STRATEGY
2018-2022

Pakistan

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AGENCE FRANÇAISE
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CONTENTS

1.

BACKGROUND

1.1. CHALLENGES OF SUSTAINABLE DEVELOPMENT

The Federal Islamic Republic of Pakistan comprises four provinces (Punjab, Sindh, Balochistan and Khyber Pakhtunkhwa) and three territories (Islamabad Capital Territory, Azad Jammu and Kashmir, and Gilgit-Baltistan). The partition from India (1947) and the separation from Bangladesh (1971) have left a deep imprint on the contemporary history of the country, which now receives substantial support from China. The tensions between Pakistan and India are a regular reminder of the historical antagonism between the two countries and the risk of escalation. Pakistan contributed to containing Soviet expansion in Afghanistan and has played a major role in the fight against terrorism following the 9/11 event. It represents an important ally for China with respect to Chinese efforts not only to open up its western region and gain access to the Arabian Sea (China-Pakistan Economic Corridor), but also to contain India's influence in the region.

Since its independence, Pakistan has experienced three military coups (1958, 1977 and 1999) leading to several alternating military and civilian regimes. Viewed as the country's foremost institution, the Army has considerable influence over the running of Pakistan's government, particularly when it comes to foreign policy, and controls whole swathes of the economy (urban land, construction, private security). Following the 2010 constitutional reform, the prime minister once again became the most powerful authority in the executive branch. More specifically, he has the right to dissolve the National Assembly, organise referendums and appoint provincial governors, general officers and senior civil servants. The prime minister is elected by the National Assembly and the president by an electoral college comprising members of the different Chambers, both serving a five-year term. The general election of May 2013 marked the second democratically elected government in the country's history. It brought to power the PML-N (Pakistan Muslim League), which held onto the reins of government for five years despite the corruption scandals that hit the party's leaders, including the family of Prime Minister Nawaz Sharif. The July 2018 election was won by the opposition party headed by Imran Khan, whose policy line for the new government sets priority on fighting corruption and building a welfare state.

The fifth most populous country in the world, Pakistan has experienced high demographic growth. Its population rose from 132 to 213 million inhabitants between 1998 and 2017 (equivalent to a annual average growth of 2.4%) and should level off at some 400 million inhabitants by 2050. While the population growth rate is slowing down, the fertility rate is higher than 3.7 children per woman (against 5 at the end of the 1990s). One-third of the population is under 15 years old and 60% aged between 15 and 64 years. The Pakistani population is unevenly spread over the territory, with the Punjab and Sindh provinces concentrating over three-quarters of the population.

In the 21st century, Pakistan's development led to a drop in the poverty rate from 64% in 2001 to under 30% in 2014. In 2016, the government identified 54 million people under the poverty line and thus eligible for pro-poor programmes. At the provincial level, poverty remains concentrated in Balochistan (57% of poverty) and Sindh (34%), while urban poverty rates are lower than those in the rural areas. Malnutrition, still acute in some isolated areas, causes severely stunted growth for 44% of children under 5. Overall, the human development indictors (health and education) have barely improved. According to the World Bank, Pakistan has the world's second-highest number of out-of-school children (6.7 million), most of whom are girls, as on average, they have 20% less chance of enrolling in school than boys.[1]

Pakistan is one of the most urbanised countries in the region with a 4% average annual growth of urban population since 1951. By 2030, 60% of the total population will be city dwellers (38% in 2014) and the country will have 12 agglomerations with over one million inhabitants. Chronic underinvestment over recent decades has led to the accelerated ageing of urban infrastructure, a structural lack of capacity and the ensuing deterioration in the quality of services such as water and sanitation. Moreover, although the energy sector has made clear headway in recent years, it is now experiencing a major crisis: the country is unable to meet the demand for electricity. Frequent power outages, although far fewer since 2012/2013, are hobbling businesses and impeding industrial production, which only worsens the economic situation a little further.

[1] *Pakistan Annual Status of Education Report* (ASER) 2015, and *Pakistan National Human Development report 2017*, UNDP.

Since its independence, Pakistan has recorded erratic economic growth patterns that correlate with unforeseen climatic events and political circumstances. The pace of growth has been slowing down since 1993 (by a yearly average of 2.8% between 2008 and 2014). This slowdown has mainly coincided with the emerging shortfall in power generation, which has been exacerbated by insufficient investment and the cumulative arrears of payments from state-owned enterprises to energy suppliers. The country's growth model is characterised by a narrow manufacturing sector (an average 13% of value-added since 2010) and a large but low-performing agricultural sector (contributing 25% of value-added in 2016/17, and over 40% of employment).[2]

The business environment is marked by a lack of transparency in public procurement particularly at provincial level (direct contracting is frequent), lengthy judicial proceedings and difficulties in enforcing court decisions, bureaucratic constraints, corruption, and the security situation. The World Bank nonetheless noted in its *Doing Business 2017* report that the ease of doing business for small and medium-sized enterprises (SMEs) had improved. Pakistan was among the ten countries that had shown most improvement in performance on the report's table of rankings. Pakistan ranked 136th in the *Doing Business 2019* report (147th in 2018 and 144th in 2017).

Today, Pakistan is identified as one the seven countries most vulnerable to climate change.[3] It is one of the countries most exposed to the risk of rising sea levels and erosion, which threatens the whole of the south coast including the city of Karachi, to the risk of landslides notably in the northern regions, and to water stress. Currently available water resources stand at around 1,080 m^3/person/year (equivalent to the level for Ethiopia), which is five times less than in the early 1950s, and this could drop to 850 m^3/per capita/year by 2030. Many studies report a mean temperature rise of between 0.6°C to 1.0°C in Pakistan's arid regions over the period 1960–2007.[4] At the same time, monsoon rainfall has increased by 15–25% in the north of the country and the number of extreme weather events has risen in the northern arid or semi-arid parts of the country (cf. map below). Temperatures could rise by up to 3.8°C by 2100 with an increase in rainfall, heatwaves, droughts and severe precipitation events, all of which impact biodiversity.

The country is heavily affected by natural disasters. Over the past fifteen years, it has had to deal with spells of severe flooding affecting 30 million people, as well as several major earthquakes, including one in 2005 that caused the death of 78,000 people. The economic and financial cost of these disasters has not been assessed with any precision, but some sources estimate it to be close to 40 billion dollars over this period.[5]

With its GHG emissions totalling 405 million tons of CO_2-equivalent ($MtCO_2e$) in 2015, Pakistan is one of the world's 25 biggest emitters, but ranks 150th in terms of per capita emissions. The challenge for Pakistan's low-carbon transition is to keep its emissions – currently estimated at 2 tons per capita and thus well below the global average of 6.7 tons – down to an acceptable level, despite the steep rise between 1994 and 2015 (+123%). The bulk of Pakistan's GHG emissions are from energy (46%) and agriculture (43%), with a more marginal contribution from land use change and deforestation (2.5%).

The country is afflicted by structural violence fuelled not only by tensions along its frontiers (Afghanistan, India, Iran), but also by sectarian tensions (Sunni, Shia, religious minorities). For many years, it was one of the countries most affected by terrorism. Added to this scourge is an endemic criminality whose activities remain closely tied to the financing of militant networks through extorsion and growing drug trafficking (from Afghanistan). Violence related to the independentist movements – especially in Balochistan – is the third dimension of a severely degraded security situation. Since late 2014, Pakistan's government and army have taken a series of radical measures against the terrorist groups that are targeting them. These measures have undeniably had a real impact on the country's security situation.

Pakistan ranks 144th out of 145 countries[6] on the count of gender equality. Large inequalities persist in the areas of education, healthcare, and economic and political life. Violence against women and girls is one of the factors exacerbating these inequalities. The NGO, Human Rights Watch, identifies some 1,000 honour killings each year.[7] This situation is worsened by women's limited mobility, lack of education and poor knowledge of their rights, along with their difficulty in accessing financial resources. Women represent only 22.7% of the workforce and are most often confined to low-paid jobs in the informal sector, where little is done to protect their social rights.

[2] The services sector generated on average more than half of value-added over the period 2010–2017 and accounts for less than 35% of jobs.
[3] https://www.climatewatchdata.org/countries/PAK
[4] *Climate Change Profile of Pakistan*, Asian Development Bank, 2017.
[5] NDMA, 2013. *National Disaster Management Plan.* Government of Pakistan.
[6] *Global Gender Gap Report 2015*, World Economic Forum, 2015.
[7] https://www.hrw.org/world-report/2018/country-chapters/pakistan

1.2. THE NATIONAL STRATEGY

The Ministry of Planning, Development and Reform published a programme document in 2016 entitled “Pakistan: Vision 2025”, which has the ambition of transforming Pakistan into a high-income, export-oriented economy that guarantees inclusive growth, peace and security, as well as a harmonious co-existence between the provinces. The government programme lists seven pillars: (i) developing social and human capital, (ii) indigenous and inclusive growth, (iii) governance, institutional reform and modernisation of the public sector, (iv) energy, water and food security, (v) entrepreneurship-driven growth, (vi) a competitive knowledge economy and (vii) modernising transport infrastructure and improving regional connectivity. The new government elected in July 2018 has not called these priorities into question, but lays emphasis on access to basic services and human development, and on the fight against corruption.

Pakistan’s ambitions are closely linked to Chinese investments under the China-Pakistan Economic Corridor (CPEC), which is part of China’s project to create new silk roads (Belt and Road Initiative). In its first phase, this agreement foresaw a US$ 20 billion investment over the period 2015–2019 (equivalent to over 7% of GDP). Much of this has already been completed – mostly power generation projects (coal-power, hydropower and solar-power plants, whose impact is estimated at 1–2 percentage points of GDP. By 2030, additional investments of more than US$ 30 billion are planned (railways,[8] roads, ports, pipelines…).

This expected influx of foreign investment can produce positive effects on long-term growth only if Pakistan makes efforts to reduce its structural macroeconomic imbalances, the main one being its fiscal deficit, by broadening its tax base (tax revenue accounts for a mere 11% of GDP) and developing trade to reduce its current account deficit.

1.2.1. Fight against climate change

Pakistan ratified the Paris Agreement on 10 November 2016 following an inter-provincial and inter-ministerial consultation process launched in January 2016. The country presented its intended nationally determined contribution (INDC) ahead of the COP 22 opening. Grounded on the country’s “Vision 2025” strategy, the INDC posits a 7% annual growth rate leading to a fourfold increase of GHG emissions, from 400 $MtCO_2e$ in 2015 to 1,600 $MtCO_2e$ by 2030. This expected increase in emissions would mean that the country’s emissions peak would be delayed by several decades beyond 2030. Moreover, the objective of a 20% reduction by 2030 compared to the business-as-usual scenario depends entirely on Pakistan receiving UD$ 40 billion in grant aid, which would seem very unlikely.

According to the government, this steep rise in emissions is justified by (i) the need to fast-track development of the energy sector to bridge the demand-supply gap (ii) the country’s stage of development, which will require higher emission levels if the population’s needs are to be met, and (iii) infrastructure deficiencies requiring immediate action. The energy sector is the primary driver of the rise in emissions (60% of the increase) mainly due to investment in coal-fired power plants.

The public emissions reduction policies announced by the government[9] will lay emphasis on (i) improving energy transmission efficiency, (ii) improving the efficiency of thermal coal-fired power plants and (iii) developing renewable energies. On the demand-side, efforts will involve adopting energy-efficiency standards for different types of equipment. The agricultural sector, the second-largest GHG emitter, will also contribute to reduction efforts by gradually changing crop-growing and livestock-farming methods. As for the transport sector; the government has not yet adopted a definite strategy to promote clean mobility modes.

To tackle the country’s high level of vulnerability, the Government of Pakistan and its National Disaster Management Authority (NDMA), tasked with protecting the population and limiting the impacts of natural disasters on the country’s development, have adopted the National Disaster Management Plan (NDMP). The NDMP includes plans for human resources development, a multi-hazard early warning system and community-based disaster risk management. Among the various priorities set out in the NDMP, the government highlights: (i) the measurement and mapping of hazards and vulnerabilities, (ii) training and awareness-raising on disaster risks, (iii) plans for managing these at community or village level, (iv) early warning systems and (v) plans for post-disaster recovery of activities. In parallel, the provinces have set up Provincial Disaster Management Authorities (PDMs).

[8] Due to its cost, the project to renovate the ML-1 line under the CPEC is currently on hold.
[9] Climate Change Act adopted by Parliament in April 2017.

1.2.2. The fight against poverty and inequality

Pakistan's most recent poverty reduction strategy dates back to 2010 and is built on nine pillars including macroeconomic stability and real sector growth, protecting vulnerable populations, increasing productivity and value addition in agriculture, human development, access to financing and reducing gender inequalities. The strategy makes no mention of the environmental dimension or the fight against climate change as a line of action to reduce poverty and inequalities by reducing vulnerabilities.

Pakistan has implemented a relatively developed safety net of direct and indirect social protection mechanisms. The direct mechanisms include social protection for employees (e.g., Employees' Old-Age Benefits Institution (EOBI), the Workers' Welfare Fund (WWF) and provincial social security benefits); direct transfer schemes for the most vulnerable (Benazir Income Support Programme, Zakat and Pakistan Bait-ul-Mal); and schemes for easier access to financing (Pakistan Poverty Alleviation Fund, National Rural Support Programme) and other microfinance institutions that help to develop income-generating activities.

Pakistan is also working to promote indirect safety nets for social security via the legislative and regulatory framework: introduction of a minimum wage, lifeline tariffs on water and electricity, and subsidies for some basic food items (e.g., flour) through the Utility Stores Corporation of Pakistan.

1.3. FINANCING DEVELOPMENT

The current account deficit is such that debt-servicing cannot be ensured, leading to a structural need for external financing. Reaching 6.1% of GDP in fiscal year (FY) 2017/18, this deficit is not likely to drop below 5% this year and is adversely impacting foreign exchange reserves, which cover 1.5 months of imports of goods and services, despite a US$ 6 billion injection from "friendly" countries (China, Saudi Arabia, the United Arab Emirates) since the beginning of the year.

Pakistan received US$ 10.1 billion of foreign aid in FY2016/17, which was a historic record and up by 35% year on year.[10] Included in this external aid, US$ 4.4 billion[11] corresponded to short-term debt to enable repayment of outstanding loans, of which US$ 2.3 billion came from Chinese commercial banks (US$ 1.7 billion from China Development Bank, US$ 300 million from the Industrial and Commercial Bank of China and Bank of China). Since 2010, external debt servicing has averaged US$ 4.2 billion per year and absorbed 40% of foreign currency reserves. In FY2019/20, external debt servicing is set to increase and should represent up to 7.5% of GDP as the government started servicing its debt to the IMF in 2018 (US$ 6.4 billion), along with ODA repayments (US$ 11.7 billion between 2017 and 2024), redemption of maturing bonds (Eurobond and Sukuk totalling US$ 2 billion), and repayment of Chinese CPEC-related loans. The question of how to finance development remains tightly linked, at least in the mid-term, to the issue of Pakistan's structural macroeconomic imbalances, particularly the external imbalance. Overall donor coordination is officially ensured by the Economic Affairs Division (EAD) under Pakistan's Ministry of Finance, Revenue and Economic Affairs. EAD chairs the D10+ group, which gathers together the country's key partners including France. This forum takes place very sporadically (the last meeting was in March 2015) and most often covers very broad topics. The technical ministries are in charge of sectoral coordination. In reality, strategic and operational coordination is managed (i) within sectoral work groups chaired by one or several donors (e.g., ADB for the energy sector, Australia for the water sector, the UNDP for environmental questions) and (ii) through joint operations.

[10] According to the data published by Pakistan's Ministry of Finance, Revenue & Economic Affairs, development aid flows amounted to US$ 11.5 billion in FY2017/2018. These data have not yet been validated by the OECD/DAC.
[11] That is, US$ 2 billion more than budgeted.

1.4. ELEMENTS FRAMING FRENCH STRATEGY AND AFD'S MANDATE

1.4.1. Diplomatic and trade relations

With 17 million middle-class households,[12] a fast-growing economy and an indisputable role in regional security, Pakistan is a key player with which France wishes to develop its economic, technical and cultural cooperation. The bilateral dialogue is built on three pillars: annual consultations among the Secretaries-General of the Foreign Affairs ministries, an annual joint commission on security issues, and annual joint commission on economic and trade issues.

In 2017, bilateral trade between France and Pakistan reached €1.4 billion, up 4.6% year-on-year. Total French sales show that Pakistan now ranks as our 67th largest trading partner (64th in 2016). French exports to Pakistan include mainly electric turbines, pharmaceuticals and dairy and cheese products. France now has a trade deficit with Pakistan as the country's textile exports have grown following the EU's attribution of a GSP+ trade facility to Pakistan in 2014.

Some 32 French companies, mostly major groups, are represented in Pakistan in key sectors of the Pakistani economy (energy, transport, public works and civil engineering, environment, pharmaceuticals, consumer goods, non-bank services). Over 147 companies are members of the Pakistan-France Business Alliance.

France's strategy identifies three priorities:[13]

- **Priority 1:** Boost trade, currently below potential
- **Priority 2:** Support Pakistan's development and promote French expertise
- **Priority 3:** Strengthen the political-security dialogue

1.4.2. Development cooperation

France's development assistance policy aims to (i) implement investment financing backed by AFD in sectors that are strategic for Pakistan and in which French know-how is recognised, (ii) respond to the growing culture-related demand through actions targeting Pakistani youth, (iii) support the professionalisation of national cultural institutions through partnerships and exchanges with French institutions and festivals, (iv) channel requests in the archaeology and heritage sectors, and (v) give more visibility to French-language teaching.

Since 2006, the year that AFD Group first began operating in Pakistan, the Group's commitments have reached €973 million, mainly in the form of concessional sovereign loans (€867 million), grants (€10 million), non-sovereign loans (€14 million) and Proparco operations (€82 million). The level of commitments was particularly sustained in 2016 and 2017 (€265 and €201 million respectively). Over the period 2016–2018, €391 million, in other words 70% of AFD's commitments in Pakistan, provided climate co-benefits.

The Group has also funded technical assistance and capacity-building actions for contracting authorities. Until 2016, the Group targeted its interventions at a sustainable resolution of the energy crisis consistent with the climate-change issue in Pakistan (cf. Box 1). It began to diversity its activities as of 2017, mainly in the area of transport (the Peshawar BRT), water and sanitation, and microfinance.

AFD's interventions are also consistent with the sectors of concentration[14] defined by France under the joint European programming initiatives begun in 2016, whose objective is to coordinate the actions of Member States and the European Commission by distributing sectors and geographies.

[12] Any household with an estimated consumption over $4 per capita per day (purchasing power parity, constant 2005 dollars) is considered as belonging to the middle class.
[13] Source: the action plan of the Ambassador of France, www.tresor.economie.gouv.fr, www.diplomatie.gouv.fr.
[14] The sectors of renewable energies, urban planning (water/sanitation, urban mobility, enhancement of historical heritage) and prevention/management of natural disasters.

Over ten years of commitment to supporting the energy transition

Since 2006, the Group has committed €665 million to Pakistan's energy transition, including €63 million in non-sovereign financing led by Proparco. Over 55% of the commitments involve small- and mid-sized hydropower plants. Based on an overall approach to the energy sector that factors in not only increased energy production capacity, but also public infrastructure and the political and regulatory environment, a €100 million public policy loan has been approved for the energy sector and €75 million for investment in energy transmission.

Thanks to this historic commitment to help further the energy transition, AFD Group is recognised by the Pakistani authorities as a landmark actor in this sector. This legitimacy was strengthened following the COP 21 chaired by France in 2015, and the international commitments that France has since upheld.

1.4.3. AFD Group's mandate

In compliance with the Framework Act on Development and International Solidarity Policy (Act of 7 July 2014) and the conclusions of the Interministerial Committee for International Cooperation and Development (Comité interministériel de la coopération internationale et du développement – CICID) of 8 February 2018, AFD intervenes in Pakistan to promote green and inclusive growth, notably by fostering economic partnerships. In line with Pakistan's major development challenges, the Group lays emphasis on support for the key transitions, including the energy, territorial and ecological, economic and financial transitions.

Consistent with AFD Group's 2018–2022 Strategy, AFD will work to ensure that its action is "100% Paris Agreement"-compliant and "100% social link"- compliant, so as to dovetail the fight against climate change with the fight against poverty and inequality. AFD will systematically ensure that its financing is compatible with resilient and low-carbon development, and also work to strengthen the social link aspect both by reducing inequalities and bolstering participatory governance modes when financing is at the appraisal stage.

2.

AFD GROUP'S INTERVENTION STRATEGY

In accordance with its intervention strategy for Asia,[15] the Group sets itself three objectives in Pakistan consistent with 100% Paris Agreement commitment to low-carbon and resilient development and 100% social link:

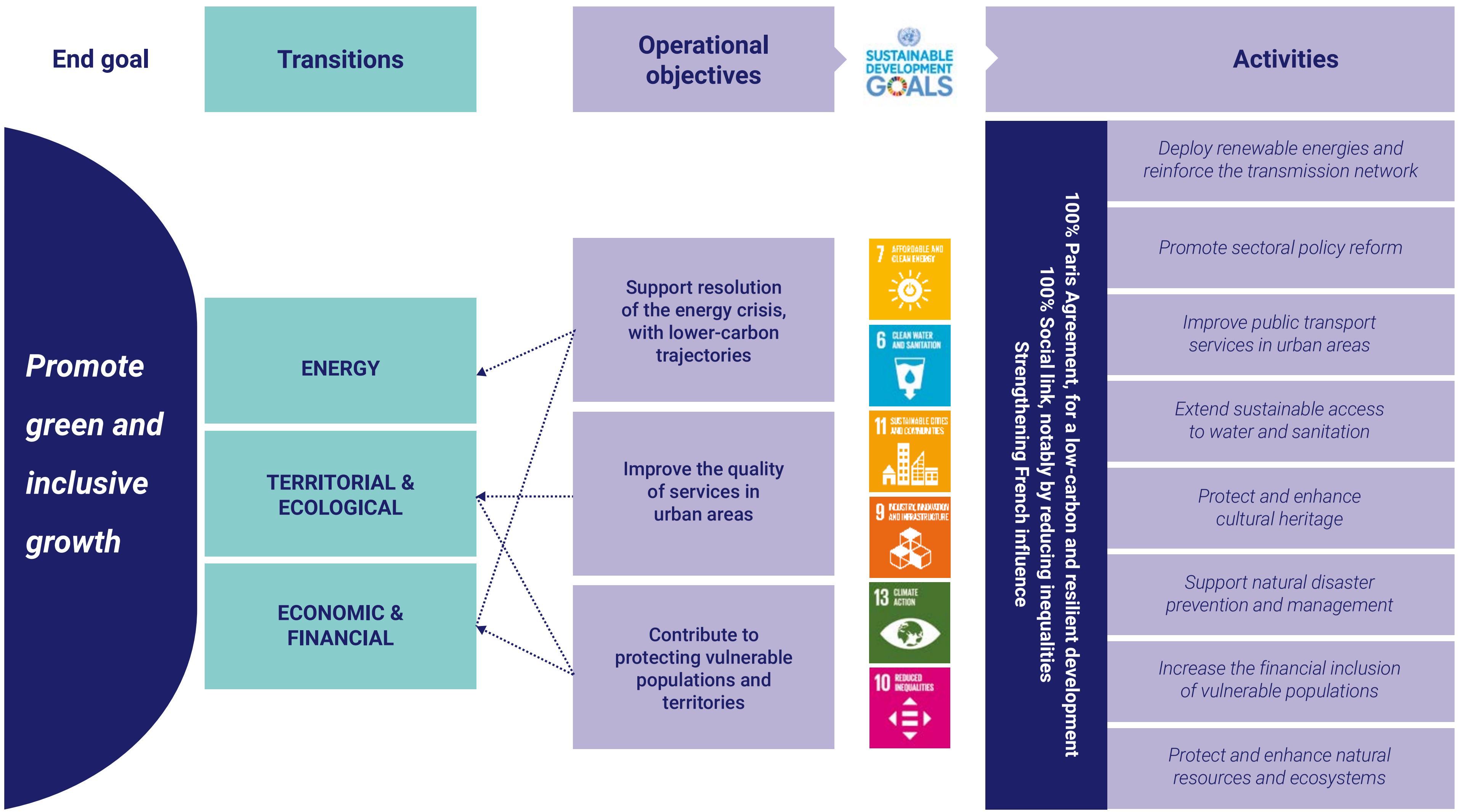
Objective 1 : support resolution of the energy crisis
Objective 2 : improve the quality of services in urban areas (water, sanitation, transport)
Objective 3 : contribute to bolstering the resilience of vulnerable populations and to protecting territories against natural disasters

The Group will continue the diversification of its intervention sectors, begun in 2017, while continuing its operations in the energy sector. The Agency is further developing its activities in urban transport, water and sanitation, as well as natural disaster prevention and management, while Proparco is diversifying into microfinance and the manufacturing sector. In response to the Pakistanis' growing demand for partnerships with French actors, AFD will mobilise tools such as FEXTE and promote the emergence of a French offer, although some French consultancies and firms are reluctant to operate in Pakistan.

To ensure that its action complies with the Paris Agreement, the objective set is to have 70% of projects with climate co-benefits. As such, AFD will continue to dialogue with the Pakistani government on low-carbon and resilient development trajectories. This dialogue will mainly focus on energy policy and on defining an optimal energy mix (energy accounts for 60% of the increase in emissions between 2015 and 2030) under the umbrella of Objective 1. It will also aim to identify additional sources of emissions mitigation chiefly in the urban services sector (Objective 2). An approach combining public policy loans and technical assistance programmes will not only provide support to the initial emissions-reduction measures set out in Pakistan's current nationally determined contribution, but also assist Pakistan in moving towards more ambitious low-carbon policies.
To help strengthen the social link, AFD Group will be attentive to the aspect of reducing inequalities, be it between regions or individuals, and notably gender inequality. AFD will mainstream the objective of reducing gender inequality into its projects, especially as regards access to basic services and training, urban mobility and stronger resilience for vulnerable populations, while also factoring in Pakistan's cultural context. The project appraisal phase offers an opportunity for dialogue with Pakistani partners with a view to ensuring that women can effectively access the opportunities created under the project. This dialogue will be informed by feasibility studies and environmental and social impact studies whose terms of reference will specifically incorporate the gender question, or by a gender diagnostic carried out in the chosen intervention sectors.

[15] Regional Intervention Framework for Asia validated in December 2017; to be revised in the framework of AFD's "Orients" strategy.

AFD's Logical Intervention Framework for Pakistan



2.1. OBJECTIFVE 1: SUPPORT RESOLUTION OF THE ENERGY CRISIS

The current organisation of the power sector was inherited from the restructuring programme undertaken in the 1990s, which aimed to separate management of the water and electricity sectors, originally grouped together under the Water and Power Development Authority (WAPDA). Thereafter, various autonomous entities were created to handle (i) thermal power generation (4 generation companies – GENCOs), (ii) hydropower generation (WAPDA Hydel), (iii) energy transmission (NTDC) and (iv) distribution (10 distribution companies – DISCOs). A vertically integrated company (KEL) was created to serve Karachi. A power sector regulator (NEPRA) was also set up. Finally, a central power purchasing agency, CPPAG, in charge of buying electricity from generators was created in 2015 to separate out the financial streams related to transport infrastructure management.

The electricity sector suffers from a supply shortfall due to a combination of factors: (i) still insufficient power generation despite the increase in capacities in recent years and (ii) an undersized transmission and distribution network. Daily power-shedding is estimated to curtail GDP growth by 2–3 percentage points a year. The sector's financial sustainability is fragile due to subsidised electricity prices and an average tariff that does not reflect production costs even though tariffs have doubled and now stand at Rs13.14/kWh (€c8.2/kWh). This disparity is the underlying cause of the circular debt that exists across the whole power supply chain and estimated in December 2018 at US$ 9.7 billion, or 4% of GDP. The debt burden constrains the sustainability of the sector and obliges the government to intervene regularly.

In recent years, Pakistan has made substantial headway in resolving the energy crisis, but major challenges remain, including (i) correcting the shortfall in power supply and (ii) continuing the sectoral reforms launched in the 1990s and modernising the transmission and distribution system.

AFD will support resolution of the energy crisis by intervening simultaneously on decarbonised power generation, the upgrading and strengthening of the distribution network, and sectoral policy dialogue. Now recognised by Pakistan's authorities and financial partners as a key actor in the sector, AFD will prioritise a comprehensive approach to resolving the energy crisis. These actions could be undertaken with contracting authorities at the federal level (WAPDA, NTDC, MoWP) or provincial level (local authorities, agencies in charge of hydropower facilities).

2.1.1. Deploy renewable energies

Given the strong growth of electricity demand, Pakistan needs to manage a significant power supply shortfall. Only three-quarters of the installed capacity of 25 GW are available due to malfunctions in production plants and the lack of largely imported fuel. This severe energy crisis has prompted the government to turn to short-term solutions, such as thermal power plants fired by coal or natural gas. Yet, the potential of renewable energies is both considerable and underexploited. Hydropower potential is estimated at 54 GW, but only 12% of this is currently exploited, covering 30% of the country's electricity needs. The government has planned to increase installed capacity to 30 GW over a ten-year period (2013–2023), mainly by developing hydropower.

To finance this investment, the government has been open to Chinese financing through the CPEC. The generation capacities currently being developed under this programme amount to 11 GW, mainly produced by coal-fired plants, but also including 2.8 GW from renewable energies.

AFD Group will focus on hydropower, notably the construction of small- and medium-capacity run-of-the-river plants and the refurbishment of ageing larger-capacity plants, as well as off-grid or on-grid solar and wind power. Proparco, already involved in financing privately owned wind and hydropower plants, will continue to support this subsector by broadening its offer to include solar energy. Given the magnitude of the projects, Proparco will preferably operate on a co-financing basis along with other development finance institutions.

2.1.2. Reinforce the transmission network

While the transforming capacity of the transmission network[16] has doubled since 2000 and line losses on the high-voltage network decreased from 3% in 2010 to 0.5% in 2016, the total annual number of unplanned power outages on the network remains high due to (i) the saturation of nearly two-thirds of transformer stations, (ii) insufficient network redundancy (low availability of back-up lines in case of failure), and (iii) the sometimes inadequate maintenance of the network notably in regions prone to climate hazards.

To deal with network saturation, NTDC is planning an ambitious programme to extend the transmission network with the construction of 5,200 km of transmission lines over the next five years to boost installed capacity and ensure connection to the distribution companies. This plan includes operationalising high-voltage direct current transmission lines to transport electricity from the areas generating thermal power in the south and from hydro-power plants in the north to areas in the centre of the country where electricity consumption is high.

In compliance with its "100% Paris Agreement" mandate and its climate co-benefit objectives, AFD will be able to participate in this investment programme on the aspects of loss reduction and the integration of renewables into the network. AFD will contribute to improving the network stability through its support for developing power plant connectivity (except for thermal plants) using the SCADA system, which increases the level of integration of supervisory and remote-control technologies.

AFD will pay particular attention to the factoring-in of climate change risks, notably the risks of flooding and heatwaves, at the time of project appraisal and in the choice of technical solutions.

2.1.3. Promote sectoral policy reform

Lastly, AFD will pursue the sectoral policy dialogue with the Authorities and financial partners in order to promote reform for (i) the transition of the energy sector to a low-carbon trajectory, (ii) improved access to energy and sounder financial sustainability of the energy sector through better management of tariffs and subsidies in order to resolve the circular debt issue, and (iii) improved management of state-owned energy companies by opening up markets to the private sector and boosting the sector's performance, while securing the energy supply. AFD will be able to use resources from the 2050 Facility to foster the dialogue on energy transition, drawing on studies and technical assistance. A first funding amount has been allocated to a French technical assistance programme to support the Ministry of Climate Change in modelling Pakistan's greenhouse gas emissions.

[16] The 500 kV and 220 kV high-voltage grid is operated by the National Transmission and Despatch Company (NTDC).

2.2. OBJECTIVE 2: IMPROVE THE QUALITY OF SERVICES IN URBAN AREAS

Given its high demographic growth and the rapid development of urban centres, Pakistan is facing serious challenges regarding access to basic services (drinking water and sanitation) and urban mobility. Without hefty investment in these sectors and improvements in the technical and financial performance of these services, the situation will continue to deteriorate.

To accompany urban growth and improve the quality of life and economic attractiveness of agglomerations, AFD will support provincial and municipal authorities' programmes designed to (i) facilitate durable access to water and sanitation services for all, (ii) propose environment-friendly urban mobility systems adapted to demand, and (iii) develop urban space and rehabilitate the historical and tourist heritage.

2.2.1. Increase sustainable access to water and sanitation

According to the estimates of the WHO-UNICEF JMP 2017 update report,[17] some 89% of the population has at least basic access to drinking water: 92% in urban areas (58% of whom have a household connection). In reality, these high percentages mask a poor quality of service and a low level of technical performance. In fact, no Pakistani city has an everyday, round-the-clock water supply. Users have to adapt to these constraints by investing in alternative systems and/or spending time managing their supply. The effects of climate change, which have led to water stress exacerbating the depletion of water resources, and public pressure have prompted the government to make this issue a priority for adaptation.

Although the competence for water management has been delegated to the provinces in the decentralisation process, the government created a federal ministry for water in 2017 tasked with steering water resources management policy at the national level. In 2018, in concertation with the provinces, the ministry drafted and introduced the first National Water Policy, which emphasises water conservation, water storage, the sharing of water among different users, and preservation of water tables. Investment in new dams and reservoirs is one of the key pillars of this policy, along with fair allocation of the resource among the provinces. The policy also integrates aspects relating to the impact of climate change and recommends adaptation and mitigation measures.

Access to sanitation services is still poor and waste water treatment barely exists. In 2015, some 58% of the population had access to basic sanitation services (74% in urban areas and 48% in rural areas[18]). Moreover only 50% of waste water is collected and 10% treated, which causes heavy pollution of surface water. Although the subject is barely addressed at countrywide, the management of waste water, rainwater and industrial effluents is one of the keys to tackling the growing pressure on water resources.

The water policy document makes no mention of sanitation policy as such, even though the country's major cities discharge 90% of their waste water without treatment. Nonetheless, given the increasing risk of water table pollution, provincial governments are under strong pressure from local communities, NGOs and the judicial system to invest in water treatment plants. Moreover, this theme was largely taken up by the political parties in the 2018 electoral campaign.

Working together with the provinces and operators, AFD will finance the construction and modernisation of infrastructure designed to expand water and sanitation services while enabling preservation of the quality of the resource. AFD will ensure that extending access to drinking water goes hand in hand with improving the capacity of waste water treatment so as to stem health risks. AFD will also take into account climate risk management in urban areas (heatwaves, flooding) particularly with respect to pipe continuity, and will optimise climate co-benefits by studying the potential for methane-production and co-generation technologies for sanitation systems. AFD will support improvements to service quality and sustainability based on more effective technical and commercial management, particularly the reduction of water losses and improvement to customer management systems. AFD will also support sectoral frameworks that strengthen water sector governance at provincial level and make it possible to define a long-term business model for the sector, increase the operators' technical and financial performance and reinforce the legislative and regulatory framework.

[17] *Progress on Drinking Water, Sanitation and Hygiene, 2017,* Joint Monitoring Programme, WHO/UNICEF, (page 70).
[18] *Progress on Drinking Water, Sanitation and Hygiene, 2017,* WHO/UNICEF Joint Monitoring Programme (page 88).

2.2.2. Improve public transport services in urban areas

Urban mobility presents multiple challenges due to the twofold pressure of demographics and economic growth. Like most major and secondary cities in emerging countries, those in Pakistan have the following characteristics:

- Public transport is ensured only by "paratransit" and unregulated services. Very old vans and minibuses account for 70% of road trips. These modes offer a flexible transport system at zero-cost for the authorities, but they develop in a disorganised and inefficient manner and greatly exacerbate city congestion, notably on main roads with heavy traffic.

- Institutional public transport services are non-existent. The authorities have given priority to developing road infrastructure, as shown by the construction of many flyovers and grade-separated intersections. Despite these investments, the level of congestion continues to worsen.

- Walking is still the dominant mode of travel, notably for the poor and women, and the rate of private car ownership is still low.

- Road congestion is very acute despite the low rate of motorisation. The inefficiency of public transport, poor traffic management, competition between the different transport modes and increasing motorisation result in an alarming deterioration of mobility conditions and air quality. On trunk roads of Pakistan's major cities, the average speed at rush hour is around 11 km/h and often much lower. Pedestrians are the main victims of road traffic accidents.

- The absence of effective state regulation. Before 2016, no public authority was in charge of planning and controlling transport services or the roadworthiness of public transport vehicles.

In 2015, transport accounted for over one-quarter of the increase in GHG emissions in the energy sector. The number of registered vehicles rose from 2 million to 9 million between 1992 and 2011, entailing a proportional increase in the consumption of petrol and compressed natural gas. Moreover, the effects of climate change do not spare transport infrastructure, particularly in very densely populated urban areas.

Against this backdrop, AFD will finance urban mobility and transport infrastructure in fast-growing agglomerations so as to limit city congestion, air pollution, CO_2 emissions and improve the resilience of transport infrastructure and services threatened by climate change. AFD will promote transport systems that provide an alternative to private vehicles through collective modes that help to structure the sector, such as bus rapid transit (BRT), tramways or urban trains, non-motorised modes (non-motorised two-wheelers), and optimise traffic flow management. AFD will leverage urban public transport projects to combat climate change, and will thus propose to Pakistan that it participate in the Mobilise Your City initiative, which encourages cities to prepare urban mobility plans linked to national Climate policies so as to reduce the carbon footprint. AFD will also pay attention to meeting user needs, to improving accessibility and safety for people, notably women, who are normally little inclined to use public transport.

2.2.3. Protect and enhance cultural heritage

The historical heritage of Pakistani cities is a unique testimony of the cultures that formerly prevailed in the Indus Valley and constitutes a major asset for promoting an attractive image of the country.

AFD will support the protection and enhancement of this historical heritage in order to help spur the growth of the tourist industry and job creation. The renovation of this heritage will be supported insofar as possible by urban regeneration programmes to integrate historical sites into their contemporary environment. AFD will support the development of a more comprehensive tourist offer based on enhanced welcome facilities, digital and museographical innovations and adapted urban planning, by promoting French expertise in this domain.

2.3. OBJECTIVE 3: CONTRIBUTE TO THE RESILIENCE OF VULNERABLE COMMUNITIES AND THE PROTECTION OF TERRITORIES

Under this third objective, AFD Group will contribute to implementing the government's strategy in the area of natural disaster adaptation and management,[19] and to improving the resilience of vulnerable populations.

Pakistan is one of the seven countries most vulnerable to the risk of heatwaves, flooding and landslides – a risk that has been constantly growing over the last fifteen years. In 2011 and 2014, two very severe floods affected 30 million people in the Indus Valley. The country is also exposed to seismic risk and has experienced several major earthquakes, including one in 2005 in Kashmir in which 78,000 people perished. The impact of these disasters has been exacerbated by the poverty of the rural communities affected, as their dwellings are makeshift and isolated, notably in Pakistan's northern and western regions. The World Bank estimates that natural disasters cost 0.5–0.8% of GDP each year.

The resilience of vulnerable populations is also aggravated as they have one of the world's lowest rates of the use of banking facilities, with 14% of adults (7% of women) having access to a banking service. Between 2013 and 2017, the number of bank account holders grew by only 4%. Cash payments and informal loans, most often from family, are still commonplace. The microfinance sector reported 4.3 million borrowers in 2016, which represents only 16% of the potential market.

AFD dovetails the third pillar of its intervention strategy for Pakistan with the guidelines mentioned in the country's National Disaster Management Plan (NDMP). In its strategy document, Vulnerabilities to Crises and Resilience 2017–2021,[20] AFD commits to work with its partners to anticipate and act upstream of crises. In this framework, it will support the initiatives defined by the Pakistani government and mentioned in the NDMP to develop structured and sustainable schemes centred on natural disaster prevention, preparedness and response, preferably in partnership with a group of donors. This will mainly involve equipping Pakistan with the means to strengthen its resilience to natural hazards and building up its capacity to rapidly respond to the needs of affected communities. This will be achieved by implementing a multi-donor fund (National Disaster Management Fund – NDMF) that will co-finance investments, along with public or private project sponsors, in line with the priorities laid out in the NDMP.

The Group will finance actions that help to strengthen the resilience of vulnerable populations in the event of natural disasters. These actions can include building protective structures and earthquake-resistant infrastructure in isolated rural areas, or improving the financial inclusion of rural communities by developing microcredit products adapted to the economic situation of rural households. Proparco will continue to diversify its products for the microfinance sector (US$ 5 million credit line to Kashf signed in 2017) – a sector subject to high-quality supervision and which has developed a broad range of financial products for vulnerable populations, notably rural communities.

[19] Disaster Management is centred on two lines of intervention: i) disaster risk reduction (DRR), which is subdivided into two categories: disaster prevention and disaster preparedness, and ii) disaster response.

[20] To minimise the cost of inaction in the area of prevention (65.5% of disaster-related funding are channelled into emergency response and 21% allocated to reconstruction efforts), AFD has developed a DRR roadmap, which promote directing funds towards actions related to the prevention and disaster preparedness and response.

2.4. POSSIBLE WAYS FORWARD FOR DIVERSIFYING ACTIVITIES

In addition to its three sectors of concentration, AFD Group will continue to explore ways forward to diversify its activity and will remain alert to opportunities for interventions in line with the 100% Paris Agreement for a low-carbon and resilient development, particularly in the areas of protection and enhancement of natural resources and ecosystems, and support for the productive sectors.

Pakistan has a wealth of biodiversity due to the broad span of its geographic and climatic zones, ranging from mangrove forests along the coast of the Arabian Sea to the summits of mountainous areas on the western flanks of the Himalayas. Over the last twenty years, many animal and plant species have been listed as being in danger of extinction due to the combined effect of climate change and the overexploitation and destruction of their natural habitat. This has been the result of land pressure, deforestation, the use of pesticides and polluting products in agriculture, and unsustainable fishing practices, in a context of strong demographic growth and the lack of a sufficiently protective legislative and regulatory framework. Mindful of this risk, the government has recently put in place a legal and regulatory arsenal to protect the ecosystem (the Pakistan Environmental Protection Act, National Conservation Strategy, Biodiversity Action Plan…).

By supporting the development of sustainable subsectors compatible with efforts for climate change adaptation, AFD can continue to protect and develop biodiversity and natural resources, particularly fisheries resources, to the benefit of the poorest local communities. The management and development of ecosystems depend on institutional, social and technical solutions specific to each region. As such, AFD will study the possibilities for actions dedicated to protected natural areas, collection of scientific data on the dynamic of stocks, sustainable exploitation of resources and fair sharing between the actors in the value chain.

Proparco intends to support private sector development in a context of sustained financial growth seen in recent years. Proparco will propose innovative tools to extend its activity to the manufacturing sector (agribusiness, the textile and building materials industries) and consolidate support to financial institutions (microfinance institutions, banks and insurance companies).

2.5. KEY STRATEGIC PARTNERSHIPS AND KNOWLEDGE PRODUCTION

Over the period 2014–2018, more than 80% of AFD's commitments involved co-financing, mainly with its key financial partners, the Asian Development Bank in the urban mobility and energy sectors, and European donors (EU, KfW, EIB and GiZ). AFD will continue this policy of co-financing with its key partners and explore new partnerships (AIIB, WB, JICA, Aga Khan Development Network), while diversifying its types of partnership:

- Co-financing in the framework of the Mutual Reliance Inititiative with KfW and EIB (e.g., the Warsak project in which AFD is the lead partner, and the Harpo project with KfW as the lead partner),

- Co-financing based on a signed co-financing agreement, with delegated project management, (power transmission project and Peshawar BRT with ADB and a training centre for hydropower skills with the EU),

- Parallel financing in which AFD and its partner align their conditions precedent for disbursement (energy development policy loan with the ADB),

- Parallel financing with information-sharing (rehabilitation of Mangla power plant with USAID).

AFD Group will also contribute to strengthening France's influence in Pakistan. The Group sets itself the objective of promoting French expertise through all the channels it has available. The existing partnerships with French actors will be reinforced particularly in the area of capacity-building for contracting authorities (e.g., the partnership with AgroParisTech in the water/sanitation sector and Groupe Energies Renouvelables, Environnement et Solidarités to support vulnerable populations). New partnerships currently being identified will be set up, chiefly in the area of preserving and enhancing historical heritage (e.g., the partnership now under discussion between the Musée Guimet and the Walled City of Lahore Authority in view of rehabilitating Lahore Fort).

AFD will also pursue its knowledge production policy mainly in two sectors: (i) energy, by developing models for low-carbon energy trajectories in collaboration with the French consulting firm Enerdata and Pakistan's Ministry of Climate Change, under the 2050 Facility, geared to support policy dialogue with the Pakistani authorities on low-carbon and resilient trajectories, and (ii) biodiversity and the blue economy following the study on Pakistan's fisheries sector, which will lead to a joint publication with the World Bank.

3.

FINANCIALS PROSPECTS AND INTERVENTION MODALITIES

3.1. FINANCIAL PROSPECTS

The AFD Group's activity over the period will be very largely based on concessional sovereign loans. The level of activity will depend mainly on the country's macroeconomic developments. It could reach some €100 to 150 million per year if the situation does not deteriorate.

The still limited non-sovereign activity will be continued mainly through Proparco financing for the private sector (at a targeted rhythm of €50–100 million a year). Finally, grants from the MEAE (budget programme 209), as well as from thematic funds (2050 Facility), from the MEF (FEXTE), and from EU delegated finds will be mobilised to accompany project and public policy loans.

Programmation indicative 2019-2020

- Karachi Bus Rapid Transit: a €90M sovereign loan (co-financed with ADB and AIIB)

- Lahore sanitation: sovereign loan of €130M

- Reform of water sector governance in Punjab: €0.5M of FEXTE funding

- Access to basic services and climate resilience in northern Pakistan: a €25M sovereign loan and a €5M grant from EU delegated funds (co-financed with the Aga Khan Agency for Habitat)

- Renovation of Fort Lahore and urban development: €25M sovereign loan

The amount of grants to be mobilised each year from different sources (FEXTE, FAPS, etc.) to finance preparatory studies and technical assistance programmes will average €1.5 million, equivalent to 1% of total annual commitments to Pakistan.

European investment from the Asia Investment Fund will also be requested to complete AFD's loan financing.

3.2. INTERVENTION MODALITIES

Over the period 2015–2018, the Group diversified its intervention modalities and will continue this approach in order to structure its project portfolio. This combines:

- Sovereign loans in the form of classic project aid to finance investment in infrastructure in priority sectors.

- Results-based loans (RBLs) disbursed as and when impact indicators are reached.

- Public policy loans to support sectoral dialogue and reforms within the framework of proactive government policy to combat climate change.

- Grants (2050 Facility, FEXTE) to fund capacity-building activities and technical assistance programmes or studies, as backing for sectoral policy loans and dialogue.

- The whole gamut of Proparco's financial products, ranging from senior, subordinated and mezzanine debt financing and guarantees.

3.3. MONITORING THE STRATEGY

The country indicators below will be monitored in AFD's main sectors of activity so as to place our action in perspective with regards to the country's trajectory and context and the public policies implemented:

- The portfolio's share of projects with climate co-benefits
- Volume of CO_2 emissions avoided
- Number of people benefiting from improved resilience to climate change
- The share of green energies in the energy mix
- Number of people benefiting from improved access to sustainable transport
- Number of people benefiting from drinking water supply
- Number of people benefiting from a sanitation service
- The volume share of AFD's annual commitments to Pakistan, where gender is either a principle or significant objective (OECD's policy markers 1 and 2)

ACRONYMS AND ABBREVIATIONS

ADB: Asian Development Bank

AFD: Agence française de développement (French development agency)

AIIB: Asian Infrastructure Investment Bank

BRT: Bus Rapid Transit

DAC: Development Assistance Committee (OECD)

CICID: Comité interministériel de la coopération internationale et du développement (Interministerial Committee for International Cooperation and Development)

COP: Conference of the Parties

CPEC: China-Pakistan Economic Corridor

CPPAG: Central Power Purchasing Agency

DISCO: Distribution company

EAD: Economic Affairs Division

EIB: European Investment Bank

EOBI: Employees Old-Age Benefits Institution

EU: European Union

FAPS: Fonds d'Appui à la Préparation et au Suivi des Projets (Project preparation funds)

FATA: Federally Administered Tribal Areas

FEXTE: *Fonds d'expertise technique et d'échanges d'expériences* (Fund for Technical Expertise andExperience Transfer)

GDP: Gross domestic product

GENCO: Generation company

GHG: Greenhouse gas

GiZ: Gesellschaft für Internationale Zusammenarbeit (German agency for international cooperation)

GSP: Generalised scheme of preferences

IMF: International Monetary Fund

INDC: Intended Nationally Determined Contribution

JICA: Japan International Cooperation Agency

KEL: Kohinoor Energy Limited

KfW: Kreditanstalt für Wiederaufbau (German development agency)

MEAE: Ministry for Europe and Foreign Affairs (France)

MEF: Ministry for the Economy and Finance (France)

MoWP: Ministry of Energy, Power Division

MRI: Mutual Reliance Initiative

$MtCO_2e$: Million tons of CO_2-equivalent

NDC: Nationally determined contribution

NDMA: National Disaster Management Authority

NDMF: National Disaster Management Fund

NDMP: National Disaster Management Plan

NGO: Non-governmental organisation

NTDC: National Transmission and Despatch Company

ODA: Official development assistance

OECD: Organisation for Economic Co-operation and Development

PDMA: Provincial Disaster Management Authority

PMD: Pakistan Meteorological Department

PML-N: Pakistan Muslim League

UNDP: United Nations Development Programme

PTI: Pakistan Movement for Justice (Pakistani political party)

RBL: Results-based loan

SBS: Sector budget support

SCADA: Supervisory control and data acquisition

USAID: United States Agency for International Development

WAPDA: Water and Power Development Authority

WB: World Bank

What is AFD?

AFD is France's inclusive public development bank. It commits financing and technical assistance to projects that genuinely improve everyday life, both in developing and emerging countries and in the French overseas territories. In keeping with the United Nations Sustainable Development Goals, AFD works in many sectors — energy, healthcare, biodiversity, water, digital technology, professional training, among others — to assist with transitions towards a safer, more equitable, and more sustainable world: a world in common. Through its network of 85 field offices, AFD currently finances, monitors, and assists more than 4,000 development projects in 115 countries. In 2018, AFD earmarked EUR 11.4bn to finance projects in developing countries and for overseas France.

http://www.afd.fr

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