



# Change to Rules Governing Contributions to the Pakistan Earthquake Fund, and Increase in Financing and Change in Implementation Arrangements of the Earthquake Emergency Assistance Project

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Project Number: 39631  
Loan Number: 2213  
November 2006

## Pakistan: Pakistan Earthquake Fund and Earthquake Emergency Assistance Project

## CURRENCY EQUIVALENTS

(as of 31 October 2006)

Currency Unit	–	Pakistan rupee/rupees (PRe/PRs)
PRe1.00	=	\$0.01667
\$1.00	=	PRs60

## ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
AJK	–	Azad Jammu and Kashmir
DRU	–	District Reconstruction Unit
EA	–	executing agency
EC	–	European Commission
EU	–	European Union
ERRA	–	Earthquake Rehabilitation and Reconstruction Authority
IA	–	implementing agency
NGO	–	nongovernment organization
OCO	–	Office of Cofinancing
OECD	–	Organization for Economic Cooperation and Development
NWFP	–	North West Frontier Province
PEF	–	Pakistan Earthquake Fund
PERA	–	Provincial Earthquake Reconstruction Authority
SERA	–	State Earthquake Reconstruction Authority
TA	–	technical assistance

## NOTES

- (i) In this report, "\$" refers to US dollars, unless otherwise indicated.
- (ii) The Earthquake Emergency Assistance Project is being partially carried out in Azad Jammu and Kashmir, an area over which Pakistan and India have been in dispute since 1947. By financing the Project, the Asian Development Bank does not intend to make any judgment as to the legal or other status of any disputed territories or to prejudice the final determination of the parties' claims.

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## I. INTRODUCTION

1. On 14 November 2005, the Asian Development Bank (ADB) approved the establishment of the Pakistan Earthquake Fund (PEF), including an initial grant contribution from ADB of \$80 million, to support the reconstruction efforts of the Government of Pakistan after the 8 October 2005 earthquake. On 13 December 2005, the ADB Board of Directors approved the Earthquake Emergency Assistance Project (EEAP) amounting to \$300 million, consisting of an \$80 million grant from the PEF and a loan of \$220 million from the Asian Development Fund (ADF).

2. In December 2005 and October 2006, the Government of Finland signed two instruments of contribution for €4.5 million and €5.5 million for the PEF, specifically to provide support for capacity building, improved governance, and overall strengthening of existing and new implementation (IA) and executing agencies (EA) of the EEAP working on social sectors. These grants include a provision for consultancy services, incremental staff, and operational support for sector institutions delivering services in the affected areas. In May 2006, the Government of Australia signed an instrument of contribution for A\$20.0 million to the PEF to support reconstruction in the primary education and health sector components of the EEAP in Azad Jammu and Kashmir (AJK). Additional donors have also expressed interest in contributing to the PEF and negotiations with these donors are in advanced stages. These contributions to the PEF can become effective only if the Board approves an extension of the deadlines to allow (i) commitments and contributions from contributors to be received; (ii) requests from the Government for funds to be allocated under the PEF to be received by ADB; (iii) the legal documents to be executed and become effective; (iv) disbursements to commence; and (v) an increase in grant financing for the EEAP, equal to the amount already committed to the PEF.

3. Before the EEAP was approved by the Board on 13 December 2005, the European Commission (EC) committed to provide €30 million to cofinance the social sectors component of the EEAP. To facilitate the EC financing, the Board approved procurement of eligible goods and services from member countries of the EU, including ADB nonmember countries. Effective 27 December 2005, the EC expanded its procurement eligibility terms to include not only legal persons, firms and goods of EU members states (as approved by the Board) but also legal persons, firms and goods established in EC-recognized official candidate countries, member states of the European Economic Area, and developing countries as specified in the OECD Development Assistance Committee<sup>1</sup> rules.

4. This proposal requests the Board's approval for: (i) an extension of the deadlines provided in paras. 18 and 24 of the paper establishing the Pakistan Earthquake Fund<sup>2</sup> approved on 7 November 2005 to allow commitments and contributions from contributors to be received, requests from the Government for funds to be allocated under the PEF to be received by ADB and legal documents to be executed and become effective, and disbursements to commence; (ii) an increase in grant financing for the EEAP, equal to the amount committed to the PEF by the governments of Australia and Finland; and (iii) an expansion of the procurement eligibility terms for the EEAP to include procurement of eligible goods and services from countries eligible for procurement under the new procurement rules of the EC as ADB's cofinancing partner.

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<sup>1</sup> Regulation (EC) No 2110/2005 of the European Parliament and Council, 14 December 2005.

<sup>2</sup> ADB. 2005. *Pakistan Earthquake Fund*. Manila.

## II. BACKGROUND

### A. Status of PEF

5. The \$80 million committed to the PEF has all been allocated and \$65.3 million has been disbursed. The majority of the PEF funds were used to finance quick-disbursing assistance for the unexpected import expenditures required for rehabilitation and reconstruction immediately after the earthquake. The remainder of the funds have been allocated for capacity development and staff resources to sector institutions but they are insufficient to enable these institutions to deliver the earthquake rehabilitation and reconstruction targets effectively. These capacity gaps were underestimated at appraisal and widened when many donors decided not to fund or use the new earthquake institutions to deliver their projects. There is now an urgent need to mobilize additional resources to strengthen these institutions and to support activities in the social sector, in the absence of which affected people are reluctant to go back to their villages. Major efforts have been made by the ADB Office of Cofinancing (OCO) to mobilize additional funds and donors have shown significant interest in contributing to the PEF. However the process of negotiating instruments of contribution with donors for the PEF funds and processing requests for use of the PEF funds from the Government has been time-consuming and laborious. After negotiations with existing and new institutions supporting the reconstruction effort, the first request for use of contributions by the governments of Australia and Finland to the PEF was received on 10 November 2006. However the deadline for making this request effective expired on 14 November 2006, before the legal documents could be executed. No contributions to the PEF can be effective until the Board allows an extension of the deadlines for (i) receiving additional commitments and contributions to the PEF from donors, (ii) receiving requests from the Government for funds to be allocated under the PEF by ADB, (iii) having the legal documents executed and declared effective, and (iv) commencing disbursements.

### B. Status of EEAP

6. The financing agreement for EEAP was declared effective on 14 February 2006 and the loan closing date is 30 June 2009. The EEAP is expected to reverse the devastating impact of the earthquake, revive economic activity, and enable people to resume their livelihoods and return to normal life. This will be achieved by rehabilitating and reconstructing damaged and destroyed infrastructure in the transport, power, health, and education sectors, and by providing implementation assistance for improved financial management and governance. In accordance with ADB's *Disaster and Emergency Assistance Policy*,<sup>3</sup> a portion of the Project (\$100 million) was used for quick-disbursing assistance, partly to finance the unusually high and unexpected import expenditures required for rehabilitation and reconstruction. This portion has already been disbursed. The Executing Agency (EA) of the EEAP is the newly created Earthquake Reconstruction and Rehabilitation Agency (ERRA). The EEAP sites cover North West Frontier Province (NWFP) and AJK.

7. The overall performance of the EEAP is satisfactory. As of 30 September 2006, the elapsed period of the EEAP was 22%, with physical progress at 10%, total contract awards at 18%, and disbursements at 16%. The ERRA is now fairly well established. Recruitment of staff for ERRA, the state reconstruction agency (SERA), the provincial reconstruction agency (PERA), and the district reconstruction units (DRUs) is in process, with more than 80% of staff appointed. Strategies for priority sectors, including housing, livelihoods, health, education, sponsorship schemes, transport, power, and governance have been approved. Accounting

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<sup>3</sup> ADB. 2004. *Disaster and Emergency Assistance Policy*. Manila.

procedures and financial management guidelines have also been approved. A basic framework for a harmonized monitoring and evaluation system for ERRA has been developed and is currently being implemented. Subproject appraisals following the subproject identification and selection criteria for the power sector have been completed and many contracts for subprojects have been awarded. There have been delays in the ongoing appraisal of transport sector subprojects due to safeguard requirements. However, design of the appraised subprojects in the health and education sectors is at an advanced stage. Because of the limited availability of information on the new institutions and the overall size of the reconstruction effort at the appraisal stage, the capacity building needs and reconstruction effort required in the social sector was underestimated for the EEAP and there is an urgent need for additional funding.

8. The use of the PEF funds for the EEAP requires the Board's approval for an increase in grant financing for the EEAP, equal to the amount already committed to the PEF, and subsequently a management approval for a major change in the scope of the EEAP.

### **III. THE PROPOSED CHANGES**

#### **A. Extension in PEF**

9. According to para. 18 of the paper establishing the PEF (footnote 2), the commitments from contributors may be received during the first 12 months of the PEF, and contributions related to such commitments may be received within the first 15 months of the PEF. Instruments of contribution for the governments of Finland (€10.0 million, specifically to support implementation assistance in earthquake-affected areas) and Australia (A\$20.0 million for the social sector component of the EEAP in AJK) were signed within this period. Other donors have expressed interest in contributing additional funding to the PEF and OCO is actively negotiating with these donors. However, the deadline for receiving further commitments expired on 14 November 2006. According to para. 24 of the paper establishing the PEF, requests from the Government of Pakistan for funds to be allocated under the PEF have to be received by ADB within 12 months of the date on which the Board approved the PEF. Legal documents have to be executed by ADB and recipients by the same date. The legal documents should become effective and disbursements commence within 15 months from the date on which Board approved the PEF. Due to the limited capacity of the newly created institutions, specifically SERA and PERA, and the overwhelming focus of the newly created ERRA on the housing sector, coordination and identification of activities to be financed in the social sector through the PEF has been slow. An effort has been made by the Government of Pakistan and ADB to mobilize the PEF funds through intensive interaction with implementing and executing agencies involved in EEAP. The request for use of the PEF contributions already committed by the Government of Australia and the Government of Finland was received on 10 November 2006 by ADB from the Government of Pakistan. However, the legal documents could not be executed, since the deadline for making this request effective expired on 14 November 2006. Approval of the Board is required to extend the deadlines provided in paras. 18 and 24 of the paper establishing the PEF, to allow time to negotiate donor agreements and to process the Government requests for funding.

#### **B. Increase in Financing for EEAP**

10. The use of the PEF funds requires the Board's approval for an increase in grant financing for the EEAP, equal to the amount committed to the PEF by the Government of Australia and the Government of Finland. The request for an increase in financing in the grant components of the EEAP from the current \$80 million to \$107.5 million (equivalent), is in line

with para. 11 of the paper establishing the PEF, which allows the PEF resources to be combined with other ADB resources to provide favorable financing terms for Pakistan. The additional funding does not fall under the scope of the supplementary financing policy or the *Operations Manual* Section H5/BP on supplementary financing. The revised financing plan is provided in Table 1.

**Table 1: Revised Financing Plan**  
(\$ million)

Source	Appraisal/Inception		Revised	
	Cost	%	Cost	%
A. Asian Development Bank Grant	80.0	21	80.0	20
Asian Development Bank ADF Loan	220.0	59	220.0	55
B. Finland Grant	0.0		12.5	3
C. Australia Grant	0.0		15.0	4
D. Government	74.2	20	74.2	18
<b>Total</b>	<b>374.2</b>	<b>100</b>	<b>401.7</b>	<b>100</b>

ADF = Asian Development Fund.

Source: Asian Development Bank estimates.

11. The additional funding will result in a major change of scope of the EEAP, based on the preferences expressed by the governments of Australia and Finland and confirmed by the Government of Pakistan. The design of the components on education, health and implementation assistance, the cost and financing, and the implementation arrangements of the EEAP will be revised. Management's approval will be sought to approve this major change in scope that will be recommended for the following reasons. The earthquake-affected population is generally reluctant to resettle in the affected areas because of the lack of schooling and health services. The reconstruction effort is currently focused mainly on housing. However, without social services, the housing efforts have been curtailed. Social sector efforts are constrained by the capacity of the institutions delivering social services and the availability of adequate funds for reconstructing the damaged infrastructure. An increase in financing for the social sector components of the EEAP will provide for the reconstruction and the purchase of equipment for 28 additional middle schools, and 29 basic health units (BHUs) and one rural health center in AJK. Additional funding of \$15.0 million equivalent will be financed by the Government of Australia's contribution of A\$20 million to the PEF. Additional financing for the implementation assistance would provide more staff and consultancy services, mainly in health and education, to newly created and existing institutions that are implementing social sector components. The focus would be on strengthening the planning, management and overall monitoring capacities of these institutions. The governance and legal assistance subcomponent would provide legal assistance, registration and vocational training to marginalized and vulnerable people. The additional funding of \$12.5 million equivalent for implementation assistance would be financed by the Government of Finland's contribution of €10 million to the PEF. The original and revised cost and financing plan of the EEAP, including revisions for the health, education, and implementation assistance components, is provided in Table 2.

**Table 2: Original and Revised Cost and Financing of EEAP**

No.	Category	Funding (\$ million)								Estimated cost (\$ million)			
		ADB		Pakistan <sup>a</sup>		Australia <sup>b</sup>		Finland <sup>c</sup>		Revised	Appraisal	Inception	
		Loan - 2213	Grant - 0029	Grant - 0029	Grant - 0029	Grant - 0029	Grant - 0029						
		%	Cost	%	Cost	%	Cost	%	Cost				
1.	<b>Quick Disbursement</b>	0.00	89	65.00	11	8.13	0.00	0.00	0.00	0.00	<b>73.13</b>	<b>73.00</b>	<b>73.13</b>
		100	35.00	0.00		0.00	0.00	0.00	0.00	0.00	<b>35.00</b>	<b>35.00</b>	<b>35.00</b>
2.	<b>Project Components</b>												
	<b>a. Education</b>	61	24.35	0.00	20	8.12	19	7.35	0.00	0.00	<b>39.82</b>	<b>23.34</b>	<b>32.46</b>
	<b>b. Health</b>	57	17.11	0.00	19	5.70	24	7.35	0.00	0.00	<b>30.16</b>	<b>30.00</b>	<b>22.81</b>
	<b>c. Transport</b>	75	114.11	0.00	25	38.04		0.00	0.00	0.00	<b>152.15</b>	<b>140.13</b>	<b>152.16</b>
	<b>d. Power</b>	75	29.43	0.00	25	9.81		0.00	0.00	0.00	<b>39.24</b>	<b>53.33</b>	<b>39.24</b>
	<b>e. Implementation Assistance</b>			55	15.00				45	12.25	<b>27.25</b>	<b>15.00</b>	<b>15.00</b>
	i. Legal Assistance and Governance	0.00	22	0.80		0.00		0.00	78	2.80	<b>3.60</b>	<b>2.50</b>	<b>0.80</b>
	ii. Incremental Administrative Support	0.00	64	5.65		0.00		0.00	36	3.17	<b>8.82</b>	<b>5.00</b>	<b>4.12</b>
	iii. Consulting Services	0.00	58	8.55		0.00		0.00	42	6.28	<b>14.83</b>	<b>7.50</b>	<b>10.08</b>
3.	<b>Service Charge</b>	0.00		0.00		0.00	55	0.30	45	0.25	<b>0.55</b>	<b>0.00</b>	<b>0.00</b>
4.	<b>Interest During Implementation</b>	0.00		0.00	100	4.40		0.00		0.00	<b>4.40</b>	<b>4.40</b>	<b>4.40</b>
	<b>Grand Total</b>		<b>220.00</b>	<b>80.00</b>		<b>74.20</b>		<b>15.00</b>		<b>12.50</b>	<b>401.70</b>	<b>374.20</b>	<b>374.20</b>

ADB = Asian Development Bank, EEAP = Earthquake Emergency Assistance Project.

<sup>a</sup> Inclusive of all duties and taxes.

<sup>b</sup> A\$1.00=US\$0.75.

<sup>c</sup> €1.00=US\$1.25.

### C. Change in Procurement Rules to use EC Grant for EEAP

12. The overall scope of the activities in the education sector cannot be fully delivered without the EC grant of €30 million which is expected to finance complete reconstruction of an addition 150 middle schools under the education sector component of the EEAP. The EC commitment of €30 million for the EEAP education component can be realized only if the cofinancing agreement can be signed by 10 December 2006, otherwise the EC contribution would lapse. Because of the importance of the EC as a cofinancing partner and the importance of the EEAP for the Government, the Board has already approved extended procurement eligibility terms to include the EC's original country list for procurement which includes EU member countries (paras. 76 and 143 (v) of the report and recommendation of the President for the EEAP). The remaining issue is to include the legal persons, firms and goods established in EC-recognized official candidate countries, member states of the European Economic Area, and developing countries as specified in the OECD Development Assistance Committee rules (footnote 1). The further expansion of the EC procurement eligibility is subject to Article 14(ix) of the Agreement Establishing the Asian Development Bank, which states that the Board may, by a vote of the directors representing not less than two thirds of the total voting power of the members, approve procurement from non-ADB member countries in appropriate circumstances.

#### IV. THE PRESIDENT'S RECOMMENDATIONS

13. I recommend that the Board approve the following:
- (i) an extension for a period of 12 months of the deadline to receive commitments from contributors and an extension for a period of 15 months of the deadline to receive the related contributions from contributors, resulting in an amendment to paragraph 18 of the paper establishing the Pakistan Earthquake Fund (PEF), approved on 14 November 2005, to reflect the requirement that commitments from other contributors must be received within 24 months of the date on which the Board approved the PEF, and that the contributions related to such commitments must be received within 30 months of the date on which the Board approved the PEF;
  - (ii) an extension for a period of 12 months of the deadline for requests from Pakistan for funds to be allocated under the PEF to be received and legal documents between the recipients and the Asian Development Bank (ADB) to be executed and an extension for a period of 12 months of the deadline for the financing legal documents to become effective and the disbursement to commence, resulting in the amendment to paragraph 24 of the paper establishing the Pakistan Earthquake Fund approved on 14 November 2005 to reflect the requirement that requests from Pakistan for funds to be allocated under the PEF must be received by ADB, and legal documents must be executed by ADB and recipients, within 24 months of the date on which the Board approved the PEF, and the legal documents must become effective and disbursements must have commenced within 27 months of the date on which the Board approved the PEF; and
  - (iii) an increase of an amount equivalent to \$27,500,000 in the grant financing for the Earthquake Emergency Assistance Project from \$80,000,000 to \$107,500,000 arising from the contributions made by the Government of Finland (€10.0 million) and the Government of Australia (A\$20.0 million) to the Pakistan Earthquake Fund.
14. I also recommend that the Board approve, by the requisite affirmative vote of the Directors representing not less than two thirds of the total voting power of the members of the Board, pursuant to Article 14 (ix) of the Articles of Agreement, the proposal set out in paragraph 12 of this report, that the procurement eligibility be expanded to include procurement of eligible good and services from countries eligible for procurement under EC regulations.