to implement the SME Development Component (Component 1), in view of SMEDA’s overarching mandate and the requisite technical capacity at SMEDA to assess and analyze SMEs. SMEDA will undertake this work through a dedicated Project Unit (PU) and by engaging a team of Field Officers (FOs). At present, five FOs are proposed for KP and three for FATA to ensure enhanced outreach in the remote and difficult areas in these regions. Initially, the existing staff of SMEDA will be assigned additional responsibilities for the FM activities and as implementation commences, dedicated FM staff will be added if required by the Bank team. The PU will report to SMEDA-KP and will be accountable to the Grants Review and Monitoring Committee (GRMC). Key responsibilities of the PU will be to:

a. Evaluate the grant applications received from the SMEs of FATA and KP
b. Present the Grant Application to the GRMC
c. Facilitate the GRMC in activities related to smooth functioning of the Project
d. Establish close liaison with the PMU at FATA and KP and keep them abreast on all Project related activities
e. Verify proper utilization of each grant through field visits and an M&E system

Grant Review and Monitoring Committee

198. An independent Grant Review and Monitoring Committee (GRMC) will be established to review (approve/reject) the matching grant applications received from the SMEs. The GRMC will comprise of: two representatives each from KP and FATA, a representative from SMEDA-KP; two representatives from the private sector (one each from KP and FATA); and one representative of the banking sector. It will be an independent committee which will meet periodically to review the applications. See figure A7.1 for implementation structure.

Figure: A7.2 (Component 1: SME Development Implementation and Monitoring Arrangement)

Project Monitoring Arrangements

199. Based on both local experience and international best practice, ERKF is governed by a set of well designed control and accountability mechanisms that provide program managers, development partners and the public, including beneficiaries, with timely information on the operational effectiveness of the program. The Project’s monitoring mechanism is in line with the PCNA recommendations for monitoring projects that could not be supervised directly owing to the law and order situation in parts of KP and FATA.

200. There are two levels of monitoring envisaged for ERKF: the strategic overview level to ensure that essential priority components and preconditions are addressed in due time; and the intervention level to track inputs, activities implemented and outputs. The PMUs at KP and FATA will monitor the overall project while the PU at SMEDA will only be responsible for monitoring the Grant component. In addition, the use of third party monitoring (TPM), maintaining comprehensive information systems, and other innovative approaches (e.g., remote monitoring) will be explored to triangulate information collected. Details of these are as follows:
201. **M&E by the Project counterparts:** The M&E focal points in the PMUs (and PU in SMEDA) will be responsible for carrying out the M&E activities on behalf of the Project counterparts. This will entail continuous follow up of the beneficiary SMEs. Actual activities/outputs will be compared with the projected activities/outputs in Results Framework and delays will be flagged to bring the Project back on track. M&E reports will be prepared on agreed regular intervals and shared with all the Bank team and Steering Committees. Progress evaluation report will be submitted at the end of every year to the Bank team. Performance Indicators for Component 1 will be measured by the PU of SMEDA and reports will be shared with the GRMC and the Project PMUs quarterly, and with the Steering Committees bi-annually.

202. **Third Party Monitoring Arrangements:** To complement Bank’s own M&E arrangements, and to independently establish performance on various indicators, the ERKF will start using the mechanism of TPM within one year of Project implementation. This will particularly be useful for the areas where access is difficult and can become impossible if the security conditions deteriorate. Separate funding for these monitoring arrangements will be provided directly by the MDTF to the Bank team.

203. **Commitment from leadership for maintaining an effective M&E mechanism:** The counterparts M&E arrangements will also apply to ERKF as the PMUs will be housed within the Department of Industries and FATA Secretariat. FATA Secretariat has an established mechanism for internal reviews as internal reviews of ongoing projects are continuously done by the authorities. The Governor’s Secretariat also has an effective monitoring cell that frequently monitors activities carried out by the FATA Secretariat. There is a proper mechanism for internal audits of the project accounts and the final reports are then submitted to the Auditor General (AG). Similar mechanisms for KP will also be sought by the Project to ensure transparency.

204. **Possible Innovative Measures:** In particular, the recently initiated pilots of the SAR Innovation Team funded by the Governance Partnership Facility grant, concluded that in the face of emerging security conditions in several South Asian countries, the Bank task teams need to find creative ways to address challenges of supervision in countries where access to field sites is not ensured at all times. One innovative way is using technological advancements such as geo-referencing through GPS enabled cameras for physical verification and mobile phones based voice messaging for beneficiary participation, tracking and verification, all of which will be explored under the project. While these measures cannot fully replace the utility of actual field visits by Bank teams, they provide a useful alternative in crisis affected areas where Bank’s supervisory capacities are challenged due to limited access. The team will explore the feasibility of these alternatives strategies for supervision and monitoring throughout the project life.

205. **Establishing Comprehensive Information Systems:** for tracking the activities and investments of multiple line agencies and implementing partners, well designed record keeping and databases will provide close to real-time monitoring of project outputs and expenditures, ideally using web based communication to the extent possible. A web based Project implementation reporting system database would enable government agencies and any other implementing partners to enter data and contribute to monitoring inputs from relatively remote locations in real-time. It may also be worth to consider the MIS to raise and evaluate red flags in terms of potential corruption points. A follow-up beneficiary interviews may also be useful to
determine whether there was any leakage involved in the payment (e.g., the beneficiary may have received money which is noted by the MIS, but in doing so was forced to provide a kick-back).
Annex 8: Communications Strategy

PAKISTAN: ECONOMIC REVITALIZATION OF KP AND FATA PROJECT (ERKF)

206. Communication with stakeholders is important for effective implementation of all the activities planned under the ERKF. The objectives of the communication campaign are to provide stakeholders with relevant project design information; bring transparency to the process; and develop a close link with, and understanding of, the targeted beneficiaries. This can only be achieved through a two-way communication. The communications strategy will be jointly implemented by both the governments of KP and FATA, SMEDA-KP and the MDTF project team. The comparative advantages of the teams will be used to maximize the impact of the strategy and reduce likelihood for duplication. The campaign will categorize direct (target beneficiaries, sponsors, partners, implementing staff, GoP) and indirect stakeholders (media, academia, donors, politicians, opinion makers and the civil society) and address their needs through appropriate communication tools. The messages will also be adapted to the specific needs of the audience.

207. The campaign will be launched at the provincial and local levels. At the provincial level, the selection of messages and medium will cater to the objective of promoting transparency and developing an understanding of the program contours. This will promote the program design and win the trust of the opinion leaders, politicians and the civil society. Provincial print and electronic media will be used to disseminate these messages. The timing of advertisements will coincide with the targeting activity to ensure that it enhances the impact of the local information campaign. Project implementers will be encouraged to participate in talk shows and public seminars to maximize project outreach and highlight the governance and transparency features of the program.

208. The communications strategy for this project emphasizes the need for novel, out-of-the-box approaches of interacting with the diverse array of beneficiaries in KP and FATA. Due to lower literacy rates in the region, emphasis will be placed on audio and visual (documentaries, podcasts, etc.) communications material versus written communications material (reports, articles, etc.).

209. A Grievance Redressal Mechanism will be established, using technology to the extent possible. Considering the deep penetration of mobile phones in the KP and FATA regions, it will be advantageous for the PMUs’ staff to use a mobile phone-based system to register grievances and complaints. Monitoring of such complaints would also become simplified and those who register complaints will find this system to be easy and hassle-free.

Opportunities

210. **Vibrant civil society:** A large number of civil society organizations exist in both KP and FATA. These organizations can be used to promote project objectives through brochures, poster, ads and public service announcements (PSAs).

211. **SMEDA’s network of organizations and positive track record:** SMEDA has an extensive network of SMEs and tremendous convening power. Not only are they implementing
partners, but their newsletter reaches hundreds of SMEs and thousands of other potentially influential business owners that can help spread the word about the project and also become sources of feedback about the project (in the form of beneficiary stories as well).

212. **Outreach to Diaspora:** The Pakistani Diaspora is significant in both numbers and financial holdings. Tapping into this vast resource could give the project a significant boost. Outreach to Pakistani Diaspora networks located in countries/regions such as the Middle East, USA, UK, and Scandinavia, and elsewhere will serve the Project well. Moreover, events organized by these networks serve as immense opportunities to partner with Pakistani consulates located in those cities.

213. **Use of high-profile citizen/public ambassadors:** The UN system has been quite successful in the recruitment of high-profile citizen ambassadors who serve as advocates for particular causes (health, disasters, etc.). The cost for travel and lodging is borne by the agency in question, while all the work done on behalf of the agency is uncompensated. The benefit of such partnership is the visibility they bring to the issue/project. For instance, UNDP Pakistan is using the tennis champion, Aisam-ul-Haq, as their Ambassador. Perhaps such an arrangement with a high profile celebrity would be worth considering for this project. Examples include Rahim Shah (singer) and Maria Toor Pakay (squash player).

**Challenges**

214. Security issues and use of local talent: Documenting user stories and hearing first-hand accounts of the effect of the SMEs on beneficiaries will be difficult. Use of freelance journalists from the region who have a deep understanding of local culture and business trends will therefore be instrumental in this activity. Though even with local “eyes and ears” on the ground, language barriers could be a potential problem.

215. Penetration into the communities with concentration of small enterprises could pose a strong challenge. Alongside non-traditional ways, innovative methods of engaging will also be utilized throughout the subcomponent communications approaches highlighted below. Op-ed pieces can be authored by the various partners (SMEDA, local governments, and influential leaders/public intellectuals) and placed in newspapers which have extensive outreach. Informal gatherings with senior community leaders (jirgas, maliks, etc.) will also be organized so as to provide opportunities for one-on-one discussions and dialogue. Workshops can also be organized on a district-wide level to allay concerns and allow for clarifications to be made, in case any exist.

216. Selection of an appropriate mode of communication is another challenge. The use of the FM radio has been identified as the best method of communicating with stakeholders in the KP-FATA region. The FM Radio is used widely and the technology is being improved due to donor attention e.g. USAID is helping to digitize the transmission of radio material and enhance radio coverage throughout the region.

217. Below are recommended communications approaches for the various project components:
Communications at the Project’s components level

218. The recommended communications approach for the component of SME Development would be to customize messages, tools and outreach methodologies for each of the three subcomponents as follows:

219. To publicize the support being provided through this MDTF project, posters, flyers and brochures will be printed and distributed widely through chambers and sector associations (SCCI, SMEDA etc.). This will be part of the initial public information campaign. The posters and brochures will highlight all the eligibility criteria and conditions that need to be fulfilled in order to qualify for funding.

220. Public service announcements (PSAs) will be recorded for radio stations (in Urdu and Pashto), thus informing remotely located businesses about this funding. Free airtime can be arranged through government intervention. As the project is implemented, beneficiary stories can be video recorded and broadcasted in various events and distributed for mass consumption via partner agencies, business associations etc. Traditional media outlets (newspaper, TV and radio) will also be used to publicize the project.

221. Multimedia CDs can also be produced to support the component related to Business Development Services (BDS). The CDs can be produced in English and Urdu and can be utilized as part of the training program envisaged. CDs with relevant information on the project as well as profiles of businesses to invest in will be featured on these multimedia CDs. These CDs can also be used in PIA’s in-flight entertainment system as well as in road show/convention stalls.

222. For reaching out to Diaspora, posters, flyers and brochures will be printed and distributed to businesses in large, urban cities in and outside of Pakistan where large Pakistani communities reside, through chambers and associations. The posters and brochures will highlight all the eligibility criteria and conditions that need to be fulfilled in order to qualify for funding. This will be part of the initial public information campaign. The Pakistan Embassies can also play an important role in the dissemination of these materials.

223. Moreover, events organized by these networks or other non-governmental entities – such as conferences and open houses - serve as immense opportunities to partner with Pakistani consulates located in overseas countries with Diaspora.

224. People living in industrialized countries are also pre-disposed to using social media as a method of communication. The project team will use Facebook, Twitter, email groups/mailing lists) as a way of communicating with potential investors and expatriate Pakistanis.

225. Not only can these events serve as “meet-and-greet” opportunities, they can also strengthen the relationship between SMEs and the public sector as a contributing force in reconstruction activities for the crisis affected areas of KP and FATA. Through this particular communications approach, the project team will help to fulfill a major strategic objective of the PCNA, which is to “build responsiveness and effectiveness of the State to restore citizen trust” and “stimulate employment and livelihood opportunities.”
## Annex 9: Project Preparation and Appraisal Team Members

**PAKISTAN: ECONOMIC REVITALIZATION OF KP AND FATA (ERKF)**

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
<th>Unit</th>
</tr>
</thead>
<tbody>
<tr>
<td>John F. Speakman</td>
<td>Lead Private Sector Development Specialist</td>
<td>SASFP</td>
</tr>
<tr>
<td>Mudassir Khan</td>
<td>Senior Financial Sector Specialist</td>
<td>SASFP</td>
</tr>
<tr>
<td>Shabana Khawar</td>
<td>Senior Investment Officer</td>
<td>CMEPI</td>
</tr>
<tr>
<td>Gabi George Afram</td>
<td>Senior Financial Economist</td>
<td>SASFP</td>
</tr>
<tr>
<td>Anjum Ahmad</td>
<td>Senior Energy and PPP Specialist</td>
<td>SASDE</td>
</tr>
<tr>
<td>Asif Ali</td>
<td>Senior Procurement Specialist</td>
<td>SARPS</td>
</tr>
<tr>
<td>Uzma Sadaf</td>
<td>Senior Procurement Specialist</td>
<td>SARPS</td>
</tr>
<tr>
<td>Mehnaz Safavian</td>
<td>Senior Economist</td>
<td>SASFP</td>
</tr>
<tr>
<td>Saeeda Sabah Rashid</td>
<td>Financial Management Analyst</td>
<td>SARFM</td>
</tr>
<tr>
<td>Javaid Afzal</td>
<td>Senior Environmental Specialist</td>
<td>SASDI</td>
</tr>
<tr>
<td>Chaohua Zhang</td>
<td>Senior Social Sector Specialist</td>
<td>SASDS</td>
</tr>
<tr>
<td>Kiran Afzal</td>
<td>Research Analyst</td>
<td>SASFP</td>
</tr>
<tr>
<td>Martin Serrano</td>
<td>Counsel</td>
<td>LEGES</td>
</tr>
<tr>
<td>Muhammad Waheed</td>
<td>Economist</td>
<td>SASEP</td>
</tr>
<tr>
<td>Sajid Maqsood</td>
<td>Information Analyst</td>
<td>ISGOS</td>
</tr>
<tr>
<td>Shaheen Malik</td>
<td>Research Analyst</td>
<td>SASEP</td>
</tr>
<tr>
<td>Zeeshan Suhail</td>
<td>ET Consultant</td>
<td>SACPK</td>
</tr>
<tr>
<td>Sahar Etezaz</td>
<td>Temp</td>
<td>CMECA</td>
</tr>
<tr>
<td>Ainul Hasan Qureshi</td>
<td>Consultant</td>
<td>SASFP</td>
</tr>
<tr>
<td>Sohail Younus Moghal</td>
<td>Consultant</td>
<td>SASFP</td>
</tr>
<tr>
<td>Javed Iqbal</td>
<td>Consultant</td>
<td>SASFP</td>
</tr>
<tr>
<td>Waqar Ahmad Sheikh</td>
<td>Consultant</td>
<td>SASFP</td>
</tr>
<tr>
<td>Muhammad Omar Khalid</td>
<td>Consultant</td>
<td>SASDI</td>
</tr>
<tr>
<td>Samina Islam</td>
<td>Consultant</td>
<td>SASDS</td>
</tr>
<tr>
<td>Intiaz A. Sheikh</td>
<td>Program Assistant</td>
<td>SASFP</td>
</tr>
</tbody>
</table>
Annex 10: Environmental and Social Safeguards Framework

PAKISTAN: ECONOMIC REVITALIZATION OF KP AND FATA PROJECT (ERKF)

226. The construction activities at, and operation of, the SMEs to be supported by the Project under its Component 1 may potentially cause negative environmental and social impacts. To assess the nature and significance of the potentially negative environmental and social impacts, and to determine appropriate mitigation measures to address these impacts, the Project will carry out environmental assessment of each subproject (e.g., rehabilitation of an SME), or a group of similar subprojects in the similar environmental setting, during the Project implementation. To define the procedure and criteria for these environmental assessments, an Environmental and Social Screening and Assessment Framework (ESSAF) has been prepared, which is applicable to all projects/operations under the MDTF. The Framework defines the environmental and social assessment requirements which the implementing agencies both in KP and FATA will need to fulfill for each subproject under the Project. The key aspects of the Framework are summarized below.

Impact Screening, Assessment and Mitigation Planning

227. While preparing any operations or projects for financing under the MDTF, the ESSAF will be followed to screen environmental and social impacts and plan any required mitigation measures. The screening process and its findings as well as the proposed mitigation measures will be documented as part of the project/subproject package. The following guidelines, codes of practice and requirements will be followed in the selection, design and implementation of any operations financed under the MDTF.

a. An environmental impact assessment will be conducted for all projects/subprojects under MDTF, during the project implementation. Criteria for the type of assessment to be conducted for individual projects/subprojects are provided in Table 1. Full Environmental Assessments (EAs) will need to be conducted and clearance obtained from the Bank prior to initiating environmental category ‘A’ projects/subprojects. Environmental and Social Management Plans (ESMPs) will need to be prepared and clearance obtained from the Bank prior to initiating environmental category ‘B’ projects/subprojects. The EAs and ESMPs will also be submitted to the relevant EPA for obtaining No Objection Certificate (NOC) before commencing the project/subprojects implementation, in line with the national regulatory requirements in the Country. For smaller subprojects, environmental and social screening and assessment will be conducted with the help of checklists (a typical checklist is provided in the ESSAF).

b. Each implementing agency for the projects under the MDTF will appoint/designate an environmental and social focal point (ESFP), who will be responsible for ESSAF implementation within his/her organization, and also for the preparation and submission of quarterly monitoring reports to the Bank on the screening of and the rationale for the proposed environmental categorization of each project.

c. While conducting environmental assessment, cumulative impacts of a large number of projects/subprojects will also be considered.
d. All projects/subprojects will be screened for need of land acquisition and resettlement. If confirmed, necessary planning efforts will be carried out to develop mitigation measures. A guideline for land compensation and resettlement planning is provided in ESSAF.

e. All projects/subprojects will be screened for impacts on physical cultural resources and necessary mitigation measures. Procedures for the protection of cultural property, including the chance discovery of archaeological artifacts, unrecorded graveyards and burial sites are outlined in ESSAF.

f. All construction contracts for the projects/subprojects financed by the MDTF will include appropriate clauses to ensure effective implementation of the mitigation measures identified in EA/ESMP/Checklist. A sample environmental safeguards procedure for inclusion in the technical specifications of contracts is provided in ESSAF.

g. The Environment, Health and Safety Guidelines developed by the International Finance Corporation (IFC) and the World Bank will also be applicable to the activities under the emergency projects/subprojects. The Guidelines are provided in ESSAF.

h. The procurement plans for the proposed projects/subprojects will include milestones for preparation of EA/ESMP/Checklist, and obtaining clearance from the Bank.

i. Subject to the needs as determined by the Bank’s safeguards’ team, the implementing agency will engage an independent consultant or consulting firm to conduct an annual environmental and social audit as third party validation, of the subprojects undertaken during each year of the Project implementation.

Consultations

228. Consultations will be mainstreamed in the preparation of new operations under the MDTF. For environmental Category ‘A’ and ‘B’ operations, the implementing agencies will consult the potentially affected groups and local nongovernmental organizations on the project environmental and social aspects, and will take their views into account. The implementing agencies will initiate these consultations as early as possible, and for meaningful consultations, will provide relevant material in a timely manner prior to consultation, in a form and language(s) that are understandable and accessible to the groups being consulted.

229. For Category ‘A’ projects/subprojects, the implementing agencies will consult these groups at least twice: (a) shortly after the environmental screening and prior to finalization of the terms of reference for the EA and Resettlement Plan (RP); and (b) once a draft EA report and RP are prepared. For the initial consultation, the implementing agencies will provide a summary of the proposed subproject's objectives, description, and potential impacts. For both Category ‘A’ and ‘B’ projects, the implementing agencies will provide these groups with a summary of the EA report and RP (including the conclusions of the assessment). In addition, the implementing agencies will make the draft reports publicly available to project-affected groups and local nongovernmental organizations.

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24 As defined in World Bank Operational Policy 4.01, Environmental Assessment.
Planning, Review and Approval

230. The entire environmental and social screening and assessment procedure described above will be integrated within the preparation of the operations under the MDTF. To this end, the screening and planning to address environmental and social impacts would be initiated during the operation preparation phase. The operation preparation agencies will be responsible for the screening and planning of any environmental and social action plans required in line with this Framework. The EA or ESMP and RPs will be submitted to the project approving authority as part of the project/subproject application package. The implementation agencies will assign specialists to review the environmental and social safeguard action plans, such as screening report, EA, ESMP and RP. The implementation agencies will submit the safeguard documents for World Bank’s review and clearance, in accordance with the procedures as described earlier in the Annex. The implementation agencies will not approve the proposed operations until the required environmental and social safeguard action plans are cleared for compliance with the Framework by the World Bank. A simplified flow chart for subproject preparation, approval and execution along with the EA/ESMP/Checklist requirements is provided below.

231. The implementing agencies will implement the projects under MDTF in close coordination with the relevant line departments, local governments, and political agents. Each implementing agency and in turn, each line department, will be responsible for applying the safeguard screening and mitigation requirements to its own projects. Separate environmental and social focal points (ESFPs) will be identified in each of the implementing agencies, with responsibility for overseeing the implementation of the ESSAF. The provincial EPAs (for KP and Balochistan), and Federal EPA (for FATA projects) will be responsible for environmental clearance for operations or projects/subprojects that require statutory environmental clearance, in accordance with the law. Although the national/provincial environmental clearance procedures are adequate and fairly reliable, the Bank will still review a samples of the EAs/ESMPs prepared under each subcomponent and provide necessary concurrence for the approval of disbursements of funds.

232. All agencies and departments who are preparing and will implement operations under the MDTF will appoint officers as the environmental and social focal points (ESFPs), who will liaise and coordinate with relevant agencies to ensure compliance with this Framework.
Capacity-Building and Monitoring Of ESSAF Implementation

233. As part of the capacity-building to be provided for implementation of the proposed operations, the ESFPs and relevant staff of the concerned line departments will also receive training in ESSAF’s application. The World Bank will monitor and provide guidance in the implementation of the ESSAF. The World Bank will also assist in this capacity-building in the implementation of approved safeguard action plans.

234. The implementing agencies through their ESFPs will be responsible, besides other functions, to monitor and supervise the implementation of any safeguard action plans. For this purpose, the implementing agencies will establish a monitoring mechanism as part of the project management system over the implementation of agreed safeguard action plans. In addition, the implementing agencies will also engage external monitors over the implementation of agreed safeguard action plans. The monitoring mechanisms should be detailed in the required action plans.

Disclosure

235. This ESSAF has been shared with all relevant agencies, line departments of the provincial and federal governments. Subsequently, it has been disclosed by the implementing agencies on December 15, 2010 and also made available at the websites of GoP, GoKP, FATA Secretariat, GoBalochistan and the relevant line departments. Copies of ESSAF have been sent to Federal EPA, KP EPA, and Balochistan EPA. It has also be made available at the World Bank’s InfoShop and disclosed on January 10, 2011. Relevant project specific safeguard documents/mitigation plans to be prepared subsequently will also be disclosed in a similar manner.

**Table 1: Criteria for Type of Environmental Instrument**

<table>
<thead>
<tr>
<th>Type of Subproject</th>
<th>Category A Projects/Subprojects Full EA Required</th>
<th>Category B Projects/Subprojects ESMP Required</th>
<th>Smaller Projects/Subprojects Environmental Screening Required</th>
</tr>
</thead>
<tbody>
<tr>
<td>Infrastructure (such as water supply, sanitation, solid waste management, access roads, drainage, and street lighting)</td>
<td>Cost: Rs 25 million or above</td>
<td>Cost: less than Rs 25 million, but more than 1 million</td>
<td>Cost: up to Rs 1 million</td>
</tr>
<tr>
<td>Roads</td>
<td>Cost: Rs. 50 million or above</td>
<td>Cost: less than Rs 50 million, but more than Rs 2 million</td>
<td>Cost: up to Rs 2 million</td>
</tr>
<tr>
<td>Schools and health care facilities</td>
<td>Cost: Rs. 50 million or above</td>
<td>Cost: less than Rs 50 million, but more than Rs 2 million</td>
<td>Cost: up to Rs 2 million</td>
</tr>
</tbody>
</table>

Note: These criteria may need to be customized for individual projects under MDTF and approval obtained from the Bank.
236. The ERKF Project is based on the PCNA Report which aimed at building peace in the crisis affected regions of KP and FATA. An important pillar of the PCNA strategy was restoration of livelihoods through quick economic recovery interventions in the crisis affected areas. The purpose was to revive private sector activity in the region by lending support to the affected enterprises. The non farm sector of KP and FATA mainly comprises of SMEs which play a vital role in creation of jobs and alleviation of economic disparities. SMEs have long been recognized as the engine of economic growth since they utilize indigenous resources, absorb local labor force and show tremendous resilience against the economic upheavals. In Pakistan, around 90% of all private enterprises in the industrial sector are SMEs which contribute over 30% to GDP. The SMEs face significant problems including low access to finance, difficult regulatory environment, high cost of doing business and overall economic slowdown owing to rising inflation and constant energy crisis. For example, as revealed by an ‘Access to Finance’ survey conducted by the Bank in year 2008, SME lending accounted for 16 percent of total lending volume and only 4 percent of total customers of the financial sector. The SMEs in FATA face further deprivation owing to the conflict and military action in the region that started back in the year 2007. The situation only worsened after the year 2010 floods. Of the thirteen districts across Pakistan, Peshawar, the provincial capital of KP was ranked 8th on the ease of doing business, which is an indication that reforms implementation is required in both KP and FATA to improve conditions for the private sector enterprises.

237. As a result of crisis situation in KP and FATA, majority of the business enterprises have suffered huge losses and are not capacitated to restart their businesses on their own. Therefore, the economic recovery process in these regions needs to be catalyzed by providing external support to the affected businesses. In view of this, the Project’s major focus has been set on providing grants to the affected businesses for their rehabilitation and up-gradation. Comprehensive project design takes into consideration both short and long range paybacks for the local economies. Interventions proposed in the SME Development Component take care of immediate to medium term needs of the local SMEs by offering direct support; while the interventions proposed in Components 2 and 3 focus on the long term gains like mobilizing investments and creating business enabling environment. It is expected that implementation of the program will yield the following outcomes:

- Rehabilitation of SMEs; which have been affected by crisis
- Up-gradation of SMEs
- Capacity building of SMEs by linking these to business support services providers
- Creation of new jobs

25 Pakistan’s Doing Business ranking dropped to 83 in year 2011 from 75 in 2010 according to Doing Business 2011 report.
• Mobilization of Diaspora investment
• Institutionalization of Public Private Dialogue (PPD)
• Capacity building of government institutions for implementation of regulatory/institutional reforms

Economic Analysis and Expected Results

238. Measuring the economic benefits of SME Development Component is difficult because there are several indirect benefits associated with the ERKF’s interventions. Absence of any baseline information on the SMEs of KP and FATA also poses difficulty in exactly quantifying the expected impact of the Project’s investment on the local economies. It is expected that the proposed grants program will act as a catalyst to revive and upgrade the local SMEs. About 850 SMEs will be directly supported through matching grants under various subcomponents of the SME Development Component over three years. About two third of these SMEs will only be supported for their rehabilitation which is expected to act as the biggest source of immediate revival of economic activity in the affected areas. Revitalization of SMEs will not only start generating incomes for the owners of those enterprises but will also immediately restore jobs for the workforce which will be employed by the revived businesses. Increase in income generation activities will lead to increase in consumer spending; thereby generating more business for the local enterprises. Impact of rehabilitation of the closed businesses will also generate a multiplier effect. The revived enterprises will also benefit the suppliers and vendors across the value chains. Assuming an average number of suppliers of three to four for each revived SME, the total number of indirect beneficiary SMEs from rehabilitation support will be around 2,000-3,000.

239. The rehabilitation of business enterprises will endorse authorities’ efforts towards peace building. Restoration of enterprises in a short period of time will act as a signal for the potential investors to start considering the option of injecting fresh investments in KP and FATA regions; which will can have multiple economic benefits for the two regions.

240. The grants for SME up-gradation are also expected to expedite economic activity in KP and FATA. Cluster development interventions proposed in the Project design are expected to bring about long range benefits to the local SMEs; such as the use of improved technologies, possibilities for new products development, achieving increased business volumes, etc. These projects will not only offer direct benefits to the participating SMEs but will also act as demonstration projects for other SMEs to copy. The intervention is thus expected to support long term sustainable SME development in the two regions.

241. Management training by IFC’s Business Edge Program is expected to sharpen the business management skills of the SMEs; thereby supporting a long term sustainable development of these very important building blocks of the economy. The project aims to enhance the management capacity of about 500 SMEs during the life of the project. Lending support for Business Development Services (BDS) procurement will not only benefit the SMEs getting these services; but will also enhance the capacity of the BDS Providers. All these factors will work in combination to expedite the economic recovery process in the crisis affected areas of KP and FATA.

242. One of the key benefits of the proposed Project is the expected increase in employment opportunities. Direct increase in the number of jobs is expected to be achieved with the
rehabilitation and up-gradation of the local SMEs. Maximum number of jobs is expected to be created in those SMEs which will be rehabilitated. Revival of such SMEs means immediate re-employment of at least the core/essential staff in those enterprises. Similarly, the beneficiary SMEs of up-gradation grants and BDS support will also play a role in creating employment opportunities. The project expects to directly revive/create about 8,000 new jobs through the proposed interventions.

243. Revival and up-gradation of SMEs is also expected to act as a source to generate revenues for the KP-FATA governments in the form of OCTROI (local value added tax). This increased revenue base for the governments is expected to contribute towards improvement in basic infrastructure and provision of public and social goods which can contribute towards the uplift of local communities in the Project’s target areas.

244. Investment mobilization component is expected to bring about long term economic benefits for the two regions by attracting Diaspora investment in KP and FATA. Using innovative measures for mobilizing Diaspora investment, the component is expected to attract US$ 10 million to KP-FATA over the next four years; provided the macro stability is restored and that the security situation remains stable.

Cost-Benefit Analysis

245. Economic and financial benefits of ERKF Project have been quantified through cost and benefit analysis. For this purpose, the expected cost and benefit streams in the three project components have been considered separately.

Assumptions and Methodology

246. For SME Development Component, it is assumed that in matching grants, every dollar given by the Project will bring in an additional one dollar of investment from the private sector. This is considered to be a direct financial benefit of this project. With this assumption, total investment injected into the two economies will be twice the amount of the grant money. For determining SME sales, it is assumed that one dollar of investment will generate one dollar of annual sales. Project’s direct benefits have been based on the value added component of the sales; which is assumed to be 30%; occurring with a lag of two years. The matching grants component is also expected to create/revive jobs. However, due to the difficulty in accurately estimating this variable, such impacts have not been included in the calculation of NPV and ERR.

247. For quantifying the direct benefits from the Investment Mobilization Component, it is assumed that every dollar of Project money spent for this purpose will generate ten dollars of investment. For converting this investment into sales and consequently into value added, same assumptions, as for SME Development Component, are used. With these assumptions, it is seen that every dollar spent for investment mobilization will bring in ten dollars of SME sales; with a lag of three years.

248. The scope of the third component is broader than the other two components since the proposed regulatory reforms are expected to benefit the entire SME sector. Share of SMEs in the
combined GDP of KP and FATA is assumed to be 30% and 25% of the total SMEs are expected to benefit from these reforms. The proposed reforms are expected to create a regulatory saving which will increase the productivity of the enterprises by 0.5%. This benefit is assumed to be achieved with a lag of four years.

249. Since the Project offers long term economic and financial benefits, a ten year time horizon has been considered for calculating NPV and ERR.

250. A discount rate of 12% is used to discount the cost and benefit streams generated by the Project. This is a standard assumption, given that the opportunity cost of capitals is 10% in most of the World Bank projects.

**Base Case Results**

**Table: A**

<table>
<thead>
<tr>
<th>Economic Analysis</th>
<th>Present Value of Flows (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Benefits</td>
<td>48.04</td>
</tr>
<tr>
<td>Costs</td>
<td>15.47</td>
</tr>
<tr>
<td>Net Benefit (NPV)</td>
<td>32.57</td>
</tr>
<tr>
<td>ERR (%)</td>
<td>44.1%</td>
</tr>
</tbody>
</table>

The results from the calculations are summarized in Table- A. The analysis shows that at a discount rate of 12% p.a. the NPV of the project will approximately be US$ 32.57 million; with an economic rate of return of 44.1%.

**Component wise Results**

**Table: B**

<table>
<thead>
<tr>
<th>Project Component</th>
<th>Present Value of Flows (US$ million)</th>
<th>ERR (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Benefits</td>
<td>Costs</td>
</tr>
<tr>
<td>SME Development</td>
<td>30.63</td>
<td>11.08</td>
</tr>
<tr>
<td>Attracting Investments from Diaspora</td>
<td>7.61</td>
<td>1.47</td>
</tr>
<tr>
<td>Institution Building to Foster Investment and Implement Regulatory Reforms</td>
<td>9.80</td>
<td>2.93</td>
</tr>
</tbody>
</table>

251. Table- B shows the detailed component-wise cost and benefit analysis. The results clearly indicate that NPVs for all the three components are positive; which means higher ERRs than the discount rate of 12% p.a. The Project is thus economically viable independently for all the three components.
Annex 12: Documents in Project Files

PAKISTAN: ECONOMIC REVITALIZATION OF KP AND FATA PROJECT (ERKF)

252. List of documents follow:

- 2009 Damage and Needs Assessment (DNA) – WB and ADB
- 2010 Post Crisis Needs Assessment Report (PCNA) – WB, ADB, EU, UN and Development Partners
- Country Partnership Strategy 2010-2013 – WB
- KP- Comprehensive Development Strategy (CDS) (2009-2015);
- NWFP Growth Policy Note (June 2008) -- WB
- Doing Business in Pakistan 2010 – WB
- KP Investment Guide 2009/10 – SMEDA
- KP, FATA and Balochistan MDTF – Administration Agreement 2010
Annex 13: Statement of Loans and Credits

PAKISTAN: ECONOMIC REVITALIZATION OF KP AND FATA PROJECT (ERKF)

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PAKISTAN
STATEMENT OF IFC’s Held and Disbursed Portfolio
In Millions of US Dollars

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Total portfolio: 239.91 72.98 59.00 14.12 134.53 56.04 7.90 14.12

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Approvals Pending Commitment
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Annex 14: Country at a Glance

PAKISTAN: ECONOMIC REVITALIZATION OF KP AND FATA PROJECT (ERKF)