

**Pakistan: Fifth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver and Modification of Performance Criteria—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Pakistan**

In the context of the fifth review under the three-year arrangement under the Poverty Reduction and Growth Facility and request for waiver and modification of performance criteria, the following documents have been released and are included in this package:

- the staff report for the fifth review under the three-year arrangement under the Poverty Reduction and Growth Facility and request for waiver and modification of performance criteria, prepared by a staff team of the IMF, following discussions that ended on **April 15, 2003**, with the officials of Pakistan on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on May 30, 2003.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of **June 13, 2003** updating information on recent developments.
- a Press Release summarizing the **views of the Executive Board as expressed during its June 18, 2003** discussion of the staff report that completed the review.
- a statement by the Executive Director for Pakistan.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Pakistan\*  
Memorandum of Economic and Financial Policies by the authorities of Pakistan\*  
Technical Memorandum of Understanding\*

\*May also be included in Staff Report

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PAKISTAN

**Fifth Review Under the Three-Year Arrangement  
Under the Poverty Reduction and Growth Facility  
and Request for Waiver and Modification of Performance Criteria**

Prepared by the Middle Eastern and the  
Policy Development and Review Departments

(In consultation with other departments)

Approved by George T. Abed and Michael T. Hadjimichael

May 30, 2003

- Discussions for the fifth review under the Poverty Reduction Growth Facility (PRGF) arrangement were held in Islamabad from March 7–18, 2003 and in Washington at the time of the 2003 Spring Meetings. The staff team consisted of Messrs. Enders (head), Joly, and Martin (all MED); Mr. Schimmelpfennig (FAD); Mr. Sobolev (PDR); and Ms. Agcaoili (staff assistant, MED). The mission was assisted by Mr. Ghesquiere (Senior Resident Representative).
- The mission held meetings with the Ministers in charge of Finance, Trade, and Devolution, the Governor of the State Bank of Pakistan (SBP), the Secretary Finance, and other senior officials dealing with economic and financial matters.
- The Managing Director and Mr. Aninat met the Finance Minister and the SBP Governor during the 2003 Spring Meetings.
- In the last Executive Board discussion (February 28, 2003), Executive Directors commended the authorities for further consolidating macroeconomic stability in a difficult economic and political environment. They welcomed the increase in social expenditures and progress made toward a full Poverty Reduction Strategy Paper (PRSP). However, Directors expressed disappointment over the limited progress in implementing energy sector reforms and the resulting poor financial performance of the Water and Power Development Authority (WAPDA). Looking ahead, Directors urged the authorities to build a strong consensus for continued fiscal discipline and for the vigorous implementation of the still unfinished structural reform agenda, particularly in the areas of tax reform, energy sector reform, poverty reduction, and governance. Directors encouraged the SBP to reduce its intervention in the foreign exchange market, so as to gain better control over monetary policy and contain sterilization costs.
- The principal authors of this report are Klaus Enders, Hervé Joly, and Edouard Martin, with inputs from Milan Zavadjil, Axel Schimmelpfennig, Yuri Sobolev, and Alina Milasiute.

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Technical Memorandum of Understanding .....47

### List of Acronyms

ABL	Allied Bank Limited
AsDB	Asian Development Bank
CBR	Central Board of Revenue
CIRR	Commercial Interest Reference Rates
CWIQ	Core Welfare Indicators Questionnaire
DFID	U.K.'s Department for International Development
FATA	Federally Administered Tribal Areas
FIBR	Floating interbank market exchange rate
FIP	Financial Improvement Plan
GDDS	General Data Dissemination System
GPF	General Provident Fund
GST	General Sales Tax
HBL	Habib Bank Limited
IDBP	Industrial Development Bank of Pakistan
I-PRSP	Interim Poverty Reduction Strategy Paper
IPPs	Independent Power Producers
JSA	Joint Staff Assessment
KESC	Karachi Electric Supply Corporation
LTU	Large Taxpayers Unit
MEFP	Memorandum of Economic and Financial Policies
NAM	New Accounting Model
NDA	National domestic asset
NEPRA	National Electric Power Regulatory Authority
NFA	National foreign asset
NHA	National Highway Authority
NSS	National Saving Schemes
NWFP	North West Frontier Province
OGRA	Oil and Gas Regulatory Authority
PIA	Pakistan International Airlines
PIB	Pakistan Investment Bonds
PIFRA	Pakistan Improvement of Financial Reporting and Accounting
PR	Pakistan Railways
PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Paper
PSDP	Public Sector Development Program
PSE	Public sector enterprises
PSM	Pakistan Steel Mills
ROSC	Report on the Observance of Standards and Codes
SDDS	Special Data Dissemination Standard
SBP	State Bank of Pakistan
TMU	Technical Memorandum of Understanding
WAPDA	Water and Power Development Authority

## Executive Summary

**Pakistan's recent economic performance remains strong.** Real growth of 4.5 percent in 2002/03 remains well within reach, while inflation further slowed. The current account and overall balance of payments continued to overperform, while the Pakistani rupee slightly appreciated against the U.S. dollar. Driven by net foreign asset (NFA) accumulation and a surge in credit to the private sector, broad money growth remained strong. Tax revenue collected by the Central Board of Revenue (CBR) during July–March was in line with program targets. I-PRSP expenditures increased significantly, coming close to the indicative target.

**While most reforms were broadly on track, there were setbacks in energy sector reforms, and to a lesser extent in privatization.** Progress was made in preparing the full PRSP and monitoring intermediate social outcomes. A strategy to reduce the scope for abuse of the “Benami” practice was prepared. The performance of the large public sector enterprises was broadly in line with their Financial Improvement Plans (FIPs), except for the two power utilities. However, privatization barely advanced, reflecting lack of investor interest. The insufficient pass-through of the recent oil price spike to electricity and gas tariffs will add to the financial imbalances of the power utilities.

**All quantitative performance criteria for end-December 2002 were met.** However, the authorities request a waiver for the nonobservance of the structural performance criterion regarding the preparation by mid-April 2003 of a revised FIP for the main power utility (WAPDA), as the FIP provided by the authorities did not include contingency measures. These contingencies were developed subsequently in consultation with Fund and World Bank staff.

**The budget for fiscal year 2003/04 (starting July) will aim at a further reduction of the fiscal deficit while raising social and poverty-related expenditures.** This will be achieved mostly through higher CBR revenue, reflecting some broadening of the tax base and tax administration improvement, and through a further rationalization of nonpriority expenditure. To improve transparency, the fiscal cost of supporting public enterprises will be explicitly budgeted. The deficit target may be adjusted upward for one-time expenditures incurred for the restructuring of two insolvent banks, and for higher grant-financed social sector spending.

**The authorities plan to deepen structural reforms, notably through:** further streamlining of the tax system, including the further elimination of income tax exemptions; continued implementation of the CBR's administrative reform program; preparing a multi-year action plan for reforming the power sector; and preparing specific legislation addressing the “Benami” practice.

**The main risks to the program arise:** from the need to build consensus within the coalition government and in parliament, where normal business has not resumed due to the opposition's rejection of constitutional amendments made under the previous military government, and in a context where strong macroeconomic results have increased populist pressures; and from regional tensions that have not fully abated.

## I. INTRODUCTION AND BACKGROUND

1. On December 6, 2001, the Executive Board approved Pakistan's request for a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) with access to 100 percent of quota (SDR 1.03 billion) and endorsed the country's Interim Poverty Reduction Strategy Paper (I-PRSP).<sup>1</sup> The Executive Board completed the fourth review of the program on February 28, 2003 (IMF Country Report No. 03/54), thus enabling Pakistan to draw SDR 86 million. As of April 30, 2003, total Fund credit and loans outstanding to Pakistan amounted to SDR 1.45 billion (140.1 percent of quota).

2. In the attached letter dated May 29, 2003 and the Memorandum of Economic and Financial Policies (MEFP) (Attachment I), the government of Pakistan requests completion of the fifth review under the PRGF arrangement, a waiver for the nonobservance of the performance criterion regarding the preparation of a revised FIP for the Water and Power Development Authority (WAPDA), and modification of a performance criterion regarding privatization of Habib Bank Limited (HBL). A sixth disbursement (SDR 86 million) is conditional on the completion of this review.

## II. PERFORMANCE UNDER THE PROGRAM FROM OCTOBER 2002–APRIL 2003<sup>2</sup>

3. **The formation of the new parliament was completed in late February 2003** with the Senate elections, which paved the way for completion of the cabinet. However, the opposition's rejection of constitutional amendments made under the previous military government has so far prevented the resumption of normal parliamentary business. The situation at the Indian and Afghan borders continues to involve deployment of significant security forces, though tensions with India appear to be subsiding.

4. **All quantitative performance criteria for end-December 2002 were met.** Recent data on agriculture and manufacturing are consistent with a 4.5 percent real GDP growth for FY 2002/03 (July–June). Inflation further slowed to 2.2 percent year-on-year in April. Due to high remittances, strong exports, and sizeable external support, the current account and overall balance of payments overperformed relative to program targets. Since January, the SBP has significantly reduced its purchases on the foreign exchange market, thus slowing the accumulation of gross official reserves, which reached \$9.1 billion (equivalent to about 7.4 months of next year imports) at end-April. The Pakistani rupee has appreciated slightly against the U.S. dollar in recent months.

5. **The fiscal deficit target for end-December 2002 was met with a comfortable margin.** Total revenue was higher than targeted, helped by an overperformance on CBR receipts. Nontax revenue shortfalls, mostly on account of WAPDA and lower-than-expected

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<sup>1</sup> Pakistan's relations with the Fund and the World Bank are described in Appendices I and II, respectively.

<sup>2</sup> Refer to Tables 1–11 and Figures 1–6.

transfer of SBP profit (reflecting, for the latter, sterilization costs), were more than offset by unexpected large payments from some public enterprises, and from the coalition against terrorism for services rendered. Expenditure analysis is hampered by data reconciliation issues, but indicates underspending relative to program targets, most likely on account of lower interest payments. According to preliminary unreconciled data, social (I-PRSP) expenditures in the first half of 2002/03 grew by 45 percent year-on-year, close to the indicative target.

6. **Broad money growth remained strong** in the second quarter (+17.6 percent year-on-year), driven by NFA accumulation and a recovery in growth of credit to the private sector. Similar trends continued through February 2003. Due to lesser sterilization, reserve money growth accelerated in early 2003 to about 15 percent. Interest rates on 6-month treasury bills dropped to 1.6 percent in April 2003 and yields on 10-year bonds to 4.0 percent in March 2003.

7. **The authorities made little progress in energy sector reforms.** A positive development was the steadfast application of the fortnightly automatic adjustment of petroleum product prices. However, setbacks were recorded in the power sector:

- The financial performance of both WAPDA and Karachi Electric Supply Corporation (KESC) through December 2002 was worse than targeted in their FIPs (MEFP, para. 6).
- In May, the government implemented only part of the automatic electricity tariff adjustments determined by the National Electric Power Regulatory Authority (NEPRA) to offset the surge in fuel costs in early 2003 in the run-up to the war in Iraq. As a result, the deficit of both utilities for the current year will be higher than planned.
- A performance criterion was missed, as the revised FIP for WAPDA provided by the authorities on April 15 (MEFP, para. 18 and 19) did not include contingency measures to be implemented if needed to achieve the financial targets; such contingencies were, however, developed subsequently in consultation with Fund and World Bank staff. The revised FIP also indicates delays in two key steps in the unbundling of WAPDA, planned for end-April and end-June 2003. Both are structural benchmarks under the program (Table 2(a)).
- In line with the gas pricing framework, which has been published by the Oil and Gas Regulatory Authority (OGRA), wellhead prices were adjusted on January 1, 2003, leading OGRA to increase the prescribed prices for the two gas distribution companies. However, the government has so far delayed the pass-through of this increase to consumers.



8. **Other structural reforms were broadly on track (MEFP, Table 2(a)).** In addition, the performances of the three other large public enterprises<sup>3</sup> during the first half of 2002/03 were broadly in line with their respective FIP targets. Work on the Core Welfare Indicators Questionnaire (CWIQ) has been initiated, and further progress has been made toward the preparation of the full PRSP. The draft fiscal responsibility law was sent to the cabinet for approval, and a strategy to reduce the scope for abuse of the Benami practice was prepared in March 2003 (Box 1). **Privatization however made little progress.** Considering that a negotiated sale of HBL to the only qualified investor could be viewed as insufficiently transparent, the authorities have re-invited expressions of interest, making the actual sale by end-June 2003—as planned under the program—unlikely. The authorities now expect privatization to take place by end-2003, and therefore request modification of the related performance criterion.

### III. REPORT ON THE DISCUSSIONS

9. **The discussions focused on the fiscal framework for 2003/04 and the power sector reforms.** The I-PRSP called for a further reduction of the deficit next fiscal year to reduce high public debt, while creating room for increasing human development expenditures to address Pakistan's large social gap. The mission therefore discussed with the authorities the scope for further enhancing revenues by broadening the tax base and for reducing subsidies to public enterprises. Since power utilities are getting most of these subsidies, discussions centered on how to reduce WAPDA and KESC's drain on the budget. Program conditionality in the power sector has been strengthened in recognition of its critical importance for the attainment of the program targets. The discussions highlighted that consensus building within parliament and the coalition government on carrying on with the reform agenda will be a challenging task, especially in a context where strong macroeconomic results fuel populist pressures.

#### A. Macroeconomic Framework for the Remainder of 2002/03 and for 2003/04

10. **The economic growth projections and inflation targets for the current and next fiscal years were kept unchanged,** with real GDP growth accelerating to 5 percent and consumer price inflation to be kept below 4 percent. **The external position is expected to further improve in 2003/04.** The current account excluding official transfers, after a large surplus this year, is projected to return close to balance. This mainly reflects the assumptions that remittances would gradually taper off, and of lower reimbursements from the coalition against terrorism. The capital account, net of exceptional financing, would record a lower surplus, mostly because of the expected repayment of foreign central bank deposits with the SBP. Gross official reserves would further increase—though much less than in 2002/03—to \$10.6 billion in June 2004 (about eight months of imports).

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<sup>3</sup> Pakistan International Airlines (PIA), Pakistan Railways (PR), and Pakistan Steel Mills (PSM).

### **Box 1. Strategy to Reduce Abuse of “Benami” Practice**

1. **The expression “Benami” refers to the practice of holding property/assets in the name of one person for the benefit of another.** Historically, the practice was widespread in parts of South Asia, reflecting deep-rooted cultural traditions. However, Benami is often aimed at concealing ownership of assets acquired through illegal means, defrauding creditors, and/or evading payment of government fees, charges, or taxes. Pakistani courts have recognized this concept as a custom and enforced the intention of the parties. Nonetheless, under the existing law, if the real owner is a defaulter or a creditor, the government can have recourse against the real owner’s property held Benami.
2. **In order to curb abuse of the Benami practice, a task force<sup>1/</sup>** will organize consultations with the provinces (which may legislate in this area) to secure their concurrence for reform. The provinces may consult relevant stakeholders such as Bar Associations, Chambers of Commerce/Industry, Trade Associations, Agricultural Associations, real estate sector, etc. The task force will submit a report to the cabinet not later than end-October 2003, with recommendations to reform legislation. Following approval of the cabinet, in accordance with the constitutional requirements, the provincial governments’ concurrence will be sought before a draft law is submitted to parliament (by end-2003).
3. **Ideas for possible legislation** emanating from a work force headed by MoF and SBP and partly based on other countries’ experience envisage to deal separately with the two different aspects of Benami:
  - (a) property held in another person’s name (**Benami property** in accordance with common usage); and
  - (b) property held in the name of a fictitious person (**ownerless property**). These ideas include:
    - With respect to both Benami and ownerless property, the law may allow the existing holders a period of one year from the date of its promulgation to transfer the said property into their own names.
    - After expiration of the immunity period, all property should vest in the person in whose name the property is held (the Benamidar). The “real” owner of the Benami property will no longer have the legal right to claim the property from the Benamidar.
    - Regarding **Benami property**, the loss of legal right to the property would be the only deterrent the proposed law shall place on a holder of Benami property. However, regarding **ownerless property**, penal sanctions (imprisonment and/or fines) may be imposed in addition to existing laws.
    - The property that is declared ownerless will vest in the government. The High Court may be given the jurisdiction to determine whether a property is ownerless.

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<sup>1/</sup> The task force includes representatives of the Ministry of Finance (MoF), provincial governments, CBR, SBP, Securities and Exchange Commission of Pakistan (SECP), and National Accountability Bureau (NAB).

11. **The planned monetary/exchange rate policy mix (MEFP, para. 8) should help curb money supply growth and avoid the emergence of inflationary pressures.** Given some evidence of asset price inflation, negative real treasury bill rates, and the recent strong money growth, the authorities and staff concurred on the heightened need to carefully monitor inflation developments and to progressively bring the growth rates of monetary aggregates in line with nominal GDP growth. The expected slowdown in remittances/private

capital inflows should help in this regard. The mission noted that although the SBP considerably reduced its intervention on the foreign exchange market in March/April 2003, the Pakistani rupee appreciated only slightly against the U.S. dollar, suggesting that the pace of foreign exchange inflows might be easing already.

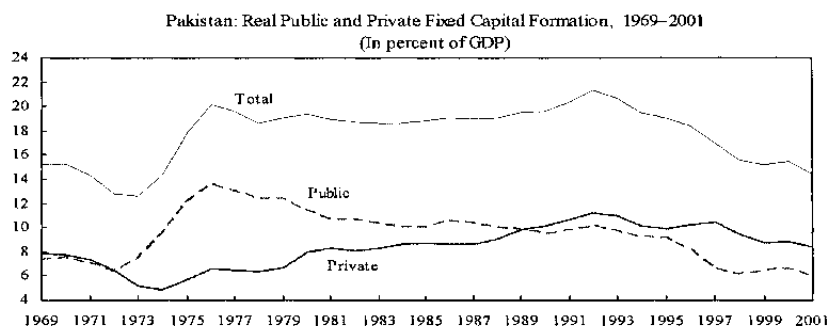
**12. The authorities plan to prepay some expensive foreign debt, and to involve outside expertise in managing official reserves.** The mission strongly encouraged the authorities to quickly implement these plans, stressing that early repayments, to be financed by issuing treasury bills and bonds, would improve the debt profile and allow the SBP to build up its dwindling stock of treasury bills, thereby enhancing its profitability and facilitating open market operations. The authorities recognized that sterilization costs of past foreign exchange inflows would still affect next year's SBP profit, and stood ready to recapitalize the central bank if needed.

**13. Meeting the end-June 2003 fiscal deficit and CBR collection targets will be a close call, and requires firm expenditure control and continued strong tax performance.** Reimbursement from the coalition against terrorism should cover much of the higher-than-projected defense expenditures on account of the fight against terrorism. Overall, overperformance on some nontax revenue items has provided an offset to the additional financing needs of some public enterprises (mostly WAPDA and KESC), and higher-than-expected subsidies. The latter reflect in the main that the General Sales Tax (GST) subsidy on electricity consumption has not been reduced as envisaged in the budget, along with the higher subsidies for wheat exports.

**14. The 2003/04 fiscal framework's goals are to further reduce the public debt-to-GDP ratio while increasing social expenditures.** The draft federal budget to be submitted to parliament in early June will aim at a consolidated deficit of 4.0 percent of GDP (excluding possible bank restructuring outlays, see below). While higher than the initial I-PRSP target (3.5 percent of GDP), the authorities believe that, given the setbacks in power sector reforms and sterilization costs, a lower deficit would have required lower social or development expenditure. They felt that many infrastructure needs already were not being met, and that low public investment partly explained low levels of private investment (see Box 2 on some quantitative evidence in this respect). CBR revenue is projected to increase by about 11 percent, reflecting a buoyant economy, some broadening of the tax base (below), and further improvement in administrative efficiency. While staff had argued for a stronger increase in the CBR revenue ratio, the authorities preferred to be cautious about assuming rapid gains from administrative reforms, pointed to possible teething problems with the introduction of universal self-assessment, and indicated that a substantial expansion of the GST to services was possible only for 2004/05 as it would require considerable preparatory work and consent of the provinces. On the expenditure side, social spending would increase from 4.0 percent to 4.2 percent of GDP. Budgetary support to public enterprises is expected to decline, reflecting the planned improvement in the financial situation of the two power utilities (see below). Specifically, budgetary support for KESC/WAPDA (including debt

## Box 2. Private Investment Determinants in Pakistan <sup>1/</sup>

The share of private investment in Pakistan has been growing steadily during 1974–92 from 4.8 percent to 11.2 percent of GDP, but both public and private investment have been declining since then, with total investment down to 14.4 percent of GDP in 2001.



The following econometric model makes an attempt to assess and measure the factors determining private investment in Pakistan from 1973–2001.<sup>2/</sup> Variables for which the initial model produced implausible or insignificant coefficient estimates (such as foreign exchange levels, export price shocks, CPI variance, workers remittances) were excluded to determine the general equation in the Table. The specific equation was estimated by performing F-tests on redundant variables.

Pakistan: Private Investment Function 1/  
(OLS dependent variable: gross fixed private investment/GDP, constant prices, in logs)

	Constant	Dependent Variable (one lag)	Real Interest Rate	Real Growth of Bank Credit to Private Sector	Real Effective Exchange Rate	External Debt Service/Exports of G&S (current prices, in logs)	Real GDP Growth (two lags)	External Debt/GDP (in logs)	Import Price Shock (in percent of GDP)	Public Investment/GDP (one lag)
<b>General Equation</b>	3.47 (1.2)***	0.69 (0.15)***	-0.004 (0.003)	0.005 (0.001)***	-0.37 (0.1)	0.009 (0.07)*	0.009 (0.003)***	-0.38 (0.2)*	-0.005 (0.004)	0.18 (0.06)**
Adjusted R-squared=0.94 S.E.E.=0.055 F-statistic=48.5*** Breusch-Godfrey LM test statistic=5.8										
<b>Specific Equation</b>	2.87 (0.92)***	0.72 (0.11)***		0.004 (0.001)***	-0.305 (0.09)***		0.007 (0.002)***	-0.308 (0.1)**		0.17 (0.07)***
Adjusted R-squared=0.94 S.E.E.=0.055 F-statistic=71.96*** Breusch-Godfrey LM test statistic=7.5**										

1/ T-statistics (\*\*=1%, \*\*\*=5%, \*=10%) were computed using heteroscedasticity and autocorrelation consistent standard errors. There are 29 observations.

The results of the specific model show that private investment is mainly influenced by debt overhang effects (an increase of 10 percent in the external debt-to-GDP ratio would reduce private investment to GDP ratio by 3.08 percent) and changes in REER (10 percent would raise private investment by 3.05 percent). The estimates also indicate significant complementarity between public and private investment in Pakistan. Bank credit to private sector and demand effect also were highly significant but had a much lower effect on private investment. Recursive estimates indicated substantial stability in coefficients at two-standard error confidence level.<sup>3/</sup> Coefficient standard errors declined as observations for the 1980s and 1990s were included in the sample, confirming the robustness of the results.

1/ Data sources: Pakistani authorities; World Bank Development Indicators; and Fund staff estimates.

2/ The initial set of possible determinants included (a) demand (lagged GDP growth) and debt overhang (external debt and debt service ratios) effect variables; (b) real interest rate proxied by the weighted average of scheduled banks' advances rates to the private sector; (c) real growth of bank credit to the private sector; (d) levels of foreign exchange reserves and worker remittances; (e) variables measuring macroeconomic uncertainty (CPI variance and real effective exchange rate (REER)); (f) terms-of-trade effects measured by the income effects of export and import price shocks; (g) ratio of public investment to GDP; and (h) lagged private investment to GDP ratio. Series' stationarity was evaluated using Kwiatkowski, Phillips, Schmidt, and Shin test: there were no rejections of the null hypothesis of stationarity at any reasonable level of significance. Public investment is the sum of investment by general government and by autonomous and semi-autonomous public organizations. Models were also estimated using these two types of public investment individually: both produced positive coefficient estimates significant at 10 percent level; however, the model in the table yielded the best fit and diagnostic tests.

3/ Forward recursion based on an initial sample 1973–81; annual observations added until the complete sample was reached.

service arrears) will decline from 1.6 percent of GDP this year to 0.7 percent in FY 2003/04 (see text table). To improve transparency, this budgetary support will be explicitly budgeted

### Budget Support to WAPDA and KESC, 2002/03–2003/04

(In billions of Pakistani rupees)

	Initial FIP 2002/03	Proj. 2002/03	Prog. 2003/04
Total support to WAPDA	0.0	34.0	21.5
Nonpayment of dues to the budget (interest and net lending)	0.0	20.7	0.0
Outflows from the budget	0.0	13.3	21.5
Subsidies	0.0	12.0	21.5
Disbursements (net lending)	0.0	1.3	0.0
Total support to KESC	20.1	29.6	11.7
Nonpayment of dues to the budget (net lending)	0.0	6.1	0.0
Outflows from the budget	20.1	23.5	11.7
Subsidies	9.5	8.2	11.7
Disbursements (net lending)	10.6	15.3	0.0
Memorandum items:			
Total support in percent of GDP	0.5	1.6	0.7
WAPDA	0.0	0.8	0.5
KESC	0.5	0.7	0.3

Sources: Pakistani authorities; and Fund staff calculations.

as subsidies rather than netted against debt repayments due, as in the current year. Interest payments as a percent of GDP are expected to decline, owing to lower interest rates and a strong Pakistani rupee. Overall, non-I-PRSP expenditures would barely increase, reflecting further rationalization of nonpriority spending. The deficit ceiling for program monitoring purposes will be adjusted upward (up to 0.5 percent of GDP) for expenditures incurred for the restructuring of two public banks (Industrial Development Bank of Pakistan (IDBP) and Allied Bank Limited (ABL)), conditional on actual transfer of ownership (or liquidation), as well as for additional I-PRSP expenditure financed by additional grants. The mission welcomed the projected reduction of the debt-to-GDP ratio (to 83.7 percent of GDP by mid-2004), as well as the efforts to increase social expenditures, but maintained that a more forceful attempt at reducing subsidies could have been made (in particular for the poorly targeted subsidies on the GST on electricity).

15. **The authorities are committed to continued streamlining of the tax system and broadening of the tax base with the 2003/04 budget.** The number of remaining income tax exemptions will be further reduced (MEFP, para. 9) and the remaining withholding tax exemptions on interest income—including from National Saving Schemes (NSS) instruments—will be abolished. These measures will not generate substantial revenue in the short term, but should reduce distortions and the potential for corruption. In the medium term, tax revenue should also benefit from efforts to limit the enforceability by courts of Benami transactions (see Box 1).

## B. Structural Issues

### Energy sector

16. **The mission expressed strong concern about the recent setbacks in the electricity and gas sectors.** The authorities argued that the high oil prices in the run-up to the war in Iraq were clearly exceptional and temporary, and that passing them on to consumers and industry through the periodic automatic tariff adjustment for gas and electricity could well be disruptive to social and economic stability. While acknowledging these arguments, the mission stressed that, to smooth price movements, NEPRA-determined tariff increases were already capped at 3 percent in any one quarter, and that the partial and delayed implementation of the latest determination would risk to re-politicize energy pricing issues, endangering a hard-won achievement of recent years. This might undermine the willingness of the private sector to invest in the gas and electricity sectors. The mission also expressed concern that this decision may adversely affect income distribution since middle and upper class consumers are likely to benefit most from subsidized utility tariffs as the poor have little access to gas, and lifeline electricity tariffs were not to be increased in any case. The cost of this policy, if it led to a higher debt burden or the crowding out of pro-poor expenditure, may well affect the poor disproportionately. To give credibility to the new gas pricing framework, the mission recommended early implementation of the envisaged modest consumer price increase.

17. **The power sector problems need to be tackled forcefully, as they have proven to be the main risk to the budget.** The financial situation of WAPDA is likely to improve in the medium term, given the lower forthcoming contractual payments to independent power producers and the coming on stream of a major hydropower project. However, the mission stressed that these factors should not distract the authorities from protecting the budget in the short term. It therefore welcomed the revised, more realistic FIP for WAPDA, as well as the commitment to make notification of tariff decreases conditional on the utilities meeting their quarterly accrual deficit targets. A substantial increase in debt-service payments to the government, and a base effect arising from the one-time payment of KESC's arrears in 2002/03, explain the modest planned reduction in the accrual deficit. The mission urged the authorities to implement steadfastly the FIP, including a workable mechanism for collection of bills from the Federally Administered Tribal Areas (FATA) and the timely payment of bills by the public sector. While the FIP includes specific measures (gradual metering of FATA users, subcontracting collection to private operators, and others), additional steps should be developed if needed to achieve at least PRs 2 billion of payments on FATA bills. WAPDA itself needs to be made more accountable for achieving the targeted reduction to line losses (from 25 percent this year to 24 percent in FY 2003/04), and should explore the scope for specific measures to reduce administrative costs. Given WAPDA's resource constraints, it needs to prioritize investments, and the FIP commits to refrain from launching any new projects. Completing the unbundling and corporatization process will be an important prerequisite for involving the private sector, and the mission urged the authorities to more forcefully tackle the administrative difficulties that are delaying the assignment of WAPDA's assets and liabilities to successor companies. The authorities plan to work out, in

consultation with the World Bank, a medium-term action plan addressing weaknesses in the power sector's regulatory framework, notably to make government notification of tariff determinations by NEPRA more automatic, and with clear guidance to NEPRA on the tariff policies for the various WAPDA successors.

### **Tax administration, trade reform, public expenditure management, and fiscal transparency**

18. **The CBR reform is on track**, and the authorities plan to implement many FAD recommendations on tax and customs administration reform (MEFP, para. 13). The mission welcomed progress made in implementing the Accountable Fiscal Management Framework (MEFP, para. 16), but **expressed concern about the quality of reporting on provincial and local government spending** (see the relatively large statistical discrepancy for the provincial accounts at end-December). Improving fiscal reporting at the local government level will require further capacity building and some institutional changes, notably to ensure better enforcement of existing accounting procedures.

### **Trade liberalization**

19. The mission welcomed the commitment to prepare a road map for the gradual reduction in the very high effective protection granted to certain industries (mostly motor vehicles). It noted the authorities' view that this policy has helped to create a fast-growing industry, but felt that a better balance needed to be struck between incentives for investment in the sector and the interest of consumers in having access to vehicles at affordable prices.

### **Social sector issues**

20. **Progress is being made in preparing a full PRSP and in strengthening social outcome monitoring.** The first report on intermediate social outcomes, which defines the monitoring framework, provides baseline estimates, and sets annual targets for the next three fiscal years, was recently published ([www.finance.gov.pk](http://www.finance.gov.pk)). The implementation of this framework and of the annual core welfare indicators survey (with World Bank assistance) will provide essential inputs for the design of the local, provincial, and federal budgets starting in 2004/05. Progress has also been made in finalizing the PRSP, including through broad-based consultation with provincial and local governments and civil society, and outreach efforts to record the concerns of the poor.

### **Privatization and public enterprise reform**

21. **Despite the authorities' strong commitment, privatization has been hampered by limited investor interest.** The mission stressed that, in the current weak global economic environment, negotiated sales might have to be seriously considered in cases where only one well-qualified investor has expressed interest. While acknowledging that the reopening of the invitation for expressions of interest was motivated by the greater transparency of a competitive bidding process, the mission regretted that HBL's privatization will now likely be delayed beyond June 2003. The restructuring of the balance sheets of IDBP and ABL as

planned is part of a clear exit strategy (transfer of ownership or liquidation). The mission was encouraged by the satisfactory implementation of their FIPs by PIA, PR, and PSM, and progress in KESC's collection performance, but emphasized that more efforts were needed to reduce KESC's line losses. The increased investment by KESC, which explains the small increase in the accrual deficit in FY 2003/04, should go with high priority to equipment needed to reduce line losses and theft.

### **Financial sector**

22. **The authorities recognize the importance of reforming the NSS** to reduce the costs to the budget (Box 3), improve debt management, reduce distortions, and foster the development of capital markets, and have requested from the Asian Development Bank (AsDB) technical assistance on this issue. However, the mission felt that more rapid reform would be preferable, in particular to close the on-tap issue of NSS instruments which was crowding out less expensive domestic financing. The mission encouraged the authorities to complement their comprehensive approach to money laundering issues (MEFP, para. 21) by submitting to parliament a related draft law as soon as possible.

## **IV. OTHER ISSUES**

### **Statistical issues**

23. **The mission welcomed recent progress toward subscribing to the Special Data Dissemination Standard (SDDS)** (MEFP, para. 24), as well as the renewed commitment to meet essential SDDS requirements by end-2003. Participation in the General Data Dissemination System (GDSS) will be soon within reach, following World Bank assistance with drafting the missing socio-demographic metadata.

### **Program financing**

24. **The program remains fully financed in the current and next fiscal years**, with most bilateral agreements implementing the Paris Club Agreed Minutes of December 2001 now signed. The recent cancellation by the U.S. of about \$1 billion of debt will contribute substantially to improve external debt sustainability.

### **Program monitoring**

25. Proposed prior actions, quantitative and structural performance criteria and indicative targets, and structural benchmarks are specified in the MEFP (see also Box 4). A new Technical Memorandum of Understanding (TMU), effective as of July 1, 2003, incorporates amendments made in the course of 2002/03, simplifies the treatment of some adjusters, defines a monitorable deficit for the power utilities, introduces a new adjuster related to the cost of restructuring IDBP and ABL, and sets the baseline assumptions for external program financing and external grants in 2003/04. In view of the uncertainties surrounding Pakistan's economic outlook, the program will continue to be monitored through quarterly reviews. The



### Box 3. Implicit Subsidy in the National Savings Schemes

**The National Savings Schemes (NSS) comprise a list of saving certificates intended to mobilize and promote private saving.** NSS certificates finance the federal government budget and are available on tap from National Savings Centers, post offices, and commercial banks. Since December 2000, the rates of return on NSS certificates have been loosely tied to those of Pakistan Investment Bonds (PIBs) of same maturity with a premium (semi-annual adjustment). The formula was designed to make commercial banks neutral between holding NSS certificates or PIBs even though banks cannot hold NSS certificates and PIBs are available only to institutional investors.

**The rates of return on NSS certificates are higher than those on deposits with commercial banks of similar maturity.** The difference can be viewed as an implicit subsidy which reflects the government's intention to promote private saving, and to give support to pensioners and others who rely on income from NSS savings. Given that the very poor do not command sufficient resources to invest in NSS, the implicit subsidy does not appear targeted to those most in need of government assistance. In the fiscal accounts, the implicit subsidy is included in the interest bill; subsidies are thus understated while interest costs are overstated.

**An estimated lower bound for the implicit subsidy is 0.7 percent of GDP in 2002/03** (16 percent of domestic interest payments).<sup>1/</sup> The highest implicit subsidy over the full maturity is paid on three-year Special Saving Certificates with a rate of return almost twice that on three-year deposits. For Regular Income Certificates, the implicit subsidy is 26 percent of the nominal return, and for Defense Saving Certificates, the implicit subsidy varies between 6 percent and 50 percent of the nominal return, depending on the time of encashment.

**Several aspects of the NSS merit reform.** First, NSS certificates should not be available on tap, so that the government regains full control over nonbank financing. Second, the rates of return should be tied closer to comparable instruments. At a minimum, the premium over PIBs should be eliminated. Third, any subsidy for a particular group should be well targeted and explicit.

	Special saving certificates	Regular income certificates	Defense saving certificates
Maturity	3 yrs	5 yrs	10 yrs
Encashable	with penalty	> 1 month	> 1 month
Stock in percent of domestic debt 1/	34.3	25.6	38.6
Average rate of return (percent) 2/	8.7	9.4	10.0
Interest differential to comparator 3/			
First year	4.2	2.9	3.5
Last year	4.4	2.9	3.4
Average	4.3	2.9	2.0
Implicit subsidy (percent of GDP)	0.3	0.1	0.2

Sources: Pakistani authorities; and Fund staff calculations and estimates.

1/ As of June 30, 2002. Table does not include some smaller instruments.

2/ As of January 1, 2003, if held over full maturity.

3/ Comparators: Deposits with scheduled banks with similar maturity.

1/ Calculating the implicit subsidy requires a number of assumptions, given the paucity of detailed data on NSS. The approach taken estimates a lower bound for the implicit subsidy based on current rates. Given that the implicit subsidy on past issues (before linking NSS rates to PIBs) was higher than today's, the actual subsidy on the outstanding NSS stock is likely to be higher. The average annual rate of return is calculated as the geometric average of the actual rates of return effective July 1, 2002. The implicit subsidy is calculated by comparing the average annual rate of return to the rate of return on deposits with similar maturities offered by commercial banks. The total subsidy included in the interest bill is calculated from average subsidies per instrument and the respective interest payments.

## **Box 4. Structural Conditionality <sup>1/</sup>**

### **1. Coverage of structural conditionality in the PRGF program for FY 2002/03**

Most of the structural conditionality has been met so far. Structural conditionality for the remainder of the 2002/03 and for 2003/04 is detailed in Tables 2(a) and 2(b) of the MEFP. The focus remains on tax policy and tax administration reforms, public expenditure management reforms, and fiscal transparency. Particular emphasis is also given to the reform of WAPDA and KESC, whose financial situation weighs considerably on public finances. This extension of Fund conditionality to an area usually covered by the World Bank reflects its critical relevance for the macroeconomic framework. The privatization of a nationalized bank is a structural performance criterion, as privatization is critical to create a sound and efficient financial sector that contributes to growth, and is less vulnerable to government interference.

### **2. Status of structural conditionality from earlier programs**

Virtually all structural measures included in the Stand-By Arrangement, which expired in September 2001, were implemented. A benchmark on the establishment of best practice anti-money laundering rules was missed because of a postponement in the scheduled FSAP mission, that was expected to provide technical advice. The benchmark on the reconciliation of provincial expenditure was only partially met because of limited institutional capacity in managing both the devolution initiative and revising accounting procedures to include the newly created district administrations. Expenditure reconciliation has further improved since the start of the current PRGF program.

### **3. Structural areas covered by World Bank and other donors' lending and conditionality**

**World Bank program lending** for FY 2001/02, as for the previous fiscal year, was delivered under a one-tranche Structural Adjustment Credit (SAC). The IDA-financed \$500 million SAC II disbursement (in June 2002) was conditional on (a) accelerating power sector reforms with a view to restoring the sector's financial viability; (b) revamping the tax administration system to improve governance and increase revenues; (c) improving the policy framework in the oil and gas sectors to attract domestic and foreign investment; (d) improving the effectiveness in the delivery of social services through civil service reforms, and enhanced transparency and accountability in the use of public resources; (e) accelerating the implementation of the Education Sector Reforms Action Plan and the National Health Policy; and (f) establishing monitoring and evaluation systems to assess progress in the implementation of the poverty reduction strategy. Overall, conditionality has proven relatively ineffective in the power sector, with the implementation of WAPDA's initial FIP largely off-track and limited progress in the utility's corporatization/unbundling process. The World Bank approved in July 2002 SACs for two provinces (Sindh and North West Frontier Province) totaling \$190 million supporting provincial reform strategies to improve fiscal transparency, resource management, and strengthen provision of public services by local governments and communities. Conditionality related to the restructuring of three nationalized banks is part of a banking sector project loan approved in October 2001. Successful implementation of reforms have facilitated the privatization of United Bank Limited and should help privatize HBL.

4. The AsDB is supporting Pakistan's adjustment effort through various program loans: an Energy Sector Restructuring Program loan (including conditionality leading to the privatization of KESC and two of the corporatized WAPDA entities), whose disbursement has been delayed due to limited reform progress; a Small and Medium Enterprise Trade Enhancement Finance loan; a Trade, Export Promotion and Industry program; an agricultural policy reform loan, aimed at reducing the government's intervention in agriculture and raising agricultural productivity; and a loan to enhance access to justice, raise the accountability of justice and law enforcement agents, and strengthen the rule of law. In December 2002, the AsDB approved two new program loans: one aimed at improving governance and operational efficiency in financial markets; the other to develop the rural finance sector, including through the restructuring of the Agricultural Development Bank of Pakistan.

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<sup>1/</sup> Updated from IMF Country Report No. 03/54.

authorities requested that discussions for the sixth review, including assessment of the end-March 2003 quantitative performance criteria (which has not been finalized yet), be held only after completion of the fifth review. The discussions with staff for the sixth review and assessment of the end-March 2003 quantitative performance criteria are expected to take place in August 2003, and the authorities plan to request to combine the seventh and eighth disbursements at that time. The ninth and tenth disbursements (and eighth and ninth review, respectively) are scheduled for December 20, 2003 and March 20, 2004, respectively (with end-September 2003 and end-December 2003 test dates).

## V. STAFF APPRAISAL

26. **Pakistan's macroeconomic performance through May 2003 remained strong.** Economic growth of 4.5 percent in 2002/03 remains within reach, despite global economic weaknesses and a difficult regional security environment. Inflation remains lower than expected, and official reserves continue to grow faster than programmed. These outcomes reflect solid macroeconomic policies, capitalizing on favorable exogenous factors such as good rains, strong external support, and persistent high private capital inflows.

27. **Structural reforms in many areas progressed well, but setbacks in power sector reform, and to a lesser extent in privatization, were disappointing.** Revenue collection is on track and CBR reform is being carried out as planned. The authorities deserve credit for adhering to the rules-based adjustments for petroleum product prices to reflect world oil prices even during the spike in the run-up to the Iraq war and in the face of strong political pressure. Little progress on privatization reflects mostly investor concerns during the recent period of Iraq-related regional and global uncertainties. However, the recent delay in notifying utility tariff adjustments has further damaged the credibility of the rules-based pricing mechanism for the gas and power utilities, and worsened financial imbalances. Staff appreciates the strong socio-political pressures leading to these decisions, but urges the authorities to keep a rules-based pricing mechanism that minimizes government interference with the application of the determinations of the sector's regulator.

28. **Looking ahead, staff welcomes the authorities' plan to persevere with the current macroeconomic policy mix.** Within a flexible exchange rate system, monetary policy will aim to maintain low inflation. Anecdotal evidence of asset price inflation and continued high growth of monetary aggregates highlight the need to continue to monitor inflation carefully. To be able to absorb liquidity aggressively, if needed, the SBP needs to replenish its stock of government paper usable in open market operations. This highlights the need to shift domestic budget financing from (nonmarketable) NSS instruments to treasury bills and treasury bonds, which would also reduce interest costs. The planned repayment of relatively expensive external debt to improve the public debt profile and enhance the profitability of the SBP would also be helpful in this regard, if financed by the issuance of treasury bills and bonds. Staff welcomes SBP plans to use outside professional expertise in investing part of the reserves and to seek greater currency diversification to limit the vulnerability to bilateral exchange rate movements.

29. **The planned reduction in the fiscal deficit for 2003/04 remains the cornerstone of Pakistan's efforts to reduce the burden of public debt which deters private investment and constrains productive expenditure.** Staff had argued for a more ambitious reduction of the deficit, while recognizing that the setbacks in the power sector, the cost of past sterilization, and the budgetary burden of continued regional tensions have made the original PRGF target virtually unattainable. Staff concurs that the restructuring of the balance sheets of two insolvent banks should not be delayed, even if it adds to the headline deficit. Nonetheless, the budget could have made a stronger effort to reduce subsidies (for wheat exports, for GST on electricity for certain classes of households, and most important for various public enterprises) and staff encourages the authorities to move ahead in this area in the near future. On the revenue side, staff concurs with the budget's emphasis on tax administration reforms and base broadening, but urges the authorities to speed up work with provincial governments on a further extension of the GST on services for FY 2004/05. The revenue targets appear realistic, but make timely implementation of these reforms critical for achieving the fiscal objectives.

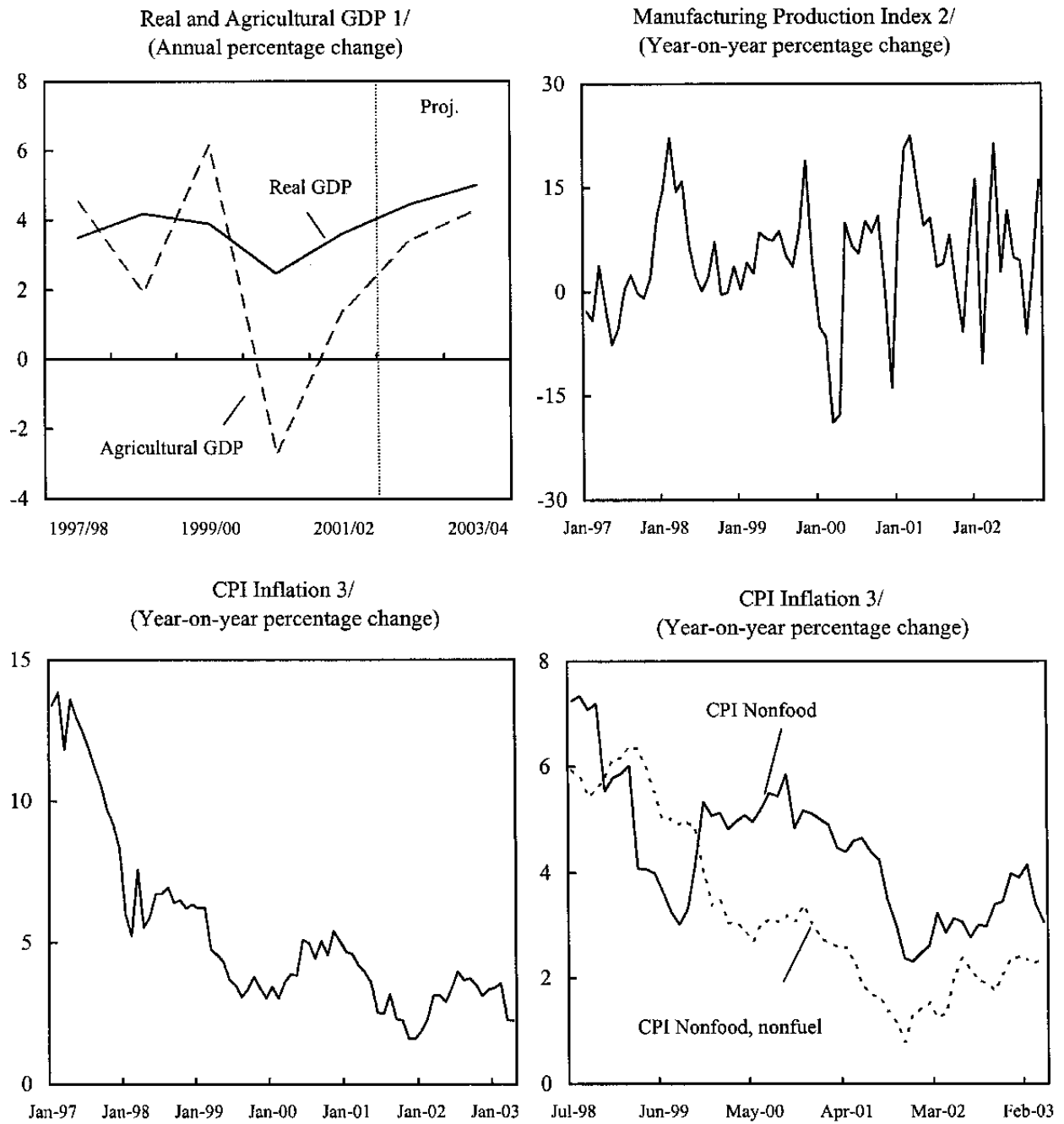
30. **Fundamental reform of WAPDA remains essential for addressing the main risk to the fiscal objectives, and for laying the foundations for higher growth.** In recognition of this, program conditionality in the power sector has been strengthened. The authorities rightly emphasize that part of WAPDA's current woes reflect temporary factors such as the frontloading of payments to the independent power producers and high investments to get the Ghazi-Barotha hydropower plant on stream. This should not deter, however, the forceful implementation of the revised FIPs. WAPDA needs to be held accountable for achieving the programmed improvements in line losses and in collecting bills from the private sector. The government needs to address the law-and-order issues hampering bill collection in FATA, improve the timely verification and payment of public sector bills, and allow full and timely implementation of tariff increases determined by the sector regulator. In this regard, staff welcomes the proposed contingency measure of making downward tariff adjustments conditional on WAPDA and KESC meeting their quarterly deficit targets. Staff urges the authorities to make stronger efforts toward completion of the unbundling and corporatization of WAPDA, as it will be essential to better localize WAPDA's problems, reduce the government's role through corporatization, and clear the way for gradual privatization.

31. **Staff is encouraged by available evidence of progress on social sector issues.** Social sector (I-PRSP) spending, as reported by the authorities, continues to grow and preparation of a full PRSP seems well advanced. The authorities have made progress in developing a better system to monitor intermediate social outcomes, which should provide inputs in the next budget. Staff remains concerned about the quality of reporting on provincial and local government spending, where progress needs to accelerate, both in terms of moving to computer-based systems and better enforcement of existing accounting procedures.

32. **Pakistan's track record over the last three years indicates that the government will hold the program broadly on course, although the risk of delay for certain structural reforms has risen.** Strong reserves and a flexible exchange rate should help

cushion unexpected external shocks, and quarterly reviews provide some assurance that an adequate response to unforeseen events will be developed quickly. The government will have to make a strong effort for maintaining a consensus on fiscal consolidation and reform, given its small majority in parliament and in the face of strong and vocal interest groups. The adoption of WAPDA contingency measures and the planned reform of the power sector tariff mechanism, as outlined in the MEFP, corrected for the factors that led to the nonobservance of a performance criterion. On this basis, staff recommends Executive Board approval of the requested waiver and modification of performance criteria, and completion of the fifth review.

Figure 1. Pakistan: Output and Inflation, 1997/98–2003/04



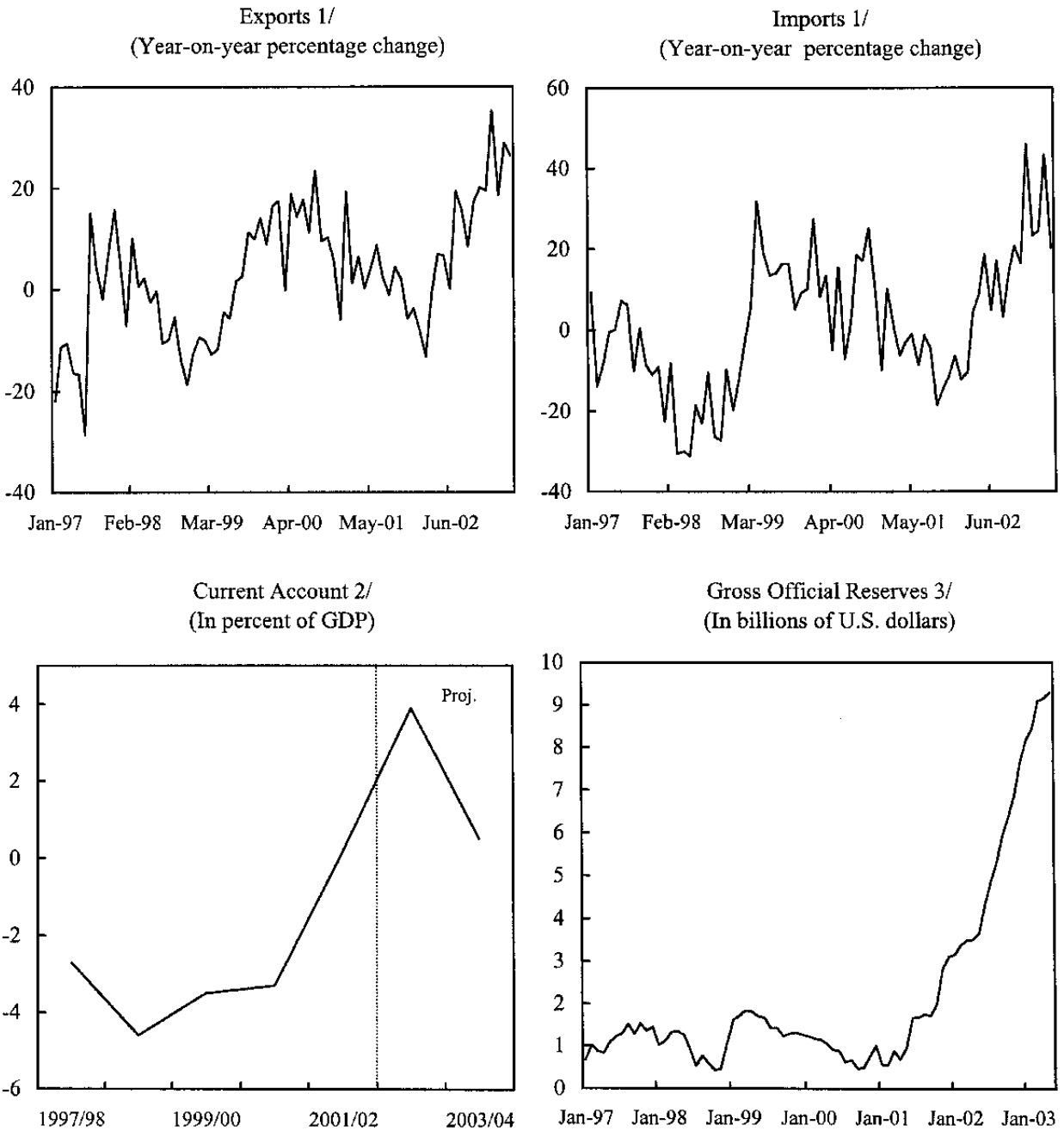
Source: Data provided by the Pakistani authorities.

1/ Last observation: projection for 2003/04.

2/ Last observation: November 2002.

3/ Last observation: April 2003.

Figure 2. Pakistan: External Sector Developments, 1997/98–2003/04



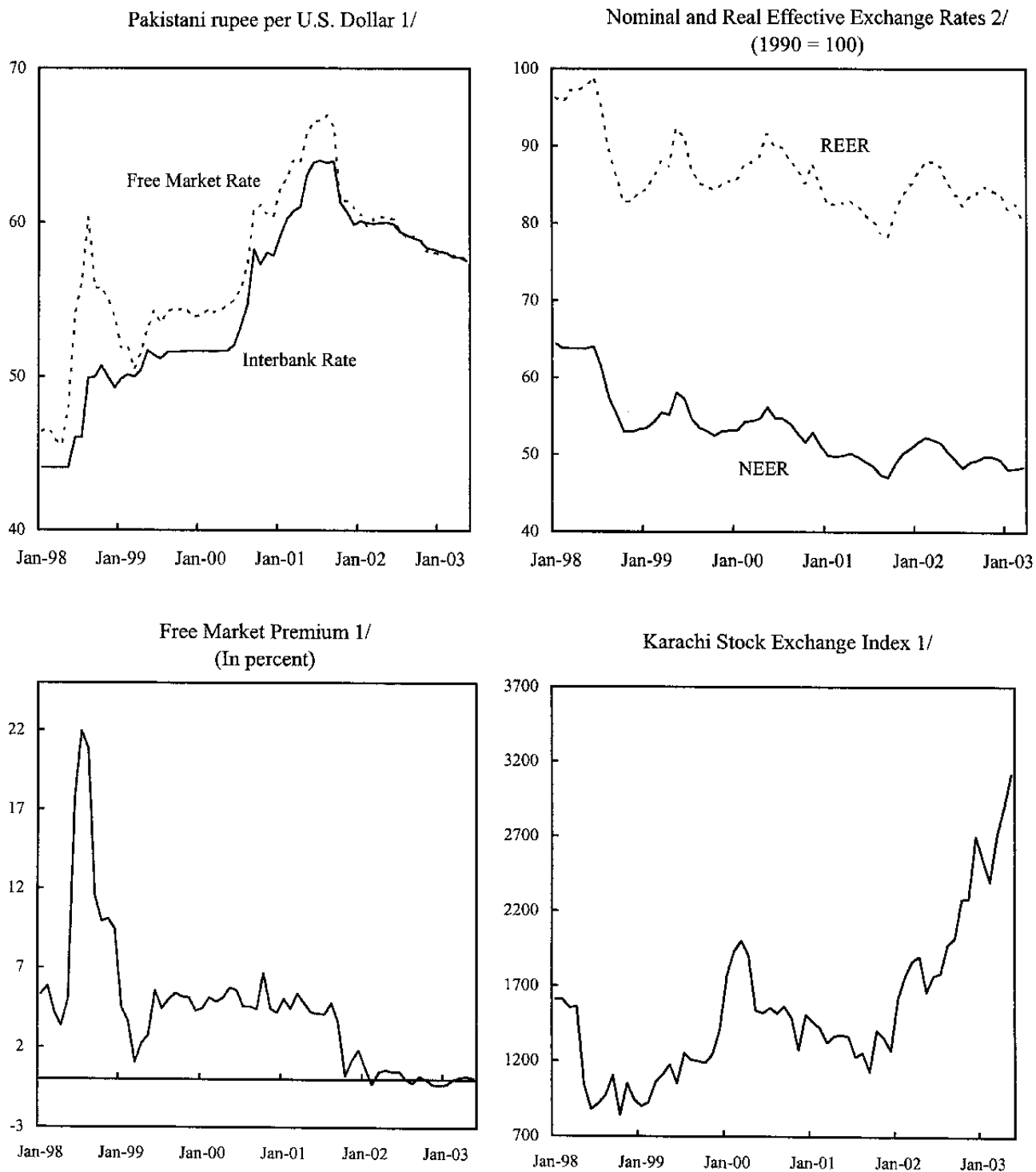
Source: Data provided by the Pakistani authorities.

1/ Customs basis, in U.S. dollar terms. Last observation: April 2003.

2/ Excluding official transfers. Last data point: projection for 2003/04.

3/ Excluding gold, foreign deposits held with SBP, short-term swap and forward commitments. Last data point: May 29, 2003.

Figure 3. Pakistan: Exchange Rate and Stock Market Developments, 1998–2003



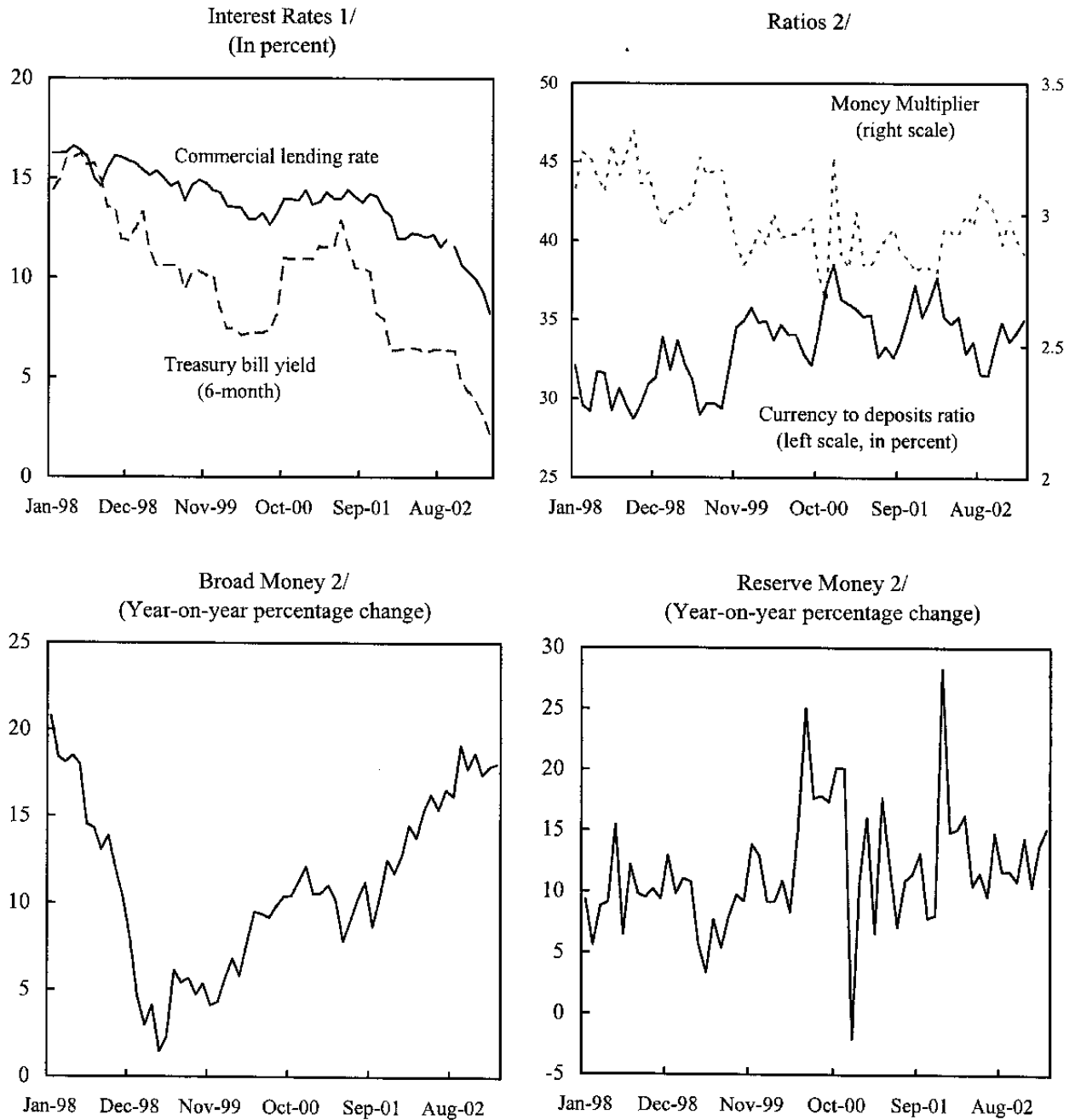
Sources: Data provided by Pakistani authorities; and Fund staff estimates.

1/ Last observation: May 29, 2003.

2/ Last observation: March 2003.



Figure 4. Pakistan: Monetary Developments, 1998–2003

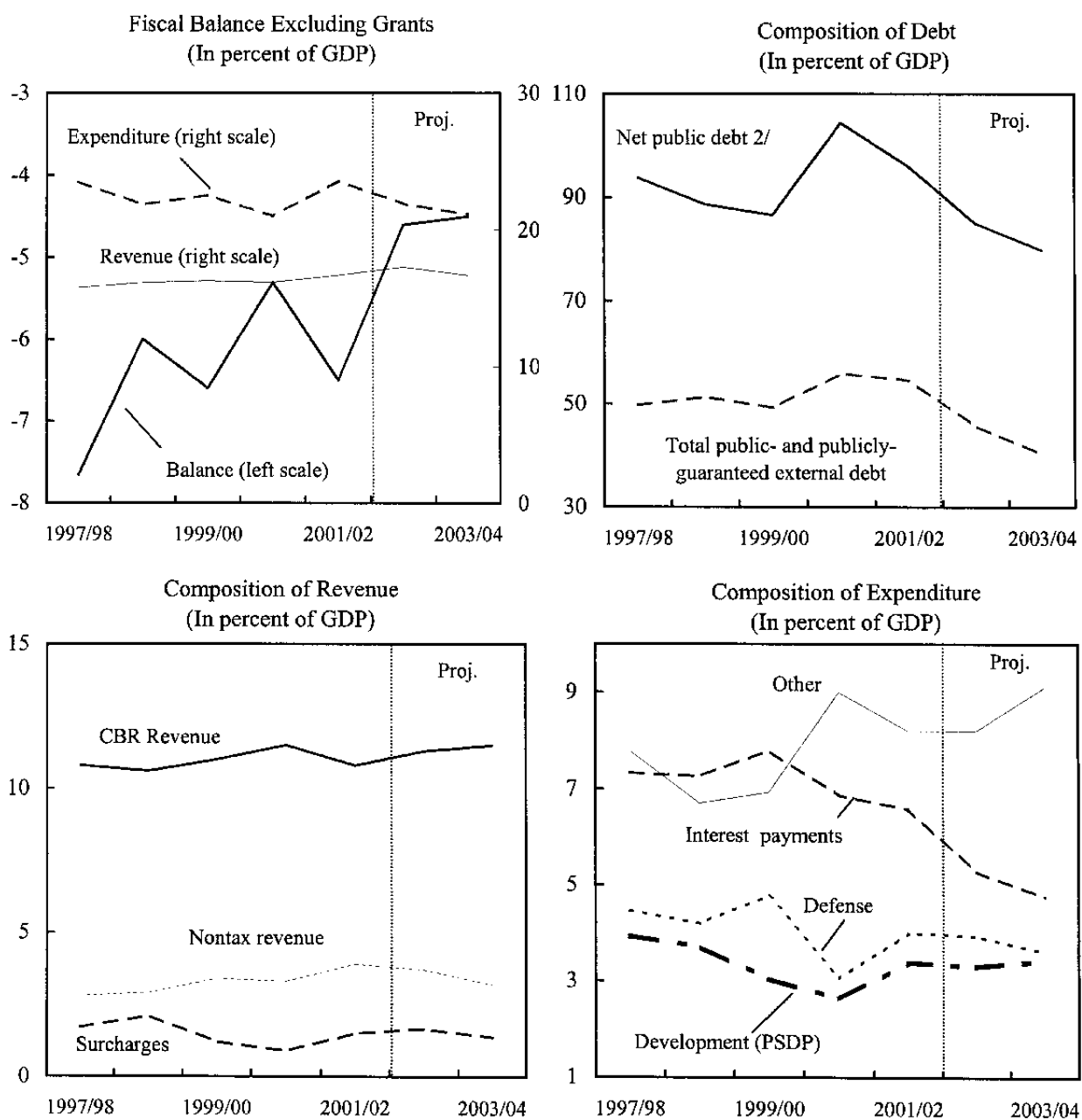


Source: Data provided by the Pakistani authorities.

1/ Last observation: March 2003.

2/ Last observation: February 2003.

Figure 5. Pakistan: Fiscal Developments, 1997/98–2003/04 1/

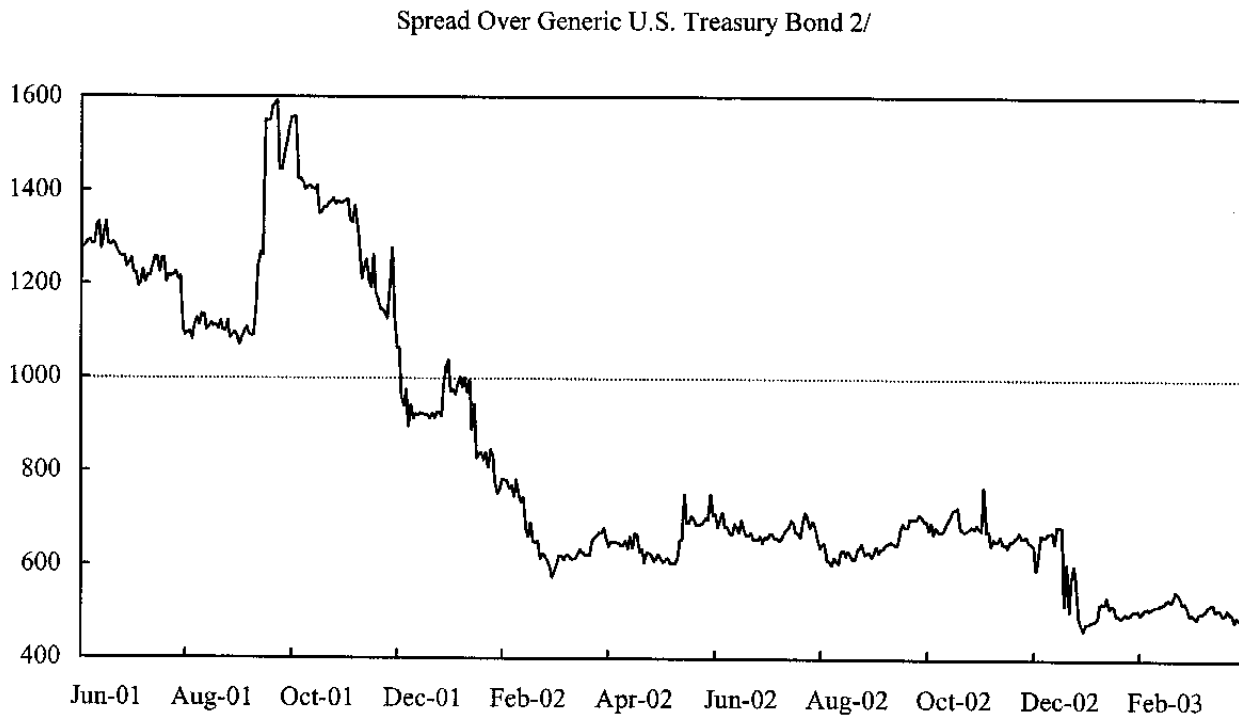


Source: Data provided by the Pakistani authorities.

1/ Last data point: projection for 2003/04.

2/ Net public debt is the sum of net domestic government debt and external public- and publicly-guaranteed debt.

Figure 6. Pakistan: Recent Financial Market Developments, 2001–03 1/



Sources: Data provided by Pakistani authorities; and Datastream.

1/ First observation: June 1, 2001; last observation: May 29, 2003.

2/ Calculated for Pakistan Islamic Republic 10 percent bond maturing on December 13, 2005.

Table 1. Pakistan: Medium-Term Macroeconomic Framework, 2000/01–2003/04

	2000/01	2001/02	Prog. 1/ 2002/03	Rev. Proj. 2002/03	Prog. 2003/04
	(Annual changes in percent)				
<b>Output and prices</b>					
Real GDP at factor costs	2.5	3.6	4.5	4.5	5.0
Real GDP at market prices	2.7	4.4	4.9	4.9	5.1
Partner country demand (WEO definition)	2.7	1.4	2.5	2.5	3.1
Consumer prices (p.a.)	4.4	2.7	4.0	3.7	4.0
Pakistani rupees per U.S. dollar (p.a.)	12.8	5.2	...	...	...
	(In percent of GDP)				
<b>Savings and investment</b>					
Gross national savings	14.0	16.5	19.7	20.3	17.5
Government	-1.5	0.2	0.2	0.6	0.3
Nongovernment 2/	15.6	16.3	19.5	19.7	17.2
Gross capital formation	15.9	13.9	15.0	15.0	16.0
Government 3/	2.6	3.4	3.3	3.3	3.4
Nongovernment 2/	13.3	10.5	11.7	11.7	12.6
	(In percent of GDP)				
<b>Public finances</b>					
Revenue (including grants)	17.4	19.0	18.1	20.2	17.6
Expenditure 4/ 5/	21.4	23.3	21.3	21.9	21.1
Overall balance (excluding grants)	-5.3	-6.5	-4.6	-4.6	-4.5
Overall balance (including grants) 5/	-4.1	-4.3	-3.2	-1.8	-3.5
Primary balance (including grants)	2.8	3.7	2.8	3.5	1.2
Net public debt 6/	104.4	95.9	88.5	85.0	79.8
Net domestic government debt 7/	43.2	42.6	41.2	40.3	39.9
Implicit interest rate on government debt (in percent) 8/	7.5	6.5	6.6	5.9	5.9
	(Annual changes in percent of initial stock of broad money)				
<b>Monetary sector 9/</b>					
Net foreign assets	5.1	13.4	15.4	18.3	6.2
Net domestic assets	3.9	2.0	0.6	1.2	4.8
Of which: credit to the private sector	3.5	2.5	2.9	2.8	4.0
Of which: net claims on the government 5/	-3.3	1.5	-2.5	-2.2	0.4
Broad money	9.0	15.4	16.0	19.5	11.0
Six-month treasury bill rate (in percent, p.a.)	10.4	8.1	...	...	...
	(In percent of GDP)				
<b>External sector</b>					
Merchandise trade balance	-2.2	-0.5	-1.2	-1.4	-1.8
Merchandise exports	15.2	15.0	14.2	14.7	13.8
Merchandise imports	17.4	15.5	15.4	16.2	15.7
Current account excluding official transfers	-3.3	0.2	3.2	3.9	0.5
Current account including official transfers	-1.9	2.6	4.7	5.3	1.5

Table 1. Pakistan: Medium-Term Macroeconomic Framework, 2000/01–2003/04 (concluded)

	2000/01	2001/02	Prog. 1/ 2002/03	Rev. Proj. 2002/03	Prog. 2003/04
(In percent of exports of goods and nonfactor services)					
External public- and publicly-guaranteed debt	318.4	300.0	274.3	246.1	242.8
Debt service 10/	28.2	34.0	32.7	28.8	22.3
Implicit interest rate (in percent) 11/	4.4	3.9	3.9	3.5	2.8
Gross reserves (in millions of U.S. dollars) 12/	1,679	4,330	7,776	9,073	10,605
In months of next year imports of goods and services	1.7	3.8	6.7	7.3	8.2
In percent of short-term external debt 13/	23.7	72.1	156.7	181.5	309.3
Memorandum items:					
Real effective exchange rate (percentage change)	-2.6	-1.2	...	...	...
Terms of trade (percentage change)	-1.6	-0.7	-1.9	-3.9	-0.8
Real per-capita GDP (percentage change)	0.5	2.2	2.6	2.6	2.9
GDP at market prices (in billions of Pakistani rupees)	3,416	3,727	4,063	4,063	4,440

Sources: Data provided by the Pakistani authorities; Fund staff; and World Economic Outlook.

1/ As published in IMF Country Report No. 03/54.

2/ Includes public sector enterprises.

3/ Expenditures included in the Public Sector Development Program.

4/ Including the statistical discrepancy.

5/ Including one-off expenditures: KESC recapitalization and CBR bonds in 2001/02, and IDBP and ABL restructuring in 2003/04.

6/ Defined as the sum of net domestic government debt and external public- and publicly-guaranteed debt.

7/ Gross domestic government debt, including U.S. dollar bonds, net of government deposits with the banking system.

8/ The implicit interest rate on government debt is calculated as interest payments in percent of the end-of-period debt stock of the previous year.

9/ Program data for 2002/03 and 2003/04 are evaluated at program exchange rates.

10/ Including interests on short-term debt.

11/ The implicit interest rate on external public debt is calculated as interest payments in percent of the average stock of debt of the current and previous fiscal year.

12/ Excluding gold, foreign deposits held with the SBP, and net of outstanding short-term foreign currency swap and forward contracts.

13/ Short-term debt is defined on the basis of remaining maturity.

Table 2. Pakistan: Balance of Payments, 2001/02–2003/04

(In millions of U.S. dollars)

	Q1		Q2		Q3		Q4	
	2001/02	2002/03	Prel. 2002/03	Est. 2002/03	Rev. Proj. 2002/03	Prog. 2002/03	Rev. Proj. 2002/03	Prog. 2003/04
Current account (excluding official transfers)	96	1,174	583	1,114	-186	2,211	2,685	398
Current account balance (including official transfers)	1,591	1,449	882	1,332	19	3,222	3,683	1,189
Trade balance	-292	-142	-327	-110	-423	-851	-1,002	-1,453
Exports f.o.b.	9,140	2,623	2,550	2,608	2,469	9,846	10,250	10,865
Imports f.o.b.	-9,432	-2,765	-2,877	-2,718	-2,892	-10,697	-11,252	-12,318
Services (net)	-2,617	-218	-645	-186	-796	-2,541	-1,844	-2,259
Of which: interest payments	-1,579	-297	-291	-312	-412	-1,492	-1,311	-1,050
Private transfers (net)	3,005	1,534	1,555	1,410	1,033	5,603	5,532	4,110
Official transfers (net) 1/	1,495	275	299	218	205	1,011	997	791
Of which: Saudi Oil Facility	579	189	207	139	132	671	667	538
Of which: additional grant pledges	742	50	68	57	50	239	225	111
Capital account	-2,322	-659	-323	-423	-142	-1,818	-1,547	-1,297
Public medium- and long-term capital	-1,613	-655	-548	-158	-150	-1,476	-1,511	-785
Project and nonproject loans	-983	-246	-197	-132	-1,118	-677	-1,693	-207
Disbursements	531	132	175	207	207	722	721	697
Amortization 2/	-1,514	-378	-372	-339	-1,325	-1,399	-2,414	-904
Commercial banks and IDB (net)	-224	-14	-114	-15	-15	-158	-158	-33
Other 3/	-407	-395	-237	-11	983	-641	340	-545
Public sector short-term (net)	-1,064	-40	-203	46	61	-97	-135	-464
Private medium and long term	-80	-80	86	64	73	-86	143	378
Nonbank	-79	-80	86	64	73	-86	143	378
Deposit money banks	-1	0	0	0	0	0	0	0
Of which: FDI	368	160	196	150	70	400	576	500
Private short-term (including errors & omissions) 4/	435	117	342	-376	-126	-159	-44	-426
Overall balance (before debt relief)	-731	791	559	909	-123	1,404	2,136	-108
Financing	731	-791	-559	-909	123	-1,404	-2,136	108
Reserve assets (increase -)	-3,082	-1,678	-1,378	-1,469	-505	-4,191	-5,030	-1,407
State Bank of Pakistan (including FE-25s)	-2,717	-2,181	-1,459	-1,524	-507	-4,371	-5,671	-907
Deposit money banks	-365	503	81	55	2	180	641	-500
Fund repurchases	-194	-89	-74	-117	-136	-399	-416	-526
Net exceptional financing	4,007	976	893	677	763	3,186	3,310	2,042
Arrears (increase +)	0	0	0	0	0	0	0	0
Rescheduling 5/	1,210	271	279	246	194	1,023	991	100
Of which: Private Sector Involvement	0	0	100	0	0	100	100	100
Rollover of foreign deposits with banking system 6/	1,314	250	150	300	200	900	900	500
Program financing from IFIs	1,367	445	290	131	369	979	1,235	1,342
World Bank	698	202	0	11	39	202	252	500
AsDB	185	128	175	2	220	331	525	400
IMF	484	115	115	118	110	446	458	442
Privatization receipts	117	10	174	0	0	284	184	100
Financing gap	0	0	0	0	0	0	0	0
Memorandum items:				(In percent of GDP)				
Current account (excluding official transfers)	0.2	1.7	0.8	1.6	-0.3	3.2	3.9	0.5
Current account balance (including official transfers)	2.6	2.1	1.3	1.9	0.0	4.6	5.3	1.5
Exports f.o.b. (growth rate, percent)	2.3	19.1	10.0	22.0	15.5	7.7	12.1	6.0
Imports f.o.b. (growth rate, percent)	-7.5	14.6	29.9	21.7	29.5	13.4	19.3	9.5
NFA accumulation by the SBP (increase +)	2,582	2,155	1,470	1,523	532	4,327	5,680	1,691
End-period gross official reserves 7/	4,330	5,934	7,648	8,963	9,073	7,776	9,073	10,605
(In months of next year imports of goods and nonfactor services)	3.8	4.8	6.1	7.2	7.3	6.7	7.3	8.2

Sources: State Bank of Pakistan; Ministry of Finance; and Fund staff estimates.

1/ Includes a grant from Saudi Arabia in the form of oil that has been agreed on through 2002/03.

2/ Includes accelerated repayment of \$1 billion USDA loan.

3/ Includes \$1 billion capital grant to finance the accelerated repayment of the USDA loan.

4/ Includes repayment of foreign currency deposits held in NBFIs and banks (reschedulings shown as exceptional financing).

5/ Includes rescheduling of bilateral debt in 1999 and 2001, and rescheduling of commercial bank credit and Eurobonds in 1999.

6/ Includes rollover of FE-45 deposits with the banking system, of Kuwait's and U.A.E.'s deposits with the SBP, and Bank of China's deposits with the NBP.

7/ Excluding gold, foreign currency deposits held with the SBP, cash reserve requirement, and net of and outstanding short-term swap and forward contracts and the sinking fund.

Table 3. Pakistan: Consolidated Government Budget, 1999/2000–2003/2004

(In billions of Pakistani rupees)

	1999/2000	2000/01	2001/02	2002/03					2003/04
	FY	FY	FY	Sep.	Dec.		FY		FY
	Prov. Act.	Prov. Act.	Prov. Act.	Prel. Act.	Prog. 1/	Prel. Act.	Prog. 1/Rev.	Proj.	Prog.
Revenue and grants	546.0	593.5	707.2	162.2	345.8	361.6	741.3	819.0	782.4
Revenue	512.6	553.0	624.1	147.9	315.5	332.9	678.7	704.5	739.7
Tax revenue	405.6	441.5	478.1	112.7	243.5	253.2	551.6	555.9	599.6
Federal	386.8	422.5	459.3	106.8	232.7	242.5	528.5	532.8	573.7
CBR revenue	346.6	392.1	403.9	90.4	199.5	203.1	458.9	458.9	510.0
Direct tax	112.6	124.6	142.6	23.6	64.4	63.3	148.4	148.4	154.8
Federal excise duty	55.6	49.0	46.9	9.6	20.6	19.8	47.5	47.5	48.8
Sales tax	116.7	153.5	166.3	43.8	88.9	92.6	204.0	204.0	232.2
Customs duties	61.6	65.0	48.1	13.4	25.6	27.3	59.0	59.0	74.2
Petroleum surcharge	25.4	17.9	36.6	10.8	23.5	21.9	48.0	46.4	46.2
Gas surcharge	13.5	12.3	17.7	5.2	7.7	11.6	18.0	21.0	15.0
Other	1.4	0.2	1.1	0.4	1.9	5.9	3.7	6.5	2.5
Provincial	18.8	19.0	18.8	6.0	10.8	10.7	23.1	23.1	25.9
Nontax revenue	106.9	111.4	146.0	35.2	72.0	79.7	127.1	148.6	140.1
Federal	90.8	91.5	124.7	31.4	63.9	71.2	104.3	125.9	114.9
Provincial	16.1	19.9	21.3	3.8	8.1	8.4	22.7	22.7	25.2
Grants	33.4	40.5	83.1	14.3	30.3	28.8	62.6	114.4	42.6
Expenditure	709.1	717.9	826.2	193.8	422.1	404.1	865.0	890.9	918.9
Current expenditure	626.4	645.7	700.2	164.2	363.4	349.9	728.0	735.2	770.2
Federal	477.9	479.0	524.6	118.7	275.7	244.8	542.9	550.1	568.2
Interest payments	245.1	234.5	245.3	50.8	124.5	103.2	242.3	214.3	211.2
Domestic	198.4	183.5	184.6	41.0	95.0	79.8	185.9	172.0	170.5
Foreign 2/	46.7	51.0	60.6	9.7	29.4	23.4	56.4	42.3	40.7
Defense	150.4	104.7	149.0	32.6	78.2	76.7	146.0	160.0	160.0
Running of the civil government	47.5	70.7	56.3	11.3	25.9	24.8	52.9	54.2	64.0
Pensions for defense and civil government	...	30.9	27.2	5.9	17.4	15.1	34.8	34.8	38.0
Subsidies 3/	14.7	19.9	23.7	13.7	17.3	16.6	41.0	60.3	64.6
Grants	12.6	18.1	22.8	4.3	11.9	8.5	25.5	26.0	29.2
Other	7.5	0.3	0.3	0.1	0.5	-0.1	0.5	0.5	1.2
Provincial	148.5	166.7	175.6	45.4	87.7	105.2	185.1	185.1	202.0
Development expenditure and net lending	82.7	72.2	125.9	29.6	59.7	54.2	141.0	155.7	148.7
Public Sector Development Program	95.6	89.8	126.2	24.5	55.4	51.5	134.0	134.0	152.0
Federal	59.3	66.9	98.4	14.6	35.0	31.5	90.0	90.0	105.0
Provincial	36.3	22.9	27.8	9.9	20.4	20.0	44.0	44.0	47.0
Net lending	-12.9	-17.6	-0.2	5.1	4.3	2.7	7.0	21.7	-3.3
Unallocated exchange rate savings in 2002/03	...	...	...	...	-1.0	...	-4.0	0.0	...
Unidentified measures	...	...	...	...	...	...	...	0.0	0.0
Statistical discrepancy ("+" = additional expenditure)	9.7	14.8	-11.7	-1.4	...	-9.0	...	...	...
Federal government	7.0	29.8	15.3	2.3	...	9.3	...	...	...
Provinces	2.7	-15.0	-26.9	-3.7	...	-18.3	...	...	...
Underlying budget balance (excluding grants) 3/	-206.3	-179.7	-190.5	-44.5	-106.6	-62.3	-186.3	-186.4	-179.2
Underlying budget balance (including grants)	-172.9	-139.2	-107.3	-30.1	-76.3	-33.5	-123.7	-72.0	-136.5
One-off expenditure items 4/	...	...	52.0	...	...	...	...	...	20.0
Budget balance (excluding grants)	-206.3	-179.7	-242.5	-44.5	-106.6	-62.3	-186.3	-186.4	-199.2
Budget balance (including grants)	-172.9	-139.2	-159.3	-30.1	-76.3	-33.5	-123.7	-72.0	-156.5
Financing	172.9	139.2	159.3	30.2	76.3	33.5	123.7	72.0	156.5
External	36.3	80.2	51.7	24.7	41.0	32.0	49.8	20.2	14.2
Of which: privatization receipts	...	...	...	...	...	7.3	10.0	10.0	...
Domestic	136.5	59.0	99.3	4.7	31.3	1.5	73.9	51.8	142.3
Bank	39.9	-33.0	14.3	-12.7	-15.9	-34.0	-29.2	-29.2	34.2
Nonbank	96.6	92.0	85.0	17.4	47.2	34.3	101.1	79.0	98.1
Privatization receipts	0.0	0.0	8.4	0.8	4.0	1.2	2.0	2.0	10.0
Memorandum items:									
Expenditure incl. statistical discrepancy and one-off	718.8	732.7	866.5	192.4	422.1	395.1	865.0	890.9	938.9
Primary balance (including grants)	72.2	95.3	138.0	20.6	48.2	69.7	118.6	142.4	74.7
Social and poverty-related expenditure	114.4	122.3	133.6	29.3	70.8	66.5	161.0	161.0	185.1
Total government debt	3,118.7	3,752.9	3,652.2	3,635.2	...	3,650.5	...	3,588.1	3,716.6
Domestic debt	1,644.8	1,799.2	1,757.5	1,763.5	...	1,799.8	...	1,842.5	1,974.9
External debt	1,473.9	1,953.7	1,894.7	1,871.7	...	1,850.7	...	1,745.6	1,741.8
Nominal GDP at market prices	3,147.2	3,416.3	3,726.6	1,015.8	2,031.5	2,031.5	4,063.0	4,063.0	4,440.3

Source: Pakistani authorities; and Fund staff estimates and projections.

1/ Program as agreed during the fourth review.

2/ Accrued payments. Excludes interest expenditure by the military which is included in the defense allocation.

3/ In 2002/03, subsidies include arrears settlement on behalf of KESOC amounting to PRs 11 billion in the initial program and PRs 8 billion in the revised projections.

4/ 2001/02: KESOC recapitalization (PRs 32 billion) and CBR bonds (PRs 20 billion). 2003/04: IDBP restructuring (PRs 12 billion) and ABL restructuring (PRs 8 billion).

Table 4. Pakistan: Consolidated Government Budget, 1999/2000–2003/04

(In percent of GDP; unless otherwise indicated)

	1999/2000	2000/01	2001/02	2002/03					2003/04
	FY	FY	FY	Sep.	Dec.		FY		FY
	Prov. Act.	Prov. Act.	Prov. Act.	Prcl. Act.	Prog. 1/	Prcl. Act.	Prog. 1/Rev.	Proj.	Prog.
Revenue and grants	17.3	17.4	19.0	16.0	17.0	17.8	18.2	20.2	17.6
Revenue	16.3	16.2	16.7	14.6	15.5	16.4	16.7	17.3	16.7
Tax revenue	12.9	12.9	12.8	11.1	12.0	12.5	13.6	13.7	13.5
Federal	12.3	12.4	12.3	10.5	11.5	11.9	13.0	13.1	12.9
CBR revenue	11.0	11.5	10.8	8.9	9.8	10.0	11.3	11.3	11.5
Direct tax	3.6	3.6	3.8	2.3	3.2	3.1	3.7	3.7	3.5
Federal excise duty	1.8	1.4	1.3	0.9	1.0	1.0	1.2	1.2	1.1
Sales tax	3.7	4.5	4.5	4.3	4.4	4.6	5.0	5.0	5.2
Customs duties	2.0	1.9	1.3	1.3	1.3	1.3	1.5	1.5	1.7
Petroleum surcharge	0.8	0.5	1.0	1.1	1.2	1.1	1.2	1.1	1.0
Gas surcharge	0.4	0.4	0.5	0.5	0.4	0.6	0.4	0.5	0.3
Other	0.0	0.0	0.0	0.0	0.1	0.3	0.1	0.2	0.1
Provincial	0.6	0.6	0.5	0.6	0.5	0.5	0.6	0.6	0.6
Nontax revenue	3.4	3.3	3.9	3.5	3.5	3.9	3.1	3.7	3.2
Federal	2.9	2.7	3.3	3.1	3.1	3.5	2.6	3.1	2.6
Provincial	0.5	0.6	0.6	0.4	0.4	0.4	0.6	0.6	0.6
Grants	1.1	1.2	2.2	1.4	1.5	1.4	1.5	2.8	1.0
Expenditure	22.5	21.0	22.2	19.1	20.8	19.9	21.3	21.9	20.7
Current expenditure	19.9	18.9	18.8	16.2	17.9	17.2	17.9	18.1	17.3
Federal	15.2	14.0	14.1	11.7	13.6	12.0	13.4	13.5	12.8
Interest payments	7.8	6.9	6.6	5.0	6.1	5.1	6.0	5.3	4.8
Domestic	6.3	5.4	5.0	4.0	4.7	3.9	4.6	4.2	3.8
Foreign 2/	1.5	1.5	1.6	1.0	1.4	1.2	1.4	1.0	0.9
Defense	4.8	3.1	4.0	3.2	3.9	3.8	3.6	3.9	3.6
Running of the civil government	1.5	2.1	1.5	1.1	1.3	1.2	1.3	1.3	1.4
Pensions for defense and civil government	...	0.9	0.7	0.6	0.9	0.7	0.9	0.9	0.9
Subsidies 3/	0.5	0.6	0.6	1.4	0.9	0.8	1.0	1.5	1.5
Grants	0.4	0.5	0.6	0.4	0.6	0.4	0.6	0.6	0.7
Other	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Provincial	4.7	4.9	4.7	4.5	4.3	5.2	4.6	4.6	4.5
Development expenditure and net lending	2.6	2.1	3.4	2.9	2.9	2.7	3.5	3.8	3.3
Public Sector Development Program	3.0	2.6	3.4	2.4	2.7	2.5	3.3	3.3	3.4
Federal	1.9	2.0	2.6	1.4	1.7	1.5	2.2	2.2	2.4
Provincial	1.2	0.7	0.7	1.0	1.0	1.0	1.1	1.1	1.1
Net lending	-0.4	-0.5	0.0	0.5	0.2	0.1	0.2	0.5	-0.1
Unallocated exchange rate savings in 2002/03	...	...	...	...	0.0	...	-0.1	0.0	...
Unidentified measures	...	...	...	...	...	...	...	0.0	0.0
Statistical discrepancy ("+" = additional expenditure)	0.3	0.4	-0.3	-0.1	...	-0.4	...	...	...
Federal government	0.2	0.9	0.4	0.2	...	0.5	...	...	...
Provinces	0.1	-0.4	-0.7	-0.4	...	-0.9	...	...	...
Underlying budget balance (excluding grants) 3/	-6.6	-5.3	-5.1	-4.4	-5.2	-3.1	-4.6	-4.6	-4.0
Underlying budget balance (including grants)	-5.5	-4.1	-2.9	-3.0	-3.8	-1.6	-3.0	-1.8	-3.0
One-off expenditure items 4/	...	...	1.4	...	...	...	...	...	0.5
Budget balance (excluding grants)	-6.6	-5.3	-6.5	-4.4	-5.2	-3.1	-4.6	-4.6	-4.5
Budget balance (including grants)	-5.5	-4.1	-4.3	-3.0	-3.8	-1.6	-3.0	-1.8	-3.5
Financing	5.5	4.1	4.3	3.0	3.8	1.6	3.0	1.8	3.5
External	1.2	2.3	1.4	2.4	2.0	1.6	1.2	0.5	0.3
Of which: privatization receipts	...	...	...	...	...	0.4	0.2	0.2	...
Domestic	4.3	1.7	2.7	0.5	1.5	0.1	1.8	1.3	3.2
Bank	1.3	-1.0	0.4	-1.3	-0.8	-1.7	-0.7	-0.7	0.8
Nonbank	3.1	2.7	2.3	1.7	2.3	1.7	2.5	1.9	2.2
Privatization receipts	0.0	0.0	0.2	0.1	0.2	0.1	0.0	0.0	0.2
Memorandum items:									
Expenditure incl. statistical discrepancy and one-off	22.8	21.4	23.3	18.9	20.8	19.5	21.3	21.9	21.1
Primary balance (including grants)	2.3	2.8	3.7	2.0	2.4	3.4	2.9	3.5	1.7
Social and poverty-related expenditure	3.6	3.6	3.6	2.9	3.5	3.3	4.0	4.0	4.2
Total government debt	99.1	109.9	98.0	89.5	...	89.8	...	88.3	83.7
Domestic debt	52.3	52.7	47.2	43.4	...	44.3	...	45.3	44.5
External debt	46.8	57.2	50.8	46.1	...	45.5	...	43.0	39.2
Nominal GDP (market prices, billions of Pakistani rupees)	3,147	3,416	3,727	1,016	2,032	2,032	4,063	4,063	4,440

Source: Pakistani authorities; and Fund staff estimates and projections.

1/ Program as agreed during the fourth review.

2/ Accrued payments. Excludes interest expenditure by the military which is included in the defense allocation.

3/ In 2002/03, subsidies include arrears settlement on behalf of KESC amounting to PRs 11 billion in the initial program and PRs 8 billion in the revised projections.

4/ 2001/02: KESC recapitalization (PRs 32 billion) and CBR bonds (PRs 20 billion). 2003/04: IDBP restructuring (PRs 12 billion) and ABL restructuring (PRs 8 billion).



Table 5. Pakistan: Monetary Survey, 2000/01–2003/04

	Act.		Monetary Program 2002/03 1/					Monetary Program 2003/04 1/		
			Sep.	Dec.		Mar.	Jun.	Sep.	Dec.	Jun.
	2000/01	2001/02	Act. 2002	Prog. 2002	Act. 2/ 2002	Rev. Prog. 3/ 2003	Rev. Prog. 3/ 2003	Prog. 2003	Prog. 2003	Proj. 2004
(End-of-period stocks; in billions of Pakistan rupees)										
Net foreign assets	26.3	230.8	348.2	453.9	414.8	519.8	559.1	580.8	599.0	671.1
Net domestic assets	1,499.7	1,530.6	1,462.6	1,509.2	1,526.3	1,507.6	1,544.1	1,565.8	1,690.3	1,647.8
Net claims on government	569.7	591.9	575.9	553.5	536.7	528.7	553.0	594.5	599.1	562.2
<i>Of which:</i>										
Net bank borrowing	499.9	514.2	501.5	498.3	480.2	475.6	485.0	528.5	538.1	499.2
Commodity operations	95.3	100.6	95.9	78.6	79.6	75.6	89.6	87.6	82.6	84.6
Net claims on nongovernment	902.4	921.6	885.6	962.6	990.0	979.4	991.6	967.7	1,087.6	1,082.0
Private sector	802.1	839.6	809.0	885.8	915.1	891.1	889.6	864.7	982.9	974.0
Public sector	100.2	82.0	76.6	76.8	75.0	88.3	102.0	103.0	104.7	108.0
Privatization account	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9
Other items, net	30.6	20.0	4.1	-3.9	2.5	2.5	2.5	6.6	6.6	6.6
Total liquidity (broad money)	1,526.0	1,761.4	1,810.8	1,963.1	1,941.2	2,027.3	2,103.2	2,146.7	2,289.2	2,318.8
<i>Of which:</i>										
Pakistani rupee liquidity	1,371.9	1,603.9	1,645.8	1,796.4	1,806.7	1,886.7	1,956.2	1,999.4	2,136.9	2,156.3
(Changes in percent of stock of broad money at the beginning of the fiscal year)										
Net foreign assets	5.1	13.4	6.3	12.3	10.1	16.1	18.3	1.9	2.8	6.2
Net domestic assets	3.9	2.0	-3.4	-0.7	0.2	-0.8	1.2	0.8	6.8	4.8
<i>Of which:</i>										
Net claims on the government	-3.3	1.5	-0.9	-2.2	-3.1	-3.6	-2.2	2.0	2.2	0.4
Net claims on private sector	3.5	2.5	-1.7	2.6	4.3	2.9	2.8	-1.2	4.5	4.0
(Changes over 12 months; in percent)										
Broad money	9.0	15.4	19.3	19.0	17.6	21.5	19.5	18.5	17.9	11.0
Net claims on private sector	6.5	4.7	3.7	4.0	7.4	6.3	6.0	6.9	7.4	9.5
Memorandum item:										
Indicative program exchange rate	...	...	60.07	60.07	60.07	60.07	60.07	58.10	58.10	58.10

Sources: State Bank of Pakistan; and Fund staff estimates.

1/ At indicative program exchange rate.

2/ Program column is the revised projection published in IMF Country Report No. 03/54. Actual numbers reflect the fact that part of the foreign assets accumulated by the SBP and pledged for the repayment of foreign banks' deposits were placed with commercial banks and thus are treated as domestic assets of the SBP.

3/ Revised program means revised projection based on: (a) flows consistent with program targets set during previous reviews for variables subject to performance criteria; and (b) revised assumptions.

Table 6. Pakistan: Accounts of the State Bank of Pakistan, 2000/01–2003/04

	Act.		Monetary Program 2002/03 1/				Monetary Program 2003/04 1/			
	2000/01	2001/02	Sep. Act. 2002	Dec. Prog. Act. 2/ 2002		Mar. Rev. Prog. 3/ 2003	Jun. Rev. Prog. 3/ 2003	Sep. Prog. 2003	Dec. Prog. 2003	Jun. Proj. 2004
	(End-of-period stocks; in billions of Pakistani rupees)									
Net foreign assets	-19.1	133.5	271.7	376.6	357.4	454.9	492.9	505.5	525.1	575.0
Net domestic assets	552.3	451.1	321.0	264.8	293.1	223.0	198.0	190.5	216.5	179.5
Net claims on government	335.6	226.2	99.6	43.2	64.3	-2.7	-21.7	-38.0	-15.8	-60.3
<i>Of which:</i>										
Budgetary support	361.1	249.2	121.1	66.7	87.3	19.8	-0.1	-16.4	5.8	-38.7
Claims on nongovernment	40.1	22.7	17.4	17.6	14.7	17.5	17.5	17.5	17.5	17.5
Claims on scheduled banks	198.0	195.8	175.8	163.8	192.1	186.1	180.1	183.9	187.6	195.1
Privatization account	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9
Other items, net	-18.4	9.4	31.1	43.1	24.9	24.9	24.9	30.0	30.0	30.0
Reserve money 4/	533.2	584.6	592.7	641.4	650.6	677.8	690.8	696.0	741.6	754.4
<i>Of which:</i>										
Banks' reserves	127.3	110.5	127.3	121.7	125.8	131.6	138.5	141.7	151.1	155.4
Currency	394.6	460.2	454.3	508.6	513.3	534.8	540.8	552.2	588.3	597.0
	(Changes in percent of stock of reserve money at the beginning of the fiscal year)									
Net foreign assets	7.3	28.6	22.6	40.6	37.3	53.9	60.4	4.2	7.1	14.5
Net domestic assets	-0.2	-19.0	-21.3	-30.9	-26.0	-38.0	-42.3	-1.8	2.0	-3.5
<i>Of which:</i>										
Budgetary support	-6.3	-21.0	-21.6	-31.3	-27.7	-39.1	-42.4	-2.4	0.9	-5.7
	(Changes over 12 months; in percent)									
Reserve money 5/	-3.7	9.6	11.5	8.7	10.3	19.3	18.1	19.3	15.7	11.0
Currency	5.2	16.6	13.8	12.6	13.6	17.4	17.0	21.5	14.6	10.4
Memorandum item:										
Indicative program exchange rate	...	...	60.07	60.07	60.07	60.07	60.07	58.10	58.10	58.10

Sources: State Bank of Pakistan; and Fund staff estimates.

1/ At indicative program exchange rates.

2/ Program column is the revised projection published in IMF Country Report No. 03/54. Actual numbers reflect the fact that part of the foreign assets accumulated by the SBP and pledged for the repayment of foreign banks' deposits were placed with commercial banks and thus are treated as domestic assets of the SBP.

3/ Revised program means revised projection based on: (a) flows consistent with program targets set during previous reviews for variables subject to performance criteria; and (b) revised assumptions.

4/ Starting in April 2000/01, reserve money includes special reserves on foreign currency deposits.

5/ For the purpose of calculating the 12-month growth rate, reserve money is considered net of the special reserves and corrected for the transformation of the special deposits accounts into treasury bills in December 2000 and March 2001.

Table 7. Pakistan: Gross Financing Requirements, 2001/02–2003/04

(In millions of U.S. dollars)

	2001/02	Rev. Proj. 2002/03	Proj. 2003/04
Gross financing requirements	-7,889	-5,696	-4,114
External current account deficit	1,591	3,683	1,189
Debt amortization	-6,204	-3,933	-3,369
Medium- and long-term debt	-2,657	-2,813	-1,892
Public sector	-2,261	-2,186	-1,492
Multilateral (excluding IMF)	-604	-612	-673
Bilateral	-817	-658	-581
Bonds (net)	-35	-195	-183
Other (including SBP liabilities)	-805	-721	-55
Private sector	-396	-627	-400
Short-term debt	-3,547	-1,120	-1,477
Public sector	-2,188	-972	-1,364
Private sector	-1,359	-148	-113
Repayment of arrears	0	0	0
Gross reserves accumulation	-3,082	-5,030	-1,407
<i>Of which:</i> official reserves	-2,717	-5,671	-907
IMF repurchases and repayments	-194	-416	-526
Available financing	7,889	5,696	4,114
FDI and portfolio investment (net, excluding public securities) 1/	475	828	700
Debt financing from private creditors	2,988	1,755	1,275
Medium- and long-term financing	487	241	188
To private sector	185	236	188
To public sector	302	5	0
Short-term financing	2,501	1,514	1,087
To public sector	1,378	1,237	900
To private sector	1,123	277	187
Official creditors	2,623	2,389	1,597
Project lending	531	721	697
Balance of payments support	2,092	1,668	900
AsDB and World Bank	883	777	900
Debt relief from bilateral creditors 2/	1,210	891	0
Private sector involvement	0	100	100
IMF	484	458	442
Other net capital flows 3/	1,319	166	0
Financing gap	0	0	0

Sources: Ministry of Finance; State Bank of Pakistan; and Fund staff estimates.

1/ Includes privatization receipts.

2/ Debt relief agreed in the January 2001 and December 2001 Paris Club Agreed Minutes.

3/ For 2001/02, includes SBP purchases in the kerb market.

Table 8. Pakistan: Summary of Public External Debt and Debt Service, 1999/2000–2003/04

	1999/2000	2000/01	2001/02	Proj.	
				2002/03	2003/04
	(In millions of U.S. dollars)				
Total public- and publicly-guaranteed external debt	29,757	32,743	33,167	31,867	31,636
Medium- and long-term debt	26,009	28,165	29,433	28,264	28,841
Project and nonproject aid	24,792	26,647	28,199	27,283	27,976
Commercial banks and IDB	560	634	383	325	392
Other (including securities and frozen foreign currency accounts)	657	885	851	656	473
Short-term debt (by initial maturity)	2,253	3,075	1,795	1,622	898
Commercial banks and IDB	671	834	212	339	343
FEBCs and DBCs	147	72	53	39	21
SBP liabilities (including swaps)	1,435	2,169	1,530	1,243	533
Fund credit and loans	1,496	1,503	1,939	1,981	1,897
Service of medium- and long-term public- and publicly-guaranteed debt	4,175	2,616	3,556	3,622	2,806
Amortization	3,113	1,540	2,455	2,602	2,018
Interest	1,062	1,076	1,101	1,020	789
Interest on public- and publicly-guaranteed short-term debt	319	284	198	112	95
	(In percent of GDP)				
Total public- and publicly-guaranteed external debt	54.6	55.8	54.5	45.7	40.3
Long-term	47.8	48.0	48.4	40.6	36.7
<i>Of which:</i> project and nonproject aid	45.5	45.4	46.4	39.2	35.6
Short-term	4.1	5.2	3.0	2.3	1.1
Fund credit and loans	2.7	2.6	3.2	2.8	2.4
Service of medium- and long-term public- and publicly-guaranteed debt	7.7	4.5	5.8	5.2	3.6
Amortization	5.7	2.6	4.0	3.7	2.6
Interest	1.9	1.8	1.8	1.5	1.0
Interest on public- and publicly-guaranteed short-term debt	0.6	0.5	0.3	0.2	0.1
	(In percent of exports of goods and nonfactor services)				
Total public- and publicly-guaranteed external debt	310.7	318.4	300.0	246.1	242.8
Service of medium- and long-term public- and publicly-guaranteed debt	43.6	25.4	32.2	28.0	21.5
Amortization	32.5	15.0	22.2	20.1	15.5
Interest	11.1	10.5	10.0	7.9	6.1
Memorandum items:					
Implicit interest on public- and publicly-guaranteed external debt	4.7	4.4	3.9	3.5	2.8
Public debt service in percent of government revenue (incl. grants)	44.2	25.7	31.1	27.9	19.3
Total external debt	34,047	36,140	36,007	35,296	34,892
(In percent of GDP)	62.5	61.6	59.2	50.7	44.4

Sources: State Bank of Pakistan; Ministry of Finance; and Fund staff estimates.

Table 9. Pakistan: Indicators of External Vulnerability, 1998/99–2002/03

	1998/99	1999/2000	2000/01	2001/02	Latest available observation	Rev. Proj. 2002/03
<b>Financial indicators</b>						
Net public debt (in percent of GDP)	93.6	91.6	100.9	95.5	...	...
Broad money (12-month percentage change)	6.2	9.4	9.0	15.2	18.0 2/	19.5
Private sector credit (12-month percentage change)	8.5	2.5	6.4	5.3	8.1 2/	6.0
180-day treasury bill yield (in percent)	12.9	8.8	10.4	8.1	1.6 3/	...
180-day treasury bill yield, real (in percent)	7.4	5.1	6.0	5.4	-2.0 3/	...
<b>Karachi Stock Exchange index</b>						
End-of-period	1,055	1,521	1,366	1,770	2,956 4/	...
Period average	985	1,514	1,436	1,514	...	...
<b>External Indicators</b>						
Exports (12-month percentage change, in U.S. dollars)	-10.7	8.8	9.1	2.3	7.2 5/	12.1
Imports (12-month percentage change, in U.S. dollars)	-6.7	-0.1	6.2	-7.5	7.3 5/	19.3
Terms of trade (12-month percentage changes)	4.1	-9.2	-1.6	-0.7	...	-3.9
Current account balance (excluding official transfers in percent of GDP)	-4.7	-3.9	-3.3	0.2	...	3.9
<b>Gross Official Reserves (in millions of U.S. dollars)</b>						
In weeks of imports of goods and nonfactor services	1.7	0.9	1.7	3.8	...	7.3
In percent of broad money	6.6	3.3	7.0	14.8	...	28.3
In percent of total short-term debt at remaining maturity	22.1	10.9	23.7	72.1	...	181.5
<b>Total external debt (in millions of U.S. dollars)</b>						
In percent of exports of goods and nonfactor services	385.1	355.5	351.4	325.7	...	272.6
Actual debt service (in percent of exports of goods and services) 1/	76.7	80.1	60.4	60.7	...	36.5
Exchange rate (Pakistani rupees per U.S. dollar, period average)	50.1	51.6	58.3	61.3	57.7 4/	...
Real exchange rate (12-month percentage change)	-9.1	-0.6	-2.6	-1.2	-12.5 2/	...

Sources: Pakistani authorities; Bank for International Settlements; and Fund staff estimates.

1/ Scheduled debt service on total debt minus rescheduled debt service plus debt service on previously rescheduled debt.

2/ February 2003.

3/ April 2003.

4/ May 13, 2003.

5/ Fourth quarter of calendar year 2002.

Table 10. Pakistan: Indicators of Fund Credit, 2000/01–2007/08 1/

	2000/01	2001/02	Proj.					
			2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
<b>Outstanding Fund credit</b>								
In millions of SDRs	1,207	1,524	1,438	1,377	1,274	1,176	1,096	987
In millions of U.S. dollars	1,503	1,939	1,981	1,897	1,755	1,620	1,509	1,360
In percent of:								
Quota	116.7	147.5	139.2	133.2	123.3	113.8	106.0	95.5
GDP	2.6	3.2	2.8	2.4	2.2	1.9	1.6	1.5
Exports of goods and nonfactor services	14.6	17.5	15.3	14.6	13.4	11.7	10.3	8.7
Public- and publicly-guaranteed debt	4.6	5.8	6.2	6.0	5.7	5.4	5.1	4.7
<b>Debt service to the Fund</b>								
In millions of SDRs	228	194	334	408	297	113	90	117
In millions of U.S. dollars	294	247	460	562	408	156	124	162
In percent of:								
Exports of goods and nonfactor services	2.9	2.2	3.6	4.3	3.1	1.1	0.8	1.0
Gross official reserves	17.5	5.7	5.1	5.3	3.5	1.3	1.0	1.2

Sources: IMF Treasurer's Department; and Fund staff estimates.

1/ Assuming PRGF disbursements as scheduled and debt service according to the expectations schedule.

Table 11. Pakistan: Social Indicators, 1970–2004

	Latest single year				I-PRSP Target 2003/04	South Asia	Lower-income
	1970–75	1980–85	1993–99	2000–02		(world-wide) Latest single year (1990–2001)	
<b>Population</b>							
Total population, mid-year (in millions)	71.0	94.8	134.8	141.5	...	1,379.5	2,511.4
Growth rate (percent annual average)	3.2	2.7	2.4	2.4	1.8	1.8	1.8
Urban population (percent of population)	26.4	29.8	36.5	37.0	...	27.8	31.0
Total fertility rate (births per woman)	7.0	6.5	4.8	4.6	4.1	3.3	3.6
Unemployment (as percentage of total labor force)	...	3.7	5.9	5.9	...	...	...
<b>Income</b>							
GNI per capita (U.S. dollars) 1/	150.0	330.0	450.0	420.0	...	450.0	430.0
Consumer price index (percentage change)	20.9	5.6	4.1	3.3	5.0	4.4	2.1
Food price index (percentage change)	...	4.4	3.9	2.4	5.0	...	...
<b>Social indicators</b>							
<b>Public expenditure</b>							
Health (percent of GDP)	...	...	0.7	0.5	0.5	0.9	1.2
Education (percent of GNP)	2.2	2.9	1.6	1.8	1.8	3.1	3.3
<b>Education 2/</b>							
<b>Gross primary school enrollment rate (in percent of age group)</b>							
Total	39.5	43.7	86.2	96.0	100.0	101.4	95.8
Male	52.7	55.7	109.1	117.0	119.0	109.4	103.4
Female	25.5	30.4	62.2	74.0	76.0	92.9	87.9
Gross secondary school enrollment rate (in percent of age group)	14.7	17.2	37.2	...	68.0	48.1	42.3
Illiteracy rate (as percentage of population aged 15 and above)	75.8	68.6	57.6	56.0	41.0	45.2	37.6
<b>Access to safe water (in percent of population)</b>							
Total	...	38.0	63.0	...	68.0	87.0	76.0
Urban	75.0	84.0	83.0	...	87.0	92.0	88.0
Rural	5.0	28.0	53.0	...	57.0	85.0	70.0
<b>Immunization rate (percent of children under 12 months)</b>							
Measles	...	38.0	54.0	54.0	...	62.7	64.0
DPT	...	30.0	56.0	...	...	75.2	70.4
<b>Life Expectancy at birth (years)</b>							
Total	52.3	57.4	61.7	63.4	64.4	62.4	58.9
Male	52.1	56.9	60.8	63.0	...	61.7	57.9
Female	52.5	58.0	62.6	64.1	...	63.0	60.0
<b>Mortality</b>							
Children under 5 years (per thousand live births)	181.0	157.0	112.0	109.0	65.0	96.5	114.9
Adult (15–59 years)							
Male (per 1,000 population)	339.5	282.5	190.0	194.0	...	227.3	294.0
Female (per 1,000 population)	381.1	290.9	158.0	164.0	...	212.2	260.9

Sources: World Bank: World Development Indicators, April 2003; and government of Pakistan.

1/ Gross national income divided by midyear population. The impact of exchange rate fluctuations in the cross-country comparison of national income is reduced notably by using three-year averages for exchange rates (World Bank's Atlas conversion factor).

2/ Education targets in the I-PRSP are not comparable with historical data for the previous years. The outstanding methodological and source issues related to the selection of education baseline indicators and output targets will be addressed during the preparation of the full PRSP.

**Pakistan: Fund Relations**  
As of April 30, 2003

**I. Membership Status:** Joined: 07/11/1950; Article VIII

<b>II. General Resources Account:</b>	<u>SDR Million</u>	<u>%Quota</u>
Quota	1,033.70	100.00
Fund Holdings of Currency	1,744.40	168.75
Reserve position in Fund	0.12	0.01
<b>III. SDR Department:</b>	<u>SDR Million</u>	<u>%Allocation</u>
Net cumulative allocation	169.99	100.00
Holdings	91.95	54.09
<b>IV. Outstanding Purchases and Loans:</b>	<u>SDR Million</u>	<u>%Quota</u>
Stand-by arrangements	446.25	43.17
Extended arrangements	132.30	12.80
Contingency and Compensatory	132.26	12.80
ESAF/PRGF arrangements	737.64	71.36

**V. Latest Financial Arrangements:**

	Approval	Expiration	Approved Amount	Amount Drawn
Type	Date	Date	(SDR Million)	(SDR Million)
PRGF	12/06/2001	12/05/2004	1,033.70	430.72
Stand-By	11/29/2000	09/30/2001	465.00	465.00
EFF	10/20/1997	10/19/2000	454.92	113.74

**VI. Projected Obligations to Fund Under the Repurchase Expectations Assumptions**  
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Overdue		Forthcoming			
	<u>04/30/03</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
Principal	0.0	288.2	383.0	163.9	72.0	97.9
Charges/Interest	<u>0.0</u>	<u>16.6</u>	<u>13.1</u>	<u>7.2</u>	<u>5.2</u>	<u>4.4</u>
Total	0.0	304.9	396.1	171.1	77.2	102.3

Repurchase Obligations: Repurchases in the credit tranches including the Compensatory Financing Facility, are to be completed in 3¼–5 years. Repurchases under the Extended Fund Facility are due in 4½–10 years.



## **A. Nonfinancial Relations**

### **VII. Exchange System**

Prior to mid-1998, Pakistan implemented a fixed exchange rate system with periodic step devaluation to compensate for the inflation differential with major trading partners. On July 21, 1998, a dual exchange system was introduced consisting of a fixed official exchange rate at PRs 46 per \$1 and a floating interbank market exchange rate (FIBR). Under this system, all authorized transactions were effectively conducted at the so-called "composite rate" which was the weighted average of the FIBR and the official exchange rate. In addition, since May 28, 1998, withdrawals from foreign currency accounts have only been allowed in Pakistani rupees (at the official exchange rate). An advance import deposit of 30 percent was introduced on July 12, 1998; it was subsequently reduced to 20 percent on January 9, 1999 and to 10 percent on January 24, 1999, and was eliminated on February 24, 1999. On May 19, 1999, the official exchange rate was eliminated and the exchange rate system unified, with all international transactions conducted at the FIBR. As of May 16, 2003, the FIBR was PRs 57.70 per \$1. Pakistan's exchange regime is classified as managed floating with no predetermined path for the exchange rate.

### **VIII. Last Article IV Consultation**

The last Article IV consultation discussions were held in Islamabad during August 2002. The staff report (IMF Country Report No. 02/246) was discussed by the Executive Board on November 1, 2002.

### **IX. Safeguards Assessments**

A Stage One Safeguards Assessment of the State Bank of Pakistan (SBP) was completed on October 26, 2000. The assessment concluded that high risks may exist in the area of external audit mechanism, financial reporting, and internal control, and recommended a Stage Two (on-site) assessment. The Stage Two (on-site) assessment was completed on February 13, 2001 and staff's findings and recommendations were reported to Fund management (IMF Country Report No. 01/58, Appendix IV) and to the authorities. A monitoring exercise related to safeguards developments at the SBP has been undertaken. All the recommended remedial actions arising from the initial safeguards assessment have been implemented and no new critical vulnerabilities have been identified. The Stage Two recommendations included in the Stand-By Arrangement conditionality remain applicable to Pakistan's PRGF arrangement, which was approved on December 6, 2001 and is scheduled to expire on December 5, 2004.

### **X. ROSCs**

Fiscal Transparency Module	11/28/2000	SM/00/264
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## XI. Recent Technical Assistance

a. **FAD:** In 1997–99, missions reviewed the public expenditure management system, the operation of the GST, and recommended measures to improve tax administration and increase tax compliance. In April 1999, a mission reviewed the income tax system and developed a strategy to improve its efficiency, potential for long-term development and ease of administration. A mission in January–February 2000 assisted with the revision of fiscal data and advised on measures to strengthen the fiscal reporting and accounting systems. In May 2000, a mission assisted with the preparation of the fiscal module of the Report on the Observance of Standards and Codes (ROSC). In August 2000, a joint FAD-STA mission reviewed progress in the strengthening of the fiscal reporting and accounting systems and assisted authorities in the preparation of revised fiscal data for 1993/94–1998/99. In September 2000, a mission provided technical assistance (TA) on overhauling the income tax law. In January 2001, a mission provided advice on priorities and strategies for improving the tax collection operations of the CBR. A follow-up mission on income tax policy took place in May 2001. In August 2001, a mission assisted the authorities in the preparation of tax administration reforms. In January 2002, another mission advised the authorities on fiscal data management, quality, and transparency. In January 2003, a mission assisted the authorities in reviewing and preparing tax administration reforms.

b. **MFD:** In May/June 1996, a mission provided TA on the transition to indirect monetary control. In June/July 1997, a TA mission assisted in developing a strategy to phase out subsidized forward cover for foreign currency deposits and to improve the institutional structure of the foreign exchange market. In February, May/June, and November 1998, MFD fielded follow-up TA missions on foreign exchange market reform. In May 1999, mission provided TA in the area of integration of open market operations and the foreign exchange market. In July 2000, a joint MFD-MED mission provided technical advice on issues relating to the transformation to a financial system that is compliant with Islamic finance principles. In September 2000, a mission provided TA on enhancing the market orientation of the foreign exchange market. In February 2001, a mission provided TA on the design of public finance investment that are compatible with Islamic finance principles.

c. **STA:** In May/June 2000, a mission reviewed the compilation of data considered most important for program design and monitoring. A follow-up mission in July helped develop a series of time-bound measures to improve the national accounts statistics. In January 2001, an expert from STA provided technical advice and training to the Federal Bureau of Statistics for a three-stage development of producer price indices. In February 2002, a mission reviewed external sector statistics and provided advice on steps to be undertaken to subscribe to the SDDS.

d. **LEG:** In May/July 2001, a LEG consultant assisted the authorities in the preparation of the new income tax law, which was promulgated in September 2001.

## XII. Resident Representative

A resident representative has been stationed in Islamabad since August 1991.

## **Pakistan: Fund-Bank Relations**

### **Partnership in Pakistan's development strategy**

1. The government of Pakistan's development strategy is set forth in its Interim Poverty Reduction Strategy Paper (I-PRSP). The I-PRSP focuses on: (a) strengthening governance and the integrity of the civil service; (b) creating opportunities through accelerating growth of agriculture, small and medium-scale industries, information technology, and oil and gas sectors; and (c) reducing poverty through revival of growth and re-orienting public expenditure towards human development and poverty reduction. A Joint Staff Assessment (JSA) on the I-PRSP was discussed by the Boards of the World Bank and the Fund on December 4 and 6, 2001, respectively. The full PRSP is expected to be completed this year.
2. The Fund is supporting Pakistan's poverty reduction efforts in the context of the three-year arrangement under the Poverty Reduction and Growth Facility (PRGF). The Fund's program supports the continued pursuit of sound macroeconomic policies, in particular sustained fiscal adjustment, while increasing the share of poverty reduction-related public spending; strengthening governance; tax policy and administration reform; public enterprise restructuring and privatization; and financial sector and foreign exchange market reforms. The Fund takes the lead in the policy dialogue on macroeconomic policies including overall fiscal and monetary policy. In addition to macroeconomic targets, the Fund has established structural performance criteria relating to reforms in the areas of tax policy and administration, power sector reform, foreign exchange market liberalization, and public expenditure management. As outlined more fully below, the World Bank has complemented the Fund's work through support to structural reforms in the social sectors and support of the growth agenda through deregulation of key sectors, such as power, oil and gas, and banking reforms whose performance have a strong bearing on growth and public finances.

### **Bank Group Strategy**

3. The objective of the World Bank Group's assistance strategy is to help Pakistan reduce poverty through support of the government's implementation of its Interim Poverty Reduction Strategy. The World Bank Group's program priorities are focused on the reforms to (a) strengthen macroeconomic stability and government effectiveness; (b) improve the business environment for growth; and (c) improve equity through support for pro-poor and pro-gender equity policies. The Country Assistance Strategy (CAS), which was presented to the World Bank's Board of Executive Directors on June 11, 2002, sets out a strategy in support of these objectives for the period FY 2003–05.<sup>1</sup>

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<sup>1</sup> <http://www.worldbank.org/pakistancas>

4. The World Bank works closely with the Fund and the government on structural reforms underpinning macroeconomic stability, particularly in areas with an impact on the balance of payments and public finances. In this context, the FY 2002 IDA-financed \$500 million Structural Adjustment Credit supports the government's actions in the areas of improving public expenditure management and supporting reforms of tax administration, safe and sound banking, efficient public utilities, and structural fiscal and governance reforms. The World Bank has also approved structural adjustment credits for two provinces (Sindh and North West Frontier Province (NWFP)) totaling \$190 million supporting provincial reform strategies to improve resource management and strengthen provision of public services by local governments and communities.

5. The World Bank Group's support to strengthening the investment climate includes a combination of analytical work and financial assistance targeted to reforms in key sectors. The World Bank Group continues to encourage the federal and provincial governments to further pursue the ongoing liberalization and modernization of trade, industrial, business, and labor regulations. To build the knowledge base to underpin the policy dialogue on private sector development, the World Bank Group is carrying out a significant program of analytical work. In addition to a Development Policy Review (completed in FY 2002), an Investment Climate Assessment, a Petroleum Sector Review, and a Public Expenditure Review are near completion. In addition to the governance reforms which have a direct bearing on the investment climate, the World Bank Group continues to support financially and through policy advice reforms of the governance and regulatory environment for power, gas, oil, financial sector, pricing and tariffs reforms, and privatization.

6. In the social sectors, the World Bank Group's assistance is geared toward support to the implementation of the Education Sector Reform (ESR) Strategy and the government's priority of strengthening public health programs and maternal and child health and family planning. Accordingly the World Bank is focusing on: (a) programmatic support to the National Education Sector Reform Strategy; (b) support to the National Education Assessment System; (c) a program of analytical work to underpin the policy dialogue during the implementation of the ESR; and (d) province-based support to implementing the ESR within the fiscal and economic reforms of Sindh and NWFP to start with. Prior actions related to the recently approved Structural Adjustment Credit included an increase in budget allocations for human development and pro-poor expenditures to 4.4 percent of GDP. In FY 2003, World Bank Group assistance to health sector reforms also includes the HIV/AIDS Prevention Project, as well as analytical work, technical assistance, and policy dialogue, as appropriate.

7. Supporting the rural sector through community-based infrastructure projects (particularly for water supply and sanitation services) and the spread of micro-credit have been part of the World Bank Group's strategy to reduce and mitigate risks for Pakistan's poor. The World Bank will continue to pilot new approaches, and also help scale up those which have proven effective such as the Community Infrastructure and Services Project (CIP) and the Pakistan Poverty Alleviation Fund (PPAF).

8. IBRD and IDA have approved 84 loans and 116 credits to Pakistan since 1952, totaling \$6,975.3 million and \$7,109.2 million, respectively. As of March 31, 2003, the World Bank lending portfolio in Pakistan consisted of 14 lending operations with a total commitment of \$ 1,227 million. (see Table 1). Undisbursed commitments total \$403.1 million.

Table 1. Pakistan: World Bank Portfolio  
(In millions of U.S. dollars, as of March 31, 2003)

Project	Approved	Amount	Disbursements	Closing Date
NWFP Community Infrastructure	1996	21.5	13.4	Jun-03
Telecom Regulation and Privatization	1996	35.0	17.6	Jun-03
Ghazi Barotha Hydropower	1996	350.0	324.4	Oct-03
Phase-out of Ozone Depleting Subs	1997	13.0	5.00	Jun-06
Improving Financial Reporting & Auditing	1997	28.8	9.3	May-04
National Drainage Program	1998	285.0	161.2	Dec-04
Northern Education	1998	22.8	10.8	Jun-03
Poverty Alleviation Fund	1999	90.0	53.8	Dec-04
GEF-Protected Areas Management Project	2001	10.1	0.2	Dec-07
Trade and Transport Facilitation	2001	3.0	1.5	Oct-04
NWFP On-Farm Water Management	2001	21.4	0.9	Jun-06
Banking Sector Restructuring & Privatization	2002	300.0	204.3	Dec-04
AJK Community Infrastructure & Services	2003	20.0	1.5	Dec-06
Banking Sector Technical Assistance	2003	26.5	2.3	Dec-07

### Bank-Fund collaboration in specific areas

9. As part of its overall assistance to Pakistan—through lending, country analytic work and technical assistance—the World Bank supports policy reforms in the following areas in collaboration with the Fund:

a. **Financial sector reforms.** Pakistan has been engaged in far-reaching reforms of the financial sector for five years. Considerable progress has been made, particularly with respect to reform of the banking sector. Regulations have been strengthened, loan recoveries increased, and the quality of management improved. Privatization of the three nationalized commercial banks—the core of the government’s reform strategy—is well advanced. The vision for the sector is for a market-oriented, predominantly private system that operates under a strong regulatory framework supported by an effective banking court system. The World Bank and the Fund have worked closely together to support needed policy reforms. The World Bank has maintained close dialogue with the government on banking sector reform following the Banking Sector Adjustment Loan in December 1997, through technical assistance to the central bank and preparation of a financial sector update in 2000.

World Bank support is also being provided through implementation of two ongoing projects: the Banking Sector Restructuring and Privatization Project, and the Banking Sector Technical Assistance Project. A joint World Bank/Fund Financial Sector Assessment Program is planned for FY 2004.

b. **Power sector reforms.** Losses in the power sector have been an ongoing source of macroeconomic instability in Pakistan, threatening achievement of fiscal deficit targets and preventing reorientation of public expenditure toward poverty reduction programs. In the context of the structural adjustment operations approved in FY 2001 and FY 2002, the World Bank has taken the lead in working with the government of Pakistan to unbundle and privatize the state-owned Water and Power Development Authority (WAPDA). During the transition toward privatization, the government of Pakistan aims to restore WAPDA's financial viability through implementation of medium-term financial improvement plans (FIPs) developed in consultation with the World Bank, which aim to sharply reduce the level of budget support to WAPDA through a combination of measures. Given the importance of this initiative to ensuring achievement of Pakistan's macroeconomic targets, progress in implementing the FIPs is being monitored closely by both the World Bank and Fund.

c. **Public expenditure management.** The quality of Pakistan's public expenditures has long been compromised by poor financial management practices. The government has made one of its top priorities to accelerate reforms towards achieving a modern public accounting and integrated financial management system at the federal, provincial, and district level. The World Bank, the Fund, and the government have been working closely in this area for more than two years. Under a policy framework agreed with the government and the Fund, the World Bank is taking the lead in supporting implementation of the reform program while the Fund is providing related technical assistance. World Bank support is being provided in the context of the ongoing Pakistan Improvement of Financial Reporting and Accounting (PIFRA) project through which the national accounting and audit systems are being modernized. A follow-on PIFRA II project will further these efforts, to improve the accuracy, completeness, reliability, and timeliness of intra-year and year end government financial reports in Pakistan at the national, provincial, and district levels. Analytical and diagnostic support is being provided in the form of a Country Financial Accountability Assessment (CFAA) which is nearing completion. Policy measures relating to financial management have been included as prior actions for World Bank structural adjustment lending at both the national and provincial level. World Bank support is also being provided through a Public Expenditure Management Report, which is near completion.

d. **Tax policy and administration reforms.** Tax administration has been among the most severe weaknesses in Pakistan's economic management. The Fund has taken the lead in supporting tax policy reforms, providing technical assistance leading, inter alia, to the formulation of an income tax reform package which became effective July 1, 2002. In consultation with the Fund and the World Bank, Pakistan has also launched a program for the fundamental restructuring of the Central Board of Revenues (CBR) in order to improve the efficiency of tax administration. The CBR reform effort is being supported by both the World Bank and the Fund. The Fund has stressed the importance of improved revenue

collection performance by CBR as key element in ensuring the sustainability of Pakistan's considerable achievements in fiscal consolidation. The structural performance criteria of the PRGF include adoption of tax policy changes and implementation of CBR reform. Through the Project Preparation Facility, the World Bank is supporting preparation of a Tax Administration Reform Project which is scheduled for approval in FY 2004. This support includes financing of consultants to develop a detailed reform strategy for restructuring of CBR in the areas of human resource management, information technology, business process re-engineering, and tax payer facilitation.

e. **Social impact analysis.** As part of the preparation of the World Bank structural adjustment lending and the Fund PRGF program, the World Bank and the Fund have agreed to review closely the social impact of reforms in a pilot program of collaboration. Work is being led by the World Bank's Social Development Unit. Two areas of reform will receive close scrutiny during implementation: (a) devolution and its impact on the quality of service delivery, especially to the poor, and (b) tariff and policy reforms in the gas and power sectors. This work is now underway.

May 29, 2003

Mr. Horst Köhler  
Managing Director  
International Monetary Fund  
Washington, D.C. 20431  
U.S.A.

Dear Mr. Köhler:

Pakistan's government remains committed to pursue the economic strategy set out in the Interim Poverty Reduction Strategy Paper (I-PRSP), as updated by the recent progress report, supported by the Poverty Reduction and Growth Facility (PRGF) arrangement. This strategy will be developed into a longer-term vision for a set of policies aimed to allow higher sustainable growth and job creation, while reducing poverty, to be articulated in the full Poverty Reduction Strategy Paper (PRSP) to be completed around mid-2003.

The Pakistani authorities held discussions with Fund staff in March–May 2003 for the fifth review under the PRGF Arrangement. Based on these discussions, the attached Memorandum of Economic and Financial Policies (MEFP) reviews economic developments and policy implementation through December 2002 and beyond under the arrangement, updates the macroeconomic framework, and discusses the financial policies and structural reform program for the remainder of the fiscal year 2002/03, and for FY 2003/04 to the extent possible. It supplements the MEFP dated November 22, 2001 as well as the supplementary MEFPs dated March 12, 2002, June 18, 2002, October 16, 2002, and February 8, 2003.

All performance criteria for end-December 2002 and for January/February 2003 were met, except for the continuous performance criterion on tax exemptions for which a waiver was granted on the occasion of the fourth review. A performance criterion regarding the preparation of a revised financial improvement plan for the Water and Power Development Authority (WAPDA) by mid-April 2003 was only partially observed, as the plan did not indicate at that time contingency measures that were subsequently developed with the assistance of Fund and World Bank staff. We now expect privatization of Habib Bank to take place by end-2003, as we had to re-invite expressions of interest for transparency reasons and given renewed investor interest. On this basis, and in view of the policies set out in the attached memorandum, the government requests a waiver for the partial nonobservance of the structural performance criterion related to WAPDA, modification of the structural performance criterion related to Habib Bank, and the completion of the fifth review. We expect the sixth review under the arrangement to be completed by end-September 2003.



The government of Pakistan will provide the Fund with such information as the Fund may request in connection with Pakistan's progress in implementing the economic and financial policies, and achieving the objectives of the program. The government believes that the policies set out in the attached memorandum are adequate to achieve the objectives of the program. However, we stand ready to take any additional measures appropriate for this purpose, and will consult with the Fund in accordance with the policies of the Fund on such consultations.

Sincerely yours,

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s  
Shaukat Aziz  
Minister of Finance and Economic Affairs

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s  
Ishrat Husain  
Governor  
State Bank of Pakistan

Attachments:  
Memorandum of Economic and Financial Policies  
Technical Memorandum of Understanding

## PAKISTAN

### Memorandum of Economic and Financial Policies for October 2002–June 2003 and Outlook for FY 2003/04

#### I. DEVELOPMENTS DURING OCTOBER 2002–MARCH 2003

1. **Building on the progress made in establishing a stable macroeconomic environment, the government will continue implementation of a reform agenda aimed at higher sustainable growth and job creation, while reducing poverty.** Its vision will be reflected in the full Poverty Reduction Strategy Paper (PRSP), which is currently under preparation with close participation of provincial and local governments, as well as civil society institutions (as detailed in our recent PRSP preparation status report). A draft PRSP summary was discussed with development partners during the Pakistan Development Forum in mid-May 2003. With the domestic security situation improving, and the military forces along the border with India gradually being reduced on both sides, the security environment has become more favorable for implementing such a reform agenda; any fallout and risks arising from the Middle East crisis appear manageable.
2. **Macroeconomic targets for FY 2002/03 are broadly on track.** Inflation fell to 2.2 percent in the year to April 2003. Export and import growth remain high, and with an improved outlook for agriculture and accelerating industrial sector growth, real GDP growth will reach at least 4.5 percent for fiscal year 2002/03. Remittances and private capital inflows continue to be strong. The State Bank of Pakistan (SBP) has begun to reduce its purchases of foreign exchange on the interbank market, given a comfortable level of foreign exchange reserves of \$9.2 billion at end-April 2003 (7.4 months of imports), and having accumulated another \$0.8 billion at end-March 2003 earmarked for repayment of certain expensive external debts. The Pakistani rupee continued to appreciate gradually against the U.S. dollar, but depreciated against the euro, and in real trade-weighted terms. All quantitative performance criteria through end-2002 were met (Table 1(a)).
3. **The end-December 2002 fiscal deficit target was met with comfortable margins, and we are confident to have met the end-March and to be on track for the end-June 2003 target.** The Central Board of Revenue (CBR) met its revenue target for both December 2002 and March 2003, reflecting a buoyant economy and administrative improvements. Nontax revenue through December was roughly on target, despite shortfalls in receipts from the Water and Power Development Authority (WAPDA), the National Highway Authority (NHA), and lower-than-budgeted profit transfers from the SBP. Interest payments were much lower than projected due to the recent fall in interest rates and the appreciation of the Pakistani rupee. According to preliminary (unreconciled) data, social sector spending (“I-PRSP expenditure”) during July–December 2002 rose by 45 percent over the same period of the preceding year, coming close to its target level. External financing was lower than projected, but domestic financing was nonetheless curtailed on account of the reduced overall

financing needs, with bank debt being reduced more than envisaged. We expect similar trends through the remainder of the current fiscal year, with expenditure overruns for WAPDA and the Karachi Electric Supply Corporation (KESC) (see below) and defense offset notably by higher nontax receipts.

4. **The monetary targets for end-2002 have also been met by comfortable margins.** Net foreign assets (NFA) of the banking system continued to grow at a rapid pace, while private sector credit picked up significantly. Thus broad money growth remained strong at 17 percent in the year through December. Similar trends continued through February 2003. Reserve money grew by 10 percent through December, reflecting sterilization efforts by the SBP, but growth has accelerated since. The yield on 6-month treasury bills fell to 1.6 percent in early April, as banks remain highly liquid. The rediscount rate, at 7.5 percent, remained positive in real terms.

5. **Structural measures through mid-April 2003 were broadly taken as programmed (Tables 2(a) and 2(b)), except mainly for some lacunae in the revised Financial Improvement Plans (FIPs) for WAPDA.** The gas pricing framework has been fully published (as specified in the February 2003 MEFP)<sup>1</sup> to enhance transparency, and is being implemented. In particular, in line with the framework, wellhead prices (including for the government-owned PPL fields) were adjusted on January 1, 2003. On the basis of total revenue requirements of the utilities, an average consumer price increase of 0.8 percent has been worked out and is awaiting final approval. Work on an annual core welfare indicator survey was launched in February 2003, as a cornerstone of monitoring intermediate social outcome indicators used to measure progress under the PRSP. The new cabinet will soon consider the comprehensive anti-corruption strategy, including specific action plans and timelines, prepared by the National Accountability Bureau (published at [www.nab.gov.pk](http://www.nab.gov.pk)). A committee involving various stakeholders (government, business community, NGOs, academia, etc.) has been set up to steer its implementation. However, only part of the WAPDA and KESC electricity tariff increases authorized by NEPRA to offset the surge in fuel cost during January–March 2003, and which were to become effective in early April, were notified by the government, and only in May. In the government's view, electricity tariffs have become unbearably high in relation to incomes and socio-political considerations ruled out making households bear the burden of the exceptional and temporary surge in fuel cost reflecting the war in Iraq. Revised FIPs for FY 2002/03 and FY 2003/04 for WAPDA were provided to Fund staff on April 15, except that contingency measures were only developed subsequently in consultation with Fund and World Bank staff (see below).

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<sup>1</sup> See [www.mpn.gov.pk/ddg](http://www.mpn.gov.pk/ddg) and [www.ogra.org.pk](http://www.ogra.org.pk).

6. **The financial performance of the large public enterprises<sup>2</sup> for the quarter of October–December 2002 was broadly in line with the targets formulated under their respective FIPs, except for the two power utilities.** As in the preceding quarter, WAPDA defaulted on its entire debt service obligations to the government for the quarter, reflecting substantial shortfalls in cash receipts. According to WAPDA's accounts (published in February 2003 as per program commitments, see [www.finance.gov.pk](http://www.finance.gov.pk)), the shortfall in receipts reflects in the main: the nonpayment of bills by customers in the Federally Administered Tribal Areas (FATA); shortfalls resulting from insufficient tariff adjustments; and an increase in receivables from provincial governments. On a positive note, supplier arrears outstanding from the previous years were reduced substantially and technical/nontechnical line losses improved compared to the first quarter of 2002/03. While KESC achieved substantial progress in collection rates, it made only marginal progress in reducing line losses.

## II. ECONOMIC AND FINANCIAL POLICIES FOR THE REMAINDER OF FY 2002/03 AND FY 2003/04

### A. Macroeconomic Framework for 2002/03 and 2003/04

7. **The macroeconomic framework for the current and next fiscal years remains broadly unchanged from the February 2003 MEFP.** The framework for FY 2003/04 aims to further enhance public-debt sustainability, reduce vulnerability to shocks, and create room for the needed increase in public human development expenditure and private investment. Inflation will be kept at or below 4 percent in 2003/04, while growth would slightly accelerate to 5 percent. Remittances and private capital inflows are projected to decline next year, as the portfolio shift underlying the exceptionally high inflows during the current year is expected to wind down. Among the various risks to the macroeconomic outlook, the temporary oil price spike associated with the war in Iraq so far has had limited impact on the budget and balance of payments. If a reversal of private capital flows were to occur (for example, because of regional security factors), it would be met by allowing a market-based exchange rate depreciation and financial tightening, with reserves used only sparingly to maintain orderly market conditions.

8. **Monetary policy remains geared toward maintaining low inflation, within a flexible exchange rate regime.** While we plan to further use the opportunity provided by temporarily high capital/remittance inflows to bolster our reserves, we will continue to limit intervention in the foreign exchange market so as to curb money supply growth and contain sterilization cost. This approach will be complemented by the early repayment of expensive external debt. We continue to closely monitor good and asset price developments, and will tighten monetary policy should inflationary pressures emerge. The monetary program for

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<sup>2</sup> WAPDA, KESC, Pakistan International Airlines (PIA), Pakistan Railways (PR), and Pakistan Steel Mills (PSM).

2003/04 is based on cautious assumptions regarding money demand, with broad money and reserve money growing by 11 percent.

9. **The 2003/04 budget proposal to be submitted to parliament in June 2003 will aim at a further reduction of the deficit and public debt (as a share of GDP).** While further rationalizing nonpriority expenditure and containing defense spending to 3.6 percent of GDP, the budget will raise social and poverty-related expenditures to 4.2 percent of GDP as envisaged in the I-PRSP. A more ambitious reduction of defense spending is not feasible, as surveillance of the Western border in the context of combating terrorism is actually increasing and tensions on the Eastern border have not completely abated. The budget will include an allocation for the restructuring of the insolvent Industrial Development Bank of Pakistan (IDBP) and Allied Bank Limited (ABL) (at a cost of 0.5 percent of GDP), to allow the effective transfer of ownership to the private sector (or liquidation). On the revenue side, we will eliminate all remaining withholding tax exemptions on interest income, and seek to widen General Sales Tax (GST) coverage to additional service categories. No new tax exemptions will be granted, and with the approval of parliament, at least 20 income tax exemptions will be eliminated by July 1, 2003. This step will limit remaining income tax exemptions to mostly those related to nonprofit organizations, to those granted under international or bilateral agreements or to constitutional post holders, and most importantly, to pension benefits. The latter will be addressed as part of an overall reform of the pension system being elaborated with support from the Asian Development Bank (AsDB), to be implemented with the 2004/05 budget. The 2003/04 budget will be based on realistic assumptions about the performance of public sector enterprises (PSE), underpinned by indicative quarterly targets on the deficits (accrual basis) of WAPDA and KESC (see below). Against this background, and given that due to this year's large-scale sterilization, zero SBP profits are expected, achieving the deficit of 3.5 percent of GDP originally envisaged under the PRGF program is unrealistic, as it would not allow for the needed increase in social and development spending and other priority outlays. We will therefore aim at an underlying budget deficit for FY 2003/04 of 4.0 percent of GDP, and 4.5 percent including the outlays for the privatization of IDBP and ABL. This would still constitute a sizeable adjustment in the underlying deficit compared to the 2002/03 target, yield a significant decline in the public debt to GDP ratio, and should prevent a repeat of this year's experience of ad-hoc measures to accommodate slippages in PSE finances.

10. **There are two risks to the outlook, and in particular to the fiscal objectives for FY 2003/04.** The first arises from the regional tensions which have not fully wound down by end-2002 as assumed under the program's fiscal projection. The second risk is that the utilities' deficits could be higher than expected, for example because another spike in fuel cost will make pass-through to electricity tariffs impossible, triggering additional transfers from the budget to the utilities (see below). To protect the budget against such risks, we would, in the event, adjust other nonpriority expenditure and/or take appropriate revenue action while protecting key social spending.

## **B. Structural Policies**

11. Building on substantial progress to date in liberalizing the economy and improving governance, we will deepen our structural reform program. Additional structural benchmarks and performance criteria for June–December 2003 are outlined in Table 2(b).

### **Domestic energy prices**

12. We will pursue the regular adjustment of various energy prices to reflect world market developments. For petroleum products, this will involve fortnightly adjustments in line with import cost, while maintaining stable average tax rates. For gas (wellhead and consumer prices), it will involve application of the gas pricing framework agreed with the World Bank through half-yearly adjustments, including the elimination of cross-subsidies by end-2004. For electricity, KESC and WAPDA will adjust tariffs as provided under the NEPRA Act, and the government will notify NEPRA's determinations within 14 days during FY 2003/04, except that downward adjustments will not be notified until and unless final data are available showing that WAPDA's and KESC's respective cumulative accrual deficits during the preceding quarter have been at or below the target levels specified in Table 1(b), starting with the adjustment related to fuel costs during April–June 2003. We will furthermore prepare by October 2003 an action plan, in consultation with the World Bank, to establish by end-2003 a transparent regulatory framework for the setting of electricity tariffs, that in particular (a) clarifies the respective roles of the government, NEPRA, and the power companies (including the new distribution companies) in the setting of tariffs, and (b) limits departures in actual tariff adjustments by distributors from NEPRA's determination based on the current procedures to well-specified cases of exceptional temporary spikes in oil prices; this will involve providing clear guidance to NEPRA on the tariff policy for the new distribution companies. Relevant elements of this action plan will be incorporated into the government's economic program.

### **Tax policy and tax administration**

13. **The CBR reform process is broadly on track.** Key recommendations from recent FAD technical assistance missions on tax and customs administration reform will be implemented with a view to increasing the number of taxpayers, raising voluntary compliance and increasing the efficiency of the audit and enforcement functions, including through the issuance of rules requiring the reporting of all interest income to the tax authority and of rules enabling the CBR's sales tax auditors to assess tax liabilities of nonfilers on the basis of presumptive methods, as already possible for income tax. We are also accelerating preparations for the introduction of full self-assessment in 2003/04 (including through setting up a steering committee to coordinate the needed steps), and are finalizing a comprehensive strategy specifying detailed plans to overhaul CBR's business procedures. Looking ahead, we plan to open a second Large Taxpayers Unit (LTU) in Lahore by mid-2004. Our customs administration reform strategy aims at increasing voluntary compliance through self-assessment, service-orientation, a fully automated environment that minimizes face-to-face

contacts, risk-based verification techniques, and parameter-based verification and audit. We will place special emphasis on strengthening the post-release verification and audit capabilities, as well as the intelligence and investigation program which will assist in developing risk criteria. While this reform strategy is long term in nature, we will introduce a pilot project in Karachi port by April 2004. Among other things, the pilot will involve entry processing on a 24-hour basis.

14. **A strategy to contain the “Benami” practice** (whereby assets are held in the name of a person that is not the true beneficiary) has been elaborated with a view to enhancing compliance with taxes and supporting Customer Due Diligence for banks. As first steps, a taskforce has been constituted which will consult with stakeholders and provincial governments on specific legislation needed to contain “Benami” transactions; its recommendations will be provided to the cabinet by end-October 2003 with a view to submitting it by end-2003 to parliament.

#### **I-PRSP issues, public expenditure management, and fiscal transparency**

15. **We plan to finalize the PRSP by mid-2003**, incorporating the experience gained from the I-PRSP process. The PRSP will put additional emphasis on some important institutional causes of poverty, such as lack of assets held by the poor, lack of a functioning justice system, and deep-rooted gender issues; include a first costing of the health and education targets; and be based on a broader participatory approach, including consultation with civil society and within the federal and provincial cabinets. Based on recent progress in developing systems to monitor 12 intermediate social outcomes, we have published a first report on such outcomes in March 2003 ([www.finance.gov.pk](http://www.finance.gov.pk)), spelling out the underlying baselines, the data collection mechanisms and the format of publication, and quarterly developments (to the extent data are available). The mechanisms for collecting data will include an annual Core Welfare Indicator Questionnaire (CWIQ) survey being developed with assistance from the World Bank that will be timed to provide input in the formulation of local, provincial, and federal budgets; the first CWIQ results will be available in January 2004, providing input for the FY 2004/05 budgets. This will complement expenditure controls at the local level to ensure that the devolution process actually improves social service delivery. We also continue working on an assessment of the poverty and social impact of energy pricing reforms with assistance from the World Bank. Following the recent establishment of an actuarial unit, we have started work on a contributory pension scheme for new recruits in the civil service, and on the next pay and pension reform package. As a first step, we will align more closely the General Provident Fund (GPF) interest rate with market rates from July 1, 2003.

16. **The implementation of the Accountable Fiscal Management Framework is proceeding.** The government will soon submit to parliament the draft fiscal responsibility law. We will publish the 2003/04 federal budget and report 2003/04 fiscal data based on both the old format and the new accounting model (NAM) for the federal government and the North West Frontier Province (NWFP), and issue the 2004/05 budget call on the basis of

NAM for all provinces, as well as the federal government. We will continue with the 2003/04 budget the traditional practice (Taamir-e-Pakistan Program) of allowing members of parliament to select a few projects for their constituency within the development budget (for altogether 0.1 percent of GDP), which will be executed through normal channels. We see this tradition as helpful in bringing local development concerns into the formulation of the development budget and in strengthening links between parliamentarians and their constituencies, thereby strengthening democracy. The ongoing preparatory work on a new revenue-sharing arrangement between the federation and the provinces should help to bring about an allocation of resources to the local governments that is more in line with their respective expenditure responsibilities. We will seek to re-invigorate the Pakistan Improvement of Financial Reporting and Accounting (PIFRA) project, strengthen the Controller General of Accounts, and ensure uniform expenditure tracking by districts, as well as pre-auditing of all transactions through the District Accounts Offices. Various actions (with support from U.K.'s Department for International Development(DFID)) are being taken toward establishing a medium-term budget framework, as detailed in the February 2003 MEFP.

#### **Public enterprises and privatization**

17. **The privatization drive has been slowed by limited investor interest due to weak global equity markets and regional political uncertainties.** We nonetheless expect to complete the sale of Pakistan State Oil (PSO) within the next few months. For Habib Bank Limited, one investor has been prequalified. To make the process more transparent, and given signs of renewed interest by investors, we have re-invited expressions of interest by end-June 2003. As a result, completion of the sale by end-June 2003 will not be feasible, and could shift to later in 2003. We therefore request modification of the related structural performance criterion. Regarding KESC, we remain open for discussing a negotiated sale with the only remaining qualified investor (who has put discussion on hold for the time being), but also explore the options of unbundling KESC and selling the power generation component, and/or contracting private management. In the meantime, we will continue to forcefully implement its FIP. However, mainly due to insufficient gas supplies to KESC (requiring additional use of expensive furnace oil), slower-than-expected progress in reducing line losses, and insufficient tariff levels, KESC's deficit (on an accrual basis) for FY 2002/03 will exceed the FIP target by around PRs 3 billion and reach PRs 14 billion; in view of higher investment needed to reduce line losses and improve collection, the FIP for FY 2003/04 aims to contain the deficit to PRs 15 billion. The restructuring of PIA is proceeding as detailed in the February 2003 MEFP, and in particular the divestiture of noncore activities (hotels, etc.) has started. A new policy framework for fixed-line telephony is expected to be adopted by the cabinet in the coming months. It will encourage competition and remove regulatory uncertainty, to facilitate the privatization of the telecom company (PTCL).

18. **WAPDA's financial situation remains unsustainable.** To a large extent, this reflects huge upfront payments under the contracts with the independent power producers (IPPs), which will decline over the coming years; large investments to complete the Ghazi Barotha hydropower station, which will start operating in FY 2003/04 and lower costs



by reducing reliance on imported fuel; and the nonpayment of bills in FATA. At the same time, there is a need for strong reform of WAPDA itself to improve operational efficiency and reduce large line losses. A medium-term projection quantifying the outlook for WAPDA will be prepared in the coming months and will further develop measures to contain costs, increase efficiency, and spell out tariff policies.

19. **In the meantime, we have prepared, in consultation with the World Bank, revised FIPs for FY 2002/03 and FY 2003/04.** The revised plans specify and quantify efforts to improve bill collection, including by initiating the metering of users in FATA (starting with commercial, industrial, and public consumers), to achieve collection of at least PRs 2 billion on FATA bills in FY 2003/04. The FIPs include quarterly financial targets for FY 2003/04 (see Table 1(b)), based on a baseline fuel cost of PRs 13,806 per ton, and a detailed timetable regarding WAPDA's restructuring process. As explained above, downward tariff revisions will be conditional on meeting the preceding quarter's cumulative deficit target. Barring exceptional circumstances in the oil market, NEPRA-authorized upward revisions will be notified. The revised FIPs aim to contain WAPDA's deficit for FY 2002/03 at PRs 21 billion (on an accrual basis as defined in the Technical Memorandum of Understanding (TMU)), limit government-guaranteed domestic borrowing to PRs 13 billion, and reduce the stock of payables to suppliers and IPPs to PRs 6.4 billion by end-June 2003. For FY 2003/04, the FIP aims at reducing WAPDA's accrual deficit to PRs 19 billion, while reducing the stock of payables to PRs 4.6 billion. This deficit will be largely covered by budget subsidies, and it will refrain from any domestic borrowing. Regarding the unbundling process, we now expect the legal transfer of WAPDA's assets and liabilities to its corporate successors to be delayed to end-2003, given delays to obtain lender's consent from official lenders and legal and administrative complications in establishing WAPDA's title to certain assets. Meanwhile, the successor distribution, generation, and transmission companies will file with NEPRA for determination of tariffs, based on financial projections being elaborated with World Bank assistance. We expect the new tariffs to be determined by January 2004 (and apply from July 2004).

#### **Trade policy**

20. **We will further liberalize the trade system with a view to rationalizing the tariff regime in the medium term.** We will prepare a plan by end-2003 for the gradual reduction in tariff levels for those industries enjoying exceptional high levels of protection, keeping in view contractual obligations.

#### **Financial sector reforms**

21. **We will pursue the implementation of the financial sector reform strategy, regrettably without any input from the Financial Sector Assessment Program mission that continues to be delayed.** By June 2003, a decision on the disposal of the 49 percent government stake in ABL will be taken and implemented. We will seek to privatize or, failing that, liquidate, the insolvent IDBP, with support from the World Bank and AsDB. Given the growing involvement of the private sector in wheat marketing, the stock of

outstanding commodity operations (government-guaranteed bank credit extended to various public commodity boards) will be reduced to at most PRs 95 billion by June 2003 and PRs 85 billion by June 2004. In the context of an AsDB-supported reform of governance in the nonbank financial sector, we are in the process of hiring consultants to help with (a) the computerization (to be completed by December 2005) and reorganization of the administration of the National Saving Scheme (NSS) (to be completed by October 2004); and (b) the reform of NSS instruments (to be completed by October 2004). We will continue during 2003/04 to apply the formula linking NSS instruments to PIB yields, with the next step to become effective on July 1, 2003.

22. **A draft anti-money laundering law incorporating best practices and FATF recommendations will be presented to cabinet by June 2003.** In the meantime, a number of tools to combat money laundering and terrorist financing are already in place, including (a) giving the Anti-Narcotic Force the authority and powers to investigate and prosecute drug-related money transactions; (b) more effective know-your-customer (KYC) regulations to provide more detailed guidelines to banks/DFIs for customer due diligence; similar regulations explicitly preventing criminal use of banking channels for the purpose of money laundering activities and other unlawful trades, by requiring banks to properly investigate transactions which are out of character with the normal operation of the account involving heavy deposits/withdrawals/transfers; (c) active participation as a member in Asia-Pacific Group on Money Laundering (APGML); (d) technical cooperation arrangements with several bilateral and multilateral organizations; and finally (e) compliance with several resolutions passed by the UN, freezing the accounts of entities that are guilty of terrorist activities; the SBP has so far has frozen 24 accounts of individuals/entities, amounting to PRs 591 million.

### III. OTHER ISSUES

#### **Program financing**

23. **The program remains fully financed in FY 2002/03 and FY 2003/04.** We will ensure that conditions attached to expected loan disbursements of the World Bank and AsDB are met. Most bilateral agreements with the Paris Club creditors have been signed, a few remaining ones are expected to be concluded by mid-2003. Debt swaps for social expenditure and outright debt cancellation are being discussed with some creditors, and the U.S. implemented the cancellation of about \$1 billion of debt in April 2003. We will ensure that implementation of any swaps will be consistent with the financial program. A \$100 million loan from the foreign branches of one of the nationalized banks has been restructured, as part of the planned private sector involvement.

#### **Data issues**

24. The World Bank is assisting us in completing the remaining steps needed to participate in the General Data Dissemination System (GDDS). To improve data dissemination and move closer to subscribing to the Special Data Dissemination Standard (SDDS), we plan to meet by end-2003 the requirements of quarterly national accounts and of

a regular survey on wage earnings. We have started to post on the SBP website data on reserves and foreign currency liquidity in accordance with the SDDS template. By end-2003, we will formally establish the Pakistan Bureau of Statistics (PBS) consolidating various existing agencies. PBS will be granted greater autonomy to enhance the quality and credibility of our statistics.

**Program monitoring**

25. We propose to continue monitoring of the program through quarterly reviews. The sixth review (combined with the seventh review) will focus on the FY 2003/04 budget and the medium-term reform strategy for the power sector. We propose the ninth disbursement (subject to the eighth review) in an amount of SDR 86.1 million for December 20, 2003 based on end-September 2003 quantitative performance criteria, and the tenth disbursement (subject to the ninth review) in an amount of SDR 86.1 million for March 20, 2004 based on end-December 2003 data. We intend to request at the time of the next review (scheduled for end-September/early October 2003) the seventh and eighth disbursements under the arrangement. The proposed additional structural performance criteria/benchmarks for June–December 2003 and the proposed end-September 2003 and end-December 2003 quantitative performance criteria and indicative targets are listed in Tables 1(b) and 2(b), respectively. An updated TMU to apply for test dates after July 1, 2003 is attached.

Table 1(a). Pakistan: Quantitative Targets, September 2002–June 2003 1/

(Cumulative flows from July 1, 2002, unless otherwise specified)

	Outstanding Stock End-Jun. 2002	Prog. End-Sep. 2002	Adj. Prog. End-Sep. 2002	Act. End-Sep. 2002	Prog. End-Dec. 2002	Adj. Prog. End-Dec. 2002	Act. End-Dec. 2002	Prog. End-Mar. 2003	Prog. End-Jun. 2003
Net foreign assets of the SBP (floor in millions of U.S. dollars)*	2,321.0	320.0	122.7	2,203.0	497.0	253.2	3,629.0	809.0	4,327.0
	(In billions of Pakistani rupees)								
Net domestic assets of the SBP*	445.4	-0.2	4.8	-124.4	8.8	17.1	-152.8	-13.2	-181.2
Overall budget balance (floor)*	...	-56.4	-64.4	-44.4	-98.7	-106.7	-62.3	-142.3	-178.4
Net government bank borrowing*	514.1	-4.4	15.5	-12.7	-15.9	6.7	-34.0	-38.6	-29.2
CBR revenue (floor)*	...	90.0	...	90.4	199.5	...	203.1	309.0	458.9
Net banking sector claims on public sector enterprises*	82.0	7.0	...	-5.5	11.7	...	-7.0	16.3	20.0
Social- and poverty-related spending ("I-PRSP budgetary expenditure") (floor)	...	35.4	...	29.3	70.8	...	66.5	114.3	161.0
WAPDA accrual balance									-20.7
KESC accrual balance									-14.1
	(In millions of U.S. dollars)								
Outstanding stock of short-term external debt owed or guaranteed by the government and the SBP*	209.0	500.0	...	194.3	500.0	...	410.5	500.0	500.0
Contracting or guaranteeing of noncessional medium-term and long-term debt by the government* 2/	...	600.0	...	88.8	600.0	...	148.8	600.0	650.0
Accumulation of external payments arrears (continuous performance criterion during the program period)*	...	0.0	...	0.0	0.0	...	0.0	0.0	0.0
SBP's forex reserves held with foreign branches of domestic banks (outstanding stock)	65.0	100.0	...	51.6	100.0	...	56.3	100.0	100.0
Of which: other than current account*	0.0	0.0	...	0.0	0.0	...	0.0	0.0	0.0
Stock of outstanding foreign currency swap and forward sales between SBP and residents*	280.0	400.0	...	50.0	400.0	...	45.0	400.0	400.0
Memorandum items:									
Net external program financing	...	447.5	...	236.6	597.4	...	342.7	689.1	365.5
Of which: privatization proceeds	...	50.0	...	10.0	100.0	...	184.0	150.0	234.0
External cash budget grants	...	36.4	...	50.0	106.6	...	117.5	193.0	238.5
Daily cash reserve requirements ratio (in percentage points)	4.0	4.0	...	4.0	4.0	...	4.0	4.0	4.0
Special cash reserve requirements ratio on foreign currency deposits (in percentage points)	20.0	20.0	...	15.0	20.0	...	15.0	15.0	15.0
Outstanding KESC borrowing (in billions of rupees) 3/	0.0	...	...	0.0	...	...	4.0	...	0.0

Source: Pakistani authorities.

1/ The relevant variables are defined in the Technical Memoranda of Understanding (TMU) dated June 18, 2002 (and as amended during the third and fourth reviews) and May 29, 2003, and are subject to adjustors specified in the TMU. For variables marked "\*" the end-September 2002, end-December 2002, end-March 2003, and end-June 2003 program flows represent ceilings (or floor, if indicated) that constitute performance criteria. All other targets are indicative.

2/ Excluding PRGF loans.

3/ Bonds issued and loans contracted by KESC in the course of 2002/03.

Table 1(b). Pakistan: Quantitative Targets, September 2003–June 2004 1/

(Cumulative flows from July 1, 2003, unless otherwise specified)

	Projected Stock End-Jun. 2003	Prop. prog. End-Sep. 2003	Prop. prog. End-Dec. 2003	Proj. End-Mar. 2004	Proj. End-Jun. 2004
Net foreign assets of the SBP (floor in millions of U.S. dollars)*	8,205.0	495.0	833.0	1,515.0	1,691.0
	(In billions of Pakistani rupees)				
Net domestic assets of the SBP*	203.1	-12.6	13.4	-19.5	-23.6
Overall budget balance (floor)*	...	-77.0	-126.3	-163.7	-179.2
Net government bank borrowing*	485.0	43.5	53.1	40.9	14.2
CBR revenue (floor)*	...	92.2	218.1	347.5	510.0
Net banking sector claims on public sector enterprises*	102.0	1.0	2.7	4.3	6.0
Social- and poverty-related spending ("I-PRSP budgetary expenditure") (floor)	...	40.7	81.4	131.4	185.1
WAPDA accrual balance	...	5.3	-3.9	-19.6	-19.2
KESC accrual balance	...	-4.4	-8.2	-12.4	-15.3
	(In millions of U.S. dollars)				
Outstanding stock of short-term external debt owed or guaranteed by the government and the SBP*	...	500.0	500.0	500.0	500.0
Contracting or guaranteeing of noncessional medium-term and long-term debt by the government* 2/	...	600.0	600.0	600.0	600.0
Accumulation of external payments arrears (continuous performance criterion during the program period)*	...	0.0	0.0	0.0	0.0
SBP's forex reserves held with foreign branches of domestic banks (outstanding stock) <i>Of which: other than current account*</i>	0.0	70.0	70.0	70.0	70.0
Stock of outstanding foreign currency swap and forward sales between SBP and residents*	...	400.0	400.0	400.0	400.0
Memorandum items:					
Net external program financing <i>Of which: privatization proceeds</i>	...	105.9	59.3	153.9	267.0
External cash budget grants	...	22.5	55.6	78.1	111.1
Daily cash reserve requirements ratio (in percentage points)	4.0	4.0	4.0	4.0	4.0
Special cash reserve requirements ratio on foreign currency deposits (in percentage points)	15.0	15.0	15.0	15.0	15.0

Source: Pakistani authorities.

1/ The relevant variables are defined in the Technical Memorandum of Understanding (TMU) dated May 29, 2003, and are subject to adjustors specified in the TMU. For variables marked "\*" the end-September 2003 and end-December 2003 program flows represent ceilings (or floor, if indicated) that constitute performance criteria. All other targets are indicative.

2/ Excluding PRGF loans.

Table 2(a). Pakistan: Structural Performance Criteria and Benchmarks Under the PRGF Arrangement as set Under the Fourth Review 1/

Measures	Timing	Status as of April 30, 2003	Related to
<b>I. Structural Performance Criteria</b>			
Publish quarterly progress reports on implementation of financial improvement plan of WAPDA/successors.	November 30, 2002 for the quarter July–September 2002; February 28, 2003 for the quarter October–December 2002, and May 31, 2003 for the quarter January–March 2003.	Observed so far. Second report on WAPDA (and other major public enterprises) published on the Ministry of Finance website in February 2003.	
No new (as per status of March 1, 2003) exemptions or special privileges regarding income tax, custom duties, or GST to be granted, no new regulatory import duties to be imposed (except for anti-dumping measures), and all time bound exemptions and regulatory import duties to lapse without extension, except for existing contracts and exemptions based on international commitment.	Continuous		
Preparation of revised WAPDA FIP for FY 2002/03 and FY 2003/04, aimed at containing WAPDA's deficit in FY 2002/03 and substantially reduce it in FY 2003/04, as detailed in the February 2003 MEFP, para. 19.	April 15, 2003	Partially observed. Revised FIPs prepared, but contingency measures specified only in May.	6 <sup>th</sup> disbursement
Submit to parliament a fiscal responsibility law, including (a) fiscal rules aimed at reducing consolidated government debt (federal and provincial) to below 60 percent of GDP within 10 years from the date of promulgation; and (b) the transparency and reporting requirements proposed in the draft published in July 2002.	June 1, 2003		7 <sup>th</sup> disbursement
Privatize Habib Bank Limited through effective transfer of majority ownership to private investors.	June 30, 2003	Unlikely to be met as bidding process recently reopened. Modification requested.	8 <sup>th</sup> disbursement
Eliminate all exemptions from withholding tax on interest income, including for NSS instruments.	June 30, 2003		8 <sup>th</sup> disbursement
Establish formulaic link between rates of return on General Provident Fund and PIB yields.	June 30, 2003		8 <sup>th</sup> disbursement

Table 2(a). Pakistan: Structural Performance Criteria and Benchmarks Under the PRGF Arrangement as set Under the Fourth Review 1/ (continued)

Measures	Timing	Status as of April 30, 2003	Related to
<b>II. Structural Benchmarks</b>			
Quarterly published progress reports on implementation of Poverty Reduction Strategy, including "I-PRSP expenditure," as well as on progress in (a) establishing institutional framework for I-PRSP monitoring; (b) preparation of full PRSP; and (c) developing baseline data and monitoring framework for intermediate indicators.	To start end-December 2001 for 2001/02 Q1 data, and continued on the basis of the same quarterly schedule throughout FY 2001/02 and FY 2002/03.	Done so far. Sixth report published in March 2003.	
Make model income tax office for small and medium taxpayers in Lahore fully operational.	October 31, 2002	Done.	
Amend SBP Act to strengthen central bank autonomy, in particular in the area of reserve management, per Safeguard Assessment recommendations.	October 31, 2002	Partially met. Amendments published in Gazette of Pakistan on November 4, 2002 strengthen autonomy but less than recommended.	
Publish first report on intermediate social outcomes as detailed in para. 16 of the MEFP.	March 31, 2003	Done.	
Prepare strategy to reduce scope for abuse of practice of holding ownership under different names ("Benami").	March 31, 2003	Done.	
Prepare specific proposals for further tax policy reforms to be implemented with the 2003/04 budget, including a substantial list of remaining income tax exemptions from the CRITO list to be abolished.	March 31, 2003	Partially met. Proposals communicated to staff orally, but list of exemptions not finalized.	
Make effective power purchase agreements between GENCOs and NTDC, and NTDC and DISCOs, in the context of the unbundling of WAPDA.	April 30, 2003	Delayed to end-2003	
Complete legal transfer of assets and liabilities to the various WAPDA successor companies (GENCOs, NTDC, and DISCOs).	June 30, 2003	Delayed to end-2003.	

1/ Conditionality as of the Executive Board's conclusion of the fourth review under the PRGF arrangement (IMF Country Report No. 03/54).

Table 2(b). Pakistan: Additional Structural Performance Criteria and Benchmarks Under the PRGF Arrangement as Proposed for the Fifth Review

Measures	Timing	Related to
<b>I. Structural Performance Criteria</b>		
KESC or WAPDA downward electricity tariff adjustments determined by NEPRA not to be implemented unless cumulative quarterly deficit targets of KESC, respectively WAPDA, for the preceding quarter were observed.	Continuous from June 30, 2003	
Elimination, with the approval of parliament, of at least 20 income tax exemptions.	July 1, 2003	8 <sup>th</sup> disbursement
Promulgation of federal budget for FY 2003/04 consistent with a consolidated overall budget deficit (excluding grants) not exceeding PRs 179.2 billion.	July 1, 2003	8 <sup>th</sup> disbursement
Preparation of an action plan to establish by end-2003 a transparent regulatory framework for the setting of electricity tariffs, that in particular (a) clarifies the respective roles of the government, NEPRA, and the power companies (including the new distribution companies) in the setting of tariffs, and (b) limits departures in actual tariff adjustments by distributors from NEPRA's determination based on the current procedures to well-specified cases of exceptional temporary spikes in oil prices.	October 31, 2003	9 <sup>th</sup> disbursement
Privatize Habib Bank Limited through effective transfer of majority ownership to private investors.	December 31, 2003	10 <sup>th</sup> disbursement
<b>II. Structural Benchmarks</b>		
Effectiveness of amendments to the tax regulations to enable sales tax auditors to assess for nonfilers tax liabilities on the basis of indirect methods of determination, such as reconstructed income statements and presumptive criteria, and to authorize the CBR to make and order for assessment of tax, penalty, and additional tax on the basis of these criteria.	July 1, 2003	
Issuance of CBR circular to require reporting by financial institutions of all interest income to the tax authority, effective from July 1, 2003.	July 1, 2003	
Publication for the federal government and NWFP of the 2003/04 budget according to the old accounting model and the new accounting model (NAM).	July 1, 2003	
Decision by Cabinet on future of the National Anti-Corruption Strategy (see MEFP, para. 5).	August 1, 2003	
Submission to cabinet by the "Benami" taskforce of a report setting out the results of consultation with stakeholders and provincial governments and proposing specific legislation to limit enforceability of "Benami" transactions and holdings.	October 31, 2003	



## PAKISTAN

### **Technical Memorandum of Understanding on the Program Supported Under the Poverty Reduction and Growth Facility**

(May 29, 2003)

1. With effect from July 1, 2003, this Technical Memorandum of Understanding (TMU) describes the monitoring under the PRGF-supported program. In the case of performance criteria, it applies to test dates beyond July 1, 2003. The main changes from the February 2003 TMU involve the monitoring of WAPDA's and KESC's deficits, and a simplification of the adjuster related to external program financing. Throughout, unless otherwise stated, "government" is meant to comprise the federal and provincial governments, except in relation to the external debt ceiling performance criteria, where it also comprises local governments, public sector enterprises, and government-owned banks. The latter refers to enterprises or banks in which the government holds a direct majority ownership interest (that is equity participation of above 50 percent).

#### **I. DEFINITIONS OF MONITORING VARIABLES**

##### **Valuation of foreign exchange denominated assets and liabilities**

2. For the purposes of monitoring under the program, all assets and liabilities as well as debt contracted, denominated in SDRs or in currencies other than the U.S. dollar, will be converted into U.S. dollars at rates prevailing as of February 28, 2003, as published in the International Financial Statistics (IFS). The U.S. dollar value of all foreign assets and liabilities, as well as external program financing and cash grants, will be converted into Pakistani rupees at the end-February 2003 exchange rate of PRs 58.1 per \$1.

3. **Reserve money (RM)** is defined as the sum of: currency outside scheduled banks (deposit money banks); scheduled banks' domestic cash in vaults; scheduled banks' required and excess rupee and foreign exchange deposits with the State Bank of Pakistan (SBP); and deposits of the rest of the economy with the SBP, excluding those held by the federal and the provincial governments and the SBP staff retirement accounts.

4. **Net foreign assets (NFA) of the SBP** are defined as the difference between its foreign assets and foreign liabilities. Foreign assets of the SBP consist of gold, foreign exchange, balances held outside Pakistan, foreign securities, foreign bills purchased and discounted, net IMF position and SDR holdings. The definition of foreign assets of the SBP will be consistent with the IMF Data Template on International Reserves and Foreign Currency Liquidity. Gold will be valued at SDRs 35 per fine troy ounce. Foreign liabilities of the SBP include deposits with the SBP of foreign governments, foreign central banks, foreign

deposit money banks, international organizations, and deposits of foreign nonbank financial institutions (NBFI).<sup>1</sup>

5. **Net domestic assets (NDA) of the SBP** are defined as the difference between RM and the NFA of the SBP.

6. **Net borrowing from the banking system by the government** is defined as the difference between the banking system's claims on the central, provincial, and local

governments and the deposits of the central, provincial, and local governments with the banking system (including district government funds balances). For the purposes of this memorandum, claims on government exclude: credit for commodity operations; government deposits exclude outstanding balances in the Zakat Fund; and balances in the various privatization accounts kept by the government in the banking system. The stock of bonds which were issued to banks in substitution of outstanding nonperforming loans to certain public entities, and which are being fully serviced by the government, are included in banking system claims on government (for example, bonds issued in 1995, 1996, and 1998 by GCP, RECP, CEC, TCP to UBL, Habib Bank, and NBP).

7. The definition of the **overall budget deficit (excluding grants)** under the program will be the consolidated budget deficit excluding grants, and including the operations of district governments financed from local funds. It will be measured by the sum of (a) total net financing to the federal, provincial, and local governments; and (b) total external grants to the federal and provincial governments. The former is defined as the sum of net external budget financing (defined below), net borrowing from the banking system (as defined above), and net domestic nonbank financing (defined below). The latter is defined as the sum of project grants, the Pakistani rupee counterpart of the Saudi Oil Facility, cash external grants for budgetary support, and capital grants reflecting the principal amounts of external debt cancellation or swaps.

8. **Net external budget financing** is defined as net external program financing minus privatization, plus all other external loans for the financing of public projects or other federal or provincial budget expenditures, and plus transfers of external privatization receipts from the privatization account to the budget. **Net external program financing** is defined to include external privatization receipts; budget support loans from multilateral (other than the IMF, but including the World Bank's BSAC and any World Bank and Asian Development Bank (AsDB) provincial structural adjustment loans), official bilateral, and private sector sources; rescheduled government debt service and change in stock of external debt service arrears net of government debt amortization due on foreign loans, the latter including any accelerated amortization including related to debt swaps or debt cancellation recorded as

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<sup>1</sup> The definition of NFA of the SBP used here implies that, for program monitoring purposes, disbursements and/or purchases from the Fund are to be recorded in the monetary accounts as external liabilities of the SBP, rather than deposits of the government.

capital grants. It includes foreign loans onlent to financial institutions and companies (public or private) and emergency relief lending. Program financing excludes all external financing counted as reserve liabilities of the SBP (defined above). Amounts assumed for net external program financing and external grants are provided in Tables 1(a) and 1(b).

9. **Net domestic nonbank financing of the budget** is defined as: domestic privatization receipts transferred from the privatization accounts to the budget, plus the change, during each fiscal year, in the stock of (a) permanent debt, which consists of nonbank holdings of prize bonds, all federal bonds and securities; plus (b) floating debt held by nonbanks; plus (c) unfunded debt, which consists of National Savings Scheme (NSS) debt, Postal Life Insurance, and the General Provident Fund (GPF); plus (d) stock of deposits and reserves received by the government (public accounts deposits); plus (e) suspense account; plus (f) any other government borrowing from domestic nonbank sources net of repayments; minus (g) government deposits with NBFIs. Nonbank holdings of permanent and floating debt is defined as total debt outstanding, as reported by the SBP, minus holdings of banks as per the monetary survey. Total treasury bill and other relevant government debt is valued at discount value.

10. **Net claims of the banking system on public sector enterprises** comprise the banking system's claims on all public sector enterprises (excluding credit for commodity operations) and credit and holding of corporate paper, netted against outstanding deposits on the special account with the SBP for payments on public enterprises' rescheduled debt.

### **External debt**

11. The performance criterion on contracting or guaranteeing of medium-term and long-term nonconcessional external debt by the government or the SBP applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (adopted by the IMF Executive Board on August 24, 2000), but also to commitments contracted or guaranteed for which value has not been received.<sup>2</sup> Excluded from this

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<sup>2</sup> The definition of debt set forth in No. 9 of the guidelines reads as follows: "(a) For the purpose of this guideline, the term "debt" will be understood to mean a current, that is, not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, that is, advances of money to obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, that is, contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, that is, arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made

(continued)

performance criterion are (a) foreign currency deposit liabilities of the SBP; and (b) the outstanding stock of debt of Foreign Exchange Bearer Certificates (FEBCs), Deposit Bearer Certificates (DBC), and Foreign Currency Bearer Certificates (FCBCs). The performance criterion setting a limit on the outstanding stock of short-term external debt refers to debt (as defined in footnote 2) with original maturity of up to and including one year. Medium- and long-term external debt comprises debt with initial maturity of over one year.

12. **Nonconcessional borrowing** is defined as borrowing with a grant element of less than 35 percent, following the methodology set out in SM/96/86. The discount rates used to calculate the grant element will be the six-month and ten-year Commercial Interest Reference Rates (CIRRs) averages, as computed by the Policy Development and Review Department of the IMF. Six-month CIRRs are updated mid-February and mid-August (covering the six-month period preceding the date of update) and the ten-year CIRRs averages are updated mid-December (covering a period of 10 years preceding the date of the update). Six-month CIRRs averages are to be used for loans whose maturity is less than 15 years, while ten-year CIRRs averages are to be used for loans whose maturity is equal or more than 15 years.

13. **Poverty-related and social public spending (“I-PRSP expenditure”)** consists of federal, provincial, and district government spending under the current budget and the Public Sector Development Program (PSDP), as defined in Table 2.

14. **The accrual balance of WAPDA, respectively KESC**, for the purposes of program monitoring, are defined as the cash balance (including the GST-subsidy but before other subsidies, grants, or other transfers from the government) minus any net change in the stock of payables to suppliers or to the government (on account of taxes or debt service due) plus foreign-financed investment. The cash deficit will be measured from below the line as the change in outstanding debt (bank and nonbank) plus gross government subsidies, grants, or other transfers.

## II. ADJUSTORS

15. The floors on the **NFA of the SBP** and ceilings on the **NDA of the SBP, respectively**, will be adjusted (a) upward/downward (respectively downward/upward) by the cumulative excess/shortfall in net external program financing (as defined below and Table 1(a)); and (b) upward/downward (respectively downward/upward) by the cumulative excess/shortfall in external cash budget and capital grants resulting from debt cancellation and debt swaps (as defined below; Table 1(b)).

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during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property. (b) Under the definition of debt set out in point 9(a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (for example, payment on delivery) will not give rise to debt.”

16. The ceiling on **net bank borrowing by the government** will be adjusted downward/upward by the cumulative excess/shortfall in net external program financing plus external cash budget and capital grants resulting from debt cancellation and debt swaps; and upward by any downward adjustment in the floor on the budget balance in conjunction with higher I-PRSP expenditure or the restructuring of IDBP and ABL as set out below. The ceiling will also be adjusted upward by the increase in net claims of the banking system on the government resulting from the takeover of NBFIs by a scheduled bank.

17. The ceilings on the NDA of the SBP will also be adjusted downward/upward by the amount of (a) banks' Pakistani rupee reserves freed/seized by any reduction/increase of the daily CRR relative to the baseline assumption; (b) banks' reserves freed/seized by any reduction/increase in the total reserve requirements on foreign currency deposits relative to the baseline assumption; and (c) any reduction/increase in the reservable deposit base that is related to definitional changes, as per the following formula:  $\Delta NDA = \Delta r B_0 + r_0 \Delta B + \Delta r \Delta B$ , where  $r_0$  denotes the reserve requirement ratio prior to any change;  $B_0$  denotes the level of the reservable deposits in the initial definition;  $\Delta r$  is the change in the reserve requirement ratio; and  $\Delta B$  denotes the change in the reservable deposits as a result of definitional changes.

18. The floor on the **consolidated overall budget balance (excluding grants)** will be adjusted downward for the cumulative excess in external cash budget grants and capital grants resulting from debt cancellation or debt swaps for up to PRs 5 billion at end-September 2003, PRs 10 billion at end-December 2003, PRs 15 billion at end-March 2004, and PRs 20 billion at end-June 2004. Downward adjustments in the floor will have to be matched by identical increases in actual budgetary I-PRSP expenditures above the program levels (Table 2). The floor will be adjusted upward for any outstanding bank borrowing or bond issue undertaken by KESC or WAPDA during FY 2003/04. The floor will be adjusted downward by the budgeted dividends from PTCL or OGDC, respectively, should dividends not be paid following effective privatization of PTCL or OGDC, respectively; this adjustment will be capped at PRs 20 billion. The floor will also be adjusted downward by the amount of outlays related to the restructuring of IDBP (for up to PRs 12 billion) and ABL (for up to PRs 8 billion), which for end-June 2004 would only become applicable if the transfer of ownership of IDBP has become effective or liquidation has been filed for IDBP, respectively transfer of the remaining government holdings in ABL to the private sector has become effective.

19. The ceiling on **net claims of the banking system on public sector enterprises** will be adjusted downward by the amount of net claims reclassified as claims on the private sector as a result of the privatization of any public enterprise.

### III. PROGRAM REPORTING REQUIREMENTS

20. The following information, including any revisions to historical data, will be provided to the Middle Eastern Department of the IMF through the office of the Senior Resident Representative of the IMF in Pakistan, within the timeframe indicated:

- Monthly provisional statements on federal tax and nontax revenue, within one month.
- Deposits into and withdrawals from the privatization accounts for each quarter, within one month. Withdrawals will be reported with the following breakdown (a) those which constitute budgetary use of privatization proceeds; (b) those which constitute costs of privatization; and (c) other (with explanation of the purpose of other withdrawals), as well as with the breakdown between domestic and external privatization receipts.
- Quarterly statements on budgetary capital receipts and disbursements, including repayments of bonds, recovery of loans from provinces and “others,” within two months.
- Monthly (unreconciled) provisional data on federal expenditure and net lending (with separate data on disbursements and repayments), within one month.
- Quarterly statement on consolidated budgetary expenditure, with federal data approved by the Auditor General Pakistan Revenue (AGPR), within two months.
- Quarterly provisional data (from AGPR and AG) on social sector and poverty-related budgetary expenditures, as defined below (Table 2), as well as on the subcategories eligible for additional grant-financed expenditure, as defined in Table 2, within six weeks.
- Quarterly data on the stock of domestic government debt, broken down by instrument, within one month.
- Quarterly data on WAPDA receivables (as per Table 3 of the June 2002 TMU) within one month.
- Monthly provisional data on external budget financing, including proceeds from the Saudi Oil Facility, and cash external grants for budget support (as defined below) as well as capital grants related to debt write-off/swaps, within one month.
- Quarterly reporting on the FIPs of KESC (as per Table 3), Pakistan International Airlines, Pakistan Steel Mill Corporation, Pakistan Railways (as per Tables 4–6), and for WAPDA and its successor entities within two months (as per table 7.)
- The following monthly monetary data on a last-Saturday basis, both at current and program exchange rates, within four weeks:
  - (i) monetary survey;
  - (ii) accounts of the SBP;
  - (iii) consolidated accounts of the scheduled banks;
  - (iv) banks’ lending to the government;

- (v) detailed table on net foreign assets (both for the SBP and scheduled banks);
  - (vi) detailed table of scheduled banks' reserves with the SBP.
- The same tables as in the preceding item, but on an end-quarter basis (last business day), both at current and program exchange rates, within four weeks.
  - SBP Table on outstanding stock of foreign currency deposits, amended to include the classification of new FCA according to the residency of the holder.
  - Daily data on exchange rates (interbank, retail market, and Telegraphic Transfers for SBP purchases on the retail market), SBP's sales and purchases in the foreign exchange markets, swaps and forward outright sales, within two business days.
  - Monthly data on the outstanding stock of the SBP's forward foreign currency operations, including swaps and outright forward sales and purchases, within two weeks. The terms of any new transactions (including rollover/renewal of existing ones) will also be provided.
  - Monthly data on the SBP's foreign exchange reserves, with details on the currencies, instruments, and institutions in which the reserves are held, within one month.
  - Monthly data on net bank claims on public enterprise as per attached list and including details on the six autonomous bodies, within one month. The data will show separately the total amount of direct credit and bank holdings of corporate bonds.
  - Monthly data on SBP direct or bridge loans to nationalized banks in the context of the restructuring and privatization operation, within four weeks.
  - Monthly data on any other quasi-fiscal operations undertaken by the SBP, on behalf of the government.
  - Monthly data on SBP holding of discounted export finance credit under the export finance scheme, within one month.
  - Monthly data on outstanding credit to agriculture under the Agriculture Mandatory Credit Targets, within one month.
  - Monthly data on scheduled banks' credit for commodity operations, with separate subcategories for Pakistan Agricultural Storage and Services Corporation (PASSCO) and Punjab Provincial Food Department operations, within four weeks.
  - The following data on external debt, within six weeks:
    - (i) Quarterly stock of public- and publicly-guaranteed external debt (including deferred payments arrangements), by maturity (initial maturities of up to and

including one year, and over one year), by creditor and by debtor (central government and publicly guaranteed);

- (ii) Quarterly contracting or guaranteeing of nonconcessional medium- and long-term government debt; and
  - (iii) Information on any rescheduling on public- and publicly-guaranteed debt reached with creditors, within one month.
- Quarterly data on external payments arrears on public- and publicly-guaranteed debt with details as in (i) of the preceding item, within six weeks.
  - Copies of new or revised ordinances/circulars regarding changes in: tax policy, tax administration, foreign exchange market regulations, and banking regulations no later than three days after official issuance, or notification that ordinances have been posted on the Central Board of Revenue (CBR) and SBP websites.
  - Copies of official notification of changes in gas and electricity tariffs (automatic or structural) and in ex-refinery petroleum product prices as well as of gas and petroleum surcharges/levies.
  - Monthly data on the import parity prices as well as central depot prices of the six major oil products, within one month.
  - Quarterly data on KESC and WAPDA loans and debt outstanding, within one month.
  - Quarterly data on the number of government pensioners, the number of accounts, and the total amount invested in the new pensioners' benefit accounts, within two months.



Table 1(a). Pakistan: Net External Program Financing FY 2002/03 and FY 2003/04

(In millions of U.S. dollars)

	(Cumulative from July 1, 2002)						(Cumulative from July 1, 2003)			
	Sep. 2002	Sep. 2002	Dec. 2002	Dec. 2002	Mar. 2003	Jun. 2003	Sep. 2003	Dec. 2003	Mar. 2004	Jun. 2004
	Prog.	Act.	Prog.	Act.	Prog.	Prog.	Prog.	Prog.	Prog.	Prog.
Program financing (a+b+c+d+e+f-g-h+i)	447.5	236.6	597.4	342.7	689.1	365.5	105.9	59.3	153.9	267.0
(a) World Bank	185.0	202.0	215.0	202.0	400.0	202.0	125.0	250.0	375.0	500.0
(b) AsDB loans	235.0	128.0	385.0	303.0	455.0	331.0	100.0	200.0	300.0	400.0
(c) Other multilaterals	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(d) Bilateral loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(e) Commercial bank borrowing	100.0	35.5	200.0	84.5	300.0	335.5	100.0	200.0	300.0	400.0
<i>Of which: IDB</i>	100.0	35.5	200.0	84.5	300.0	335.5	100.0	200.0	300.0	400.0
(f) Privatization receipts	50.0	10.0	100.0	184.0	150.0	284.0	25.0	50.0	75.0	100.0
(g) Amortization due	393.0	410.1	790.9	981.0	1,346.2	1,710.4	244.1	740.8	996.1	1,233.0
Multilateral creditors	130.7	134.7	270.6	272.0	400.6	531.6	151.1	290.5	453.8	589.9
Bilateral creditors	184.9	196.7	302.0	331.8	467.3	577.4	3.3	15.9	18.3	29.4
<i>Of which: debt cancellation</i>	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Commercial creditors	49.5	50.2	169.7	327.4	397.7	499.5	74.0	403.0	477.0	551.0
Other (military)	27.9	28.5	48.6	49.8	80.6	101.9	15.7	31.4	47.0	62.7
(h) Accelerated amortization							0.0	0.0	0.0	0.0
(i) Debt service rescheduled/arrears	270.5	271.2	488.3	550.2	730.3	923.4	0.0	100.0	100.0	100.0
Multilateral creditors	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Bilateral creditors	245.9	246.0	440.3	401.0	656.6	826.3	0.0	0.0	0.0	0.0
Commercial creditors	0.0	0.0	0.0	100.0	0.0	0.0	0.0	100.0	100.0	100.0
Other (military)	24.6	25.2	48.0	49.2	73.7	97.1	0.0	0.0	0.0	0.0

Table 1(b). Pakistan: External Grants for FY 2002/03 and FY 2003/04

(In millions of U.S. dollars)

	(Cumulative from July 1, 2002)						(Cumulative from July 1, 2003)			
	Sep. 2002 Prog.	Sep. 2002 Act.	Dec. 2002 Prog.	Dec. 2002 Act.	Mar. 2003 Prog.	Jun. 2003 Prog.	Sep. 2003 Prog.	Dec. 2003 Prog.	Mar. 2004 Prog.	Jun. 2004 Prog.
External cash budget grants	36.4	50.0	106.6	117.5	193.0	238.5	22.5	55.6	78.1	111.1
United States	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
European Union	13.1	0.0	21.9	0.0	21.9	0.0	0.0	0.0	0.0	0.0
Japan	19.0	0.0	19.0	0.0	64.0	64.0	22.5	22.5	45.0	45.0
United Kingdom	0.0	0.0	57.0	0.0	57.0	57.0	0.0	33.1	33.1	66.1
Other	4.3	50.0	8.7	117.5	50.1	117.5	0.0	0.0	0.0	0.0
Saudi Oil Facility	164.3	189.0	325.6	396.0	484.7	671.4	134.4	268.8	403.2	537.6
Project grants	25.2	26.6	50.4	40.4	35.5	69.3	26.5	53.1	79.6	106.1
Capital Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Table 2. Pakistan: Social- and Poverty-Related Expenditure (I-PRSP Expenditure), Cumulative, 1997/98–2003/04

	Rev. Act. 1997/98	Rev. Act. 1998/99	Prel. Act. 1999/2000	Prel. Act. 2000/01	Prel. Act. 2001/02	Proj. 2002/03	Proj. 2003/04
Total	100,378	103,890	114,358	122,349	133,582	175,905	185,060
Roads, highways and bridges	5,174	6,043	5,134	8,332	6,339	9,713	...
Current	1,643	1,847	1,880	3,585	3,191	1,443	...
Development	3,531	4,196	3,254	4,747	3,148	8,270	...
Water supply and sanitation	6,100	5,294	5,553	4,497	4,644	3,295	...
Current	1,865	1,909	1,879	2084	1,707	2,551	...
Development	4,235	3,385	3,674	2413	2,937	744	...
Education	49,084	49,406	54,002	56,536	66,290	78,409	...
By economic classification	49,084	49,406	54,002	56,536	66,290	78,409	...
Current	46,100	46,979	51,572	54,574	60,798	69,320	...
Development	2,984	2,427	2,430	1,962	5,492	9,089	...
By functional classification	...	...	...	56,506	66,290	...	...
Primary education	...	...	...	27,018	31,310	...	...
Current	...	...	...	26,374	29,333	...	...
Development	...	...	...	644	1,977	...	...
Secondary education	...	...	...	15,981	16,712	...	...
Current	...	...	...	15,761	16,327	...	...
Development	...	...	...	220	385	...	...
General universities, colleges and institutes	...	...	...	6,391	8,051	...	...
Current	...	...	...	6,036	7,178	...	...
Development	...	...	...	355	873	...	...
Professional and technical universities, colleges and institutes	...	...	...	2,819	3,756	...	...
Current	...	...	...	2,613	3,028	...	...
Development	...	...	...	206	728	...	...
Teacher and vocational training	...	...	...	1,370	3,009	...	...
Current	...	...	...	1,155	1,651	...	...
Development	...	...	...	215	1,358	...	...
Others	...	...	...	2,927	3,452	...	...
Current	...	...	...	2,635	3,281	...	...
Development	...	...	...	292	171	...	...
Health	14,731	15,547	17,342	17,508	19,211	26,677	...
By economic classification	14,731	15,547	17,342	17,508	19,211	26,677	...
Current	11,900	12,388	14,308	14,984	16,717	21,534	...
Development	2,831	3,159	3,034	2,524	2,494	5,143	...
By functional classification	...	...	...	17,508	19,211	...	...
General hospitals and clinics	...	...	...	13,124	14,088	...	...
Current	...	...	...	12,551	13,630	...	...
Development	...	...	...	573	458	...	...
Mother and child care	...	...	...	59	59	...	...
Current	...	...	...	59	59	...	...
Development	...	...	...	0	0	...	...
Health facilities and preventive measures	...	...	...	2,578	2,610	...	...
Current	...	...	...	734	841	...	...
Development	...	...	...	1,844	1,769	...	...
Others	...	...	...	1,747	2,454	...	...
Current	...	...	...	1,640	2,187	...	...
Development	...	...	...	107	267	...	...
Population planning	1,974	2,593	3,439	1,588	1,332	3,836	...
Current	34	33	35	42	46	171	...
Development	1,940	2,560	3,404	1,546	1,286	3,665	...
Social security and social welfare	1,947	2,022	2,069	1,576	3,663	3,625	...
Current	1,861	1,874	1,985	1,502	3,557	3,379	...
Development	86	148	84	74	106	246	...
Natural calamities and other disasters	214	1,074	1,243	912	189	402	...
Current	214	1,074	1,243	912	189	402	...
Development	0	0	0	0	0	0	...
Irrigation	9,722	9,147	8,274	8,154	10,132	20,780	...
Current	5,536	5,220	5,400	5,791	5,830	9,849	...
Development	4,186	3,927	2,874	2,363	4,302	10,931	...
Land reclamation	541	815	939	1,380	1,838	2,365	...
Current	541	815	939	1,380	1,838	2,365	...
Development	0	0	0	0	0	0	...
Rural development	3,552	4,852	6,513	11,415	12,324	12,203	...
Current	718	550	1,260	3,892	4,811	10,095	...
Development	2,834	4,302	5,253	7,523	7,513	2,108	...
Food subsidies	7,339	7,097	9,850	9,390	5,603	11,570	...
Current	7,339	7,097	9,850	9,390	5,603	11,570	...
Development	0	0	0	0	0	0	...
Food support program	...	...	...	1,061	2,017	3,030	...
Current	...	...	...	1,061	2,017	3,030	...
Development	...	...	...	0	0	0	...
Memorandum item:							
Kushal Pakistan program	...	...	3,500	5,030	15,000	9,844	...

Source: Pakistani authorities.

Table 3. Pakistan: Financial and Operational Targets for KESC, 2001/02–2003/04

(In millions of Pakistani rupees, unless otherwise indicated)

	Prel. Est.		2002/03	Rev. FIP				2003/04	
	Q1	Q2		Q1	Q2	Q3	Q4		
	2001/02	2002/03	2002/03	2003/04	2003/04	2003/04	2003/04	2003/04	
<b>Main assumptions</b>									
Furnace oil price (PRs per metric ton)									
Average exchange rate (Pakistani rupees per U.S. dollar)									
Average tariff (PRs per kWh)									
Units generated (in GWh)			11,980	3,240	2,906	2,605	3,468	12,219	
Of which: purchased units (in GWh)			3,919	836	799	563	1,063	3,262	
<b>Main operational and financial targets</b>									
Technical and nontechnical losses 1/		40.5	37.8	40.0	39.9	36.7	38.4	37.0	38.0
Total receivables	21,130	21,519	20,933	20,334	20,334	20,334	20,334	20,334	20,334
Of which: public sector receivables	2,347.0	2,635	2,138	2,316	2,316	2,316	2,316	2,316	2,316
Stock of payables to fuel suppliers and IPPs 2/	16,949	9,656	10,177	6,674	6,674	6,674	6,674	6,674	6,674
<b>Summary cash flow statement</b>									
Receipts	34,649	9,103	10,047	38,429	10,505	9,918	8,654	11,770	40,846
Collection of dues	32,452	8,695	9,335	35,736	9,889	9,330	8,127	11,094	38,439
GST	1,436	187	500	1,689	496	468	407	556	1,927
Other receipts	761	221	212	1,004	120	120	120	120	480
Payments	49,807	17,308	15,412	59,915	13,602	12,348	11,155	13,199	50,304
Purchase of power	14,147	10,587	5,804	24,561	3,761	3,618	2,746	4,738	14,864
Cost of fuel	21,721	4,284	6,984	24,050	6,378	5,315	4,998	6,409	23,100
Debt service (interest and amortization)	9,587	1,536	1,630	6,771	2,226	2,072	2,066	645	7,008
Taxes	837	162	242	1,096	356	425	391	415	1,587
Operations and maintenance	3,515	739	752	3,436	880	917	955	992	3,744
Net cash available before investment program	-15,158	-8,205	-5,365	-21,486	-3,097	-2,430	-2,502	-1,429	-9,458
Investment program	1,560	317	322	2,937	1,293	1,407	1,621	1,563	5,884
Regular component	1,560	317	322	1,859	514	550	566	582	2,212
Additional component	0	0	0	1,078	779	857	1,055	981	3,672
Cash surplus (+)/deficit(-)	-16,718	-8,522	-5,687	-24,423	-4,390	-3,837	-4,123	-2,992	-15,342
Financing		8,522	5,687	24,423	4,390	3,837	4,123	2,992	15,342
Banking financing		522	3,687	0	0	0	0	0	0
TFCs		0	0	0	0	0	0	0	0
Other		522	3,687	0	0	0	0	0	0
Nonbanking financing		0	0	0	0	0	0	0	0
Budget financing		8,000	2,000	24,423	4,390	3,837	4,123	2,992	15,342
<b>Memorandum items:</b>									
Net change in payment arrears 3/		-7,293	521	-10,275	0	0	0	0	0
Accrual balance 4/		-1,229	-6,208	-14,148	-4,390	-3,837	-4,123	-2,992	-15,342
Operating expenditures									
Fixed charges and taxes									

Source: Pakistani authorities (KESC), see [www.finance.gov.pk/other/financial.pdf](http://www.finance.gov.pk/other/financial.pdf).

1/ Defined as units generated minus units sold, as a percentage of units generated.

2/ Ceiling under FIP.

3/ Change in the stock of arrears vis-à-vis IPPs, WAPDA, fuel suppliers and the government (including debt service).

4/ For monitoring purposes, defined as the cash balance minus any net change in the stock of arrears to suppliers and to the government plus foreign-financed investment.

Table 4. Pakistan: Financial Accounts of Pakistan International Airlines, 2002–03

(In millions of Pakistani rupees)

	H1 2002	Q1 Proj. 2002/03	Q1 Act. 2002/03	Q2 Proj. 2002/03	Q2 Act. 2002/03	Q3 Proj. 2002/03	Q4 Proj. 2002/03	Proj. 1/ 2002/03
Operating revenue and expenditure								
Operating revenue	22,690	12,129	11,054	11,926	12,253	15,104	13,354	52,513
Passengers	19,315	10,236	9,561	9,854	9,683	12,960	10,870	43,920
Cargo	1,842	1,243	1,020	1,157	1,246	1,386	1,455	5,241
Others	1,533	650	473	915	1,324	758	1,029	3,352
Operating expenditure	21,021	9,963	9,267	10,017	12,786	12,974	12,137	45,091
Operating costs								
<i>Of which:</i> salaries and pensions	3,878	2,054	1,936	2,066	1,601	2,176	2,191	8,487
<i>Of which:</i> fuel	4,391	2,340	2,370	2,296	2,468	2,672	2,367	9,675
Interest charges								
Net operating balance incl. interest charges	1,669	2,166	1,787	1,909	-533	2,130	1,217	7,422
Capital expenditure	-209	0	16	6,718	7,490	0	24,798	31,516
Overall balance (cash basis)	1,878	2,166	1,771	-4,809	-8,023	2,130	-23,581	-24,094
Financing								
Financing from federal government (net)								
Amortization								
Gross lending								
<i>Of which:</i> onlent foreign loans								
Net bank financing								
Repayments								
New loans								
<i>Of which:</i> guaranteed by the government								
TFCs detained by the banks								
Other								
<i>Of which:</i> TFCs detained by nonbanking institutions								
Memorandum items:								
Net change in the stock of payables			297		-3122			
Accrual balance 2/			1,474		-4,901			
Depreciation		685		707		696	696	2,784

Source: Pakistani authorities.

1/ The projection for 2002/03 is the sum of the four quarterly projections.

2/ Total cash receipts minus accrual expenditures (including debt amortization).

Table 5. Pakistan: Financial Accounts of Pakistan Steel Mills, 2000/01–2003/04

(In millions of Pakistani rupees)

	2000/01	2001/02	Q1 Proj. 2002/03	Q1 Act. 2002/03	Q2 Proj. 2002/03	Q2 Act. 2002/03	Q3 Proj. 2002/03	Q4 Proj. 2002/03	Proj. 1/ 2002/03	Proj. 2003/04
Operating revenue and expenditure										
Operating revenue	17,199	14,934	5,470	4,903	4,957	5,908	4,837	4,836	20,100	18,793
Net sales	16,075	14,423	5,000	4,590	4,757	5,009	4,707	4,736	19,200	18,393
Other receipts	1,124	511	470	313	200	899	130	100	900	400
Operating expenditure	15,061	13,633	3,738	3,762	4,040	3,250	4,220	4,218	16,216	16,969
Raw material costs	7,067	7,009	1,750	1,940	1,950	1,309	2,150	2,127	7,977	8,484
Salaries and pensions	4,174	2,901	1,038	937	1,040	1,022	970	939	3,987	4,048
Other operating expenses	3,820	3,723	950	885	1,050	919	1,100	1,152	4,252	4,437
Interest charges	1,342	1,369	25	2	26	24	30	973	1,054	954
Net operating balance including interest charges	796	-68	1,707	1,139	891	2,634	587	-355	2,830	870
Capital expenditure	23	200	150	48	170	31	220	340	880	600
Overall balance (cash basis)	773	-268	1,557	1,091	721	2,603	367	-695	1,950	270
Financing										
Net budgetary financing	-773	268	-1,557	-1,091	-721	-2,603	-367	695	-1,950	-270
Amortization (due basis)										
New loans										
Net bank financing	-773	268	-1,557	-1,091	-721	-2,603	-367	695	-1,950	-270
Amortization (due basis)	-1,172	-1,172	-56	-38	-56	-432	-56	-1,004	-1,172	-1,172
New loans	0	0	0	0	0	0	0	0	0	0
<i>Of which: guaranteed by the government</i>	0	0	0	0	0	0	0	0	0	0
Change in cash balances	399	1,440	-1,501	-1,053	-665	-2,171	-311	1,699	-778	902
Memorandum items:										
Net change in the stock of payables				-176		274				
Accrual balance 2/				1,267		2,329				
Depreciation	736	696	120	164	186	165	188	206	700	680
Tons of steel produced (in thousands)	945	882	228	225	223	223	268	271	990	1,045
Tons of steel sold (in thousands)	898	796	290	296	270	268	268	268	1,096	965
Number of employees	14,407	13,625								

Source: Pakistani authorities.

1/ The projection for 2002/03 is the sum of the four quarterly projections.

2/ Total cash receipts minus accrual expenditures (including debt amortization).

Table 6. Pakistan: Financial Accounts of Pakistan Railways, 2000/01–2002/03

(In millions of Pakistani rupees)

	2000/01	2001/02	Q1 Rev. FIP 2002/03	Q1 Act. 2002/03	Q2 Rev. FIP 2002/03	Q2 Act. 2002/03	Q3 Rev. FIP 2002/03	Q4 Rev. FIP 2002/03	FIP Proj. 2002/03
Operating revenue	12,188	13,573	3,491	3,374	3,491	3,851	3,565	3,703	14,000
Passengers	5,602	6,390	1,766	1,769	1,766	1,819	1,760	1,808	7,064
Goods	4,648	4,846	1,250	1,217	1,250	1,285	1,160	1,190	5,000
Others 1/	1,938	2,337	475	388	475	747	645	704	1,937
Expenditure	16,707	16,370	4,705	4,163	4,705	4,306	5,178	6,191	18,818
Operating expenditure	14,194	13,924	4,086	3,832	4,086	3,969	4,372	4,610	16,345
<i>Of which: salaries and pensions</i>	7,206	7,490	2,153	2,017	2,153	1,924	1,820	1,931	8,613
Interest charges	2,513	2,447	618	331	618	337	806	1,581	2,473
Net operating balance including interest charges	-4,519	-2,797	-1,213	-789	-1,213	-455	-1,613	-2,489	-4,818
Capital expenditure	2,700	6,436	1,731	1,463	1,731	762	1,480	1,586	6,923
Foreign-financed component	1,184	2,959	973	671	973	203	750	801	3,891
Locally-financed component	1,517	3,477	758	792	758	559	730	786	3,032
Overall balance (cash basis)	-7,219	-9,234	-2,944	-2,252	-2,944	-1,217	-3,093	-4,075	-11,741
Financing	7,219	9,234	2,944	2,252	2,944	1,217	3,093	4,075	11,741
External financing net	494	1,626	677	435	677	-37	450	120	2,709
Amortization	690	1,334	295	236	295	240	300	681	1,182
Drawings	1,184	2,959	973	671	973	203	750	801	3,891
<i>Of which: guaranteed by the government</i>	1,184	2,959	973	671	973	203	750	801	3,891
Budgetary financing	6,167	9,969	2,258	1,810	2,258	1,955	2,258	4,358	9,032
Budget transfer to cover operational shortfall	4,400	6,000	1,500	1,203	1,500	1,197	1,500	3,600	6,000
Budget investment transfer	1,767	3,969	758	606	758	758	758	758	3,032
Other (including SBP overdraft)	558	-2,361	9	7	9	-701	385	-403	0
Memorandum items:									
Net change in the stock of payables									
Accrual balance 2/									
Passenger traffic									
Number of passengers (in million)	68.8	63.3	16.3	14.3	16.3	17.3	16.3	16.3	65.2
Number of kilometers travelled (in million)	19,590	19,660	5,062	4,500	5,062	5,092	5,062	5,062	20,250
Average kilometer per passenger	285	311	311	314	311	295	311	311	311
Average rate per passenger kilometer (in rupees)	0.29	0.33	0.35	0.39	0.35	0.36	0.35	0.36	0.35
Freight traffic									
Number of tons (in thousands)	5,890	5,720	1,500	1,330	1,500	1,610	1,500	1,500	6,000
Number of kilometers travelled (in million)	4,520	4,465	1,175	1,044	1,175	1,181	1,167	1,183	4,700
Average kilometers per ton	767	781	783	785	783	733	778	789	783
Average rate per ton per kilometer (in rupees)	1.03	1.09	1.06	1.17	1.06	1.09	0.99	1.01	1.06
Number of employees	92,500	90,500	94,000	94,000	94,000	94,000	94,000	94,000	94,000

Source: Pakistani authorities.

1/ Includes public service obligation, which are transfers from the budget to cover the cost of public services provided by Railways.

2/ Total cash receipts minus accrual expenditures (including debt amortization).

Table 7. Pakistan: Financial and Operational Targets for WAPDA and Successor Companies, 2001/02–2003/04 1/

(In millions of Pakistani rupees, unless otherwise indicated)

	Q1 2001/02	Q1 Prel. Est. 2002/03	Q2 Prel. Est. 2002/03	Rev. FIP 2002/03	Q1 Rev. FIP 2003/04	Q2 Rev. FIP 2003/04	Q3 Rev. FIP 2003/04	Q4 Rev. FIP 2003/04	Rev. FIP 2003/04
<b>Main assumptions</b>									
Furnace oil prices (PRs per metric ton)	11,440	13,221	13,159	13,688	13,806	13,806	13,806	13,806	13,806
Average exchange rate (Pakistani rupees per U.S. dollar)	61.0	59.4	58.8						
Average revenue (PRs/kWh) 2/	3.9	4.7	4.4	4.423	4.172	4.200	4.369	4.557	4.313
Units generated (in GWh)	60,849	18,204	14,343	63,318	18,455	15,198	14,079	17,842	65,574
Of which: thermal units (in percent of units generated)	68.7	49.9	67.2	68.0	51.1	72.5	82.4	68.2	67.3
purchased units (in GWh)	23,242	4,750	5,124	24,378	5,177	5,839	6,624	7,045	24,685
<b>Main operational and financial targets</b>									
Technical and nontechnical losses 3/ 4/	25.8	25.6	22.5	25.0	23.4	22.7	25.0	25.8	24.0
Total receivables	46,909			49,600					59,644
Of which: public sector and FATA receivables				30,903					40,947
Stock of payables to fuel suppliers and IPPs 3/	25,565	16,967	14,077	6,406	5,959	5,512	5,065	4,618	4,618
<b>Summary cash flow statement</b>									
Total cash receipts (excluding GST, ED, & W/Tax)	177,409	56,616	48,905	202,943	56,506	46,866	43,648	57,864	204,884
Total cash outflows	178,649	52,812	44,677	210,099	48,612	53,537	56,792	54,976	213,918
Purchase of power from IPPs	109,101	28,535	25,131	114,907	23,587	25,286	28,437	28,739	106,049
Cost of fuel	37,365	12,325	10,074	39,707	8,765	11,778	11,454	8,695	40,692
Debt service to GOP (interest and amortization)	3,423	3	0	0	5,726	5,726	5,725	5,725	22,902
Debt service other than to GOP (interest and amortization)	11,684	6,064	3,313	16,017	3,067	3,067	3,067	3,068	12,269
Hydel profit payment	6,000	0	1,000	6,000	1,500	1,500	1,500	1,500	6,000
Operations and maintenance	17,261	4,150	4,607	19,309	4,807	5,021	5,449	6,089	21,366
Other cash outflows 5/	-6,185	1,735	552	14,159	1,160	1,160	1,160	1,160	4,640
Net cash available before investment program	-1,240	3,804	4,228	-7,156	7,894	-6,672	-13,144	2,888	-9,034
Investment expenditure	20,618	2,651	1,980	23,511	7,732	7,732	7,732	7,732	30,928
Foreign-financed component	13,034	0	0	11,511	4,732	4,732	4,732	4,732	18,928
Locally-financed component	7,584	2,651	1,980	12,000	3,000	3,000	3,000	3,000	12,000
Cash surplus (+)/deficit(-)	-21,858	1,153	2,248	-30,667	162	-14,404	-20,876	-4,844	-39,962
Financing	21,858	-1,153	-2,248	30,667	-162	14,404	20,876	4,844	39,962
Banking financing		-1,153	-648	0	0	0	0	0	0
Nonbanking financing		0	0	7,000	0	0	0	0	0
Budgetary support (subsidies and grants)		0	-1,600	12,156	-4,894	9,672	16,144	112	21,034
External financing		0	0	11,511	4,732	4,732	4,732	4,732	18,928
<b>Memorandum items:</b>									
Net change in payment arrears 6/		-1,584	3,127	1,569	-447	-447	-447	-447	-1,788
Of which: arrears to the government		7,014	6,017	20,728	0	0	0	0	0
Of which: arrears to IPPs and suppliers		-8,598	-2,890	-19,159	-447	-447	-447	-447	-1,788
Accrual balance 7/		2,737	-879	-20,725	5,341	-9,225	-15,697	335	-19,246
Total budgetary support (including debt arrears)		7,014	4,417	32,884	-4,894	9,672	16,144	112	21,034
Operating expenditures									
Fixed charges and taxes									

Source: Pakistani authorities (WAPDA), see [www.finance.gov.pk/other/financial.pdf](http://www.finance.gov.pk/other/financial.pdf).

1/ Actuals for 2001/02.

2/ Defined as the billing (equal to total cash receipts plus increase in receivables) divided by the number of units sold.

3/ Ceiling under FIP.

4/ Defined as units generated minus units sold, as a percentage of units generated.

5/ Negative "other cash outflows" in 2001/02 appears to reflect bond financing and government support, including through debt-equity swaps in the past, and is not strictly comparable with the 2002/03 presentation.

6/ Change in the stock of arrears vis-à-vis IPPs, fuel suppliers and the government (including debt service).

7/ For monitoring purposes, defined as the cash balance minus any net change in the stock of arrears to suppliers and to the government plus foreign-financed investment.



**Statement by the IMF Staff Representative**  
**June 16, 2003**

1. This statement summarizes the information that has become available since the staff report was circulated to the Board on June 2, 2003. It does not change the thrust of the staff appraisal. The delay in government approval (and submission to parliament) of the fiscal responsibility law (see below) illustrates, however, the risks noted in the staff appraisal.
2. The additional information on macroeconomic and financial developments includes partial data for end-March 2003 which indicate that all end-March quantitative performance criteria are likely to have been observed.
3. Official GDP growth estimates for the fiscal year ending June 2003 have been revised upward to 5.1 percent (compared to 4.5 percent) due to higher-than-expected growth in agriculture, manufacturing, and commerce. Inflation remains subdued at 2.6 percent year-on-year in May (or an average of 3.2 percent in June 2002–May 2003 over the same period a year ago). Exports and imports for July 2002–April 2003 grew both by about 20 percent in U.S. dollar terms over the corresponding period of 2001/02, and the level of remittances remains high. Gross official international reserves continued to increase, reaching US\$9.3 billion by end-May, while the Pakistani rupee slightly appreciated against the U.S. dollar (4.1 percent year-on-year). As of June 12, 2003, the main stock market index (KSE) was up 20 percent over end-2002.
4. End-April monetary data are broadly in line with staff projections. Net foreign assets of the banking system continued to grow at a rapid pace. Broad money growth eased somewhat to 18 percent in the year through April while reserve money growth was 16 percent. Credit to the private sector picked up, increasing by about 13 percent in the year through April.
5. Preliminary unreconciled fiscal data for the federal government through April suggest that meeting the end-year fiscal targets remains within reach. The Central Board of Revenue slightly exceeded its implicit cumulative revenue target for April. The performance of other revenue items was mixed with petroleum surcharges, in particular, slightly below target. On the expenditure side, there appears to be a possibility of underspending on the Public Sector Development Program at the end of the fiscal year. The growth of cumulative social and poverty-related expenditures has slowed to 23 percent for the period July 2002–March 2003 over the corresponding period of the previous fiscal year, falling short of the indicative target by 14 percent, but still above the growth of 21 percent targeted for the year as a whole.
6. The 2003/04 federal budget that was submitted to parliament on June 7 appears consistent with a consolidated deficit (excluding grants) of 4.0 percent of GDP, and includes the various tax measures planned under the program. Both revenues and expenditures in the proposed budget are somewhat higher than in the staff report, and their composition has been modified. Staff is seeking clarification and assessment of the financial impact of a recent cabinet decision to raise federal public sector base salaries and pensions by 15 percent, as well as of a number of proposals made in the Finance Minister's budget speech, including

extension of the special National Saving Schemes pensioner scheme to widows. Staff would urge the authorities to pursue pension and pay reform in the context of an overall comprehensive strategy of right-sizing the civil service and enhancing the sustainability of the public pension system.

7. In the area of structural reform, beyond the status of compliance with structural conditionality indicated in the MEFP (Table 2(a)), the authorities met a structural performance criterion by publishing on May 31 the third quarter progress report on implementation of financial improvement plan (FIP) of large public enterprises, including the Water and Power Development Authority (WAPDA) and the Karachi Electric Supply Corporation (KESC). The reports confirm the expected deterioration of the operational and financial situation of the two power utilities. Line losses increased while revenue declined, notably due to lower tariffs. According to preliminary estimates, the accrual deficits of WAPDA and KESC amounted to PRs 19.6 billion and PRs 9.9 billion respectively during July 2002–March 2003, broadly in line with the projections under the revised FIPs.

8. In breach of a structural performance criterion for the seventh disbursement, the fiscal responsibility law was not submitted to parliament by June 1. The delay seems related to the dispute, noted in the staff report, between the government and the opposition parties on the legality of constitutional amendments passed under the previous government. However, cabinet approval of the draft law is expected in the coming days and submission to parliament in late June.

9. In line with program commitments, the Oil Companies' Advisory Committee increased on May 31 the price of major petroleum products in line with changes in import costs while leaving the surcharges on all petroleum products unchanged.

10. Finally, in the staff report, the staff of the Fund does not intend to make any judgment on the legal or other status of any disputed territories or to prejudice the final determination of the parties' claims.



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International Monetary Fund  
Washington, D.C. 20431 USA

### **IMF Completes Fifth Review of Pakistan's PRGF-Supported Program, Approves US\$123 Million Disbursement**

The Executive Board of the International Monetary Fund (IMF) completed today the fifth review of Pakistan's performance under a three-year, SDR 1.03 billion (about US\$1.47 billion) Poverty Reduction and Growth Facility (PRGF) arrangement (see [Press Release No. 01/51](#)). The completion of this review enables Pakistan to draw a further SDR 86 million (about US\$123 million) under the arrangement, which would bring total disbursements thus far under the arrangement to SDR 517 million (about US\$738 million).

In approving the disbursement, the Executive Board granted a waiver for Pakistan's non-observance of a structural performance criterion regarding the preparation by April 15, 2003 of a revised Financial Improvement Plan (FIP) for the nation's main power utility, the Water and Power Development Authority.

The PRGF is the IMF's concessional facility for low-income countries. PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners, and articulated in a Poverty Reduction Strategy Paper, or PRSP. This is intended to ensure that each PRGF-supported program is consistent with a comprehensive framework for macroeconomic, structural, and social policies, to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent, and are repayable over 10 years with a 5 ½-year grace period on principal payments.

Following the Executive Board's review of Pakistan, Eduardo Aninat, Deputy Managing Director and Acting Chair, made the following statement:

"The Fund commends the authorities for Pakistan's strong macroeconomic performance, in a context of global economic weaknesses and a difficult regional security environment. All quantitative performance criteria for end-December 2002 were met. Available data indicate that GDP growth remains strong, inflation low, and Central Board of Revenue (CBR) tax collections are in line with projections. The external current account and the overall balance of payments continue to overperform, with the value of the Pakistani rupee stable in U.S. dollar terms. Poverty-related spending rose significantly during the first half of fiscal year 2002/03 compared to the same period of 2001/02.

“Most structural reforms planned through April were broadly on track except for limited progress on privatization owing largely to regional security concerns that resulted in a lack of investor interest, and for setbacks in energy sector reforms. Further progress was made toward the completion of a full Poverty Reduction Strategy Paper and in strengthening the monitoring of intermediate social outcomes to ensure that higher human development expenditure translates into better public service delivery. However, the financial performance of the power utilities remains disappointing, owing to high line losses, nonpayment of bills in certain areas, electricity tariffs that do not cover cost, and delays in implementing the unbundling of the Water and Power Development Authority.

“Looking ahead, to strengthen further the foundation of higher sustainable growth and job creation the authorities need to persevere with the current macroeconomic policy mix, based on a flexible exchange rate, a monetary policy aimed at maintaining low inflation, and a fiscal policy aimed at further reducing the public debt burden while raising effective spending for human development. The submission to parliament of a draft budget for the next fiscal year that provides for a further reduction of the overall deficit while raising social and poverty-related expenditures is a significant step in that direction.

“Macroeconomic policy will have to be supplemented by a broad range of structural reforms to create an environment more conducive to private investment. This will require forceful pursuit of reforms aimed at simplifying the tax system and broadening the tax base, including through the elimination of a number of tax exemptions, to reduce distortions and the potential for corruption. Vigorous implementation of plans to improve the performance of the power utilities is needed to limit their drain on the budget as well as free resources for priority social and development expenditures. The planned better remuneration of civil servants needs to be part of a comprehensive civil service and pension system reform. The planned privatization of Habib Bank Ltd., the financial restructuring of insolvent banks, and the reform of the National Savings Schemes should improve the financial sector’s ability to support investment and growth,” Mr. Aninat stated.

**Statement by Abbas Mirakhor, Executive Director for Pakistan  
and Meekal A. Ahmed, Advisor to Executive Director  
June 16, 2003**

My authorities thank staff for fruitful discussions in the context of the fifth review under the PRGF and for a concise, balanced and well-written report on Pakistan's accomplishments since the last review as well as the challenges that lie ahead.

The continued commitment to sound macroeconomic policies, favorable exogenous factors, including good rains, and continued high private capital inflows along with strong external support have produced impressive results. Economic growth in 2002/03, based on the latest information contained in the staff supplement, should exceed 5 percent, thanks to robust growth in agriculture and manufacturing; inflation is forecast to be lower than projected; and, the external current account and the overall balance of payments are expected to overperform relative to program targets, reflecting in part a surge in workers' remittances to a new historical record. In the fiscal area, tax revenues were higher than the target in part due to overperformance by the Central Board of Revenue (CBR)—a trend which appears to have continued in April—and while I-PRSP expenditure growth has slowed somewhat, it still remains above the growth (21 percent) targeted for the year as a whole. All end-March quantitative performance criteria are likely to have been observed and the authorities are confident of meeting the end year fiscal deficit target.

Implementation of the agenda of structural reforms, outside the energy sector, was broadly on course, further progress was made with preparing the full PRSP, and a strategy was prepared to reduce abuse of the "benami" practice (Box 1 of the staff report). However, limited investor interest hindered progress with privatization. In the energy sector, while the government remained diligent in the application of the fortnightly automatic adjustment of petroleum prices, it did not see it politically and economically advisable to pass through all of the surge in fuel costs that occurred in the run-up to the war in Iraq onto higher electricity and gas prices. Since the oil price surge was considered as temporary and exceptional, it made the determination that passing much of the spike through would have been unduly disruptive to economic stability and hurt competitiveness. One consequence of the less-than-full pass-through was, however, that the performance of the two major power utilities, WAPDA and KESC was worse than targeted in their respective Financial Improvement Plans (FIPs). Their deficits in the current year are therefore expected to be higher than planned. Fortunately, overperformance of some nontax revenue items provided an offset to the additional financing needs of these utilities.

The policy framework for 2003/04 requires perseverance with the present macroeconomic policy mix marked by a tight fiscal and monetary policy stance, further improvement in the external position, a determined effort to raise further development and I-PRSP spending so as to make progress with closing Pakistan's large "social gap" and alleviate poverty, and renewed efforts to implement what the authorities judge to be a more realistically ambitious FIP for WAPDA and KESC so as to durably reduce fiscal risks.

The new budget for 2003/04—the linchpin of the continued adjustment effort—which was presented on June 7 gives concrete expression to these goals, and its broad contours and structural content have been well described in the staff supplement. The staff would have preferred a more ambitious path of deficit reduction but have given due consideration to the high costs of sterilization, continued regional tensions, and the financial difficulties in the power sector. Nevertheless, reaching a consolidated fiscal deficit target of 4 percent of GDP in 2003/04 would still be a major landmark. On the revenue side, the budget contains important initiatives aimed at streamlining the tax system through, inter alia, a sweeping reduction in remaining income tax exemptions, and envisages a continuation of reforms in CBR to improve tax buoyancy and efficiency. Staff has expressed concerns regarding the cabinet decision to raise base salaries and pensions by 15 percent and by the decision to extend the special National Saving Scheme (NSS) for pensioners to widows. The authorities assure the Executive Board that the recent rise in salaries and pensions barely compensates for past inflation and would therefore be consistent with forthcoming reforms of the civil service and sustainability in the pension system. In regards to the special NSS scheme for widows, the authorities have responded to a long-standing demand from a relatively less well-off section of the society; they will ensure that documentation requirements will be stringent so as to preclude abuse of this privilege.

The authorities face a challenge in 2003/04 to forcefully implement the FIPs for WAPDA and KESC, two institutions which pose risks for the budget. They are, however, cognizant of the stakes involved and welcome the strengthened conditionality. To be sure, a significant part of WAPDA's financial difficulties can be attributed to temporary factors such as the front loading of payments to Independent Power Producers (IPPs). As this bunching of payments is traversed and the Ghazi-Barotha hydropower plant comes on stream, WAPDA's financial condition should improve significantly. Nevertheless, the authorities are alert to the need for WAPDA to be accountable for achieving durable improvements in line losses and billing, including in the difficult Federally Administered Tribal Area (FATA). The authorities' commitment to ensuring successful implementation of the FIP in WAPDA and KESC is reflected in their undertaking not to pass on downward tariff adjustments unless they are assured that quarterly deficit targets are being adhered to.

Good progress continues to be made on social sector issues in terms of higher spending and the development of improved systems of monitoring social outcomes. However, there continues to be room for improving the quality of reporting on provincial and local government spending. This will require further efforts at capacity building and stricter adherence to existing accounting procedures.

Despite limited investor interest, the authorities remain committed to privatization. They expect to complete the sale of Pakistan State Oil within the next few months and, given some signs of investor interest, have reinvited expressions of interest for Habib Bank. The authorities remain open to a negotiated sale with the sole qualified investor in the case of KESC but will also, concurrently, explore the option of unbundling KESC and selling the power generation component.