

**Pakistan: Eighth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waivers 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 eighth review under the three-year arrangement under the Poverty Reduction and Growth Facility and request for waivers and modification of performance criteria with Pakistan, the following documents have been released and are included in this package:

- the staff report for the eighth review under the three-year arrangement under the Poverty Reduction and Growth Facility and request for waivers and modification of performance criteria, prepared by a staff team of the IMF, following discussions that ended on **April 20, 2004**, 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 June 8, 2004.** 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 23, 2004** updating information on recent developments.
- a Press Release summarizing the **views of the Executive Board as expressed during its June 23, 2004 discussion** of the staff report that completed the request and review.
- a statement by the Executive Director for Pakistan.

The document(s) listed below have been or will be separately released.

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

\*May also be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

PAKISTAN

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

Prepared by the Middle East and Central Asia and  
Policy Development and Review Departments

(In consultation with other departments)

Approved by Saleh M. Nsouli and Michael T. Hadjimichael

June 8, 2004

- Discussions for the eighth review under the Poverty Reduction and Growth Facility (PRGF) arrangement were held in Islamabad during April 7–20, 2004. The staff team consisted of Messrs. Iqbal (head), van Rooden, Schimmelpfennig (all MCD), Baig (FAD), Finger (PDR), and Ms. Alavi, assistant (MCD). The mission was assisted by Mr. Lorie (Senior Resident Representative).
- The mission met with Finance and Economic Affairs Minister Aziz, State Bank of Pakistan (SBP) Governor Husain, Finance Secretary Ahsan, and other senior officials.
- Pakistan's request for a three-year arrangement under the PRGF, with access of 100 percent of quota (SDR 1.03 billion), was approved by the Executive Board on December 6, 2001 (IMF Country Report No. 01/222). So far, Pakistan has drawn SDR 689 million under the current arrangement. As of April 30, 2004, total Fund credit and loans outstanding to Pakistan amounted to SDR 1.27 billion (122 percent of quota, of which 89 percent of quota were PRGF resources).
- The Executive Board completed the combined sixth and seventh reviews on October 27, 2003 (IMF Country Report No. 03/38). At that time, Executive Directors commended the authorities for consolidating macroeconomic stability, achieving key macroeconomic targets, and advancing a broad structural agenda. They emphasized that sound policy implementation and further structural reforms would be essential to achieving sustained growth and reducing poverty.
- Pakistan finalized its Poverty Reduction Strategy Paper (PRSP) in December 2003. The PRSP was discussed by the Executive Board on March 8, 2004 (IMF Country Report No. 04/24 and 04/70). Directors noted that the PRSP represents an adequate framework for Pakistan's efforts toward sustainable growth and poverty reduction and provides a sound basis for Fund concessional assistance.
- The principal authors of this report are Milan Zavadjil and Ron van Rooden, with contributions from Axel Schimmelpfennig, Taimur Baig, Harald Finger, and Alina Milasiute.

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### List of Acronyms

ABL	Allied Bank Limited
AsDB	Asian Development Bank
CBR	Central Board of Revenue
CWIQ	Core Welfare Indicators Questionnaire
DFID	U.K. Department for International Development
FATA	Federally Administered Tribal Areas
FIBR	Floating interbank market exchange rate
FIP	Financial Improvement Plan
FRP	Financial Recovery Plan
FSAP	Financial Sector Assessment Program
FSSA	Financial System Stability Assessment
GDDS	General Data Dissemination System
HBL	Habib Bank Limited
IDBP	Industrial Development Bank of Pakistan
KESC	Karachi Electric Supply Corporation
LTU	Large taxpayer unit
MEFP	Memorandum of Economic and Financial Policies
MTBF	Medium-term budget framework
MTU	Medium taxpayer unit
NAB	National Accountability Bureau
NAM	New Accounting Model
NEPRA	National Electric Power Regulatory Authority
NSS	National Saving Schemes
NPV	Net present value
NWFP	North West Frontier Province
PIA	Pakistan International Airlines
PIB	Pakistan Investment Bonds
PRGF	Poverty Reduction and Growth Facility
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
PSDP	Public Sector Development Program
ROSC	Report on the Observance of Standards and Codes
SAFTA	South Asian Free Trade Agreement
SBP	State Bank of Pakistan
SDDS	Special Data Dissemination Standard
TMU	Technical Memorandum of Understanding
WAPDA	Water and Power Development Authority
WTO	World Trade Organization

## Executive Summary

**Macroeconomic performance continues to be very strong.** Growth has been stronger than forecast. While inflation has remained low, inflationary pressures have recently picked-up somewhat. External vulnerabilities have been reduced further, with debt indicators declining broadly as programmed, and a further substantial accumulation of international reserves.

**Implementation of the PRGF program remains broadly on track.** All quantitative performance criteria for end-December 2003 were met and it seems that most indicative targets for end-March 2004 were also met. Structural reforms are advancing, albeit only slowly in the energy sector. Four structural performance criteria were breached, but the slippages were minor and mainly reflected timing issues.

**The discussions focused on the 2004/05 macroeconomic framework and on maintaining the momentum of structural reforms.** To help lift a significant share of the population out of poverty, the authorities are targeting economic growth rates of at least 6 percent annually over the medium term. This is ambitious, but achievable, and will require a substantial increase in private and public investment. This, in turn, will depend on the continuation of sound macroeconomic policies and broad-based structural reforms.

**With the budget for 2004/05, the authorities aim to balance the need for increased social and development spending and further debt reduction.** The overall fiscal deficit (excluding grants) will be contained to 4 percent of GDP, helping to reduce the public debt ratio to below 80 percent of GDP. CBR revenue is projected to increase by 0.2 percent of GDP in 2004/05, reflecting further improvements in administrative efficiency and broadening of the tax base. Together with renewed efforts to reduce subsidies to loss-making public enterprises and a further decline in interest spending, this will create room to increase social- and poverty-related spending.

**The authorities believe that with the economy now growing at a faster pace, the rate of inflation in 2004/05 is likely to be marginally higher.** The SBP has started to moderately tighten monetary policy and stands ready to tighten more aggressively, should inflationary pressures continue to build. The SBP has reduced its foreign exchange purchases in recent months and will implement a monetary policy aimed at slowing down the pace of monetary expansion.

**Structural measures in the period ahead focus on further strengthening tax administration and the forceful implementation of energy sector reforms.** The government is working with the World Bank on a medium-term adjustment program to reduce the fiscal burden imposed by the power sector and to achieve expanded access, increased reliability, and lower costs. Urgent short-term actions include the completion of a transparent tariff setting mechanism and subsidy policy, and the development of structural recovery plans for the individual enterprises.

## I. INTRODUCTION AND BACKGROUND

1. **In the attached letter dated June 7, 2004 and the accompanying Memorandum of Economic and Financial Policies (MEFP), the government of Pakistan requests the completion of the eighth review under the PRGF arrangement.** The authorities also request waivers for the nonobservance of four structural performance criteria (see paragraphs 9 and 13), as well as a modification of the end-June 2004 limit on nonconcessional borrowing. The ninth disbursement (SDR 172 million) is conditional upon completion of this review.

2. **The political situation in Pakistan has improved, but the perception of fragile security conditions continues to affect investment.** The constitutional dispute has been resolved, based on parliamentary approval of the Legal Framework Order that defines the role of the president in the political system. Recent improvements in the relations with India and the implementation of the South Asian Free Trade Agreement (SAFTA) should bolster regional stability and trade. On the other hand, tensions remain high in a few areas along the Afghan border and terrorist acts occur occasionally.

3. **Since the start of the current PRGF arrangement, Pakistan's macroeconomic situation has improved considerably.** Economic growth has rebounded, inflation has remained low, debt indicators have improved considerably, and foreign exchange reserves have increased sharply (Table 1). However, it is difficult to say if there has been a reduction in poverty during the program period. The latest available data are from the 2000/01 household survey—according to which just under one-third of the population lived in poverty—but these figures do not take into account the strong economic growth of the last two years and particularly the recovery of agriculture from drought.<sup>1</sup>

## II. PERFORMANCE UNDER THE PROGRAM DURING JULY 2003–MARCH 2004

4. **Macroeconomic performance continues to be very strong and implementation of the PRGF program remains broadly on track.** Economic growth is expected to exceed the target and reach 6.4 percent in 2003/04 (July–June).<sup>2</sup> Growth is broad-based, but most pronounced in the export-oriented large-scale manufacturing. Price pressures increased modestly, reflecting strong domestic and external demand, high capacity utilization in some

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<sup>1</sup> Poverty issues were discussed extensively in the PRSP (IMF Country Report No. 04/24), the JSA (IMF Country Report No. 04/70), and in Box 3 of the staff report for the sixth and seventh reviews of the PRGF (IMF Country Report No. 03/38).

<sup>2</sup> In May 2004, the Federal Bureau of Statistics completed a comprehensive revision of Pakistan's national account statistics, including moving the base year from 1980/81 to 1999/2000 and incorporating several new sectors of activity. The results of this revision is a nominal GDP for 1999/2000 and subsequent years that is about 20 percent higher than previously estimated levels. The current staff report still utilizes the "old" GDP series; the "new" series will be discussed during the 2004 Article IV consultation.



sectors, rising petroleum prices, and pressures emanating from the partial liberalization of the wheat market. Consequently, twelve-month inflation rose to 6 percent in April 2004 (Figure 1). Equity and, reportedly, real estate prices have risen sharply. All quantitative performance criteria for end-December 2003 were met (Table 1(a) of the MEFP). Similarly, most indicative targets for end-September and end-December 2003 were met (MEFP, paragraph 7), and preliminary data suggest that most indicative targets for end-March 2004 have been met as well.

Pakistan: Main Economic Indicators, 2002/03–2004/05				
(In percent of GDP, unless otherwise noted)				
	2002/03	2003/04		2004/05
		Prog.	Proj.	
Real GDP growth (in percent)	5.1	5.3	6.4	6.0
Inflation (annual average, in percent)	3.1	4.0	4.1	5.0
Budget balance (excluding grants)	-4.5	-4.0	-4.0	-4.0
Broad money growth (in percent)	18.3	11.5	17.5	12.8
Current account balance (including official transfers)	6.1	1.6	2.9	0.4
Gross international reserves (in months of imports)	6.8	7.4	7.6	7.4

Sources: Pakistani authorities; and Fund staff estimates.

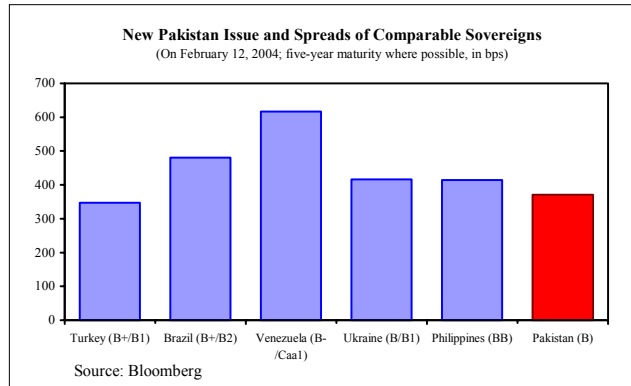
5. **External vulnerabilities have been reduced further.** Exports continued to grow strongly in 2003/04, while private transfers, although declining, remained sizable. Imports grew even more rapidly, with a shift toward raw materials and machinery. As a result, the current account surplus, excluding official transfers, is estimated at about 2 percent of GDP in 2003/04, compared with 4½ percent of GDP in 2002/03 (Table 2; Figures 2 and 3). The SBP absorbed part of the foreign exchange inflows and its gross official reserves increased further to \$11 billion by end-April 2004, equivalent to over seven months of imports. Reflecting early repayments of \$1.1 billion in relatively expensive Asian Development Bank (AsDB) loans and lower-than-expected program and project financing, Pakistan’s external public and publicly guaranteed debt is estimated to fall by four percentage points to 43 percent of GDP this year (Table 3).

6. **Pakistan successfully re-entered the international capital markets.** Pakistan issued a \$500 million five-year Eurobond with a 6¾ percent coupon in February 2004 (see Box 1). Because of the improved fundamentals and a scarcity of Pakistani paper in the market, the issue was greatly oversubscribed.

7. **Budget execution is comfortably on track.** The overall deficit (excluding grants) for the consolidated government was lower than programmed in the first nine months of 2003/04 (Tables 4 and 5; Figure 4). Higher-than-targeted revenues reflected strong economic activity, front-loaded defense receipts (from the coalition against terrorism), and some timing factors. On the expenditure side, lower-than-programmed interest payments and disbursement delays more than offset higher defense expenditures resulting from increased military activity on the Afghan border.

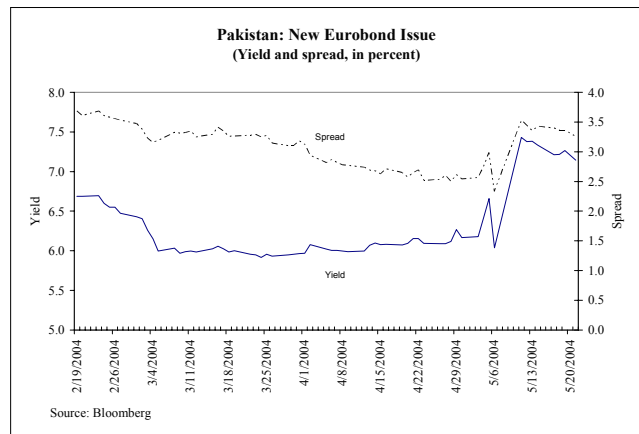
### Box 1. Pakistan's Return to International Capital Markets

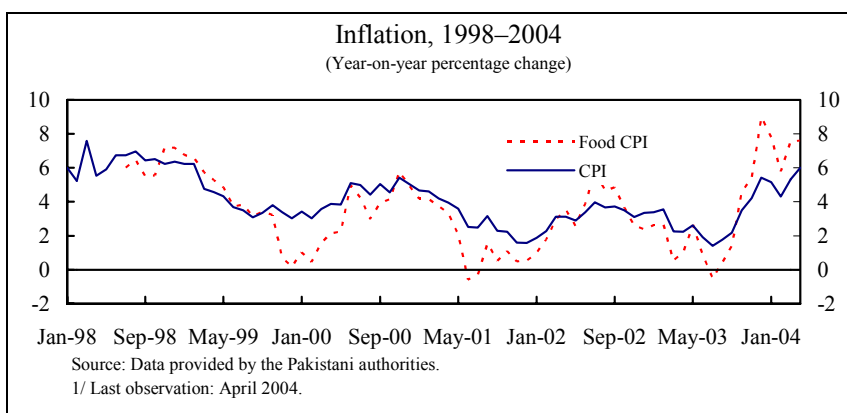
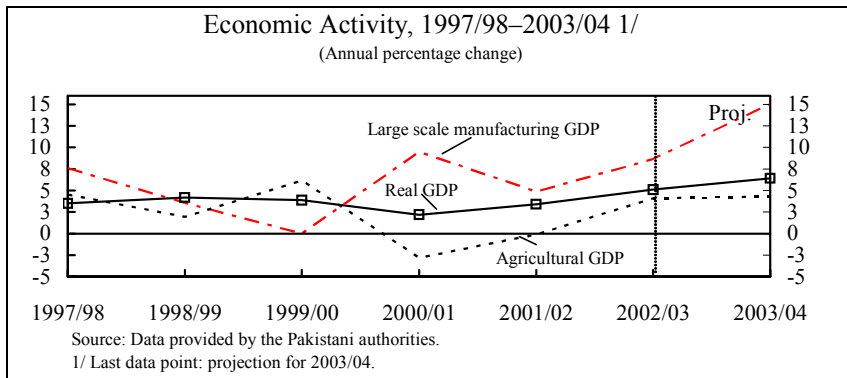
On February 12, 2004, Pakistan issued a \$500 million five-year Eurobond, thereby successfully returning to the international capital markets after the restructuring of international obligations in 1999. A road show generated strong demand, leaving the issue four times oversubscribed. The issue was priced to yield 6.75 percent, implying a spread of 370 bps over U.S. treasuries. An even lower spread may have been possible had the bond been targeted at a narrower investor base in the Middle East, but the intention was explicitly to target European and Far Eastern investors in order to establish a wider market presence. The bond was rated B by Standard & Poor's and B2 by Moody's, and the spread places the bond in the vicinity of or slightly better than similarly rated countries, reflecting an upbeat market sentiment but also a 'scarcity value' of the bond, allowing investors to diversify their portfolios. The bond has traded broadly favorably since floatation. In spite of a recent market correction, the spread has remained consistently below its level at the date of issuance. Pakistan's Eurobond is governed by English law and thus includes collective action clauses, as has been long-standing market practice for such bonds.



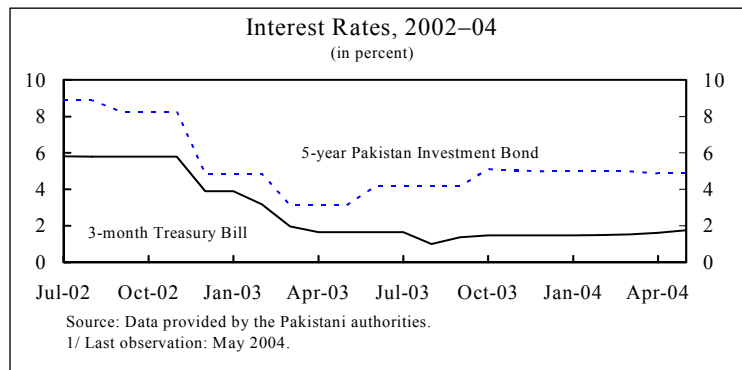
Pakistan issued the bond at a time of strong external accounts and in the absence of a need for foreign budgetary financing. The bond was issued at the time of a \$1.1 billion prepayment of relatively expensive foreign debt owed to the AsDB, thereby on aggregate neither increasing foreign debt nor the cost of debt servicing. The size and investor base of the bond puts Pakistan on the list of countries subject to more extensive private market research, making it eligible, for example, for a return to the Emerging Markets Bond Index (EMBI Global). Greater international research coverage could facilitate foreign investment. At the same time, the bond could serve as a useful pricing benchmark for future Pakistani corporate foreign borrowing.

On April 21, 2004, Pakistan engaged in an interest rate swap, effectively transforming its obligation from fixed to floating interest rates. Pakistan will pay 6-month U.S. dollar LIBOR plus 323 bps over the life of the bond, reducing the interest payments from the previous fixed rate as long as short-term rates remain favorable. The contract limits the interest rate risk for Pakistan during the final two years of the agreement, adding a clause that caps the floating rate at 6.75 percent during this period as long as LIBOR stays below 5.52 percent.





8. **Monetary aggregates grew rapidly in the first nine months of 2003/04** (Tables 6 and 7; Figure 5). Reserve money growth was again driven by an increase in net foreign assets of the SBP. However, unlike in previous years, commercial bank credit to the private sector expanded rapidly, reflecting the strong economic recovery, combined with low interest rates and ample liquidity in banks. With high money and credit growth, the SBP has started to tighten monetary policy modestly and short-term interest rates have started to increase somewhat.



9. **Progress was made in implementing structural reforms, although some slippages occurred.** Four structural performance criteria were not observed (Table 2(a) of the MEFP and paragraph 13 below). However, the slippages were minor and reflected mostly timing issues, and all have largely been corrected. Moreover, the delays did not affect overall macroeconomic performance.

10. **Additional steps were taken in the ongoing program to strengthen tax policy and administration** (MEFP, paragraph 10). A fundamental change was the introduction of universal self-assessment for the 2002/03 tax returns, with risk-based audit procedures to minimize taxpayers' interaction with tax officials. A new sales tax office in Karachi became operational in October 2003.

11. **The modernization of Pakistan's banking sector is continuing.** The government sold a majority stake in Habib Bank Limited (HBL) in December 2003. This was the largest strategic sale so far undertaken by the government and, with this, over three quarters of banking system assets are now in private hands. In addition, National Bank of Pakistan shares were sold through a public offering, bringing private ownership in this bank to 23 percent. Little progress was made, however, in the privatization or restructuring of Allied Bank Limited (ABL) and the Industrial Development Bank of Pakistan (IDBP). Interest rates on National Savings Schemes (NSS) instruments were adjusted on January 1, 2004 to be better aligned with interest rates on Pakistan Investment Bonds (PIB). A new formula linking the semiannual adjustment of NSS rates more directly to changes in PIB yields was recently agreed and will become effective on July 1, 2004. NSS rates will, nevertheless, continue to contain a subsidy element.

12. **Progress in energy sector reforms continues to be slow.** The oil and gas sector is gradually becoming a more efficient and privately owned sector, with recent steps including public offerings of shares in key companies (MEFP, paragraph 30), though the state retains a dominating role. Petroleum prices have been adjusted fortnightly, but the latest spike in prices was not passed on to consumers; the authorities intend to revert to previous surcharge rates shortly, bearing in mind the need to achieve revenue targets. Reforms in the power sector have proven to be more difficult, because of the political sensitivity of electricity pricing and the challenging technical issues. Notably, delays occurred in the formulation and implementation of the government's electricity tariff and subsidy policy; a framework for the setting of regional electricity tariffs was only announced in June 2004. Still, the Water and Power Development Authority (WAPDA) and the Karachi Electric Supply Company (KESC) met the end-December 2003 accrual balance targets set in their Financial Improvement Plans (FIP) by considerable margins (Tables 8 and 9). The improvement in WAPDA's financial position stemmed from both an increase in the availability of low-cost hydro power and—to a lesser extent—from an improvement in operational efficiency. WAPDA's unbundling is nearing completion and is awaiting consent from lenders.

13. **All but one of the nonobserved structural performance criteria were related to the power sector and all reflected the timing of actions.** While the government did prepare an action plan for establishing a transparent regulatory framework for the setting of electricity tariffs in October 2003, the plan stated that the framework for regional tariff setting would be determined by February 2004, rather than by end-December 2003 as envisaged under the program. It was announced only in June 2004 (first waiver). This delay also had some impact on recent tariff adjustments. A downward tariff adjustment for KESC, determined by the National Electric Power Regulatory Agency (NEPRA) in mid-January 2004, was

implemented only in mid-April, well after KESC's second quarter FIP results were known (second waiver). Earlier, the government had implemented a downward tariff adjustment for WAPDA in November 2003, although WAPDA had missed the accrual balance target for the first quarter by a very small margin (third waiver). The government delayed the implementation, however, until it was confident that WAPDA would meet its (cumulative) second quarter target, which, as noted, it did. Outside the energy sector, the full transfer of ownership—and management—of HBL was completed by end-February 2004, two months later than envisaged under the program (fourth waiver).

### III. REPORT ON THE DISCUSSIONS

14. Within the overall framework provided in the PRSP, endorsed by the Executive Board in March 2004, the eighth review discussions focused on the 2004/05 macroeconomic framework and on maintaining the momentum of structural reforms in the areas of taxation, expenditure management, financial intermediation, and the energy sector. Following several years of consolidation, pressures are mounting for the government to adopt a looser fiscal stance to support growth. Critics of the government argue that public investment needs to be raised massively and taxation of investment goods reduced to help achieve economic growth rates in excess of 6 percent, even if this might imply a higher fiscal deficit. These pressures are reinforced by demands that the gains from the improved macroeconomic performance be distributed fairly amongst the population. Consequently, there are demands to raise government wages, reduce taxes, and lower energy prices. The Pakistani authorities are trying to balance these pressures with the need to raise social spending and continue to reduce Pakistan's still substantial public debt burden.

#### A. Macroeconomic Framework

15. **To help lift a significant share of the population out of poverty, the authorities are targeting economic growth rates of at least 6 percent annually over the medium term.** This is ambitious, but achievable, assuming structural reforms are continued; in the 25 years before the liquidity crisis of the late 1990s, economic growth had averaged close to 5 percent annually. For 2004/05, a growth rate of 6 percent could very well be realized, building on the current momentum, provided that external demand and local weather conditions remain favorable. But maintaining growth rates of 6 percent and higher over the medium term will require a substantial increase in private and public investment, accompanied by significant improvements in productivity.

16. **Beyond achieving more rapid economic growth, poverty reduction will require substantial investment in human capital and an improvement in public service delivery.** In the PRSP, the authorities project a gradual increase in social expenditures—about 1.6 percentage points of GDP over five years—as well as an increase in the effectiveness of those expenditures. The latter involves building adequate institutional capacity and improving governance at the local level by advancing the devolution process, as discussed extensively in the PRSP.

17. **While prospects for achieving debt sustainability have greatly improved, Pakistan remains a highly indebted country.** Debt indicators are still relatively high and reducing these further to sustainable levels will require continued fiscal adjustment and strong economic growth (Tables 10a, 10b, 11a, and 11b; Figures 6 and 7). The baseline scenario discussed in Box 2, based on the gradual fiscal adjustment envisaged in the PRSP, would allow for a substantial decline in the debt burden and would limit the risk of crisis in case of various unfavorable shocks.

### **Box 2. Fiscal and External Debt Sustainability**

**Public and external debt are projected to decline significantly over the medium term.** Recent years have seen strong primary surpluses, robust real growth, falling interest costs, and a modest appreciation of the Pakistani rupee against the U.S. dollar. In the projections, continued primary surpluses, averaging slightly below 1 percent of GDP, and a positive growth-interest differential contribute to a continued reduction of debt indicators. Consequently, under the baseline scenario—which assumes that growth is maintained at 6 percent annually and that inflation and interest rates stay low—gross public debt would decline, from its peak of 108 percent of GDP in 2000/01, to 63 percent in 2008/09 (Table 10a).

**A battery of stress tests indicate that the public debt path is not likely to deteriorate significantly under various shocks to the baseline scenario** (Table 10b). Replacing a number of key parameters with less favorable outcomes (lower primary balance, lower growth, and a sharp exchange rate depreciation) shows that key ratios would continue to decline over the forecast horizon, though at a slower pace.

**Pakistan's external debt ratio also continues to decline, but remains still relatively high and is a potential source of vulnerability.** The end-2003/04 net present value (NPV) of public and publicly guaranteed external debt is estimated at 179 percent of exports. Under the baseline scenario, Pakistan's external debt indicators are projected to continue to improve (Table 11a). Within 10 years, the ratio of external debt to GDP is expected to halve and the NPV of public and publicly guaranteed external debt could fall to 101 percent of exports.

**The stress tests, however, show that considerable vulnerabilities remain** (Table 11b). Two of the eight simulations (one applying lower exports and the other using a combination of shocks) would temporarily increase the NPV of debt-to-exports ratio to above 200 percent. However, none of the applied shocks leads to an explosive debt path. Even under a scenario applying historical averages of the last 10 years to the key variables (thus simulating a repetition of the difficult 1990s), the NPV of debt-to-exports ratio would peak in 2006/07 at 195 percent.

## **B. Fiscal Policy**

18. **Fiscal targets for 2003/04 are expected to be met.** Revenues are likely to be somewhat higher than programmed, mostly on account of nontax revenues (mainly defense receipts). The Central Board of Revenue (CBR) is expected to collect at least the amount envisaged under the program (MEFP, paragraph 14). Gains in customs duties reflecting stronger-than-projected imports will be offset by a shortfall in sales tax receipts. Expenditures

are also expected to be higher than budgeted, with savings on interest expenditures more than offset by higher defense spending, as noted above. Social- and poverty-related expenditures are expected to reach 5.4 percent of GDP, as programmed, up from 5.2 percent of GDP in the previous year.<sup>3</sup> Overall, the consolidated government deficit (excluding grants) will be contained to 4 percent of GDP, while the public debt ratio is projected to be reduced to 84.1 percent of GDP, slightly less than programmed.

Pakistan: Main Fiscal Indicators, 2002/03–2004/05				
(In percent of GDP; unless otherwise indicated)				
	2002/03	2003/04		2004/05
		Prog.	Proj.	
Revenue and grants	20.8	18.3	18.2	17.3
Tax revenue	13.8	13.6	13.5	13.7
<i>Of which:</i> CBR revenue	11.5	11.6	11.4	11.6
Nontax revenue	4.1	3.7	4.0	3.2
Grants	2.8	1.0	0.7	0.5
Expenditure	22.4	21.4	21.5	20.8
Current expenditure	19.7	17.7	17.8	17.0
Development expenditure and net lending	2.7	3.7	3.7	3.8
Budget balance (excluding grants)	-4.5	-4.0	-4.0	-4.0
Total government debt	89.2	84.4	84.1	78.6

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

19. **With the budget for 2004/05, the authorities aim to balance the need for increased social and development spending and further debt reduction.** Provided growth remains strong, containing the overall fiscal balance (excluding grants) to 4 percent of GDP is achievable. This would reduce the public debt ratio to below 80 percent of GDP (MEFP, paragraph 15), a slightly faster reduction than envisaged in the draft Fiscal Responsibility Law and in the PRSP. The authorities felt strongly that a further reduction in the deficit would compromise the need for increased social and development spending, given that revenues are expected to fall in percent of GDP in 2004/05, on account of a very cautious projection of defense receipts. CBR revenue, on the other hand, is projected to increase by 0.2 percent of GDP, which seems feasible in light of further improvements in administrative efficiency and broadening of the tax base, despite some reduction in tax rates (see paragraph 23). Together with renewed efforts to reduce subsidies to loss-making public enterprises and a further decline in interest spending, this should create the fiscal space to increase social- and poverty-related spending further to 5.6 percent of GDP. The populist pressures for an easier fiscal policy and lower energy prices discussed earlier remain an important risk to the implementation of fiscal policy.

<sup>3</sup> These figures reflect a new definition of social- and poverty-related expenditures, as used in the full PRSP (see Table 4, Footnote 5). There was a similar increase under the old definition.

### C. Monetary and Exchange Rate Policy

20. **The authorities believe that with the economy now growing at a faster pace, the rate of inflation in 2004/05 is likely to be marginally higher.** Consequently, while annual average inflation is expected to be close to, or slightly above, 4 percent in 2003/04, inflation is targeted not to exceed 5 percent in 2004/05 (MEFP, paragraphs 13 and 17). The SBP envisages some further modest tightening in the months ahead to slow monetary expansion and contain price pressures. But on balance, the authorities believe that the risks of a marked increase in inflation are low, with weak import prices—except for petroleum products—and a strong Pakistani rupee. The SBP assured the mission, however, that it stands ready to tighten monetary policy more aggressively, should there be any sign of significant inflationary pressures. The mission noted that rapid monetary expansion and substantial recent increases in sensitive prices argued for an early tightening of monetary policy.

21. **The SBP has reduced its foreign exchange purchases in recent months.** Private transfers and capital inflows have slowed somewhat compared with the previous two years—although they remain sizable—so that pressures for nominal appreciation are now limited. The Pakistani rupee has remained largely stable in the past few months. In the period ahead, the SBP will limit its operations to smooth short-term fluctuations and will not resist sustained pressures for the Pakistani rupee/U.S. dollar exchange rate to appreciate.

22. **The build-up of international reserves is expected to slow.** The current account surplus is projected to diminish further in 2004/05. While exports will continue to benefit from the expanding world economy, there is some uncertainty regarding the impact of the elimination of the existing quota system by end-2004 on Pakistan's textile sector (see Box 3).<sup>4</sup> Imports are projected to continue to expand rapidly, reflecting strong domestic growth. Overall, the SBP is projected to continue to accumulate reserves in 2004/05, but at a slower pace than in previous years.

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<sup>4</sup> The likely impact of this and of SAFTA will be assessed in the 2004 Article IV staff report.



### **Box 3. Trade Policy Developments**

#### **South Asian Free Trade Agreement (SAFTA)**

On January 6, 2004, India, Pakistan, Bangladesh, Nepal, Bhutan, Sri Lanka, and the Maldives signed the SAFTA Framework Treaty. Starting January 2006, members must reduce tariffs on goods not on the sensitive list (see below) vis-à-vis member countries to 20 percent (India, Pakistan, and Sri Lanka) or 30 percent (the remaining countries) by end-2007. In a second stage, tariffs must be reduced to 0–5 percent. India and Pakistan must implement this within five years of the initial stage, Sri Lanka within six years, and the other countries within eight years.

Member countries will be allowed to maintain ‘sensitive lists’ of products that would be exempted from tariff reductions. These lists are currently under negotiation and will be periodically reviewed with a view to reducing the number of items. Member countries are also obliged to eliminate all quantitative trade restrictions, except those permitted under the World Trade Organization (WTO) rules.

#### **SAFTA and trade with India**

While India has granted most favored nation status to Pakistan, Pakistan’s imports from India remain governed by a restrictive positive list. With the advent of SAFTA, Pakistan will need to open itself to imports from India by January 2006. Pakistan’s Ministry of Commerce estimates the potential of liberalizing trade flows to be about \$700 million per annum for exports from Pakistan to India and \$2 billion in the reverse direction.

#### **Expiration of textile and apparel quota system**

Under the WTO Agreement on Textiles and Clothing, the quota system that was previously put in place under the Multifiber Agreement is to expire by end-2004. This is likely to lead to shifts in trade patterns. Consequently, for Pakistan, with a share of textiles and clothing in total merchandise exports of approximately 70 percent, the stakes are high. Studies undertaken by the U.S. International Trade Commission<sup>1/</sup> and by the World Bank<sup>2/</sup> predict that China will become a dominant producer, while Pakistan could emerge as a major supplier for a narrower range of goods. At the moment, the effect on Pakistani exports is difficult to quantify, as several key factors are not yet known. An important factor will be the way importing countries make use of the textile-specific safeguard provisions contained in China’s WTO accession protocol.

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1/ Textiles and Apparel: Assessment of the Competitiveness of Certain Foreign Suppliers to the U.S. Market; January 2004

2/ Textile and Clothing Policy Note: Implications for Pakistan of Abolishing Textile and Clothing Export Quotas; April 2004

## **D. Structural Reforms**

### **Tax policy and administration**

23. **The authorities are further expanding the tax base and improving tax administration.** The 2004/05 budget contains measures to broaden the tax net, including the removal of several remaining tax exemptions (MEFP, paragraph 19). Meanwhile, corporate income tax rates will be reduced further as planned with a view to aligning all top income tax rates at 35 percent. In addition, some import duties on raw materials and machinery will be reduced to help foster investment. Following the success of the large taxpayer unit (LTU) that opened in 2002 in Karachi, work is underway to open an additional LTU in Lahore and five medium taxpayer units (MTU) in regional centers. In addition, a pilot customs house will be set up in Karachi shortly.

## Public expenditure management and governance

24. **The authorities are moving ahead on their agenda to improve expenditure management and fiscal transparency.** For the federal government, the New Accounting Model (NAM) will be used for the 2004/05 budget. However, because of capacity constraints at the provincial level, the NAM will be used in parallel with the existing model only in the North West Frontier Province (NWFP), while implementation in other provinces will take place later during the year (MEFP, paragraph 21). A medium-term budget framework (MTBF) is being developed, but progress has been relatively slow (see MEFP, paragraph 21).

25. **The authorities are taking steps to strengthen governance** (see Box 4 and MEFP, paragraph 22). Considerable progress has been made already in political devolution and next steps will need to focus on administrative and financial devolution to ensure that local governments have both the means and capacity to take on the increased responsibility for achieving development goals. With this in mind, the National Finance Commission is discussing a new division of revenues between the federal and provincial governments. The Fiscal Responsibility Law, submitted to parliament in October 2003, is still being discussed, while new anti-money laundering and *Benami* laws have not yet been submitted to parliament.

### Box 4. Improving Governance

Governance reform is one of the poverty reduction strategy's four pillars. Reforms are ongoing in many areas, and are intended to make the public sector more efficient and accountable. Nevertheless, Pakistan continues to rank moderately low in corruption indices compiled, for example, by Transparency International. The police, land administration, tax administration, and the judiciary are viewed as most in need of reform.

As part of the National Anti-Corruption Strategy, introduced in October 2002, the National Accountability Bureau (NAB) has initiated an awareness campaign to change society's acceptance of corruption, targeted initially at the middle class, students, civil servants, and legislators. Pilot projects in the Islamabad traffic police and one local government administration are intended to eliminate corrupt practices through restructuring, capacity building, and provision of adequate resources for service delivery. A set of new procurement rules and regulations for the public sector is also being prepared. Through political devolution, local administrations have received responsibility for delivering municipal services, and report directly to elected local officials, thus strengthening accountability. Civil service reform will be aimed at improving governance through a flatter hierarchy and merit-based recruitment and promotion; a World Bank-supported capacity building project is on its way.

The Access to Justice Program is, inter alia, designed to improve the accountability of courts and speed up the processing of smaller claims, including through establishing exclusive family, juvenile, and small claims courts that will be supplemented by alternate dispute resolution mechanisms at the local level. The number of judges and support staff is being increased to effectively deal with existing case loads. Local governments have received greater authority over the police to better protect citizens' rights. An independent prosecution service has been established in each province.

The authorities are preparing unified legislation to limit the *Benami* practice by which an asset is held in the name of one person for the benefit of another, which gives wide scope for abuse. At present, *Benami* is only partly addressed in the NAB law in relation with corruption, as well as by the CBR and the SBP for operational purposes.

## **Energy sector reforms**

26. **Forceful implementation of energy sector reforms is now needed.** The continuing fiscal burden created by the power sector stems not only from unfinished reforms, but also reflects under-investment in maintenance and expansion. The government is currently working with the World Bank on a medium-term adjustment program for the power sector. This program will aim to improve governance and accountability—including by accelerating privatization—reduce costs, and reform tariff and subsidy policies. Such a policy framework would promote investment in the sector and help to achieve expanded access, increased reliability, and lower costs, which is necessary to support rapid economic growth. To be effective, the reform plan will need to include both short-term actions to improve financial performance and medium-term actions for locking in and reinforcing these gains. Following the issuance of the government's regional tariff policy in June 2004, short-term actions include finalizing its subsidy policy, completing the break-up of WAPDA, and finalizing financial recovery plans for all power sector entities (MEFP, paragraphs 26–28). WAPDA's recent overperformance, if continued, is expected to be at least partially passed-on to consumers. In addition, the authorities intend to offer KESC, the Jamshoro generation company, and the Faisalabad Electric Supply Corporation for sale this summer (MEFP, paragraph 30), although these transactions are complicated and may take more time. In the oil and gas sector, Pakistan State Oil, Pakistan Petroleum Limited, and the National Refinery Limited are also scheduled to be offered for sale in 2004.

## **Financial sector reforms**

27. **Far-reaching reforms have resulted in a healthier and more efficient and competitive financial system that is capable of supporting economic growth.** A major achievement has been the transformation of a predominantly state-owned and weak banking system into one that is predominantly privately owned. The Financial System Stability Assessment (FSSA) (refer to [www.imf.org](http://www.imf.org)) that accompanies this document found good compliance with international supervisory standards. The authorities agreed with the thrust of the FSSA and its recommendations. According to the FSSA, financial soundness indicators have greatly improved in recent years, with the share of nonperforming loans declining, capital adequacy improving, and a return to profitability. The system is now more resilient to credit, market, and liquidity risks and is thus better placed to absorb shocks. Still, there are some risks related to the rapid expansion in credit, which could undermine loan portfolio quality, and the sharp rise in equity prices. In order to consolidate the progress made, the process of privatization and legal reforms will need to be continued. In addition, the reform process will need to be broadened to nonbank financial services (insurance and pensions). The mission urged the authorities to submit the draft anti-money laundering law to parliament as soon as feasible.

#### IV. OTHER ISSUES

##### A. Statistical Issues

28. **Pakistan started participating in the General Data Dissemination System (GDDS) in November 2003.** The authorities are working on further improvements in Pakistan's statistics, as recommended by a Statistics Department mission that visited Pakistan in December 2003, with a view to subscribing to the Special Data Dissemination Standard (SDDS). Shortcomings in some statistical practices and databases were identified—particularly in the national accounts and government finance statistics, and to a lesser extent in monetary statistics—that could detract from the accurate and timely analysis of economic developments. The Report on the Observance of Standards and Codes—Data Module and the Detailed Assessments Using the Data Quality Assessment Framework is expected to be submitted to the Executive Board shortly, pending a formal response from the authorities.

##### B. Program Financing and Monitoring

29. **The program remains fully financed.** Discussions for the ninth and final review under the PRGF arrangement and assessment of end-June 2004 performance criteria are expected to take place late this summer, in combination with the discussions for the 2004 Article IV consultation. Accordingly, the tenth disbursement (SDR 172.28 million) remains scheduled for after September 20, 2004. Quantitative and structural performance criteria and indicative targets, as well as structural benchmarks are specified in the MEFP (see also Box 5). As regards the quantitative performance criteria for end-June 2004 established at the time of the last review, the authorities request that the end-June 2004 limit on contracting and guaranteeing of nonconcessional debt be increased from \$750 million to \$1 billion. This is to accommodate a government guarantee on a larger-than-anticipated loan that has been contracted by Pakistan International Airlines (PIA) for the purchase of new airplanes as part of its fleet-renewal program. PIA has made a strong turnaround in the past few years; operations are expanding and the company has become profitable, and PIA is expected to be privatized in steps. PIA is expected to service the loan itself, but the guarantee allows PIA to benefit from favorable borrowing terms, which further aids its profitability.

#### V. STAFF APPRAISAL

30. **Pakistan has made an impressive recovery from macroeconomic crisis, despite often difficult domestic and external political circumstances.** Growth has picked up further in 2003/04 and the country has become considerably less vulnerable to external shocks. Inflation, meanwhile, has remained low. Key to the recovery has been strong ownership of the program by both the military and the civilian governments and the sustained implementation of sound macroeconomic policies and a broad structural reform agenda. Strong external support has also contributed to the success of the program. As a result, Pakistan is expected to “graduate” from concessional Fund support to market financing after the current PRGF arrangement expires in December 2004 (while continuing to borrow from

the International Development Association and the AsDB). These achievements have established a solid foundation for future economic progress.

### **Box 5. Structural Conditionality**

#### **1. Coverage of structural conditionality in the remainder of the PRGF program**

The focus of structural conditionality for the remainder of the program remains on further broadening the tax base, strengthening tax administration, financial reform, and electricity sector reform (Table 2(b) of the MEFP). The extension of Fund conditionality to the energy sector reflects its importance for the achievement of macroeconomic objectives, notably fiscal consolidation, as well as continuing weaknesses in implementing reforms in this sector.

#### **2. Status of structural conditionality from earlier program years**

The status of structural measures for the first nine months of 2003/04 is described in detail in Table 2(a) of the MEFP. Some structural measures for 2002/03 and for the first half of 2003/04 were only partially implemented, while others were delayed. Ultimately, however, all of the structural conditionality has been (largely) met. Some tax exemptions that were to be eliminated were maintained, while some new exemptions were introduced. The impact on the budget, however, was minor. A plan for extending GST coverage to additional services is delayed until July 2004. The authorities established the framework for setting regional electricity tariffs only in June 2004, while clarifying the subsidy policy is delayed until July 2004 (a performance criterion for the ninth review).

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

The World Bank is currently negotiating the first of three Poverty Reduction Support Credits (PRSCs), which is expected to be discussed by the World Bank's Executive Board in July 2004. Conditionality is expected to aim predominantly at (a) maintaining macroeconomic stability; (b) accelerating power sector and gas sector reforms; (c) increasing fiscal space for health and education expenditures; and (d) improving governance through: (i) reforms in financial management, procurement, and other anti-corruption and accountability institutions; (ii) civil service reform; and (iii) devolution, through the transfer of increased resources to lower levels of government.

**31. Considerable challenges remain, however, as poverty is still widespread in Pakistan and the Millennium Development Goals could be difficult to achieve.** The recently completed PRSP provides a solid framework for the country's efforts toward achieving sustainable growth and poverty reduction. The authorities now need to develop a prioritized action plan for implementing the PRSP agenda as part of the next PRSP progress report. The attached MEFP makes a substantial contribution to elaborating the PRSP agenda in terms of macroeconomic policies for 2004/05 and structural reforms in several key areas.

**32. Staff concurs broadly with the authorities' proposed macroeconomic and structural policies for 2004/05.** These policies should contribute to creating an environment for continued strong growth based on increasing investment, while maintaining financial

stability and further reducing external vulnerabilities. The staff urges the authorities not to yield to pressures for easier fiscal and energy pricing policies now that the overall economic outlook has improved, but instead to use this as an opportunity to accelerate reforms further.

33. **The 2004/05 draft budget discussed with the authorities appropriately balances the need for increased social and development expenditures and a further reduction in the debt-to-GDP ratio.** But staff urges the authorities to make every effort to increase revenue collection beyond the budget target, for which there is scope. The additional revenues could be used to further increase investment expenditures to the level envisaged in the PRSP. Higher revenues would also help to safeguard poverty spending in case some of the risks related to pressures for higher government wages or lower energy prices materialize, or if the targeted reduction in support for public enterprises proves to be too ambitious.

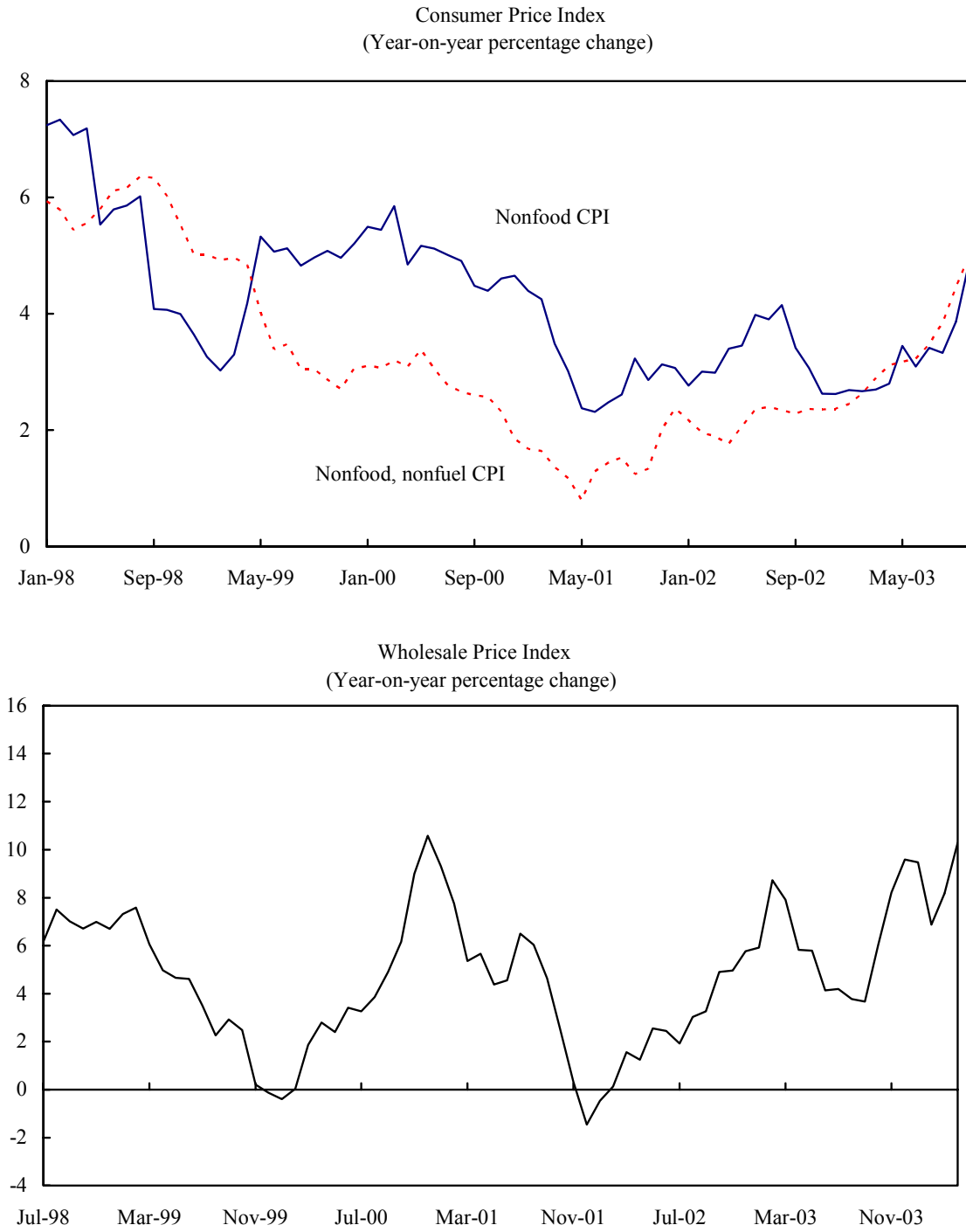
34. **The SBP has appropriately begun to modestly tighten monetary policy.** Inflation remains modest given the pace of economic growth. Nevertheless, staff urges the SBP to further tighten monetary policy promptly and more substantially, especially if inflationary pressures continue to build. The staff supports the current exchange rate policy followed by the SBP and its intention not to resist sustained pressures on the rate in either direction.

35. **Structural reforms have been advancing in most sectors.** Solid progress has been made in fiscal and financial sector reforms. However, progress has been slow in the power sector and some major laws are still pending. The authorities now need to implement forcefully the power sector reforms, especially the establishment of a transparent tariff setting mechanism that will enable the authorities to avoid the current weaknesses in determining tariffs. The staff looks forward to the adoption of the Fiscal Responsibility Law and urges the authorities to quickly advance legislation to prevent money laundering and to limit the *Benami* practice.

36. **Impressive strides have been made in banking sector modernization.** Banks appear to be financially sounder, and the legislative framework and the supervision capacity of the SBP have been improved. Nevertheless, with the current expansion of private sector credit and sharp asset price increases, staff urges the SBP to keep a close eye on financial sector soundness, as many banks are entering into new areas at a rapid pace.

37. **Overall, the authorities continue to make solid progress under the PRGF arrangement.** The MEFP outlines appropriate policies for the period ahead. Staff recommends approval of the requested waivers of performance criteria and the completion of the eighth review, given the temporary nature of the delays in implementing the measures and the limited impact on Pakistan's overall macroeconomic performance. The staff also supports the authorities' request for modification of the end-June 2004 performance criterion regarding the contracting and guaranteeing of nonconcessional debt, as PIA's financial position has improved remarkably, while the ratio of public and publicly guaranteed debt to GDP, including the additional guarantee, is expected to turn out slightly lower than programmed.

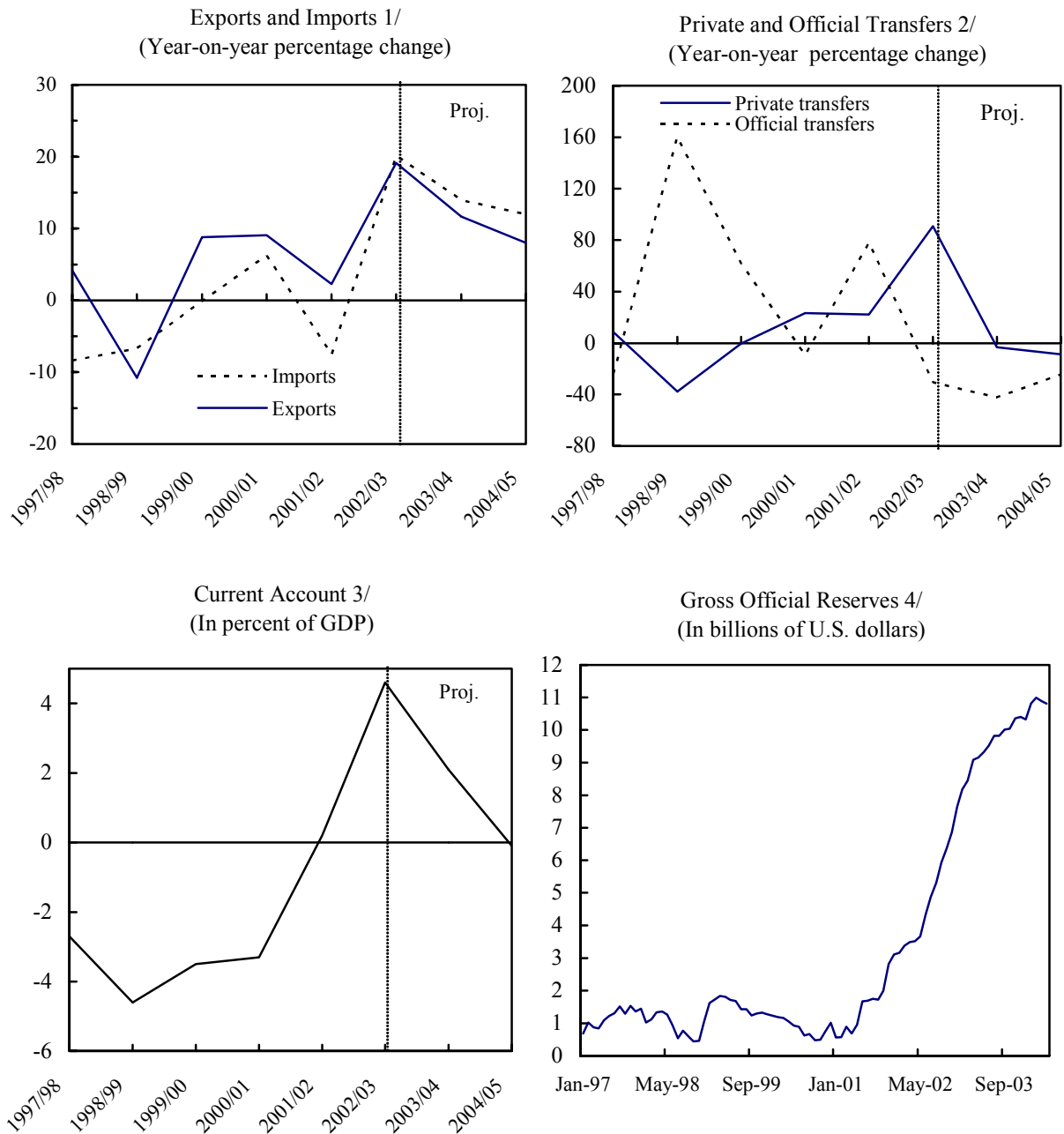
Figure 1. Pakistan: Inflation, 1998–2004 1/



Source: Data provided by the Pakistani authorities.

1/ Last observation: April 2004.

Figure 2. Pakistan: External Sector Developments, 1997/98–2004/05



Source: Data provided by the Pakistani authorities.

1/ Customs basis, in U.S. dollar terms. Last observation: projection for 2004/05.

2/ Last observation: projection for 2004/05.

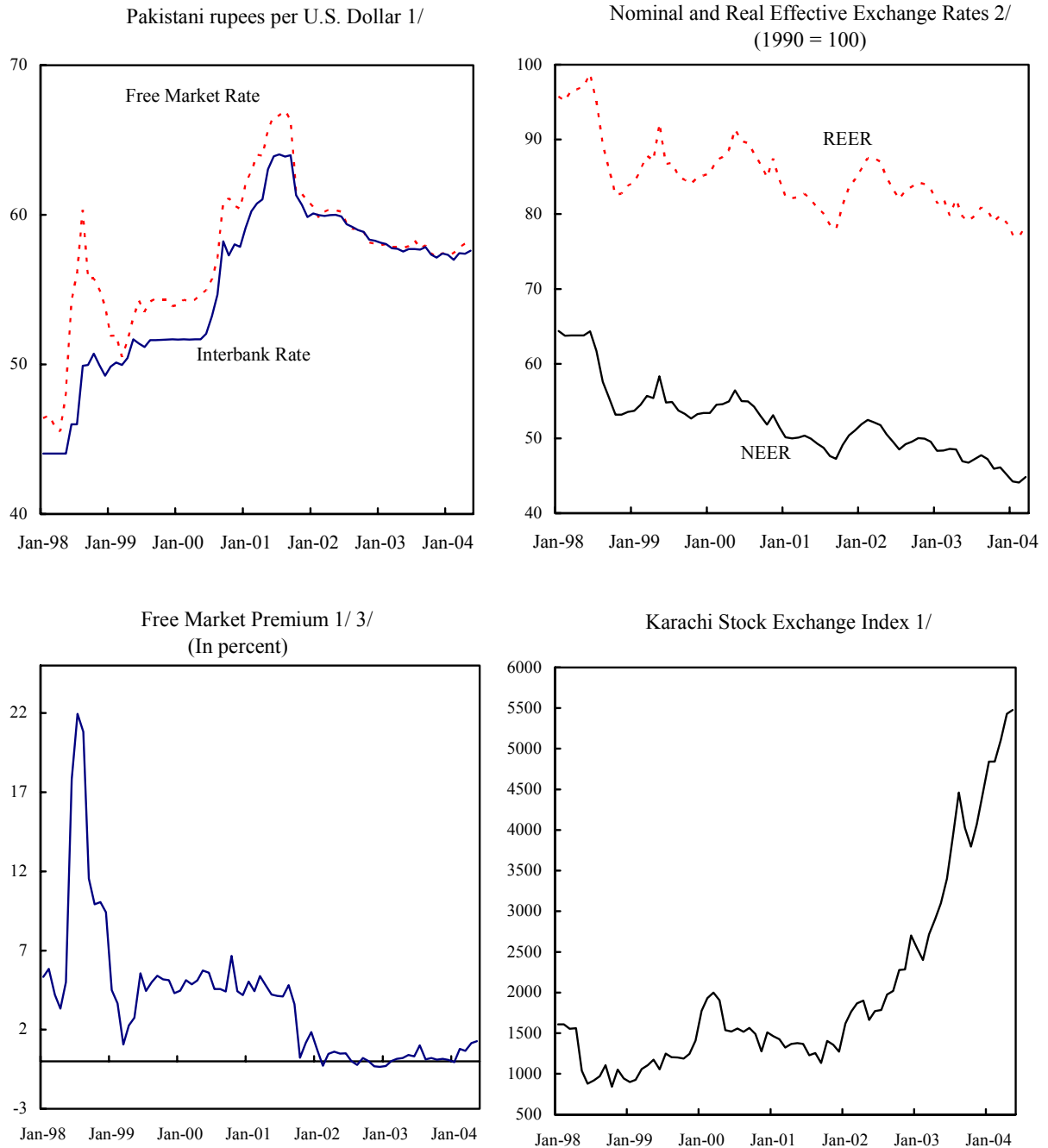
3/ Excluding official transfers. Last data point: projection for 2004/05.

4/ Excluding gold, foreign deposits held with SBP, short-term swap and forward commitments.

Last observation: May 27, 2004.



Figure 3. Pakistan: Exchange Rate and Stock Market Developments, 1998–2004



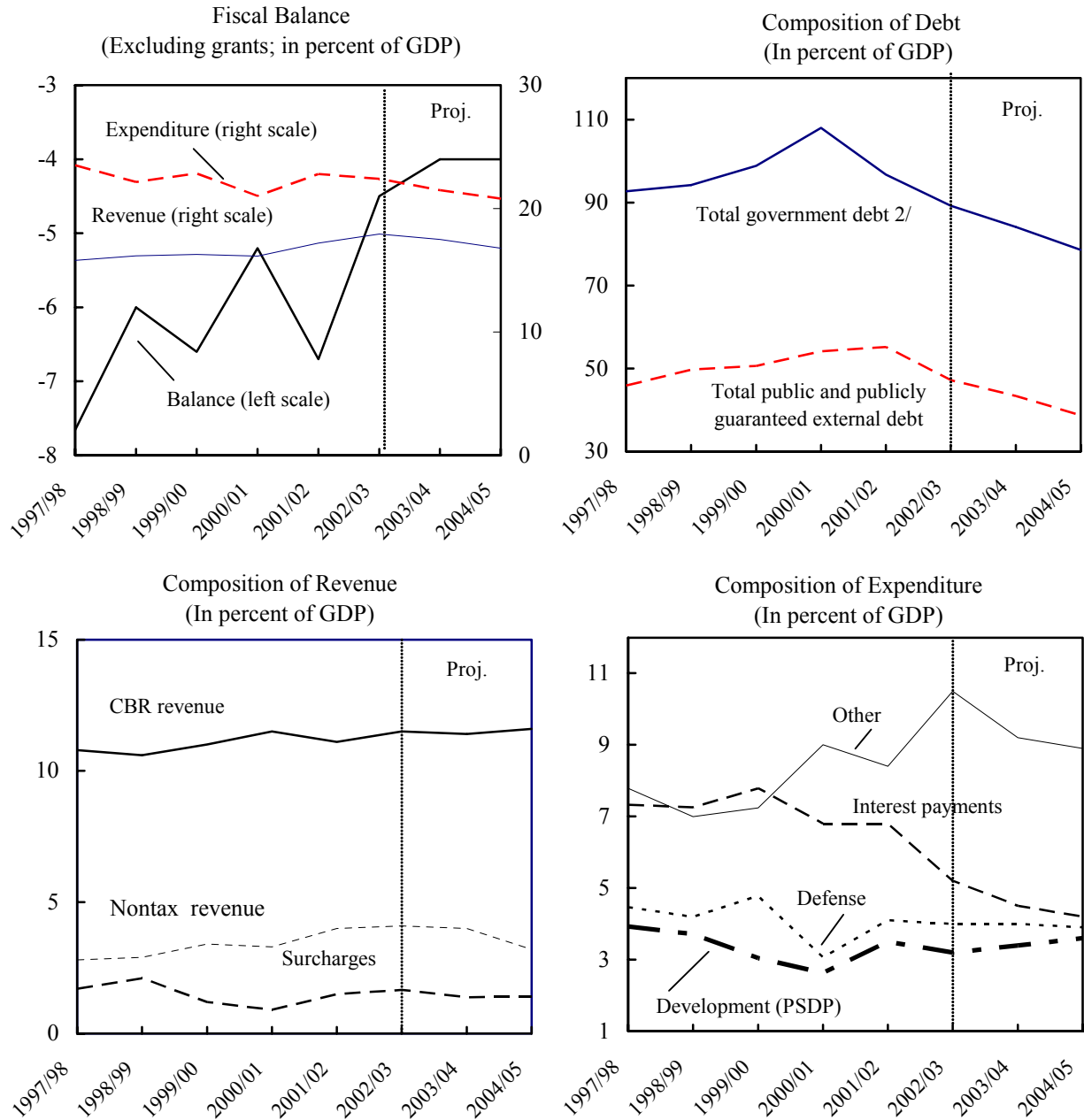
Sources: Data provided by Pakistani authorities; and Fund staff estimates.

1/ Last observation: May 27, 2004.

2/ Last observation: March 2004.

3/ The free market premium is defined as the percent difference between the interbank rate and the kerb rate.

Figure 4. Pakistan: Fiscal Developments, 1997/98–2004/05 1/

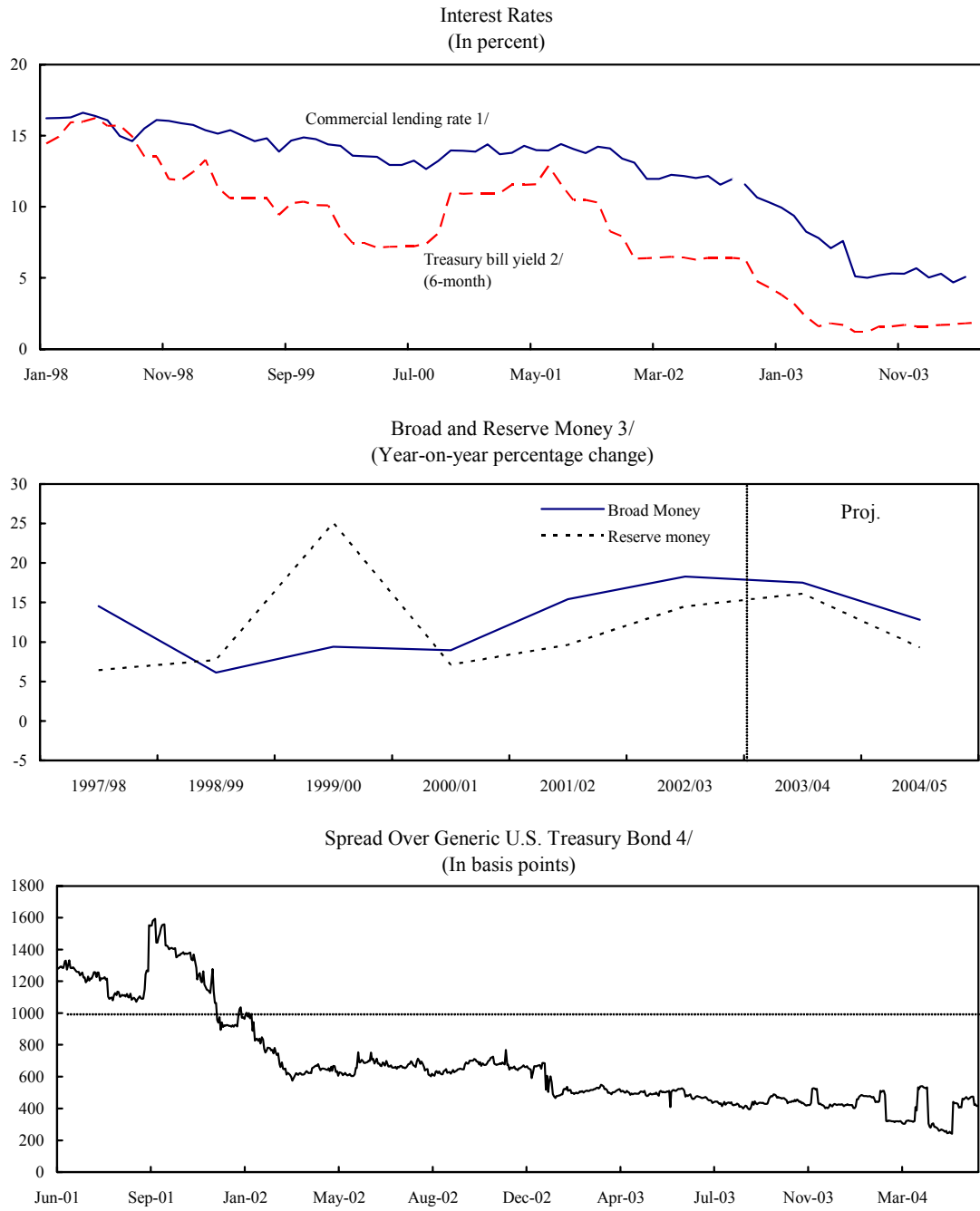


Source: Data provided by the Pakistani authorities.

1/ Last data point: projection for 2004/05.

2/ Total public debt is the sum of domestic government debt and external public and publicly guaranteed debt.

Figure 5. Pakistan: Monetary and Financial Market Developments, 1997/98–2004/05



Source: Data provided by the Pakistani authorities.

1/ Last observation: April 2004.

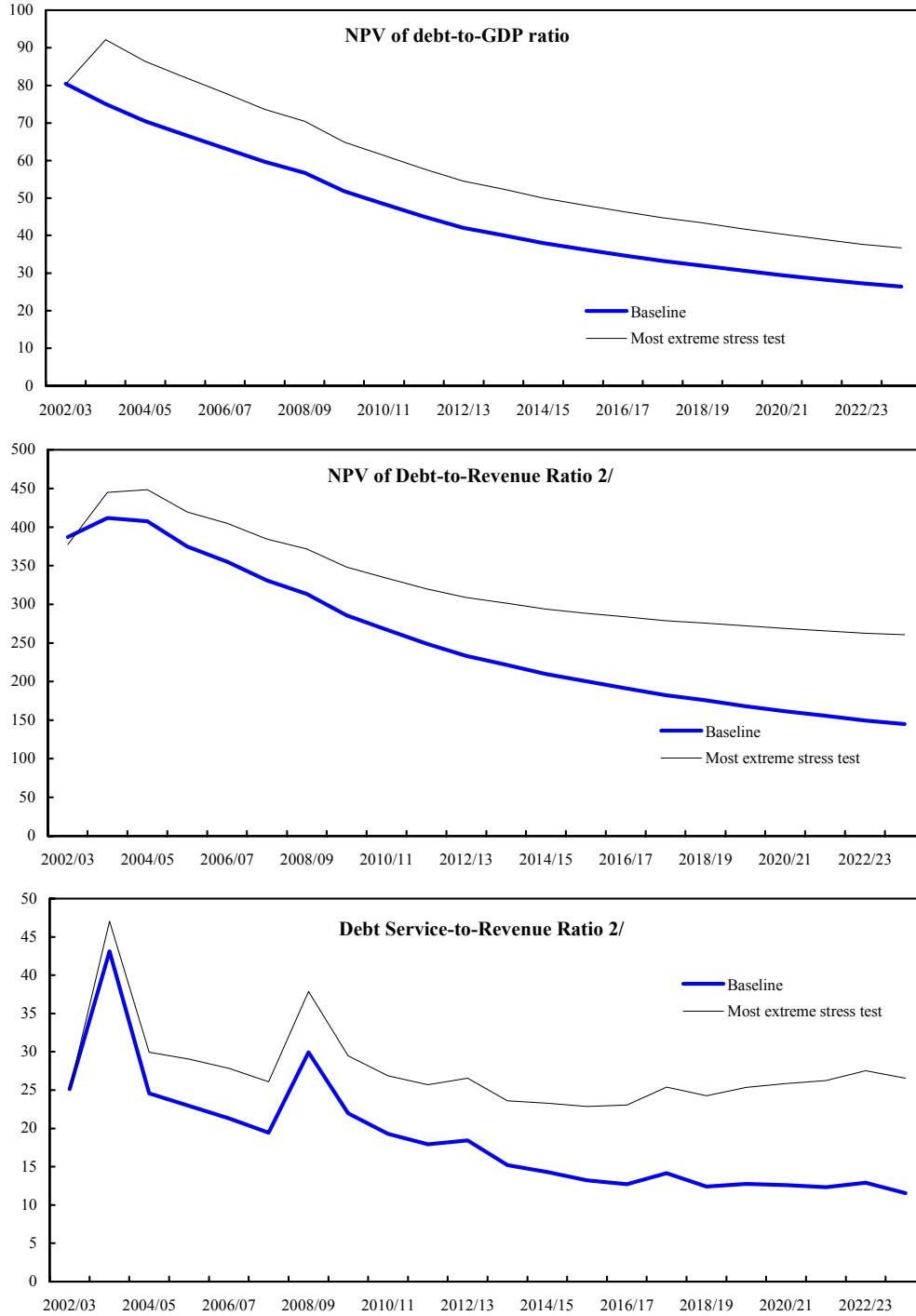
2/ Last observation: May 2004.

3/ Last observation: projection for 2004/05.

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

Last observation: May 31, 2004.

Figure 6. Pakistan: Indicators of Public Debt Under Alternative Scenarios, 2002/03–2023/24 1/  
(In percent)

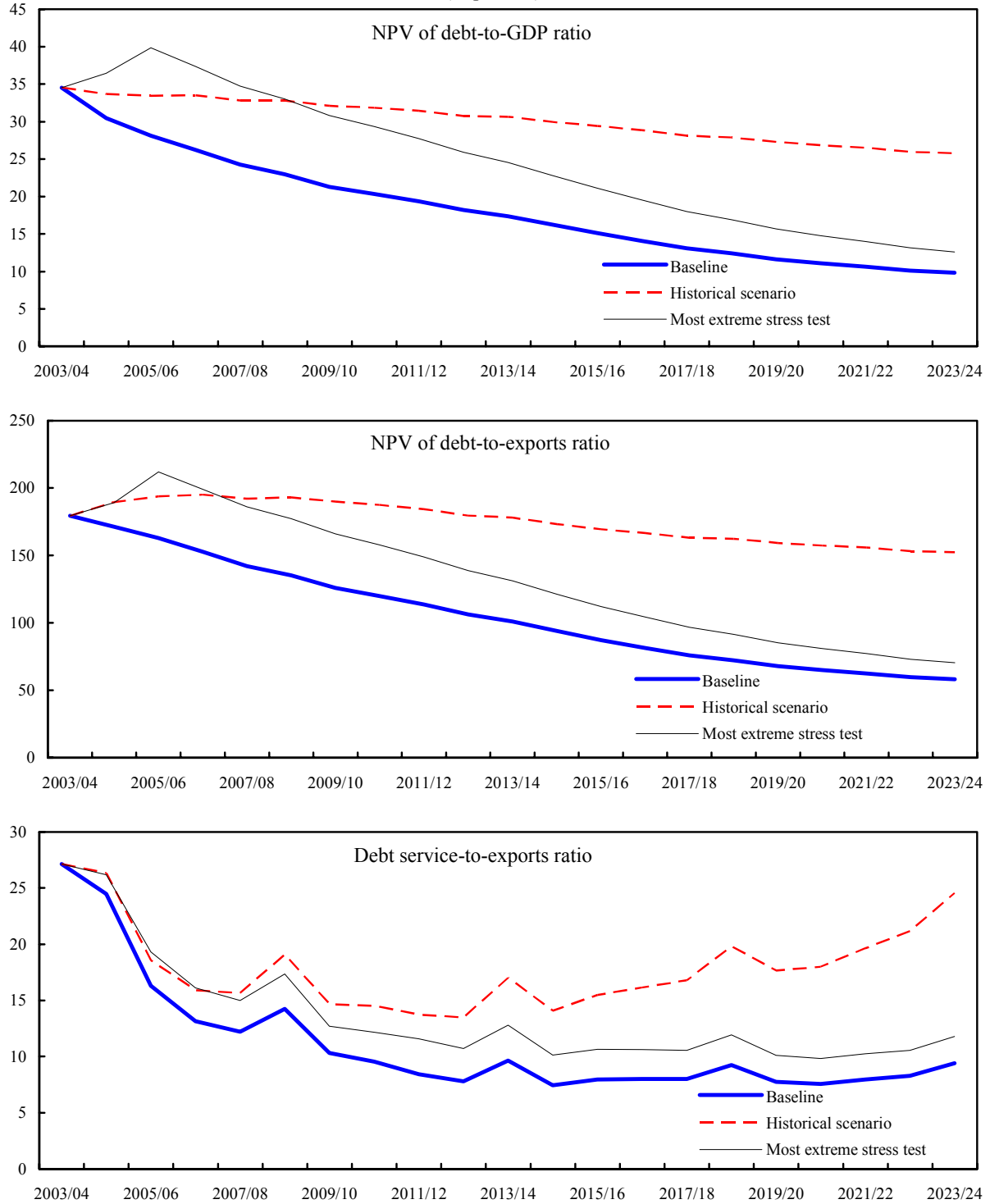


Source: Staff projections and simulations.

1/ Most extreme stress test is test that yields highest ratio in 2013.

2/ Revenue including grants.

Figure 7. Pakistan: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2003/04–2023/24  
(In percent)



Source: Staff projections and simulations.

Table 1. Pakistan: Selected Economic Indicators, 2000/01–2004/05

	2000/01	2001/02	2002/03	2003/04		2004/05
				Prog.	1/ Proj.	Proj.
(Annual changes in percent)						
Output and prices						
Real GDP at factor costs	2.2	3.4	5.1	5.3	6.4	6.0
Partner country demand (WEO definition)	3.4	1.9	2.6	2.9	3.4	3.7
Consumer prices (period average)	4.4	2.7	3.1	4.0	4.1	5.0
Pakistani rupees per U.S. dollar (period average)	12.8	5.2	-4.9	...	...	...
(In percent of GDP)						
Savings and investment						
Gross national savings	13.6	17.4	21.6	16.9	19.1	17.4
Government	-1.5	0.2	1.0	0.6	0.4	0.1
Nongovernment 2/	15.2	17.2	20.5	16.3	18.6	17.3
Gross capital formation	15.5	14.7	15.5	15.3	16.2	17.0
Government 3/	2.6	3.5	3.2	3.5	3.4	3.6
Nongovernment 2/	12.9	11.2	12.2	11.8	12.8	13.4
(In percent of GDP)						
Public finances						
Revenue (including grants)	17.3	19.5	20.8	18.3	18.2	17.3
Expenditure 4/ 5/	21.4	22.8	22.4	21.4	21.5	20.8
Budget balance (excluding grants)	-5.2	-5.2	-4.5	-4.0	-4.0	-4.0
Budget balance (including grants)	-4.1	-3.0	-1.7	-3.1	-3.3	-3.5
Primary balance (including grants)	2.8	2.4	3.6	1.2	1.3	0.7
Total government debt	108.0	96.7	89.2	84.4	84.1	78.6
Domestic government debt	52.6	48.4	47.2	44.4	44.7	43.4
Implicit interest rate on government debt (in percent) 6/	6.8	6.8	5.7	5.8	5.6	5.5
(Annual changes in percent of initial stock of broad money)						
Monetary sector 7/						
Net foreign assets	5.1	13.4	18.9	5.5	4.9	0.7
Net domestic assets	3.9	2.0	-0.4	6.0	12.6	12.1
Of which: credit to the private sector	3.5	2.5	9.1	5.0	11.2	7.9
Of which: net claims on the government	-3.3	1.5	-1.4	0.7	3.2	4.1
Broad money	9.0	15.4	18.3	11.5	17.5	12.8
Six-month treasury bill rate (period average, in percent)	10.4	8.1	4.1	...	...	...
(In percent of GDP)						
External sector						
Merchandise trade balance	-2.2	-0.5	-0.6	-1.4	-1.0	-1.5
Merchandise exports	15.2	15.4	15.8	15.2	15.7	15.3
Merchandise imports	17.4	15.9	16.5	16.7	16.6	16.8
Current account excluding official transfers	-3.3	0.2	4.6	0.6	2.1	-0.1
Current account including official transfers	-1.9	2.7	6.1	1.6	2.9	0.4

Table 1. Pakistan: Selected Economic Indicators, 2000/01–2003/04 (concluded)

	2000/01	2001/02	2002/03	2003/04		2004/05 Proj.
				Prog. 1/	Proj.	
(In percent of exports of goods and nonfactor services)						
External public and publicly guaranteed debt	309.4	295.8	238.0	230.7	225.3	217.8
Debt service 8/	27.8	33.8	26.3	20.6	27.1	24.5
Implicit interest rate (in percent) 9/	4.3	4.2	3.4	2.7	3.0	2.9
Gross reserves (in millions of U.S. dollars) 10/	1,679	4,330	9,521	10,695	11,657	11,745
In months of next year imports of goods and services	1.7	3.7	6.8	7.4	7.6	7.4
In percent of short-term external debt 11/	26.1	73.1	195.5	249.5	206.7	251.2
Memorandum items:						
Real effective exchange rate (period average, percentage change)	-2.6	-1.1	-1.8	...	...	...
Terms of trade (percentage change)	-1.6	-0.5	-0.9	3.4	4.1	-0.6
Real per-capita GDP (percentage change)	0.3	0.7	3.6	3.2	4.4	3.9
GDP at market prices (in billions of Pakistani rupees)	3,423	3,629	4,018	4,399	4,455	4,960

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

1/ Program as updated during the combined sixth and seventh review (IMF Country Report No. 03/38)).

2/ Includes public sector enterprises and changes in inventories.

3/ Expenditures included in the Public Sector Development Program.

4/ Including the statistical discrepancy.

5/ Including KESC recapitalization and CBR bonds in 2001/02.

6/ 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.

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

8/ Including interest on short-term debt.

9/ Current-year interest payments divided by previous period debt stock.

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

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

Table 2. Pakistan: Balance of Payments, 2001/02–2004/05

	2001/02	2002/03	2003/04				2004/05
			Est.	Jul.–Mar.		FY	
				Prog. 1/	Prel. Est.		
(In millions of U.S. dollars)							
Current account (excluding official transfers)	96	3,166	359	1,404	448	1,613	-70
Current account balance (including official transfers)	1,591	4,204	1,006	1,961	1,237	2,213	384
Trade balance	-292	-444	-908	-711	-1,093	-755	-1,332
Exports f.o.b.	9,140	10,889	8,531	9,059	11,760	12,158	13,130
<i>Of which: cotton manufactures</i>	5,368	6,650	...	5,449	7,463	7,410	7,976
Imports f.o.b.	-9,432	-11,333	-9,439	-9,770	-12,853	-12,913	-14,462
Services (net)	-2,617	-2,127	-2,425	-2,169	-3,230	-3,179	-3,806
<i>Of which: interest payments</i>	-1,579	-1,276	-754	-837	-1,040	-1,111	-1,076
Private transfers (net)	3,005	5,737	3,692	4,284	4,771	5,547	5,069
<i>Of which: workers' remittances</i>	2,390	4,237	2,730	2,875	3,500	3,700	3,300
Official transfers (net)	1,495	1,038	646	557	788	600	453
<i>Of which: Saudi Oil Facility</i>	579	637	417	302	538	302	0
<i>Of which: additional grant pledges</i>	742	209	148	183	148	203	330
Capital account	-2,322	-1,709	-1,354	-2,592	-1,647	-2,521	-2,475
Public medium- and long-term capital	-1,613	-1,656	-668	-1,353	-750	-1,372	-1,796
Project and nonproject loans	-983	-1,840	-128	-1,316	-172	-1,297	-1,291
Disbursements	531	581	546	482	728	727	742
Amortization 2/	-1,514	-2,421	-674	-1,798	-900	-2,024	-2,033
Commercial banks and IDB (net)	-224	-158	-33	-33	-33	-33	-16
Other 3/	-407	342	-507	-4	-545	-42	-489
Public sector short-term (net)	-1,064	-268	-560	-719	-564	-707	-469
Private medium- and long-term	-80	164	189	199	218	466	315
<i>Of which: FDI</i>	368	612	400	433	500	778	500
Private short-term (including errors & omissions) 4/	435	51	-315	-719	-551	-908	-525
Overall balance (before debt relief)	-731	2,495	-348	-631	-410	-308	-2,091
Financing	731	-2,495	348	631	410	308	2,091
Reserve assets (increase -)	-3,082	-5,261	-1,193	-635	-1,844	-1,402	-460
State Bank of Pakistan (including FE-25s)	-2,717	-5,911	-963	-763	-1,444	-1,455	-160
Deposit money banks	-365	650	-230	128	-400	53	-300
Fund repurchases	-194	-418	-394	-522	-526	-578	-294
Net exceptional financing	4,007	3,185	1,935	1,788	2,780	2,288	2,845
Arrears (increase +)	0	0	0	0	0	0	0
Rescheduling	1,210	1,009	100	100	100	100	100
<i>Of which: Private Sector Involvement</i>	0	100	100	100	100	100	100
Rollover of foreign deposits with banking system 5/	1,314	900	1,000	1,000	1,200	1,200	1,200
Program financing from IFIs	1,367	1,090	760	489	1,380	789	1,446
World Bank	698	213	100	0	500	100	540
AsDB	185	408	300	244	400	444	400
IMF	484	469	360	245	480	245	506
Privatization receipts	117	186	75	199	100	199	99
Financing gap	0	0	0	0	0	0	0
(In percent of GDP)							
Memorandum items:							
Current account (excluding official transfers)	0.2	4.6	0.5	1.8	0.6	2.1	-0.1
Current account balance (including official transfers)	2.7	6.1	1.3	2.5	1.6	2.9	0.4
Exports f.o.b. (growth rate, percent)	2.3	19.1	9.7	16.5	8.0	11.7	8.0
Imports f.o.b. (growth rate, percent)	-7.5	20.2	13.1	16.8	12.5	13.9	12.0
End-period gross official reserves 6/	4,330	9,521	10,283	10,986	10,695	11,657	11,745
(In months of next year imports of goods and nonfactor services)	3.7	6.8	7.1	7.2	7.4	7.6	7.4

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

1/ Program as agreed during the combined sixth and seventh reviews (IMF Country Report No. 03/38).

2/ Includes accelerated repayments. In 2002/03: \$1 billion to the U.S.; in 2003/04: \$1.1 billion to AsDB; in 2004/05: \$1 billion to multilaterals.

3/ Includes U.S. capital grants to finance accelerated repayment of U.S. debt. In 2002/03: \$1 billion.

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

5/ 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.

6/ 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: Summary of Public External Debt and Debt Service, 1999/2000–2004/05

	1999/2000	2000/01	2001/02	2002/03	2003/04 Proj.	2004/05 Proj.
(In millions of U.S. dollars)						
Total public and publicly guaranteed external debt	30,847	31,817	32,704	32,569	33,671	33,335
Medium- and long-term debt	27,732	27,888	29,052	29,045	30,440	29,892
Project and nonproject aid	26,012	26,140	28,095	28,332	29,069	28,718
Commercial banks and IDB	1,100	1,103	314	231	548	532
Other	620	645	643	482	823	642
Short-term debt (by initial maturity)	1,565	2,426	1,713	1,432	1,349	1,349
Commercial banks and IDB	130	257	183	187	105	105
SBP liabilities (including swaps)	1,435	2,169	1,530	1,245	1,244	1,244
Fund credit and loans	1,550	1,503	1,939	2,092	1,882	2,094
Service of medium- and long-term public and publicly guaranteed debt	4,140	2,578	3,534	3,513	3,967	3,659
Amortization 1/	3,113	1,540	2,455	2,548	3,145	2,832
Interest	1,027	1,038	1,079	965	822	827
Interest on public and publicly guaranteed short-term debt	319	284	198	88	87	86
(In percent of GDP)						
Total public and publicly guaranteed external debt	50.6	54.2	55.2	47.3	43.4	38.7
Long-term	45.5	47.5	49.0	42.2	39.2	34.7
Short-term	2.6	4.1	2.9	2.1	1.7	1.6
Fund credit and loans	2.5	2.6	3.3	3.0	2.4	2.4
Service of medium- and long-term public and publicly guaranteed debt	6.8	4.4	6.0	5.1	5.1	4.2
Amortization 1/	5.1	2.6	4.1	3.7	4.1	3.3
Interest	1.7	1.8	1.8	1.4	1.1	1.0
Interest on public and publicly guaranteed short-term debt	0.5	0.5	0.3	0.1	0.1	0.1
(In percent of exports of goods and nonfactor services)						
Total public and publicly guaranteed external debt	322.1	309.4	295.8	238.0	225.3	217.8
Service of medium- and long-term public and publicly guaranteed debt	43.2	25.1	32.0	25.7	26.5	23.9
Amortization 1/	32.5	15.0	22.2	18.6	21.0	18.5
Interest	10.7	10.1	9.8	7.1	5.5	5.4
Memorandum items:						
Implicit interest on public and publicly guaranteed external debt	4.7	4.3	4.2	3.4	3.0	2.9
Public debt service in percent of government revenue (incl. grants)	39.2	25.3	30.6	24.6	28.1	24.6
Total external debt	35,137	35,239	35,545	35,084	35,434	34,863
(In percent of GDP)	57.7	60.0	60.0	51.0	45.7	40.5

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

1/ Includes accelerated repayments. In 2002/03: \$1 billion to the U.S.; in 2003/04: \$1.1 billion to AsDB; and in 2004/05: \$1 billion to multilaterals.

Table 4. Pakistan: Consolidated Government Budget, 2000/01–2004/05

(In billions of Pakistani rupees)

	2000/01	2001/02	2002/03	2003/04						2004/05
	FY	FY	FY	Dec.		Mar.		FY		Staff
	Prov. Act.	Prov. Act.	Prov. Act.	Prog.	Prov. Act.	Prog.	Prov. Act.	Prog. 1/	Rev. Proj.	Proj.
Revenue and grants	593.5	707.2	835.0	343.1	398.5	555.8	579.9	804.2	812.0	857.7
Revenue	553.0	624.1	720.8	321.7	379.1	525.9	555.4	762.4	780.3	833.5
Tax revenue	441.5	478.1	555.8	260.6	277.7	412.0	424.7	599.8	600.9	677.2
Federal	422.5	459.3	534.0	248.5	264.0	392.2	404.4	573.6	574.7	647.8
CBR revenue	392.1	403.9	461.6	218.1	230.8	347.5	354.6	510.0	510.1	576.0
Direct tax	124.6	142.6	152.9	58.4	71.7	101.7	107.1	161.1	161.1	180.0
Federal excise duty	49.0	46.9	44.9	22.8	19.0	34.0	29.7	47.7	43.8	45.5
Sales tax	153.5	166.3	195.1	104.1	98.7	160.8	152.7	223.1	218.1	248.6
Customs duties	65.0	48.1	68.8	32.8	41.4	51.0	65.1	78.1	87.1	102.0
Petroleum surcharge	17.9	36.6	46.9	22.6	24.3	35.3	36.7	46.1	46.1	49.0
Gas surcharge	12.3	17.7	21.3	6.4	8.9	8.5	13.0	15.0	16.0	17.8
Other	0.2	1.1	4.1	1.3	0.0	0.9	0.1	2.5	2.5	5.0
Provincial	19.0	18.8	21.8	12.1	13.7	19.8	20.4	26.2	26.2	29.4
Nontax revenue	111.4	146.0	165.0	61.0	101.4	114.0	130.7	162.6	179.4	156.3
Federal	91.5	124.7	139.6	52.0	90.2	94.6	115.8	134.4	152.2	126.7
Provincial	19.9	21.3	25.4	9.0	11.2	19.3	14.9	28.2	27.2	29.6
Grants	40.5	83.1	114.2	21.4	19.5	29.8	24.5	41.8	31.7	24.2
Expenditure	717.9	826.2	898.1	448.0	416.2	690.0	630.8	941.6	957.7	1,032.7
Current expenditure	645.7	700.2	791.7	387.0	352.5	575.7	536.1	779.4	793.6	844.6
Federal	479.0	524.6	599.8	291.3	252.3	430.3	385.6	573.9	589.2	614.6
Interest payments	234.5	245.3	209.7	108.1	98.8	162.3	140.4	210.0	202.5	210.8
Domestic	183.5	184.6	160.5	87.2	76.3	131.4	109.2	170.5	161.5	169.6
Foreign 2/	51.0	60.6	49.2	20.9	22.5	30.9	31.2	39.5	41.0	41.2
Defense	104.7	149.0	159.7	85.7	87.3	123.2	129.3	160.3	180.0	194.0
Running of the civil government	70.7	56.3	60.9	32.0	26.5	49.4	45.3	70.5	70.5	75.0
Pensions for defense and civil government	30.9	27.2	37.2	19.0	14.7	32.0	24.4	39.6	42.6	44.0
Subsidies 3/	19.9	23.7	50.0	32.3	11.3	42.2	24.7	62.5	62.5	59.5
Grants	18.1	22.8	24.4	13.6	13.3	19.8	21.1	29.2	29.2	29.2
Other	0.3	0.3	57.9	0.6	0.3	1.4	0.4	1.9	1.9	2.1
Provincial	166.7	175.6	191.9	95.7	100.2	145.4	150.6	205.4	204.4	230.0
Development expenditure and net lending	72.2	125.9	106.4	61.0	63.7	114.3	94.7	162.2	164.1	188.1
Public Sector Development Program	89.8	126.2	129.2	62.6	56.8	107.0	85.0	152.1	152.0	180.0
Federal	66.9	98.4	90.0	40.8	35.2	71.2	54.9	107.5	107.5	126.0
Provincial	22.9	27.8	39.2	21.8	21.6	35.8	30.1	44.5	44.5	54.0
Net lending	-17.6	-0.2	-22.7	-1.7	7.0	7.3	9.7	10.1	12.1	8.1
Statistical discrepancy ("+" = additional expenditure)	14.8	-11.7	3.2	...	-3.4	...	-4.2	...	...	...
Federal government	29.8	15.3	-2.5	...	7.3	...	7.6	...	...	...
Provinces	-15.0	-26.9	5.6	...	-10.7	...	-11.8	...	...	...
Underlying budget balance (excluding grants) 3/	-179.7	-190.5	-180.5	-126.3	-33.7	-164.0	-71.2	-179.2	-177.4	-199.2
One-off expenditure items 4/	...	52.0	...	20.0	0.0	20.0	0.0	20.0	0.0	...
Budget balance (excluding grants)	-179.7	-242.5	-180.5	-146.3	-33.7	-184.0	-71.2	-199.2	-177.4	-199.2
Budget balance (including grants)	-139.2	-159.3	-66.3	-124.9	-14.2	-154.2	-46.8	-157.2	-145.7	-175.0
Financing	139.2	159.3	66.3	124.9	14.2	154.2	46.8	157.2	145.7	175.0
External	80.2	51.7	-1.3	5.3	-9.4	-30.2	-49.6	53.0	-17.3	-17.1
Of which: privatization receipts	...	...	7.6	...	0.0	...	0.0	7.0	0.0	0.0
Domestic	59.0	99.3	63.9	115.6	22.0	177.4	87.9	104.2	163.0	192.0
Bank	-33.0	14.3	-55.6	73.1	-8.3	60.9	53.6	40.2	82.0	90.0
Of which: not related to bank restructuring 4/	...	...	...	53.1	-8.3	40.9	53.6	20.2	82.0	...
Nonbank	92.0	85.0	119.5	42.5	30.3	116.5	34.3	61.0	70.0	87.0
Privatization receipts	0.0	8.4	3.7	4.0	1.7	7.0	8.5	3.0	11.0	15.0
Memorandum items:										
Expenditure incl. statistical discrepancy and one-off	732.7	866.5	901.3	468.0	412.8	710.0	626.6	961.6	957.7	1,032.7
Primary balance (excluding grants and one-offs)	54.8	2.8	29.2	-38.2	65.1	-21.7	69.2	10.8	25.1	11.6
Primary balance (including grants and one-offs)	95.3	86.0	143.4	-16.8	84.6	8.1	93.7	52.8	56.8	35.8
Social and poverty-related expenditure 5/	122.3	133.5	169.7	81.4	80.2	131.4	128.6	185.1	185.1	278.0
Total government debt	3,695	3,508	3,584	...	3,646	...	3,670	3,711	3,748	3,899
Domestic debt	1,799	1,758	1,896	...	1,915	...	1,958	1,954	1,991	2,153
External debt	1,896	1,751	1,687	...	1,731	...	1,712	1,756	1,757	1,746
Nominal GDP at market prices	3,423	3,629	4,018	2,220	2,220	3,330	3,341	4,399	4,455	4,960

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

1/ Program as agreed during the sixth and seventh review (IMF Country Report No. 03/38)).

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).

5/ Figures for 2004/05 incorporate an expanded definition, in line with the full PRSP, including items such as law and order, justice, low cost housing, and village electrification. Using this definition, social- and poverty-related expenditure in 2003/04 amounts to 5.4 percent of GDP.

Table 5. Pakistan: Consolidated Government Budget, 2000/01–2004/05

(In percent of GDP; unless otherwise indicated)

	2000/01	2001/02	2002/03	2003/04		2003/04		2004/05		2004/05
	FY	FY	FY	Dec.		Mar.		FY		Staff
	Prov. Act.	Prov. Act.	Prov. Act.	Prog.	Prov. Act.	Prog.	Prov. Act.	Prog. 1/	Proj.	Proj.
Revenue and grants	17.3	19.5	20.8	15.5	18.0	16.7	17.4	18.3	18.2	17.3
Revenue	16.2	17.2	17.9	14.5	17.1	15.8	16.6	17.3	17.5	16.8
Tax revenue	12.9	13.2	13.8	11.7	12.5	12.4	12.7	13.6	13.5	13.7
Federal	12.3	12.7	13.3	11.2	11.9	11.8	12.1	13.0	12.9	13.1
CBR revenue	11.5	11.1	11.5	9.8	10.4	10.4	10.6	11.6	11.4	11.6
Direct tax	3.6	3.9	3.8	2.6	3.2	3.1	3.2	3.7	3.6	3.6
Federal excise duty	1.4	1.3	1.1	1.0	0.9	1.0	0.9	1.1	1.0	0.9
Sales tax	4.5	4.6	4.9	4.7	4.4	4.8	4.6	5.1	4.9	5.0
Customs duties	1.9	1.3	1.7	1.5	1.9	1.5	1.9	1.8	2.0	2.1
Petroleum surcharge	0.5	1.0	1.2	1.0	1.1	1.1	1.1	1.0	1.0	1.0
Gas surcharge	0.4	0.5	0.5	0.3	0.4	0.3	0.4	0.3	0.4	0.4
Other	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.1	0.1	0.1
Provincial	0.6	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.6
Nontax revenue	3.3	4.0	4.1	2.7	4.6	3.4	3.9	3.7	4.0	3.2
Federal	2.7	3.4	3.5	2.3	4.1	2.8	3.5	3.1	3.4	2.6
Provincial	0.6	0.6	0.6	0.4	0.5	0.6	0.4	0.6	0.6	0.6
Grants	1.2	2.3	2.8	1.0	0.9	0.9	0.7	1.0	0.7	0.5
Expenditure	21.0	22.8	22.4	20.2	18.7	20.7	18.9	21.4	21.5	20.8
Current expenditure	18.9	19.3	19.7	17.4	15.9	17.3	16.0	17.7	17.8	17.0
Federal	14.0	14.5	14.9	13.1	11.4	12.9	11.5	13.0	13.2	12.4
Interest payments	6.8	6.8	5.2	4.9	4.5	4.9	4.2	4.8	4.5	4.2
Domestic	5.4	5.1	4.0	3.9	3.4	3.9	3.3	3.9	3.6	3.4
Foreign 2/	1.5	1.7	1.2	0.9	1.0	0.9	0.9	0.9	0.9	0.8
Defense	3.1	4.1	4.0	3.9	3.9	3.7	3.9	3.6	4.0	3.9
Running of the civil government	2.1	1.6	1.5	1.4	1.2	1.5	1.4	1.6	1.6	1.5
Pensions for defense and civil government	0.9	0.7	0.9	0.9	0.7	1.0	0.7	0.9	1.0	0.9
Subsidies 3/	0.6	0.7	1.2	1.5	0.5	1.3	0.7	1.4	1.4	1.2
Grants	0.5	0.6	0.6	0.6	0.6	0.6	0.6	0.7	0.7	0.6
Other	0.0	0.0	1.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Provincial	4.9	4.8	4.8	4.3	4.5	4.4	4.5	4.7	4.6	4.6
Development expenditure and net lending	2.1	3.5	2.6	2.7	2.9	3.4	2.8	3.7	3.7	3.8
Public Sector Development Program	2.6	3.5	3.2	2.8	2.6	3.2	2.5	3.5	3.4	3.6
Federal	2.0	2.7	2.2	1.8	1.6	2.1	1.6	2.4	2.4	2.5
Provincial	0.7	0.8	1.0	1.0	1.0	1.1	0.9	1.0	1.0	1.1
Net lending	-0.5	0.0	-0.6	-0.1	0.3	0.2	0.3	0.2	0.3	0.2
Statistical discrepancy ("+" = additional expenditure)	0.4	-0.3	0.1	...	-0.2	...	-0.1	...	...	...
Federal government	0.9	0.4	-0.1	...	0.3	...	0.2	...	...	...
Provinces	-0.4	-0.7	0.1	...	-0.5	...	-0.4	...	0.0	...
Underlying budget balance (excluding grants) 3/	-5.2	-5.2	-4.5	-5.7	-1.5	-4.9	-2.1	-4.1	-4.0	-4.0
One-off expenditure items 4/	...	1.4	...	0.9	0.0	0.6	0.0	0.5	0.0	...
Budget balance (excluding grants)	-5.2	-6.7	-4.5	-6.6	-1.5	-5.5	-2.1	-4.5	-4.0	-4.0
Budget balance (including grants)	-4.1	-4.4	-1.7	-5.6	-0.6	-4.6	-1.4	-3.6	-3.3	-3.5
Financing	4.1	4.4	1.6	5.6	0.6	4.6	1.4	3.6	3.3	3.5
External	2.3	1.4	0.0	0.2	-0.4	-0.9	-1.5	1.2	-0.4	-0.3
Of which: privatization receipts	...	...	0.2	...	0.0	...	0.0	0.2	0.0	0.0
Domestic	1.7	2.7	1.6	5.2	1.0	5.3	2.6	2.4	3.7	3.9
Bank	-1.0	0.4	-1.4	3.3	-0.4	1.8	1.6	0.9	1.8	1.8
Of which: not related to bank restructuring 4/	...	...	...	2.4	-0.4	1.2	1.6	0.5	1.8	...
Nonbank	2.7	2.3	3.0	1.9	1.4	3.5	1.0	1.4	1.6	1.8
Privatization receipts	0.0	0.2	0.1	0.2	0.1	0.2	0.3	0.1	0.3	0.3
Memorandum items:										
Expenditure incl. statistical discrepancy and one-off	21.4	23.9	22.4	21.1	18.6	21.3	18.8	21.9	21.5	20.8
Primary balance (excluding grants and one-offs)	1.6	0.1	0.7	-1.7	2.9	-0.7	2.1	0.2	0.6	0.2
Primary balance (including grants and one-offs)	2.8	2.4	3.6	-0.8	3.8	0.2	2.8	1.2	1.3	0.7
Social and poverty-related expenditure 5/	3.6	3.7	4.2	3.7	3.6	3.9	3.8	4.2	4.2	5.6
Total government debt	108.0	96.7	89.2	...	...	...	...	84.4	84.1	78.6
Domestic debt	52.6	48.4	47.2	...	...	...	...	44.4	44.7	43.4
External debt	55.4	48.3	42.0	...	...	...	...	39.9	39.4	35.2
Nominal GDP (market prices, billions of Pakistani rupees)	3,423	3,629	4,018	2,220	2,220	3,330	3,341	4,399	4,455	4,960

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

1/ Program as agreed during the sixth and seventh review (IMF Country Report No. 03/38).

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).

5/ Figures for 2004/05 incorporate an expanded definition, in line with the full PRSP, including items such as law and order, justice, low cost housing, and village electrification. Using this definition, social- and poverty-related expenditure in 2003/04 amounts to 5.4 percent of GDP.

Table 6. Pakistan: Accounts of the State Bank of Pakistan, 2000/01–2004/05

	2000/01		2001/02		2002/03		Monetary Program 2003/04 1/						2004/05
	Act.	Act.	Sep. Act.	Dec. Act.	Mar. Act.	Jun. Act.	Dec.		Mar.		Jun.		FY Proj.
							Prog. 2/	Act.	Prog. 2/	Act.	Prog. 2/	Rev. Proj.	
Net foreign assets	-19.1	133.5	271.8	357.4	451.6	492.0	524.2	538.0	533.6	529.7	562.3	572.9	569.9
Net domestic assets	552.3	451.1	311.5	283.8	198.7	178.0	205.7	208.5	191.0	243.0	181.7	204.8	280.2
Net claims on government	335.6	279.2	152.6	117.3	57.5	34.1	-12.9	11.8	-31.3	89.2	-44.3	51.0	126.4
<i>Of which:</i>													
Budgetary support	361.1	302.2	174.1	140.3	77.9	52.9	5.8	29.9	-12.6	107.3	-25.6	68.8	144.3
Claims on nongovernment	40.1	22.7	17.4	14.7	14.2	11.5	12.0	6.7	12.0	5.4	12.0	5.4	5.4
Claims on scheduled banks	198.0	195.8	175.8	222.8	177.1	180.6	177.1	194.7	180.9	184.9	184.6	184.9	184.9
Privatization account	-2.9	-2.9	-2.9	-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	-43.7	-31.4	-68.1	-47.1	-45.3	32.4	-1.7	32.4	-33.5	32.4	-33.5	-33.5
Reserve money 3/	533.2	584.6	583.3	641.2	650.4	670.0	729.8	746.5	724.6	772.7	744.0	777.7	850.1
<i>Of which:</i>													
Banks' reserves	127.3	110.5	127.3	125.8	128.6	141.5	155.2	145.2	155.6	161.1	159.7	150.4	172.1
Currency	394.6	460.2	454.3	513.3	518.3	525.0	571.8	597.8	566.2	609.4	581.4	625.3	675.9
Net foreign assets	7.3	28.6	22.6	37.3	53.4	60.3	7.2	10.3	8.7	9.1	13.0	15.5	-0.4
Net domestic assets	-0.2	-19.0	-22.9	-27.6	-42.2	-45.7	2.0	1.1	-0.2	6.2	-1.6	0.5	9.7
<i>Of which:</i>													
Budgetary support	-6.3	-21.0	-12.6	-18.6	-28.8	-32.8	0.9	-3.4	-1.9	8.1	-3.8	2.4	9.7
									(Changes over 12 months; in percent)				
Reserve money 4/	-3.7	9.6	9.7	8.7	14.4	14.6	13.8	16.4	11.4	18.8	11.4	16.1	9.3
Currency	5.2	16.6	13.8	13.6	13.8	13.5	11.4	16.5	9.2	17.6	10.7	19.1	8.1

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. 03/38.

3/ Reserve money includes special reserves on foreign currency deposits.

4/ 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: Monetary Survey, 2000/01–2004/05

	2000/01		2002/03				Monetary Program 2003/04 1/				2004/05		
	FY	Act.	Dec.	Mar.	Jun.	Dec.	Mar.	Jun.	Jun.	Rev. Proj.	FY	Proj.	
			Act.	Act.	Act.	Prog. 2/	Act.	Prog. 2/	Act.	Prog. 2/	Act.	Prog. 2/	
Net foreign assets	26.3	230.8	348.2	414.8	512.7	569.1	603.3	601.1	623.8	602.6	664.0	649.3	665.8
Net domestic assets	1,499.7	1,530.5	1,453.2	1,502.4	1,464.6	1,514.5	1,683.8	1,668.1	1,646.1	1,732.4	1,657.1	1,793.9	2,090.2
Net claims on government	569.7	644.9	628.9	589.8	555.6	566.5	560.0	536.2	544.8	583.9	529.1	632.6	732.6
<i>Of which:</i>													
Net bank borrowing	499.9	567.2	554.5	533.2	514.7	511.2	511.7	501.5	499.5	564.8	478.8	593.2	683.2
Commodity operations	95.3	100.6	95.9	79.6	61.2	74.0	67.0	52.8	64.0	37.2	69.0	57.2	67.2
Claims on nongovernment	902.4	921.6	885.6	990.0	1,017.0	1,069.0	1,177.1	1,221.8	1,154.6	1,255.7	1,181.2	1,268.5	1,464.8
Private sector	802.1	840.9	811.3	916.8	942.2	999.9	1,102.6	1,177.6	1,078.6	1,219.4	1,103.5	1,232.2	1,424.5
Public sector	100.2	80.7	74.4	73.3	74.8	69.1	74.5	44.2	76.1	36.3	77.8	36.3	40.3
Privatization account	-2.9	-2.9	-2.9	-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	-33.0	-58.4	-74.4	-105.1	-118.1	-50.4	-87.0	-50.4	-104.2	-50.4	-104.2	-104.2
Total liquidity (broad money)	1,526.0	1,761.4	1,801.4	1,917.2	1,977.3	2,083.6	2,287.1	2,269.1	2,269.9	2,335.0	2,321.1	2,443.2	2,756.0
<i>Of which:</i>													
Pakistani rupee liquidity	1,371.9	1,603.9	1,636.3	1,782.8	1,848.8	1,952.6	2,150.2	2,132.6	2,127.9	2,195.0	2,174.0	2,298.0	2,589.8
(Changes in percent of stock of broad money at the beginning of the fiscal year)													
Net foreign assets	5.1	13.4	6.3	10.1	15.7	18.9	2.5	2.6	3.5	2.7	5.5	4.9	0.7
Net domestic assets	3.9	2.0	-3.9	-1.1	-3.3	-0.4	7.3	6.5	5.5	9.6	6.0	12.6	12.1
<i>Of which:</i>													
Net claims on the government	-3.3	1.5	2.1	-0.1	-2.1	-1.4	2.2	-1.5	1.5	0.8	0.7	3.2	4.1
Net claims on private sector	3.5	2.5	-1.6	4.4	5.8	9.1	5.0	8.5	3.8	10.6	5.0	11.2	7.9
(Changes over 12 months; in percent)													
Broad money	9.0	15.4	18.6	16.2	18.5	18.3	17.8	18.4	13.8	18.1	11.5	17.5	12.8
Net claims on private sector	6.5	4.8	4.0	7.6	12.4	19.1	20.5	28.5	14.6	29.4	10.5	23.2	15.6

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. 03/38.

Table 8. Pakistan: Financial and Operational Targets for WAPDA and Successor Companies, 2001/02–2003/04

(In millions of Pakistani rupees; unless otherwise indicated)

	2001/02 Act.	2002/03 Act.	2003/04							
			Q1		Q2		Q3		Q4 FIP	Year FIP
			FIP	Prel. Est.	FIP	Prel. Est.	FIP	Prel. Est.		
<b>Main assumptions</b>										
Furnace oil prices (PRs per metric ton)	11,440.0	13,297	13,806	...	13,806	...	13,806	...	13,806	13,806
Average exchange rate (Pakistani rupees per U.S. dollar)	61.0	58.4	...	57.7	...	57.4	...	57.3	...	...
Average revenue (PRs/kWh) 1/	3.93	4.40	4.21	4.35	4.47	4.61	4.13	4.22	4.58	4.34
Units generated (in GWh)	60,849	64,038	18,455	19,668	15,198	14,840	14,079	15,121	17,842	65,574
<i>Of which:</i> thermal units (in percent of units generated)	68.7	65.1	51.1	46.0	72.5	52.0	82.4	80.0	68.2	67.3
purchased units (in GWh)	23,242	22,106	5,177	3,885	5,839	3,665	6,624	6,080	7,045	24,685
<b>Main operational and financial targets</b>										
Technical and nontechnical losses 2/	25.8	25.9	23.4	25.6	22.7	21.0	25.0	27.0	25.8	24.0
Total receivables	50,969	58,842	60,087	68,503	65,743	70,030	65,743	75,825	68,591	68,591
<i>Of which:</i> public sector and FATA receivables	29,182	33,986	38,586	40,835	44,231	45,408	44,231	49,174	47,089	47,089
Stock of payables to fuel suppliers and IPPs	25,565	6,406	5,959	5,772	5,512	5,526	5,065	4,878	4,618	4,618
<b>Summary cash flow statement</b>										
Total cash receipts (excluding GST, ED, & W/Tax)	177,409	201,016	56,506	53,404	46,866	52,481	43,648	40,770	57,864	204,884
Total cash outflows	178,649	207,879	48,612	39,469	53,537	47,202	56,792	39,262	54,976	213,918
Purchase of power from IPPs	109,101	116,133	23,587	21,021	25,286	22,051	28,437	21,994	28,739	106,049
Cost of fuel	37,365	47,978	8,765	10,519	11,778	8,786	11,454	8,786	8,695	40,692
Debt service to GOP (interest and amortization)	3,423	46	5,726	0	5,726	0	5,725	0	5,725	22,902
Debt service other than to GOP (interest and amortization)	11,684	15,944	3,067	1,712	3,067	7,684	3,067	1,331	3,068	12,269
Hydel profit payment	6,000	6,000	1,500	1,000	1,500	2,237	1,500	750	1,500	6,000
Operations and maintenance	17,261	19,411	4,807	4,357	5,021	5,739	5,449	5,479	6,089	21,366
Other cash outflows 3/	-6,185	2,367	1,160	860	1,160	705	1,160	922	1,160	4,640
Net cash available before investment program	-1,240	-6,863	7,894	13,935	-6,672	5,279	-13,144	1,508	2,888	-9,034
Investment expenditure	20,618	11,630	7,732	4,801	7,732	2,531	7,732	2,699	7,732	30,928
Foreign-financed component	13,034	0	4,732	1,482	4,732	0	4,732	0	4,732	18,928
Locally-financed component	7,584	11,630	3,000	3,319	3,000	2,531	3,000	2,699	3,000	12,000
Cash surplus (+)/deficit(-)	-21,858	-18,493	162	9,134	-14,404	2,748	-20,876	-1,191	-4,844	-39,962
<b>Memorandum items:</b>										
Net change in payment arrears 4/	...	1,523	-447	5,592	-447	4,743	-447	5,827	-447	-1,788
<i>Of which:</i> arrears to the government	...	20,682	0	6,226	0	4,989	0	6,475	0	0
<i>Of which:</i> arrears to IPPs and suppliers	...	-19,159	-447	-634	-447	-246	-447	-648	-447	-1,788
Accrual balance 5/	...	-20,016	5,341	5,024	-9,225	-1,995	-15,697	-7,018	335	-19,246
Accrual balance, cumulative since start of fiscal year 5/	...	-20,016	5,341	5,024	-3,884	3,029	-19,581	-3,989	-19,246	-19,246
Total budgetary support (including debt arrears)	...	32,282	-4,894	6,226	9,672	4,989	16,144	6,475	112	21,034

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

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

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

3/ 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.

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

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

(In millions of Pakistani rupees; unless otherwise indicated)

	2001/02 Act.	2002/03 Act.	2003/04							
			Q1		Q2		Q3		Q4 FIP	Year FIP
			FIP	Prel. Est.	FIP	Prel. Est.	FIP	Prel. Est.		
<b>Main assumptions</b>										
Furnace oil price (PRs per metric ton)	9,386	10,953	10,922	10,801	10,922	10,522	10,922	...	10,922	10,922
Average tariff (PRs per kWh)	4.5	4.6	4.6	4.8	4.6	4.8	4.6	...	4.6	4.6
Units generated (in GWh)	11,548	12,036	3,240	3,469	2,906	2,921	2,605	2,733	3,468	12,219
<i>Of which:</i> purchased units (in GWh)	3,406	3,809	836	1,081	799	710	563	...	1,063	3,262
<b>Main operational and financial targets</b>										
Technical and nontechnical losses 1/	41.1	40.8	39.9	41.7	36.7	33.9	38.4	36.4	37.0	38.0
Total receivables	21,130	19,842	20,334	20,459	20,334	20,739	20,334	...	20,334	20,334
<i>Of which:</i> public sector receivables	2,366	1,913	2,316	2,301	2,316	2,214	2,316	...	2,316	2,316
Stock of payables to fuel suppliers and IPPs	11,198	928	923	4,536	923	4,000	923	899	923	923
<b>Summary cash flow statement</b>										
<b>Receipts</b>										
Collection of dues	34,649	38,848	10,505	10,659	9,918	10,405	8,654	9,196	11,770	40,846
GST	32,452	36,183	9,889	10,141	9,330	9,984	8,127	8,669	11,094	38,439
Other receipts	1,436	1,656	496	340	468	260	407	375	556	1,927
	761	1,008	120	178	120	161	120	152	120	480
<b>Payments</b>										
Purchase of power	49,807	60,536	13,601	10,323	12,348	13,152	11,155	13,218	13,199	50,304
Cost of fuel	14,147	25,293	3,761	3,231	3,618	4,748	2,746	3,806	4,738	14,864
Debt service (interest and amortization)	21,721	23,930	6,378	4,411	5,315	5,811	4,998	6,745	6,409	23,100
Taxes	9,587	6,883	2,226	1,659	2,072	1,450	2,066	1,529	645	7,008
Operations and maintenance	837	987	356	196	425	290	391	318	415	1,587
	3,515	3,443	880	826	917	853	955	820	992	3,744
Net cash available before investment program	-15,158	-21,689	-3,096	336	-2,430	-2,747	-2,502	-4,022	-1,429	-9,458
<b>Investment program</b>										
Regular component	1,560	1,881	1,293	551	1,407	569	1,621	697	1,563	5,884
Additional component 2/	1,560	1,614	514	382	550	331	566	441	582	2,212
	0	267	779	169	857	238	1,055	256	981	3,672
Cash surplus (+)/deficit(-)	-16,718	-23,570	-4,389	-215	-3,837	-3,316	-4,123	-4,719	-2,992	-15,342
<b>Memorandum items:</b>										
Net change in payment arrears 3/	...	-10,270	0	3,608	0	-536	0	-3,101	0	0
Accrual balance 4/	...	-13,300	-4,389	-3,823	-3,837	-2,780	-4,123	-1,618	-2,992	-15,342
Accrual balance, cumulative since start of fiscal year 4/	...	-13,300	-4,389	-3,823	-8,226	-6,603	-12,349	-8,221	-15,342	-15,342

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/ The additional component of the investment program was introduced in KESC's FIP. It is financed by the government and aims at improving KESC's financial situation through technical and administrative improvements.

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 10a. Pakistan: Public Sector Debt Sustainability Framework, Baseline Scenario, 2000/01–2023/24  
(In percent of GDP, unless otherwise indicated)

	Actual		Estimate		Projections										
	2000/01	2001/02	2002/03	Historical Average 5/	Standard Deviation 5/	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2003/04–2008/09 Average		2009/10–2023/24 Average	
<b>Public sector debt 1/</b>	108.0	96.7	89.2			84.1	78.6	74.6	70.7	67.0	63.4	44.8	28.5		
<i>Of which:</i> foreign-currency denominated	57.5	49.4	43.1			40.3	35.9	33.6	31.6	29.7	28.0	21.1	11.5		
Change in public sector debt	7.1	-11.3	-7.5			-5.1	-5.5	-4.0	-3.9	-3.7	-3.6	-2.6	-1.2		
Identified debt-creating flows	-0.5	-1.7	-8.7			-9.1	-5.0	-3.5	-3.5	-3.3	-3.3	-1.5	-0.5		
Primary deficit	-2.8	-2.4	-3.6		-0.5	1.8	-0.8	-0.7	-1.0	-1.0	-0.9	-0.8	-0.9		-0.9
Revenue and grants	17.3	19.5	20.8			18.2	17.3	17.8	17.8	18.0	18.1	18.1	18.2		
<i>Of which:</i> grants	1.2	2.3	2.8			0.7	0.5	0.7	0.7	0.5	0.5	0.1	0.0		
Primary (non-interest) expenditure	14.6	17.1	17.2			17.4	16.6	16.8	16.8	17.2	17.3	17.0	17.9		
Automatic debt dynamics	2.2	0.9	-4.8			-7.9	-3.9	-2.4	-2.4	-2.4	-2.3	-0.5	-0.2		
Contribution from interest rate/growth differential	4.7	2.7	-4.9			-6.2	-3.9	-2.4	-2.4	-2.4	-2.3	-0.9	-0.4		
<i>Of which:</i> contribution from average real interest rate	7.2	5.7	0.4			-0.7	0.8	2.1	1.8	1.6	1.5	1.4	1.0		
<i>Of which:</i> contribution from real GDP growth	-2.5	-3.0	-5.3			-5.4	-4.8	-4.4	-4.2	-4.0	-3.8	-2.3	-1.4		
Contribution from real exchange rate depreciation	-2.4	-1.8	0.1			-1.7	0.0	0.0	0.0	0.0	0.0	0.4	0.2		
Other identified debt-creating flows	0.0	-0.2	-0.3			-0.4	-0.3	-0.1	-0.1	-0.1	-0.1	0.0	0.0		
Privatization receipts (negative)	0.0	-0.2	-0.3			-0.4	-0.3	-0.1	-0.1	-0.1	-0.1	0.0	0.0		
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Bank recapitalization	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Residual, including asset changes	7.6	-9.6	1.2			4.1	-0.5	-0.5	-0.4	-0.4	-0.4	-1.1	-0.7		
NPV of public sector debt	...	...	80.4			75.1	70.4	66.8	63.2	59.6	56.7	40.1	26.4		
<i>Of which:</i> foreign-currency denominated	...	...	34.3			31.2	27.7	25.8	24.2	22.4	21.3	16.4	9.3		
<i>Of which:</i> external	...	...	33.2			30.4	27.0	25.2	23.7	22.0	21.1	16.4	9.3		
NPV of contingent liabilities (not yet officially recognized in public sector debt)	...	...	...			...	...	...	...	...	...	...	...		
Gross financing need 2/	...	...	1.6			7.0	3.5	3.0	2.8	2.6	4.6	1.7	1.8		
NPV of public sector debt-to-revenue ratio (in percent) 3/	...	...	387.1			411.9	407.2	375.0	355.0	330.7	313.3	221.5	144.9		
<i>Of which:</i> external	...	...	...			166.7	156.2	141.6	133.1	122.2	116.5	90.8	51.3		
Debt service-to-revenue ratio (in percent) 3/ 4/	39.5	34.7	25.1			43.1	24.6	22.9	21.3	19.4	29.9	15.2	11.6		
Primary deficit that stabilizes the debt-to-GDP ratio	-9.8	8.9	3.9			4.2	4.8	3.0	2.9	2.9	2.8	1.6	0.9		
<b>Key macroeconomic and fiscal assumptions</b>															
Real GDP growth (in percent)	2.6	2.8	5.8			1.3	6.5	6.0	6.0	6.0	6.0	6.1	5.0		5.1
Average nominal interest rate on forex debt (in percent)	4.2	3.4	3.0		4.8	0.7	2.9	3.0	2.9	2.8	2.8	2.9	2.8		3.1
Average real interest rate on domestic currency debt (in percent)	6.9	8.0	6.1		8.3	1.3	4.4	3.5	4.3	4.0	3.8	3.9	3.2		3.3
Real exchange rate depreciation (in percent, + indicates depreciation)	-4.6	-2.9	0.2		-2.3	2.6	-4.1	0.0	0.0	0.0	0.0	-0.7	2.0		1.9
Inflation rate (in percent)	4.4	2.5	3.1		7.4	4.0	4.1	5.0	4.0	4.0	4.0	4.2	4.0		4.0
Growth of real primary spending (deflated by GDP deflator, in percent)	-0.9	21.0	6.4		4.4	9.9	7.7	1.0	7.2	6.3	8.2	6.7	7.9		5.4
	...	...	...		...	...	...	...	...	...	...	39.7	44.3		25.6
	...	...	...		...	...	...	...	...	...	...	44.3	44.3		4.3
	...	...	...		...	...	...	...	...	...	...	17.5	17.5		18.4

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

1/ The public sector is defined to include the federal, provincial, and district governments (consolidated government). Public debt is gross debt.

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues including grants.

4/ Debt service is defined as the sum of interest and amortization of medium- and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.



Table 10b. Pakistan: Sensitivity Analyses for Key Indicators of Public Sector Debt, 2002/03–2023/24

	Estimate	Projections							
	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2012/13	2013/14	2023/24
<b>NPV of Debt-to-GDP Ratio</b>									
Baseline	80	75	70	67	63	60	42	40	26
A. Alternative scenarios									
A1. Real GDP growth and primary balance are at historical averages	80	75	71	67	64	61	47	45	26
B. Bound tests									
B1. Real GDP growth is at baseline minus one standard deviations in 2004–05	80	76	72	69	65	62	45	43	31
B2. Primary balance is at baseline minus one standard deviations in 2004–05	80	76	73	69	66	63	46	44	31
B3. Combination of 2-3 using one half standard deviation shocks	80	76	72	69	65	62	45	43	30
B4. Long-run real GDP growth is at baseline minus one standard deviations	80	75	71	68	65	62	47	46	40
B5. One time 30 percent real depreciation in 2004	80	92	86	82	78	74	54	52	37
B6. 10 percent of GDP increase in other debt-creating flows in 2004	80	83	78	74	70	66	47	45	29
<b>NPV of Debt-to-Revenue Ratio 1/</b>									
Baseline	387	412	407	375	355	331	233	221	145
A. Alternative scenarios									
A1. Real GDP growth and primary balance are at historical averages	383	411	408	378	361	338	259	247	144
B. Bound tests									
B1. Real GDP growth is at baseline minus one standard deviations in 2004–05	386	416	417	386	367	343	250	239	170
B2. Primary balance is at baseline minus one standard deviations in 2004–05	386	419	422	389	370	347	253	242	168
B3. Combination of 2-3 using one half standard deviation shocks	386	417	418	386	367	344	250	239	167
B4. Long-run real GDP growth is at baseline minus one standard deviations	386	413	411	381	365	343	262	254	219
B5. One time 30 percent real depreciation in 2004	386	505	499	461	437	408	302	289	201
B6. 10 percent of GDP increase in other debt-creating flows in 2004	384	456	449	413	392	365	262	249	158
<b>Debt-to-GDP Ratio</b>									
Baseline	89	84	79	75	71	67	47	45	29
A. Alternative scenarios									
A1. Real GDP growth and primary balance are at historical averages	89	84	79	76	72	69	53	51	29
B. Bound tests									
B1. Real GDP growth is at baseline minus one standard deviations in 2004–05	89	85	81	77	73	70	51	49	34
B2. Primary balance is at baseline minus one standard deviations in 2004–05	89	86	82	78	74	71	52	49	34
B3. Combination of 2-3 using one half standard deviation shocks	89	86	81	77	74	70	51	49	34
B4. Long-run real GDP growth is at baseline minus one standard deviations	89	85	80	76	73	70	54	52	44
B5. One time 30 percent real depreciation in 2004	89	107	100	95	90	86	64	61	41
B6. 10 percent of GDP increase in other debt-creating flows in 2004	89	94	88	83	79	75	53	51	32
<b>Debt Service-to-Revenue Ratio 1/</b>									
Baseline	25	43	25	23	21	19	18	15	12
A. Alternative scenarios									
A1. Real GDP growth and primary balance are at historical averages	26	44	26	24	23	21	23	19	14
B. Bound tests									
B1. Real GDP growth is at baseline minus one standard deviations in 2004–05	25	44	26	24	23	21	21	17	16
B2. Primary balance is at baseline minus one standard deviations in 2004–05	26	45	29	28	24	22	21	18	16
B3. Combination of 2-3 using one half standard deviation shocks	26	45	27	26	24	22	21	18	16
B4. Long-run real GDP growth is at baseline minus one standard deviations	26	45	26	25	23	22	22	19	21
B5. One time 30 percent real depreciation in 2004	26	46	29	28	26	24	23	20	18
B6. 10 percent of GDP increase in other debt-creating flows in 2004	26	44	43	30	25	22	20	19	15
<b>Debt Service-to-GDP Ratio</b>									
Baseline	5	8	4	4	4	4	3	3	2
A. Alternative scenarios									
A1. Real GDP growth and primary balance are at historical averages	5	8	4	4	4	4	4	4	3
B. Bound tests									
B1. Real GDP growth is at baseline minus one standard deviations in 2004–05	5	8	4	4	4	4	4	3	3
B2. Primary balance is at baseline minus one standard deviations in 2004–05	5	8	5	5	4	4	4	3	3
B3. Combination of 2-3 using one half standard deviation shocks	5	8	5	5	4	4	4	3	3
B4. Long-run real GDP growth is at baseline minus one standard deviations	5	8	5	4	4	4	4	4	4
B5. One time 30 percent real depreciation in 2004	5	8	5	5	5	4	4	4	3
B6. 10 percent of GDP increase in other debt-creating flows in 2004	5	8	8	5	4	4	4	3	3

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

1/ Revenues are defined inclusive of grants.

Table 11a. Pakistan: External Debt Sustainability Framework, Baseline Scenario, 2000/01–2023/24 1/

	(In percent of GDP, unless otherwise indicated)														
	Actual			Historical			Projections								
	2000/01	2001/02	2002/03	Average 6/	Standard Deviation 6/	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2003/04–2007/08 Average	2013/14	2023/24	2009/10–2023/24 Average
<b>External debt (nominal) 1/</b>	<b>60.0</b>	<b>60.0</b>	<b>51.0</b>			<b>45.7</b>	<b>40.5</b>	<b>37.5</b>	<b>35.2</b>	<b>33.0</b>	<b>31.0</b>	<b>33.0</b>	<b>23.2</b>	<b>13.2</b>	
<i>Of which:</i> public and publicly guaranteed (PPG)	54.2	55.2	47.3			43.4	38.7	35.9	33.6	31.4	29.4	33.0	21.7	11.8	
Change in external debt	2.3	0.0	-9.0			-5.3	-5.2	-2.9	-2.4	-2.2	-2.1	-2.1	-1.4	-0.6	
Identified net debt-creating flows	3.5	-3.8	-15.4			-6.8	-3.5	-3.3	-3.1	-2.5	-2.3	-2.3	-1.8	-1.1	
<b>Non-interest current account deficit</b>	<b>-0.7</b>	<b>-5.2</b>	<b>-7.9</b>	<b>-0.4</b>	<b>3.7</b>	<b>-4.2</b>	<b>-1.7</b>	<b>-1.6</b>	<b>-1.5</b>	<b>-0.9</b>	<b>-0.8</b>	<b>-0.8</b>	<b>-0.8</b>	<b>-0.4</b>	<b>-0.7</b>
Deficit in balance of goods and services	3.8	1.0	0.5			2.3	3.6	3.3	2.8	2.6	2.4	2.4	1.6	1.1	
Exports	17.5	18.7	19.9			19.3	17.8	17.3	17.2	17.1	17.0	17.0	17.2	16.9	
Imports	21.3	19.7	20.4			21.6	21.4	20.5	20.0	19.7	19.4	19.4	18.8	18.0	
Net current transfers (negative = inflow)	-5.6	-7.6	-9.8			-7.9	-6.4	-5.9	-5.3	-4.5	-4.2	-4.2	-3.2	-2.3	
Other current account flows (negative = net inflow)	1.1	1.4	1.4			1.4	1.2	1.1	1.1	1.0	1.0	1.0	0.9	0.7	
<b>Net FDI (negative = inflow)</b>	<b>-0.5</b>	<b>-0.6</b>	<b>-0.9</b>	<b>-0.9</b>	<b>0.3</b>	<b>-1.0</b>	<b>-0.6</b>	<b>-0.6</b>	<b>-0.6</b>	<b>-0.6</b>	<b>-0.6</b>	<b>-0.6</b>	<b>-0.5</b>	<b>-0.5</b>	<b>-0.5</b>
<b>Endogenous debt dynamics 2/</b>	<b>4.7</b>	<b>2.0</b>	<b>-6.6</b>			<b>-1.6</b>	<b>-1.3</b>	<b>-1.1</b>	<b>-1.1</b>	<b>-1.0</b>	<b>-1.0</b>	<b>-1.0</b>	<b>-0.5</b>	<b>-0.1</b>	
Contribution from nominal interest rate	2.6	2.5	1.8			1.4	1.2	1.1	1.0	0.9	0.9	0.9	0.7	0.5	
Contribution from real GDP growth	-1.5	-1.7	-3.0			-2.9	-2.5	-2.2	-2.1	-1.9	-1.8	-1.8	-1.2	-0.6	
Contribution from price and exchange rate changes	3.7	1.2	-5.4			...	...	...	...	...	...	...	...	...	
<b>Residual (3-4) 3/</b>	<b>-1.2</b>	<b>3.8</b>	<b>6.3</b>			<b>1.5</b>	<b>-1.7</b>	<b>0.3</b>	<b>0.7</b>	<b>0.3</b>	<b>0.3</b>	<b>0.3</b>	<b>0.4</b>	<b>0.5</b>	
NPV of external debt 4/	...	...	41.3			36.8	32.2	29.7	27.8	25.9	24.6	24.6	18.8	11.2	
In percent of exports	...	...	207.6			191.1	181.2	172.1	161.8	151.3	144.4	144.4	109.5	66.3	
<b>NPV of PPG external debt</b>	<b>...</b>	<b>...</b>	<b>37.6</b>			<b>34.5</b>	<b>30.4</b>	<b>28.1</b>	<b>26.2</b>	<b>24.3</b>	<b>23.0</b>	<b>23.0</b>	<b>17.4</b>	<b>9.8</b>	
In percent of exports	...	...	189.2			179.3	171.2	162.9	152.7	141.9	135.1	135.1	101.0	58.1	
Debt service-to-exports ratio (in percent)	34.6	40.5	31.8			32.5	28.0	18.7	15.0	13.7	15.6	15.6	11.1	10.7	
<b>PPG debt service-to-exports ratio (in percent)</b>	<b>27.8</b>	<b>33.8</b>	<b>26.3</b>			<b>27.1</b>	<b>24.5</b>	<b>16.3</b>	<b>13.1</b>	<b>12.2</b>	<b>14.3</b>	<b>14.3</b>	<b>9.7</b>	<b>9.4</b>	
Total gross financing need (billions of U.S. dollars)	6.2	4.0	1.8			2.2	4.4	2.6	2.2	2.7	3.2	3.2	2.8	4.7	
Non-interest current account deficit that stabilizes debt ratio	-3.0	-5.2	1.1			1.1	3.5	1.4	0.9	1.3	1.3	1.3	0.7	0.1	
<b>Key macroeconomic assumptions</b>															
Real GDP at market prices (change in percent)	2.6	2.8	5.8			3.6	6.0	6.0	6.0	6.0	6.0	6.0	6.1	5.0	5.1
GDP deflator in U.S. dollar terms (change in percent)	-6.0	-2.0	9.8			-0.5	6.3	4.7	1.9	2.1	2.0	2.0	3.1	2.0	2.0
Effective interest rate (percent) 5/	4.3	4.2	3.4			4.8	0.7	3.0	2.9	3.0	2.8	2.8	2.9	2.9	3.1
Growth of exports of G&S (U.S. dollar terms, in percent)	7.4	7.5	23.8			5.5	9.4	4.8	7.7	7.5	7.6	7.6	6.5	6.8	7.2
Growth of imports of G&S (U.S. dollar terms, in percent)	6.6	-7.1	20.6			1.6	12.7	9.8	3.6	5.3	6.6	6.6	8.5	6.6	6.7
Grant element of new public sector borrowing (in percent)	...	...	...			...	39.7	44.3	44.3	44.3	44.3	44.3	39.6	17.5	18.4
Memorandum item:															
Nominal GDP (billions of U.S. dollars)	58.8	59.2	68.8			77.6	86.1	92.9	100.5	108.7	117.5	117.5	167.4	333.6	

Source: Staff simulations.

1/ Includes both public and private sector external debt.

2/ Derived as  $[-g - r(1+g)] / (1+g+r)$  times previous period debt ratio, with  $r$  = nominal interest rate;  $g$  = real GDP growth rate; and  $r$  = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief), changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that NPV of private sector debt is equivalent to its face value.

5/ Current year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 11b. Pakistan: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2002/03–2023/24

(In percent)

	Est.		Projections						
	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2013/14	2023/24
<b>NPV of debt-to-GDP ratio</b>									
Baseline	38	35	30	28	26	24	23	17	10
A. Alternative Scenarios									
A1. Key variables at their historical averages in 2004/05–2023/24 1/	...	35	34	33	34	33	33	31	26
A2. New public sector loans on less favorable terms in 2004/05–2023/24 2/	...	35	31	29	27	26	25	20	14
B. Bound Tests									
B1. Real GDP growth at historical average minus one standard deviation in 2004/05–2005/06	...	35	32	30	28	26	25	19	11
B2. Export value growth at historical average minus one standard deviation in 2004/05–2005/06 3/	...	35	31	31	29	27	26	19	10
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2004/05–2005/06	...	35	34	35	32	30	28	21	12
B4. Net non-debt creating flows at historical average minus one standard deviation in 2004/05–2005/06 4/	...	35	33	32	30	28	26	20	10
B5. Combination of B1-B4 using one-half standard deviation shocks	...	35	36	40	37	35	33	25	13
B6. One-time 30 percent nominal depreciation relative to the baseline in 2004/05 5/	...	35	43	39	37	34	32	24	14
<b>NPV of debt-to-exports ratio</b>									
Baseline	189	179	171	163	153	142	135	101	58
A. Alternative Scenarios									
A1. Key variables at their historical averages in 2004/05–2023/24 1/	...	179	189	194	195	192	193	178	152
A2. New public sector loans on less favorable terms in 2004/05–2023/24 2/	...	179	174	168	160	151	146	118	84
B. Bound Tests									
B1. Real GDP growth at historical average minus one standard deviation in 2004/05–2005/06	...	179	171	163	153	142	135	101	58
B2. Export value growth at historical average minus one standard deviation in 2004/05–2005/06 3/	...	179	189	212	199	186	177	131	70
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2004/05–2005/06	...	179	171	163	153	142	135	101	58
B4. Net non-debt creating flows at historical average minus one standard deviation in 2004/05–2005/06 4/	...	179	183	185	174	163	155	114	60
B5. Combination of B1-B4 using one-half standard deviation shocks	...	179	186	201	189	177	169	124	65
B6. One-time 30 percent nominal depreciation relative to the baseline in 2004/05 5/	...	179	171	163	153	142	135	101	58
<b>Debt service ratio</b>									
Baseline	26	27	24	16	13	12	14	10	9
A. Alternative Scenarios									
A1. Key variables at their historical averages in 2004/05–2023/24 1/	...	27	26	19	16	16	19	17	25
A2. New public sector loans on less favorable terms in 2004/05–2023/24 2/	...	27	24	16	13	11	13	9	10
B. Bound Tests									
B1. Real GDP growth at historical average minus one standard deviation in 2004/05–2005/06	...	27	24	16	13	12	14	10	9
B2. Export value growth at historical average minus one standard deviation in 2004/05–2005/06 3/	...	27	26	19	16	15	17	13	12
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2004/05–2005/06	...	27	24	16	13	12	14	10	9
B4. Net non-debt creating flows at historical average minus one standard deviation in 2004/05–2005/06 4/	...	27	24	17	14	13	15	11	10
B5. Combination of B1-B4 using one-half standard deviation shocks	...	27	25	18	15	14	16	12	11
B6. One-time 30 percent nominal depreciation relative to the baseline in 2004/05 5/	...	27	24	16	13	12	14	10	9
Memorandum item:									
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	...	...	15	15	15	15	15	15	15

Source: Staff projections and simulations.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and nondebt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline, while grace and maturity periods are the same as in the baseline.

3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in U.S. dollar/local currency rate, such that it never exceeds 100 percent.

6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in Footnote 2.

Table 12. Pakistan: Gross Financing Requirements, 2001/02–2004/05

(In millions of U.S. dollars)

	2001/02	2002/03	2003/04		2004/05 Proj.
			Prog. 1/ Rev. Proj.	Rev. Proj.	
Gross financing requirements	-7,889	-5,472	-4,702	-4,842	-4,723
External current account deficit	1,591	4,204	1,237	2,213	384
Debt amortization	-6,204	-3,996	-3,568	-5,075	-4,352
Medium- and long-term debt	-2,657	-2,813	-2,032	-3,294	-2,973
Public sector	-2,261	-2,130	-1,478	-2,567	-2,538
Multilateral (excluding IMF)	-604	-612	-673	-1,780	-1,745
Bilateral	-817	-658	-581	-185	-224
Bonds (net)	-35	-193	-183	-181	-181
Other (including SBP liabilities)	-805	-667	-41	-421	-388
Private sector	-396	-683	-554	-727	-435
Short-term debt	-3,547	-1,183	-1,536	-1,781	-1,379
Public sector	-2,188	-976	-1,364	-1,362	-1,319
Private sector	-1,359	-207	-172	-419	-60
Repayment of arrears	0	0	0	0	0
Gross reserves accumulation	-3,082	-5,261	-1,844	-1,402	-460
<i>Of which:</i> official reserves	-2,717	-5,911	-1,444	-1,455	-160
IMF repurchases and repayments	-194	-418	-526	-578	-294
Available financing	7,889	5,472	4,702	4,842	4,723
FDI and portfolio investment (net, excluding public securities) 2/	475	793	690	927	699
Debt financing from private creditors	2,988	1,949	1,802	2,480	1,735
Medium- and long-term financing	487	354	182	965	150
To private sector	185	350	182	465	150
To public sector	302	4	0	500	0
Short-term financing	2,501	1,595	1,620	1,515	1,585
To public sector	1,378	1,108	1,500	1,355	1,550
To private sector	1,123	487	120	160	35
Official creditors	2,623	2,111	1,628	1,271	1,682
Project lending	531	581	728	727	742
Balance of payments support	2,092	1,530	900	544	940
AsDB and World Bank	883	621	900	544	940
Debt relief from bilateral creditors 3/	1,210	909	0	0	0
Private sector involvement	0	100	100	100	100
IMF	484	469	480	245	506
Other net capital flows 4/	1,319	50	1	-181	0
Financing gap	0	0	0	0	0

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

1/ Program as agreed during the combined sixth and seventh reviews, October 2003 (IMF Country Report No. 03/38).

2/ Includes privatization receipts.

3/ Debt relief agreed in January 2001 and in December 2001.

4/ Including errors and omissions; for 2001/02, also including SBP purchases in the kerb market.

Table 13. Pakistan: Indicators of External Vulnerability, 2000/01–2004/05

	2000/01	2001/02	2002/03	Latest available observation	Rev. Proj. 2003/04	Proj. 2004/05
<b>Financial indicators</b>						
Total government debt (in percent of GDP)	108.0	96.7	88.8	...	84.1	78.6
Broad money (12-month percentage change)	9.0	15.4	18.3	18.1 1/	17.5	12.8
Private sector credit (12-month percentage change)	6.5	4.8	19.1	29.4 1/	23.2	15.6
180-day treasury bill yield (in percent)	10.4	8.1	4.1	1.8 1/	...	...
180-day treasury bill yield, real (in percent)	6.0	5.6	1.0	-1.5 1/	...	...
<b>Karachi Stock Exchange index</b>						
End-of-period	1,366	1,770	3,402	5,465 2/	...	...
Period average	1,436	1,514	2,443	...	...	...
<b>External Indicators</b>						
Exports (12-month percentage changes, in U.S. dollars)	9.1	2.3	19.1	...	11.7	8.0
Imports (12-month percentage changes, in U.S. dollars)	6.2	-7.5	20.2	...	13.9	12.0
Terms of trade (12-month percentage changes)	-1.6	-0.5	-0.9	...	4.1	-0.6
Current account balance (excluding official transfers in percent of GDP)	-3.3	0.2	4.6	...	2.1	-0.1
Gross Official Reserves (in millions of U.S. dollars)	1,679	4,330	9,521	10,806 2/	11,657	11,745
In months of next year imports of goods and nonfactor services	1.7	3.7	6.8	...	7.6	7.4
In percent of broad money	7.0	14.7	26.4	...	25.9	24.8
In percent of total short-term debt at remaining maturity	26.1	73.1	195.5	...	206.7	251.2
Total external debt (in millions of U.S. dollars)	35,239	35,545	35,084	...	35,434	34,863
In percent of exports of goods and nonfactor services	342.7	321.5	256.3	...	237.1	227.8
Exchange rate (Pakistani rupees per U.S. dollar, period average)	58.2	61.6	58.6	57.6 2/	...	...
Real exchange rate (12-month percentage changes)	-2.6	-1.1	-1.8	...	...	...

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

1/ March 2004

2/ May 25, 2004.

Table 14. Pakistan: Indicators of Fund Credit, 2001/02–2008/09 1/

	2001/02	2002/03	Proj.					
			2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
<b>Outstanding Fund credit</b>								
In millions of SDRs	1,524	1,519	1,280	1,419	1,180	1,011	862	676
In millions of U.S. dollars	1,939	2,092	1,882	2,094	1,747	1,500	1,280	1,004
In percent of:								
Quota	147.5	146.9	123.9	137.3	114.2	97.8	83.4	65.4
GDP	3.3	3.0	2.4	2.4	1.9	1.5	1.3	0.9
Exports of goods and nonfactor services	17.5	15.3	12.6	13.7	10.9	8.7	6.9	5.0
Public and publicly guaranteed debt	5.9	6.4	5.6	6.3	5.2	4.4	3.7	2.9
<b>Debt service to the Fund</b>								
In millions of SDRs	194	333	410	212	251	181	160	196
In millions of U.S. dollars	247	458	602	313	372	269	237	290
In percent of:								
Exports of goods and nonfactor services	2.2	3.3	4.0	2.0	2.3	1.6	1.3	1.5
Gross official reserves	5.7	4.8	5.2	2.7	3.0	2.0	1.7	2.0

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

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

Table 15. Pakistan: Millennium Development Goals, 1990–2015 1/

(Latest available data)

	1990	1995	2000	2001	2002	PRSP targets	
						2005	2015
<b>Goal 1. Eradicate extreme poverty and hunger</b>							
Target 1. Halve, between 1990 and 2015, the proportion of people whose income is less than one dollar a day.							
1. Population below \$1 a day (percent)	...	...	...	...	...	...	...
2. Poverty gap at \$1 a day (percent)	...	...	...	...	...	...	...
3. Share of income or consumption held by poorest 20 percent (percent)	...	...	...	8.8	...	...	...
Target 2. Halve, between 1990 and 2015, the proportion of people suffering hunger.							
4. Prevalence of child malnutrition (percent of children under 5)	40.2	38.2	...	...	...	...	...
5. Population below minimum level of dietary energy consumption (percent)	25.0	...	...	19.0	...	...	...
<b>Goal 2. Achieve universal primary education</b>							
Target 3. Ensure that, by 2015, children will be able to complete a full course of primary schooling.							
6. Net primary enrollment ratio (percent of relevant age group)	...	...	...	66.2	...	...	...
7. Percentage of cohort reaching grade 5	...	...	...	...	...	...	...
8. Youth literacy rate (percent, ages 15–24)	47.4	53.0	...	57.8	58.7	60.0	86.0
<b>Goal 3. Promote gender equality and empower women</b>							
Target 4. Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education by 2015.							
9. Ratio of girls to boys in primary and secondary education (percent)	46.8	...	...	60.7	...	...	...
10. Ratio of young literate females to males (percent, ages 15–24)	49.0	53.8	...	60.0	...	65.0	93.0
11. Share of women employed by the nonagricultural sector	...	...	...	...	...	...	...
12. Proportion of seats held by women in the National Assembly	10.0	...	...	...	21.0	...	...
<b>Goal 4. Reduce child mortality</b>							
Target 5. Reduce by two-thirds, between 1990 and 2015, the under-five mortality rates.							
13. Under five-mortality rate (per 1,000)	128.0	118.0	...	109.0	107.0	65.0	52.0
14. Infant mortality rate (per 1,000 live births)	96.0	90.0	...	84.0	80.0	63.0	40.0
15. Immunization, measles (percent, children under 12 months)	50.0	53.0	...	54.0	...	...	...
<b>Goal 5. Improve maternal health</b>							
Target 6. Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.							
16. Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	200.0	...	...	...	...	...
17. Births attended by skilled health staff (percent of total)	18.8	18.0	...	20.0	...	...	...
<b>Goal 6. Combat HIV/Aids, malaria, and other diseases</b>							
Target 7. Halt by 2015, and begin to reverse, the spread of HIV/AIDS.							
18. HIV prevalence among females (percent, ages 15–24)	...	...	...	0.1	...	...	...
19. Contraceptive prevalence rate (percent of women, ages 15–49)	14.0	17.8	...	27.6	...	...	...
20. Number of children orphaned by HIV/AIDS	...	...	...	25,000	...	...	...
Target 8. Halt by 2015, and begin to reverse, the incidence of malaria and other diseases.							
21. Prevalence of death associated with malaria	...	...	...	...	...	...	...
22. Share of population in malaria risk areas using effective prevention and treatment	...	...	...	...	...	...	...
23. Incidence of tuberculosis (per 100,000 people) 2/	...	...	...	174.5	...	133.0	45.0
24. Tuberculosis cases detected under DOTS (percent)	...	1.0	...	3.0	...	...	...

Table 15. Pakistan: Millennium Development Goals, 1990–2015 (concluded)

(Latest available data)

	1990	1995	2000	2001	2002	PRSP targets	
						2005	2015
<b>Goal 7. Ensure environmental sustainability</b>							
Target 9. Integrate the principles of sustainable development into policies and programs. Reverse the loss of environmental resources.							
25. Forest area (percent of total land area)	3.6	...	...	3.2	...	...	...
26. Nationally protected areas (percent of total land area)	...	4.8	...	4.8	4.9	...	...
27. GDP per unit of energy use (PPP \$ per kg oil equivalent)	3.4	3.8	...	4.1	...	...	...
28. CO2 emission (metric tons per capita)	0.6	0.7	...	0.7	...	...	...
Target 10. Halve by 2015 proportion of people without access to safe drinking water.							
29. Sustainable access to safe water (percent of population)	83.0	...	...	90.0	...	90.0	93.0
Target 11. Achieve by 2020 significant improvement for at least 100 million slum dwellers.							
30. Access to improved sanitation (percent of population)	36.0	...	...	62.0	...	...	...
31. Access to secure tenure (percent of population)	...	...	...	...	...	...	...
<b>Goal 8. Develop a global partnership for development</b>							
Target 16. Develop and implement strategies for productive work for youth.							
45. Unemployment rate of population ages 15–24 (total)	3.6	8.9	...	...	...	...	...
Target 17. Provide access to affordable essential drugs.							
46. Proportion of population with access to affordable essential drugs	...	...	...	...	...	...	...
Target 18. Make available new technologies, especially information and communications.							
47. Fixed line and mobile telephones (per 1,000 people)	7.5	16.9	...	28.9	...	...	...
48. Personal computers (per 1,000 people)	1.3	3.5	...	4.1	...	...	...

Source: World Development Indicators.

1/ Targets 12–15 and indicators 33–44 are excluded because they can not be measured on a country specific basis. These are related to official development assistance, market access, and the HIPC initiative.



**PAKISTAN: FUND RELATIONS**

As of April 30, 2004

**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	1,382.68	133.76
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	164.21	96.60

<b>IV. Outstanding Purchases and Loans:</b>	<u>SDR Million</u>	<u>% Quota</u>
Stand-by arrangements	253.13	24.49
Extended arrangements	95.97	9.28
PRGF arrangements	916.13	88.63

**V. Latest Financial Arrangements:**

<u>Type</u>	<u>Approval Date</u>	<u>Expiration Date</u>	<u>Amount Approved (SDR Million)</u>	<u>Amount Drawn (SDR Million)</u>
PRGF	12/06/2001	12/05/2004	1,033.70	689.14
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>4/30/04</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
Principal	0.0	229.57	163.91	72.03	97.88	116.12
Charges/Interest	<u>0.0</u>	<u>9.88</u>	<u>7.05</u>	<u>5.17</u>	<u>4.42</u>	<u>3.57</u>
Total	0.0	239.45	170.96	77.20	102.30	119.73

**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. 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 October 10, 2003, the FIBR was PRs 57.40 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 in August 2002. The staff report (IMF Country Report No. 02/246) was discussed by the Executive Board on November 1, 2002.

**IX. Safeguards Assessments**

In accordance with the Fund’s safeguards assessment policy, the State Bank of Pakistan (SBP) was subject to a full safeguards assessment under the Stand-By Arrangement that expired on September 30, 2001. This assessment, which included a safeguards mission to the SBP, was completed on February 13, 2001. The staff’s findings and recommendations were reported in IMF Country Report No. 01/58, Appendix IV. The authorities have implemented all of the recommended remedial measures that were included under SBA conditionality, and no new critical vulnerabilities have been identified under Pakistan’s current 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	(refer to <a href="http://www.imf.org">www.imf.org</a> )
Financial System Stability Assessment	6/9/2004	(refer to <a href="http://www.imf.org">www.imf.org</a> )
Data Module and Detailed Assessment Using the Data Quality Assessment Framework	Report under preparation (STA mission December 1–16, 2003)	

**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 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. In March 2003, a mission advised the authorities on customs administration reform. In April 2004, a mission advised the authorities on improving fiscal reporting at the subnational level.

**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-MCD 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: IMF-WORLD BANK RELATIONS

Thomas Buckley, Senior Country Office; Telephone: (202)473-0075

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

1. The government of Pakistan's Poverty Reduction Strategy Paper (PSRP) for 2002/03 to 2007/08,<sup>5</sup> completed in December 2003, constitutes a broad-based strategy for addressing poverty, including human development, governance, and vulnerability, and builds on the economic program first articulated in the fall of 1999 and further elaborated in the I-PRSP of 2001. The Bank-Fund Joint Staff Assessment (JSA), discussed by the Board of the IMF on March 8, 2004 and the Board of the World Bank on March 11, 2004, endorsed the PRSP and indicated it provides a good policy framework for the implementation of a reform program which can accelerate progress toward the Millennium Development Goals (MDGs).
2. The Fund takes the lead in the policy dialogue with Pakistan 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, 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.

### **World 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 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) was presented to the World Bank's Board of Executive Directors on June 11, 2002. A CAS Progress Report, which was presented to the Board on April 20, 2004, confirms that the strategy set out in the 2002 CAS remains valid in light of the full PRSP.
4. The World Bank works closely with the Fund and the government on structural reforms underpinning macroeconomic stability. In this context, the World Bank's lending program has featured structural adjustment lending to support 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

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<sup>5</sup> Government of Pakistan, 2003, *Accelerating Economic Growth and Reducing Poverty: the Road Ahead*.

governance reforms. The World Bank has also approved structural adjustment credits for two provinces (Sindh and North West Frontier Province (NWFP)) supporting provincial reform strategies to improve resource management and strengthen provision of public services by local governments and communities. Further structural adjustment lending is planned, including follow-on provincial adjustment credits and a Poverty Reduction Support Credit.

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 perform analytical work to support the ongoing liberalization and modernization of trade, industrial, business, and labor regulations.

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, NWFP, and an Education Sector Adjustment Credit for Punjab. In FY 2003, World Bank Group assistance to health sector reforms also included the HIV/AIDS Prevention Project and Partnership for Polio Eradication Project.

7. Supporting the rural sector through community-based infrastructure projects (particularly for water supply and sanitation services) and the increased availability 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). Follow-on PPAF and CIP projects were approved in FY 2004.

8. IBRD and IDA have approved 85 loans and 121 credits to Pakistan since 1952, totaling \$7,025.3 million and \$7,648.6 million, respectively. Since 1999, World Bank lending has totaled \$2,692.8 million (see Table 1). As of April 30, 2004, there were 170 outstanding IBRD and IDA loans and credits representing a total obligation of \$8,404.1 million. The World Bank active portfolio in Pakistan consisted of 15 lending operations with a total commitment of \$1,296.5 million of which \$795.1 million is undisbursed.

**Table 1. Pakistan: World Bank Lending FY1999-2004**

Project Name	Fiscal year Approved	Amount	Disbursed
Structural Adjustment Loan	1999	350.0	350.0
Poverty Alleviation Fund	1999	90.0	78.7
Trade & Transport	2001	3.0	2.1
NWFP On-Farm Water Management Project	2001	21.4	2.6
Structural Adjustment Credit	2001	350.0	343.9
Banking Sector Restructuring and Privatization Project	2002	300.0	204.6
Structural Adjustment Credit II	2002	500.0	510.3
Community Infrastructure & Services	2003	20.0	2.9
Banking Sector Technical Assistance	2003	26.5	4.7
Sindh Structural Adjustment Credit	2003	100.0	106.4
NWFP Structural Adjustment Credit	2003	90.0	95.8
Partnership for Polio Eradication	2003	20.0	20.0
HIV/AIDS Prevention Project	2003	37.1	1.2
National Education Assessment System	2003	3.6	0.0
Highways Rehabilitation	2004	200.0	0.5
Poverty Alleviation Fund II	2004	238.0	0.0
Punjab Education Reform Program	2004	100.0	100.6
Sindh On-Farm Water Management Project	2004	61.1	0.0
NWFP Community Infrastructure II ( CIP2)	2004	37.1	0.0
PK Public Sector Capacity Building Project	2004	55.0	0.0
NWFP SAC II	2004	90.0	0.0

### 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.** A major achievement of the reform process has been the transformation of a predominantly state-owned and weak banking system into a healthier, market-based system, owned primarily by the private sector. This has been supported by considerable strengthening of the legal and regulatory environment, and significant improvements in transparency, corporate governance, and credit culture. World Bank support is being provided through implementation of two ongoing projects: the Banking Sector Restructuring and Privatization Project and the Banking Sector Technical Assistance. A Banking Sector Adjustment Credit is planned in FY 2005. A joint World Bank/Fund Financial Sector Assessment Program (FSAP) was completed in FY 2004.

b. **Power sector reforms.** The Fund PRGF arrangement includes conditionality related to energy tariff adjustments and other power sector reforms with the aim of reducing the sector's fiscal burden. 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 corporatize the state-owned Water and Power Development Authority (WAPDA) with the eventual aim for privatizing the generation and transmission of electricity. The World Bank is currently working with the government on the finalization of a comprehensive medium-term adjustment program to improve the electric services to Pakistan's industry and households at lower cost and higher reliability.

c. **Public expenditure management.** 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. Analytical and diagnostic support is being provided in the form of a Country Financial Accountability Assessment (CFAA), which was completed in FY 2003, as well as provincial financial accountability assessments, as appropriate. 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.

d. **Tax policy and administration reforms.** 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 structural performance criteria of the PRGF include adoption of tax policy changes and implementation of CBR reform. A planned World Bank tax administration reform project will support CBR reforms and is expected to be approved in FY 2005.

June 7, 2004

Mr. Rodrigo de Rato  
Managing Director  
International Monetary Fund  
Washington, D.C. 20431  
U.S.A.

Dear Mr. de Rato:

Pakistan's government remains committed to implementing the economic strategy set out in the Poverty Reduction Strategy Paper (PRSP), published in December 2003, supported by the Poverty Reduction and Growth Facility (PRGF) arrangement. The strategy aims to create an enabling environment for sustained high growth, job creation, and poverty reduction.

We held discussions with Fund staff in April 2004 for the eighth review under the PRGF arrangement. In light of these discussions, the attached Memorandum of Economic and Financial Policies (MEFP) reviews economic developments and policy implementation through December 2003 and beyond under the arrangement, updates the macroeconomic framework, and discusses the financial policies and the structural reform program for the remainder of 2004. It supplements the MEFP dated November 22, 2001, as well as the supplementary MEFPs dated March 12, 2002, June 18, 2002, October 16, 2002, February 8, 2003, May 29, 2003, and October 11, 2003.

All quantitative performance criteria for end-December 2003 were met. Moreover, structural performance criteria were met, except for minor deviations on (a) effective transfer of ownership of Habib Bank Limited by end-December 2003; (b) preparation of an action plan by end-October 2003 for establishing a transparent regulatory framework for regional electricity tariff setting by end-December 2003; (c) notification of electricity tariff adjustments within 30 days of the determination by the National Electric Power Regulatory Agency (NEPRA); (d) not implementing downward electricity tariff adjustment determined by NEPRA unless the respective utility met its accrual balance target in the previous quarter. The effective transfer of ownership of Habib Bank Limited took place in February 2004 upon request of the investor, although we had accepted the bid on December 29, 2003. While we had prepared the action plan for establishing a transparent electricity tariff policy in October 2003, the announcement of the electricity tariff guidelines for NEPRA was delayed until May 2004 to allow for comprehensive discussions with the World Bank on developing a financial recovery plan for the power sector. The downward tariff adjustment for the Karachi Electric Supply Company (KESC), determined by NEPRA in mid-January 2004, was notified only in mid-April after we had confirmed that the accrual balance of the preceding quarter was met and to allow time for discussions on the overall subsidy policy. Finally, we notified a



downward electricity tariff adjustment for the Water and Power Development Authority (WAPDA) in November 2003, even though WAPDA missed its accrual balance target for end-September 2003, albeit by a very small margin. However, we delayed the notification until we were confident that WAPDA would meet its cumulative end-December 2003 target, which it did by a comfortable margin.

The government has also reassessed its needs for external nonconcessional borrowing. In particular, a larger-than-expected guarantee for external borrowing by Pakistan International Airlines (PIA) has been provided on favorable terms to proceed with its fleet renewal and build on its successful business turnaround. PIA should be able to service this loan out of its own resources. To accommodate this guarantee, the \$500 million Eurobond issue and other smaller loans, we would need to increase the ceiling on contracting of nonconcessional loans to \$1 billion, still less than prepayment of expensive external debt that we effected earlier this year.

On this basis, and in view of the policies set out in the attached MEFP, including the measures to strengthen our power sector reform strategy, the government requests waivers for the nonobservance of the structural performance criteria listed above, modification of the performance criterion discussed above, and the completion of the eighth review.

The government 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 MEFP are adequate to achieve the objectives of the program, but will take any further measures that may become appropriate for this purpose. The government of Pakistan will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation.

Sincerely yours,

/s/  
Shaukat Aziz  
Minister of Finance and Economic Affairs

/s/  
Ishrat Husain  
Governor  
State Bank of Pakistan

Attachments:  
Memorandum of Economic and Financial Policies  
Amendments to the Technical Memorandum of Understanding

## PAKISTAN

### Memorandum of Economic and Financial Policies for 2004

#### I. INTRODUCTION

1. Pakistan continues to make solid progress under its economic program supported by the current arrangement under the IMF's Poverty Reduction and Growth Facility (PRGF). Economic growth has recovered and is strengthening, while inflation has remained low. Fiscal and external vulnerabilities have been reduced through a reduction in fiscal imbalances. The debt situation continues to improve toward sustainable levels, while the strengthened external position has allowed the State Bank of Pakistan (SBP) to rebuild its international reserves.
2. Notwithstanding the economic successes, the challenges ahead include reducing poverty, creating job opportunities, and improving social indicators. We have outlined our strategy to meet these challenges in our Poverty Reduction Strategy Paper (PRSP) entitled "Accelerating Economic Growth and Reducing Poverty: The Road Ahead," which was completed by end-2003.
3. As part of our overall strategy described in the PRSP, this Memorandum of Economic and Financial Policies sets out our economic policies for the remainder of 2003/04 and for 2004/05. The government remains strongly committed to its reform agenda. We recognize that sound macroeconomic policies and further structural reforms are needed to create and maintain an environment conducive to private sector growth. We also recognize that while economic growth is necessary, it is not a sufficient condition to reduce poverty. Thus, apart from focusing on growth, our policies also aim to reduce poverty through greater social inclusion, including through human development and devolution of political and economic power.

#### II. RECENT DEVELOPMENTS

4. **Macroeconomic performance continues to be favorable.** The 5.3 percent economic growth target for 2003/04 (July–June) is expected to be exceeded, reflecting strong growth across all sectors. Twelve-month inflation reached 5.3 percent in March 2004, compared with 1.9 percent at end-June 2003, following a temporary surge in food prices in the last months of 2003. Inflation in July–March 2003/04 was 3.7 percent, slightly higher than in the same period a year before, but still below the 4 percent inflation target for 2003/04 as a whole.
5. **The external position remains strong.** Exports and imports (on f.o.b. basis) grew by 16.5 and 16.8 percent in U.S. dollar terms, respectively, in the first nine months of 2003/04, following very high growth rates in the previous year. This, coupled with still sizable private transfers, implies that the current account continues to show a sizable surplus. Despite a reduction in SBP purchases of foreign exchange in the interbank market in recent months and

the early repayment of loans to the Asian Development Bank (AsDB), equivalent to \$1.1 billion, gross official reserves reached \$11 billion by end-March 2004.

6. **Pakistan successfully re-entered international capital markets, with the issuance of a \$500 million, five-year Eurobond in February 2004.** The overall setting for this issue proved favorable in view of Pakistan's improved fundamentals and the issue was four times oversubscribed. With a 6¾ percent coupon rate and issued at par, the yield spread was 370 bps over U.S. treasury bonds, significantly lower than prevailing yields on bonds of many other emerging economies, with similar, and in some cases better, credit ratings.

7. **All quantitative performance criteria for end-December 2003 have been met (Table 1(a)).** Similarly, almost all indicative targets for end-September and end-December have been met. Exceptions were the end-September and end-December targets for social- and poverty-related spending that were missed by a very small margin, though we believe that these preliminary data may somewhat understate actual expenditures. Reconciliation of preliminary expenditure data has typically resulted in some upward revisions, for example for 2002/03. Thus, there is a high probability that actual expenditure may have exceeded the end-September and end-December targets. However, full reconciliation is only done on an annual basis and not for quarterly data. Another exception is the end-September accrual balance target for the Water and Power Development Authority (WAPDA), which was missed, also by only a very small margin. However, the end-September shortfall in WAPDA's accrual balance was made up by end-December.

8. **Budget execution is on track.** The overall deficit (excluding grants) for the consolidated government was lower than programmed in the first half of 2003/04, with higher-than-targeted revenues and lower expenditures in most categories, except for defense. Revenue collection by the Central Board of Revenue (CBR) exceeded the end-December target by a comfortable margin. Preliminary data indicate that these trends have continued in recent months.

9. **Monetary growth continued to be strong, driven mainly by strong private sector credit growth.** Broad money grew by 18.5 percent in 2003, while reserve money grew by 16.5 percent. Credit to the private sector accelerated to 28.5 percent. This rapid pace of monetary expansion reflects a much stronger-than-expected increase in money demand. Meanwhile, the strong credit growth appears to reflect the buoyant economy, low interest rates, and ample liquidity in banks. The rate of monetary and credit expansion remained high in the first few months of 2004.

10. **Further progress was made in implementing structural reform measures, although some delays occurred (Table 2(a)).** In the area of tax policy and administration, the introduction of universal self-assessment has been successful. Guidelines for presumptive taxation of nonfilers under the sales tax were issued in December 2003. No new exemptions have been granted regarding income tax, customs duties, or the general sales tax (GST). Significant progress has been made toward opening an additional large taxpayer unit (LTU)

in Lahore and five medium taxpayer units (MTU) in regional centers. Work for compiling a database of taxpayers covered by these new units was completed in March 2004. We expect that the National Finance Commission award, when finalized, will strengthen and consolidate the devolution process by allocating a larger share of the divisible tax pool to provinces.

11. In the **energy sector**, an action plan for establishing a transparent regulatory framework for the setting of electricity tariffs was prepared by late October 2003, with a view to implementing these actions in the following months. However, the implementation of this plan has been delayed, and the petitions for the determination of structural tariffs for WAPDA's successor entities, filed by end-June 2003 with the National Electric Power Regulatory Agency (NEPRA), are all still pending for the distribution entities (the transmission and most of the generation petitions have now been finalized). We are working closely with the World Bank to develop a medium-term recovery plan for the sector. Electricity tariffs were reduced in November 2003 in accordance with the automatic tariff adjustment, despite that WAPDA had missed its accrual balance target under its Financial Improvement Plan (FIP) in the preceding quarter, albeit by a very small margin. The financial performance of both WAPDA and the Karachi Electric Supply Company (KESC) improved significantly in the last quarter of 2003, however, largely reflecting a greater availability of hydro power in the case of WAPDA, but also a reduction in technical and operational losses. As a result, both entities met the end-December targets under their FIPs by considerable margins.<sup>6</sup> Notification of the electricity tariff for KESC, determined by NEPRA in mid-January 2004 under the automatic tariff adjustment, has been notified on April 15, 2004. The delay was mainly due to discussions on overall subsidy policy and confirmation of the accrued balance of the preceding quarter.

12. In the area of **financial sector** reform, a bid for a majority stake in Habib Bank Limited (HBL) was accepted on December 29, 2003. The transfer of ownership was completed by end-February 2004, and the new owner has taken over HBL's management. With this transaction, nearly 80 percent of the country's banking sector assets are now in private hands. National Savings Schemes (NSS) rates were adjusted on January 1, 2004, to better align them with interest rates on Pakistan Investment Bonds (PIB).

### **III. ECONOMIC AND FINANCIAL POLICIES FOR THE REMAINDER OF 2003/04 AND 2004/05**

#### **A. Macroeconomic Framework**

13. **We are aiming for economic growth of above 6 percent annually, over the medium term, to significantly reduce poverty.** This is ambitious, but achievable. Economic growth in 2003/04 is expected to be about 6.4 percent, while for 2004/05, a growth rate of

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<sup>6</sup> The financial performance of Pakistan International Airlines and Pakistan Steel Mills also exceeded targets under their FIPs in the first half of 2003/04, contrary to that of Pakistan Railways, which suffered from a sharp drop in oil transport and a reduction in tariffs for transit trade to Afghanistan.

6.5 percent could very well be realized, building on the current momentum and provided that external demand and local weather conditions remain favorable. Average inflation for 2003/04 is expected to be close to, or moderately above, the 4 percent target. Inflation will be targeted not to exceed 5 percent in 2004/05.

## **B. Fiscal Policy**

14. **Prospects for meeting the overall 2003/04 budget targets are good.** We expect CBR revenue to slightly exceed the target of PRs 510 billion (11.4 percent of GDP), while lower spending on domestic interest and a slightly lower-than-budgeted need for transfers to public sector enterprises are expected to result in savings for the year as a whole. These savings could be offset partially by higher-than-budgeted defense spending, primarily due to increased activity along the Afghan border. All in all, the consolidated government overall deficit (excluding grants) will not exceed PRs 179 billion (4 percent of GDP) and is expected to be less than that. Bank financing of the budget will be limited to PRs 82 billion. The government is determined to meet its fiscal targets and will be ready to take additional steps, including expenditure cuts, in the event of any unexpected weakening in revenue performance in the last quarter.

15. **We are fully aware that the budget for 2004/05 will need to balance the need for accelerating growth through increased social and development spending and further debt reduction.** We believe that both of these objectives can be achieved with the right mix of fiscal policies. We will submit a 2004/05 federal budget to parliament that will limit the consolidated government overall deficit (excluding grants) to PRs 199.2 billion (equivalent to 4 percent of GDP). Provided growth remains strong, this will be sufficient to further reduce the ratio of public debt to less than 80 percent, consistent with our projections outlined in the PRSP and the draft Fiscal Responsibility Law, which is expected to be approved by parliament during 2004. The continued decline in the debt ratio will contribute to further lowering the claim of debt service obligations on scarce government resources. We will have to maintain defense outlays at 3.9 percent of GDP to meet the newly arisen challenges along the Afghan border. At the same time, we remain committed to our PRSP agenda and will also increase social- and poverty-related spending in 2004/05 to PRs 278 billion (5.6 percent of GDP). To create the necessary fiscal space for this, fiscal policy will continue to need to focus on strengthening revenue collection and reducing subsidies to loss-making public enterprises by improving their performance. We expect CBR revenue to grow somewhat faster than nominal GDP growth to PRs 576 billion, as a result of past and ongoing reforms (see below).

16. **We have endeavored to expeditiously reduce the external debt burden through early repayments of \$1.1 billion in expensive debt, refinancing, and to restore our credit ratings in the global capital market.** At the same time, we have re-entered international capital markets through an issuance of a \$500 million, five-year sovereign bond, with a view to establish an effective international pricing benchmark to facilitate foreign investors in gauging Pakistan risk. In addition, we needed to extend a guarantee for borrowing by PIA on

highly favorable terms to proceed with its fleet renewal and build on its successful business turnaround. In the event, the contracting of new nonconcessional external debt will exceed the limit agreed under the existing PRGF arrangement for June 2004. In light of the rationales for these new borrowing needs, and given our improving debt capacity (including on account of the prepayment), we request that the limit in the contracting of nonconcessional loans be increased to \$1 billion.

### **C. Monetary and Exchange Rate Policy**

17. **Monetary policy will remain geared toward maintaining low inflation.** The risks for a further upsurge in inflation are expected to be limited because of weak import prices of most nonenergy products, the strong Pakistani rupee, and the positive outlook for agricultural output. Nevertheless, with average inflation close to the target, and given the rapid pace of monetary expansion, including strong growth of private sector credit, rising wholesale and asset prices, and the very low level of short-term interest rates, the SBP will continue to carefully monitor inflation developments. The SBP has already tightened its policy stance slightly in the last few months—short-term interest rates have already begun to rise marginally—and will be ready to tighten further should any renewed inflationary pressures arise. In addition, the SBP has reduced its purchases in the foreign exchange market in recent months to help slow down the rate of monetary expansion and contain inflationary pressures. For the months ahead, SBP operations in the foreign exchange market will be limited to smooth short-term fluctuations, and the SBP will not resist sustained pressures for the Pakistani rupee/U.S. dollar exchange rate to appreciate.

18. **Monetary projections for end-June 2004 have been revised to take into account the stronger-than- envisaged demand for money so far in 2003/04.** Broad money is now expected to grow by about 17½ percent in 2003/04. The indicative monetary program for 2004/05 assumes a modest further strengthening in money demand, with broad money and reserve money growing by 12.8 percent and 9.3 percent, respectively.

### **D. Structural Policies**

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

19. **We will continue to build on the considerable progress already made in tax policy and administration reform.** The 2004/05 budget will contain measures removing income and sales tax exemptions, as well as other base-broadening measures, yielding a total of PRs 5 billion. In addition, we intend to implement an action plan on extending GST coverage to additional services after approval of the cabinet and provincial governments /legislatures. Furthermore, in line with our strategy to rationalize our tax and tariff regime, in order to stimulate private investment, the 2004/05 budget will continue to reduce the corporate income tax rates, as per the pre-announced roadmap in the income tax ordinance, reduce excise rates on certain products, and rationalize import duties on raw materials and equipment. Following the success of the LTU in Karachi, a second LTU will be established

in Lahore by end-August 2004. In addition, two MTUs will be made operational by end-June 2004, and three more are going to be established in regional centers by end-August. A pilot customs house in Karachi will begin its operations by end-June 2004, featuring 24-hour processing of entry, electronic filing of declarations by importers on a self-assessment basis, and parameter and risk-based auditing.

### **Public expenditure management and transparency**

20. A more regular monitoring of social indicators will help our efforts to increase the effectiveness of social- and poverty-related spending. A full Core Welfare Indicators Questionnaire (CWIQ), covering 77,000 subjects throughout the country, started in June 2004. The results from this survey will become available in time to serve as input for the 2005/06 budget discussions. We have broadened the definition of social- and poverty-related spending to include law and order, justice, and rural electrification; as the PRSP consultation process made it clear that these policy areas are important for addressing rural poverty.

21. **We aim to make further progress in strengthening expenditure management and fiscal transparency.** In 2003/04, we released budgetary funds on a timely basis, and thus allowed ministries to operate without facing financing constraints. Consequently, we were able to largely execute our spending plans on social and poverty-related expenditures, as well as the Public Sector Development Program (PSDP). Further improvements have been made in reconciliation of fiscal data. With support from the U.K.'s Department for International Development (DFID), we have begun developing a medium-term budget framework. A pilot costing and projection exercise was undertaken to improve budgeting health and population welfare ministries. Based on lessons learned, consultancy support is being arranged to develop a costing model that can assist the two ministries in budgeting their expenditure. Subsequently, the model will be rolled out to all other ministries. A Government Finance Statistics (GFS) compatible New Accounting Model (NAM) is being used for the 2004/05 budget for the federal government. The North West Frontier Province is undertaking this exercise in a parallel mode. The NAM-based accounting is being introduced in the provinces in a phased manner.

22. **Further progress is being made in the implementation of our national anti-corruption strategy.** The National Accountability Bureau (NAB) has been focusing on raising awareness, enforcement, and prevention. The NAB is working in close coordination with the provincial anti-corruption agencies. Vigilance units have been set up in several government departments, to which the NAB provides support. An awareness campaign has been started with workshops and discussions in civil service academies, banks, and other private sector bodies, and a broad media campaign was started in January 2004. We will continue our efforts to contain the "*Benami*" practice (whereby assets are held in the name of a person who is not the true beneficiary). The "*Benami*" task force submitted its report to the cabinet in October 2003, and we will start implementing the recommendations after approval by the Cabinet and provinces and initiate legislation to prohibit "*Benami*" transactions and holdings.

### **Financial sector**

23. A Financial Sector Assessment Program (FSAP) has been conducted to assess the strengths and vulnerabilities of Pakistan's financial sector. The FSAP will form the basis for a Financial System Stability Assessment (FSSA) that will be included with the documents provided to the IMF's Executive Board for the eighth review under the PRGF. The Cabinet has approved, in principle, a new anti-money laundering legislation. We will submit the draft law to the cabinet and subsequently to parliament by end-2004, at the latest.

24. As part of our strategy to transform the NSS into a modern savings institution, NSS rates will be adjusted semi-annually in line with changes in prevailing PIB yields for corresponding maturities, starting on July 1, 2004, as described by the formula in the attached amendments to the TMU. Over time, we intend to transform the NSS into a modern savings institution, probably in the form of a mutual fund.

### **Energy sector, public enterprises, and privatization**

25. **We hope to accelerate reforms in the power sector.** While the financial performance of WAPDA and KESC has been better than envisaged in their FIPs, progress in addressing underlying structural problems through improved bill collection—notably in the Federally Administered Tribal Areas (FATA)—reducing losses, and tariff reform has proven to be very difficult. In light of this, the government is working with the World Bank within the framework of a Poverty Reduction Support Credit (PRSC) to prepare a medium-term adjustment program for the sector. This program will aim to eliminate the sector's drain on the budget by improving governance and accountability, including by accelerating privatization, reducing costs, reforming tariff and subsidy policies, and establishing a policy framework that ensures that investments are fully funded to achieve expanded access, increased reliability, and lower costs necessary to support rapid economic growth.

26. **We are in the process of re-articulating our electricity tariff framework.** As a first step, the government will issue the broad principles of regional electricity tariff determination by end-May 2004. In addition, we will announce our subsidy policy for regional tariff setting and its financing in July 2004. This framework, which is being prepared in close consultation with the World Bank, will allow for differentiated electricity tariffs by region, with tariffs based on cost of production and services (including capital cost). The principles will clarify the respective roles of the government, NEPRA, and the power companies in the setting of tariffs, and they will limit departures in actual tariff adjustments by distributors from NEPRA's determination to well-specified cases of exceptional temporary spikes in oil prices.

27. **NEPRA will determine the structural tariffs for each of WAPDA's successor entities based on the newly established tariff framework.** In addition, electricity tariffs for KESC and WAPDA (and its successor companies) will continue to be adjusted each quarter in line with NEPRA's Automatic Tariff Adjustment. The government will notify tariffs as



determined by NEPRA within 30 days; new tariffs will take effect on the day of notification. However, any downward tariff adjustments in the last quarter of 2003/04, or the first quarter of 2004/05, 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 levels targeted in Table 1(a).

28. **Following the notification of the (structural) tariffs, individual Financial Recovery Plans (FRPs) will be finalized for the WAPDA successor companies.** These FRPs will be prepared in close coordination with the World Bank and will be finalized no later than end-July 2004. They will set detailed multiyear operational and financial targets and include both short-term actions to facilitate improvements in financial viability and a medium-term plan to advance the privatization of the sector and enhance competition. In addition to preparing FRPs, we will improve the management environment for the WAPDA successor companies by making them report directly to the ministry of water and power as the active shareholder. We will also strive to appoint professional management to head the successor entities and will provide them with measurable targets and an adequate incentive structure to reward overperformance and deal effectively with underperformance.

29. **We will also continue with the regular adjustment of other energy prices to reflect world market developments.** For petroleum products, this will continue to involve fortnightly adjustments in line with import costs, while maintaining stable average tax rates, except for exceptional spikes in international prices. For gas (wellhead and consumer prices), it will involve application of the gas pricing framework agreed with the World Bank through semiannual adjustments.

30. **We will continue with our privatization program.** Since the fall of 2003, we sold a majority share in HBL, as noted above, and successfully launched public offerings of shares in the National Bank of Pakistan, the Oil and Gas Development Company Limited, and the Sui Southern Gas Corporation Limited. For the near future, we expect to sell majority stakes in Pakistan State Oil, National Refinery Limited, KESC, Faisalabad Electric Supply Corporation, and the Jamshoro generation company, as well as a minority stake in Pakistan International Airlines, Pakistan Petroleum Limited, and Kot Addu Power Company Limited through public offerings.

#### IV. OTHER ISSUES

##### **Program financing**

31. **The program remains fully financed through end-2004.** We will ensure that conditions attached to expected loan disbursements of the World Bank and AsDB are met. All (but one) bilateral agreements with the Paris Club creditors have been signed, with the remaining one (with the Russian Federation) expected to be concluded soon. Discussions are ongoing with creditors on debt swaps (cancellations) for additional social expenditures. We

will keep Fund staff informed about the discussions with creditors and ensure that implementation of any swaps will be consistent with the financial program.

**Program monitoring**

32. **The ninth review will be the last one under the current arrangement.** The ninth review will be based on end-June 2004 data and will allow for the tenth disbursement in the amount of SDR 172.28 million on, or after, September 20, 2004. The proposed structural performance criteria and benchmarks for April–August 2004 and revised quantitative performance criteria and indicative targets for end-June 2004 are listed in Tables 2(b) and 1(a), respectively.

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

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

	2003			2004							
	End-September			End-March							
	End-June Stock	Prog.	Adj. Prog.	End-December Prog.	Adj. Prog.	End-June Rev. Prog.					
Net foreign assets of the SBP (floor in millions of U.S. dollars)*	8,068.4	495.0	246.4	708.4	833.0	390.2	1,191.7	996.0	185.8	1,048.2	1,489.0
Net domestic assets of the SBP*	201.3	-12.6	1.8	-52.4	13.4	39.1	7.2	-1.3	45.8	41.7	-10.5
Overall budget balance (floor)*	...	-77.0	-77.0	-41.7	-126.3	-126.3	-33.7	-163.7	-163.7	-71.2	-179.2
Net government bank borrowing*	511.2	43.5	57.5	9.9	53.1	78.9	-9.7	40.9	100.2	53.6	20.2
CBR revenue (floor)*	...	92.2	...	95.3	218.1	...	230.9	347.5	...	354.6	510.0
Net banking sector claims on public sector enterprises*	69.1	1.0	...	-17.2	2.7	...	-24.9	4.3	...	-32.8	6.0
Social- and poverty-related spending (*I-PRSP budgetary expenditure <sup>2/</sup> )	...	40.7	...	39.5	81.4	...	80.2	131.4	...	128.6	185.1
WAPDA accrual balance	...	5.3	...	5.0	-3.9	...	3.0	-19.6	...	-3.9	-19.2
KESC accrual balance	...	-4.4	...	-3.8	-8.2	...	-6.6	-12.4	...	-8.2	-15.3
							(In billions of Pakistani rupees)				
							(In millions of U.S. dollars)				
Outstanding stock of short-term external debt owed or guaranteed by the government and the SBP*	...	500.0	...	250.9	500.0	...	189.6	500.0	...	138.8	500.0
Contracting or guaranteeing of noncessional medium-term and long-term debt by the government* 2/	...	600.0	...	104.2	600.0	...	454.2	750.0	...	954.2	1,000.0
Accumulation of external payments arrears (continuous performance criterion during the program period)*	...	0.0	...	0.0	0.0	...	0.0	0.0	...	0.0	0.0
SBP's forex reserves held with foreign branches of domestic banks (outstanding stock)	0.0	0.0	...	69.8	70.0	...	68.4	70.0	...	69.8	70.0
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*	...	400.0	...	45.0	400.0	...	45.0	400.0	...	45.0	400.0
Memorandum items:											
Net external program financing	...	105.9	...	-164.2	59.3	...	-461.7	-239.1	...	-1,084.0	132.7
Of which: privatization proceeds	...	25.0	...	0.0	50.0	...	0.0	75.0	...	198.7	100.0
External cash budget grants	...	22.5	...	44.0	55.6	...	133.8	148.3	...	183.0	148.3
External capital grants	...	0.0	...	0.0	0.0	...	0.0	0.0	...	0.0	0.0
External privatization budget receipts	...	17.2	...	0.0	51.6	...	0.0	86.1	...	0.0	120.5
Daily cash reserve requirements ratio (in percentage points)	4.0	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)	15.0	15.0	...	15.0	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-December 2003, and end-June 2004 program flows represent ceilings (or floors, if indicated) that constitute performance criteria. All other targets are indicative.

2/ Excluding PRGF loans.

Table I(b). Pakistan: Quantitative Targets, September 2004–June 2005 1/

(Cumulative flows from July 1, 2004, unless otherwise specified)

	2004		2004		2005	
	End-June Stock Proj.	End-Sept. Proj.	End-Dec. Proj.	End-Mar. Proj.	End-Jun. Proj.	
Net foreign assets of the SBP (floor in millions of U.S. dollars)	9,861.1	208.8	-194.5	7.5	-52.5	
		(In billions of Pakistani rupees)				
Net domestic assets of the SBP	204.8	-8.9	39.3	61.3	75.4	
Overall budget balance (floor)	...	-78.5	-115.9	-160.1	-199.2	
Net government bank borrowing	...	15.0	30.0	70.0	90.0	
CBR revenue (floor)	...	110.0	255.0	400.0	576.0	
Net banking sector claims on public sector enterprises	36.3	1.0	2.0	3.0	4.0	
Social- and poverty-related spending ("1-PRSP budgetary expenditure") 2/	...	59.8	119.2	159.2	278.0	
<i>Memorandum items:</i>		(In millions of U.S. dollars)				
Net external program financing	...	247.7	-823.6	-809.9	-926.2	
<i>Of which:</i> privatization proceeds	...	0.0	0.0	99.0	99.0	
External cash budget grants	...	0.0	315.0	315.0	330.0	
External capital grants	...	0.0	0.0	0.0	0.0	
External privatization budget receipts	...	...	...	...	15.0	
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 adjusters specified in the TMU. All program flows are indicative ceilings or floors as indicated.

2/ Expanded definition as described in the December 2003 PRSP.

Table 2(a). Pakistan: Structural Performance Criteria and Benchmarks  
Under the PRGF Arrangement for the Eighth Review

Measures	Timing	Status as of April 15, 2004
<b>I. Structural Performance Criteria</b>		
No new exemptions (as per status of March 1, 2003) 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	Observed.
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	Not observed. Electricity tariffs for WAPDA were reduced in November 2003, despite that the quarterly accrual balance target for Q1 was missed by a small margin. However, the decrease took place only once it became clear that targets for the first half of the year would be respected. Accrual balance targets for the first half of the year were met comfortably.
Publish quarterly progress reports on implementation of financial improvement plan of WAPDA/successors.	November 30, 2003 for the quarter July–September 2003, February 29, 2004 for the quarter October–December 2003, May 31, 2004 for the quarter January–March 2004, and August 31, 2004 for the quarter April–June 2004.	Observed for the first, second, and third quarters.
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	Partially observed. An action plan was prepared on time. However, the plan stated that the framework for regional tariff setting would be announced by end-February 2004, rather than by end-December 2003.
Privatize Habib Bank Limited through effective transfer of majority ownership to private investors.	December 31, 2003	Not observed. A bid was accepted on December 29, 2003. Transfer of ownership and management, however, was completed by end-February 2004.

Table 2(a). Pakistan: Structural Performance Criteria and Benchmarks  
Under the PRGF Arrangement for the Eighth Review (concluded)

Measures	Timing	Status as of April 15, 2004
Adjust NSS rates to reflect PIB yields according to formula set in the amendment to the Technical Memorandum of Understanding (TMU).	January 1, 2004	Observed.
Government to notify electricity tariff adjustments determined by NEPRA within 30 days of their determination (effective on day of notification).	Continuous from January 1, 2004	Not observed. Downward tariff adjustment for KESC determined by NEPRA on January 15, 2004 was notified on April 15, 2004.
<b>II. Structural Benchmarks</b>		
Submission to cabinet by the “ <i>Benami</i> ” taskforce of a report setting out the results of consultation with stakeholders and provincial governments and proposing specific legislation to limit enforceability of “ <i>Benami</i> ” transactions and holdings.	October 31, 2003	Observed. Submitted to cabinet in October 2003.
Submit to cabinet an action plan on extending the coverage of the GST to additional services.	February 29, 2004	Now targeted for end-July 2004.
Establish a new formula in consultation with Fund staff that will align NSS rates to government bonds of the same maturity.	March 31, 2004	New formula was established in April 2004.

Table 2(b). Pakistan: Structural Performance Criteria and Benchmarks  
Under the PRGF Arrangement for the Ninth Review

Measures	Timing	Related to
<b>I. Structural Performance Criteria</b>		
No new exemptions (as per status of March 1, 2003) 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	
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	
Publish quarterly progress reports on implementation of financial improvement plan of WAPDA/successors.	May 31, 2004 for the quarter January–March 2004, and August 31, 2004 for the quarter April–June 2004.	10 <sup>th</sup> disbursement
Government to notify electricity tariff adjustments determined by NEPRA within 30 days of their determination (effective on day of notification).	Continuous	
Propose to Parliament removing income and sales tax exemptions and adopt other tax-base broadening measures yielding a total of PRs 5 billion in estimated revenues in the context of the 2004/05 budget.	June 30, 2004	10 <sup>th</sup> disbursement
Set up a pilot customs house in Karachi that will involve entry processing on a 24-hour basis, electronic filing of declarations by importers on a self-assessment basis, and parameter and risk-based audits.	June 30, 2004	10 <sup>th</sup> disbursement
Promulgation of a federal budget for FY 2004/05 consistent with a consolidated overall budget deficit (excluding grants) not exceeding PRs 199.2 billion.	June 30, 2004	10 <sup>th</sup> disbursement
Adjust NSS rates to reflect PIB yields according to formula set in the amendment of the Technical Memorandum of Understanding (TMU).	July 1, 2004	10 <sup>th</sup> disbursement
Announce tariff and subsidy policy for regional electricity tariff setting, as further specified in paragraph 26 of the MEFP.	July 31, 2004	10 <sup>th</sup> disbursement

Table 2(b). Pakistan: Structural Performance Criteria and Benchmarks  
Under the PRGF Arrangement for the Ninth Review (concluded)

Measures	Timing	Related to
Publish Financial Recovery Plans for WAPDA and its successor entities, prepared in consultation with the World Bank, including financial targets for the power utilities, as specified in paragraph 28 of the MEFP.	July 31, 2004	10 <sup>th</sup> disbursement
<b>II. Structural Benchmarks</b>		
Set up two additional medium taxpayers units.	June 30, 2004	
Open second large taxpayers unit in Lahore	August 31, 2004	







### Amendments to the Technical Memorandum of Understanding

1. In the first sentence of paragraph 16 (original numbering of the May 29, 2003 version), “less external privatization receipts as reported in the balance of payments, plus external privatization receipts as reported in the fiscal accounts of the consolidated government” will be inserted after “The ceiling on **net bank borrowing by the government** will be adjusted downward/upward by the cumulative excess/shortfall in net external program financing.”
2. Paragraph 15 (new numbering after the amendments made in the sixth and seventh reviews) will be replaced with: “For purposes of the performance criterion on applying the revised formulas on adjusting NSS rates to reflect PIB yields, the formulas are defined as follows:

For Special Savings Certificates (3 years), the yield is set as

$$Y_3 = (3 * AP_3 + Z) / 3 + 0.45$$

With  $AP_3$  being the average annual PIB yield realized over the last 6 months:

$$AP_3 = \sum (\text{amount realized in auction } j) / (\text{amount realized over last 6 months}) * P_{3,j}$$

And  $P_{3,j}$  being the annual 3-year PIB yield realized in auction  $j$  (coupon rate is semi-annual)

$$P_{3,j} = (2 * \text{coupon rate} * \text{bid amount}) / \text{amount realized}$$

For Regular Income Certificates (5 years), the yield is set as

$$Y_5 = AP_5 + 0.45$$

With  $AP_5$  being the average annual 5-year PIB yield realized over the last 6 months:

$$AP_5 = \sum (\text{amount realized in auction } j) / (\text{amount realized over last 6 months}) * P_{5,j}$$

And  $P_{5,j}$  being the annual 5-year PIB yield realized in auction  $j$  (coupon rate is semi-annual):

$$P_{5,j} = (2 * \text{coupon rate} * \text{bid amount}) / \text{amount realized}$$

For Defense Savings Certificates (10 years), the yield is set as

$$Y_{10} = [ [(1 + AP_{10}/100)^{2*10} * (1 + Z/100)]^{1/10} - 1 ] * 100 + 0.45$$

With  $AP_{10}$  being the average semi-annual 10-year PIB yield realized over the last 6 months:

$$AP_{10} = \sum (\text{amount realized in auction } j) / (\text{amount realized over last 6 months}) * P_{10,j} / 2$$

And  $P_{10,j}$  being the annual 10-year PIB yield realized in auction j (coupon rate is semi-annual):

$$P_{10,j} = (2 * \text{coupon rate} * \text{bid amount}) / \text{amount realized}$$

Where:

- $n$  = maturity in years
- $Y_n$  = yield on NSS instrument with n-year maturity (in percent)
- $P_{n,j}$  = yield on PIB with n-year maturity realized in auction j (in percent)
- $AP_n$  = average yield on PIB with n-year maturity (in percent)
- $Z$  = zakat rate (in percent) withheld on principle and yield at time of encashment or maturity (2.5)''

**Statement by the IMF Staff Representative  
June 23, 2004**

1. This statement summarizes information that has become available since the staff report for the eighth review under Pakistan's Poverty Reduction and Growth Facility (PRGF) arrangement was circulated to the Board on June 9, 2004. It does not change the thrust of the staff appraisal.

2. **In addition to strong external and consumer demand, there has been a significant increase in private investment in 2003/04.** The government's annual Economic Survey, published on June 10, shows that fixed investment increased by an estimated 1.6 percentage points to 16.4 percent of GDP in 2003/04 (July–June). Private investment has picked up significantly in the manufacturing and services sectors, as well as in housing. For 2004/05, the authorities are now targeting 6.5 percent economic growth, slightly higher than the projection in the staff report.

3. **The results of a new household survey suggest a reduction in poverty.** To gauge the impact of the economic policies of the past few years, the authorities conducted a small-scale household survey in April–May of this year, the results of which were presented in the government's Economic Survey. This survey used a different methodology and was less comprehensive than the full-scale Household Consumption Expenditure Survey or the Core Welfare Indicators Questionnaire, both of which will be launched shortly, but for which results will become available only in 2005. The survey does indicate an improvement in social indicators (see Table). The reduction in poverty appears to have been most pronounced in urban areas, reflecting the rapid expansion in manufacturing and services that has provided more employment opportunities.

Pakistan: Selected Social Indicators

	1998/99	2000/01	2004
	(In percent)		
Poverty rate			
National	...	27.3	23.1
Urban	...	23.1	13.6
Rural	...	30.6	28.4
Living conditions			
Housing units with one room	38.1	...	25.0
Housing units with 1-4 rooms	55.0	...	68.3
Electricity (as source of lightning)	70.5	...	83.7
Education			
Population ever attended school	50.0	51.0	57.0
Net enrollment 5-9 years	42.0	42.0	56.0
Net enrollment 10-12 years	16.0	16.0	20.0
Net enrollment 13-14 years	9.0	9.0	12.0

Source: Pakistan Economic Survey 2003/04.

4. **Consumer prices continued to rise in May.** Twelve-month inflation rose further to 7.1 percent in May, while prices in the period July 2003–May 2004 were 4.2 percent higher compared to the corresponding period of the previous year. Core inflation has been edging upwards as well, but is still lower at 3.6 percent during July 2003–May 2004 compared to the same period of the previous year. Annual average inflation for 2003/04 as a whole is expected to slightly exceed the 4 percent target. The State Bank of Pakistan is continuing to gradually tighten its monetary policy and both short- and long-term interest rates have moved up further.

5. **The fiscal and monetary outlook for 2003/04 remain as envisaged in the staff report.** Quantitative performance criteria for end-June will probably be met. The external current account surplus may turn out slightly lower than projected in the staff report, as imports have accelerated somewhat in the last quarter. Some early repayments of external debts by public and private corporations are impacting the capital account. As a result, foreign exchange reserves declined slightly in the fourth quarter, although the end-June target should still be achieved.

6. **The 2004/05 federal budget that was submitted to parliament on June 12 is consistent with the agreed consolidated deficit (excluding grants) of PRs 199 billion** (4 percent of GDP). Revenue and expenditure aggregates are also broadly in line with the numbers presented in the staff report. The draft budget contains a number of proposed measures to broaden the tax base as planned under the program, including elimination of the sales tax exemption on cotton seed and introduction of a tax on share purchases. In addition, the draft contains several proposals to streamline tax rates and customs duties with a view to promote investment, as well as some proposals to extend existing exemptions and possibly introduce a few new ones (which, if implemented, could be a breach of a performance criterion). Key tax measures are: (i) to streamline the sales tax regime by putting most effective rates at 15 percent; (ii) to exclude all plant, machinery, and equipment from sales tax and tax withholding, and to reduce import duties on these items if they are not produced locally; and (iii) to significantly reduce import duties on cars (many of which are currently over 100 percent). Overall, the tax measures are likely to have a modest negative impact on tax revenues. The authorities also announced an increase in government wages by 15 percent and pensions by 8 to 16 percent, although the financial impact of this measure had not yet been reflected in the budget proposal. The authorities indicated that this increase will be accommodated by higher non-tax revenues. The 2004/05 budget is expected to be approved by end-June. As envisaged under the program, the staff will make a full assessment of the budget as approved by parliament during the ninth review under the PRGF.

7. **Petroleum surcharge rates were returned closer to the levels prevailing prior to the latest spike in petroleum prices.** This was made possible by the recent decline in international petroleum prices, which was not passed on to domestic consumers in the fortnightly adjustment made on June 15. International prices would have to decline further to allow the surcharge rates to return fully to their original levels. If international prices were to remain at their current levels, however, or go back up, the authorities will have to accept an increase in domestic petroleum prices if they are to avoid a major revenue shortfall.



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FOR IMMEDIATE RELEASE  
June 23, 2004

International Monetary Fund  
Washington, D.C. 20431 USA

**IMF Executive Board Completes Eighth Review Under Pakistan's PRGF-Supported Program and Approves Disbursement Amounting to US\$253 Million**

The Executive Board of the International Monetary Fund (IMF) today completed the eighth review of Pakistan's performance under a three-year, SDR 1.034 billion (about US\$1.52 billion) Poverty Reduction and Growth Facility (PRGF) arrangement. Completion of the review enables the release of a further SDR 172.28 million (about US\$252.60 million) under the arrangement, which would bring total disbursements to SDR 861.42 million (about US\$1.263 billion).

In completing the review, the Executive Board also approved Pakistan's request for waivers for the non-observance of certain structural performance criteria and for the modification of one of the end-June 2004 quantitative performance criteria.

Following the Executive Board's discussion of Pakistan's economic performance, Agustín Carstens, Deputy Managing Director and Acting Chair, stated:

"Pakistan has come a long way in a short period of time in the context of the three-year arrangement under the PRGF, and there was strong macroeconomic performance during the first nine months of 2003/04. GDP growth accelerated further, inflation remained within target, and significant surpluses in the external balance were achieved. In addition, the fiscal deficit was lower than expected, and tax collections were slightly higher than projected. Poverty-related expenditures grew by 28 percent over the same period in the previous fiscal year.

"Structural reforms were further advanced. Financial and tax administration reforms were implemented broadly as envisaged, and energy prices and tariffs were adjusted in line with international prices.

"Far-reaching reforms have also resulted in a more efficient and competitive financial system. In particular, the predominantly state-owned banking system has been transformed into one that is predominantly under the control of the private sector. The legislative framework and the State Bank of Pakistan's supervisory capacity have been improved substantially. As a result, the financial sector is sounder and exhibits an increased resilience to shocks. Looking ahead, it will be important to continue to restructure the banking system, and to implement the recommendations of the recent assessment of the financial sector under the FSAP.

“The macroeconomic policy framework for 2004/05 is broadly appropriate. Fiscal policy aims to further increase poverty-related expenditures while reducing the public debt burden. Accordingly, the 2004/05 budget envisages a consolidated fiscal deficit of 4.0 percent of GDP and an increase in poverty-related expenditures. Monetary policy will continue to be geared toward reining in inflationary pressures, and the exchange rate will continue to be managed flexibly.

“Continued prudent debt management remains a key priority. The early repayment of some relatively expensive external debt is commendable, as well as Pakistan’s successful return to international capital markets in early 2004.

“To maintain or accelerate the current growth momentum and make continued progress on poverty reduction, the authorities need to steadfastly pursue their reform agenda to further improve the environment for private sector investment, along the lines envisaged in Pakistan’s Poverty Reduction Strategy Paper. It will be essential to press ahead with the ongoing reforms to simplify the tax system and broaden the tax base. In the energy sector, measures should be implemented to contain demands on the budget while improving service delivery and putting power utilities on a sound financial footing over the medium term. This will require close collaboration with the World Bank,” Mr. Carstens said.

The PRGF is the IMF’s concessional facility for low-income countries. PRGF loans carry an annual interest rate of 0.5 percent, and are payable over 10 years with a 5 1/2 –year grace period on principal payments. Pakistan’s PRGF arrangement ([see Press Release No. 01/51](#)) was approved on December 6, 2001 and is due to expire in December 2004. The Pakistani authorities have stated that they do not intend to request a successor arrangement.



**Statement by Abbas Mirakhor, Executive Director for Pakistan  
June 23, 2004**

**Introduction**

My authorities express their appreciation to the staff, management, and the Executive Board for their advice and continued support, and concur with the thrust of the balanced staff report. Their firm commitment to the implementation of sound policies, aided by robust capital inflows and external assistance, has resulted in continued strong performance under their PRGF-supported program despite ongoing regional security problems and high international oil prices. All quantitative performance criteria for end-December 2003 were met as well as most indicative targets for end-September 2003, end-December 2003, and end-March 2004. The authorities seek waivers for the non-observance of structural performance criteria relating to: a) effective transfer of ownership of Habib Bank Limited by end-December 2003; b) preparation of an action plan by end-October 2003 for establishing a transparent regulatory framework for regional electricity tariff setting by end-December 2003; c) notification of electricity tariff adjustments within 30 days of determination by the National Electric Power Regulatory Agency (NEPRA); and d) non-implementation of downward electricity tariff adjustment determined by NEPRA unless the respective utility met its accrual balance target in the previous quarter.

The effective transfer of ownership of Habib Bank Limited was delayed until February 2004 to accommodate the investor. The tariff setting framework was announced in early-June 2004. The downward tariff adjustment for the Karachi Electric Supply Company (KESC), determined by NEPRA in mid-January 2004, was implemented in mid-April after confirming that the accrual balance of the preceding quarter was met and allowing time for discussions on the overall subsidy policy. Finally, the downward electricity tariff adjustment for the Water and Power Development Authority (WAPDA) in November 2003 was implemented only after the authorities were assured that WAPDA would meet its cumulative end-December 2003 accrual balance target, which it did by a comfortable margin. The authorities also request modification of the performance criterion on contracting nonconcessional loans to accommodate a larger-than-expected guarantee for external borrowing by Pakistan International Airlines, which the company will service out of its own resources. The airlines has recently performed quite strongly.

**Recent economic developments**

As indicated in the staff paper, macroeconomic performance in 2003/04 continues to be very strong. Growth is accelerating and broad-based, and is expected to reach 6.4 percent, substantially higher than projected, suggesting that reforms are starting to bear fruit. Moreover, as announced by the Finance Minister in his Budget Speech for 2004/05, a recent survey shows that sustained growth has also resulted in a tangible reduction of poverty and improvement in living standards over the last three years. Inflation has edged up modestly, driven by oil and wheat prices, and the authorities have appropriately begun to tighten monetary policies to ensure that inflation targets are met. The central bank will respond to

contain inflationary pressures in a measured way that does not disrupt the momentum of the incipient growth which has set in this year. The external situation has been consolidated with a continued current account surplus, excluding official transfers, a strong reserve position, and a broadly stable Pakistani rupee, reflecting buoyant export performance and private transfers. This has allowed Pakistan to pre-pay expensive external debt to the Asian Development Bank, thus reducing external vulnerabilities and future debt servicing requirements. The higher-than-projected imports, increase in oil prices, and repayments of external debt by private and public sector borrowers has led to effective depreciation of the rupee in the recent months and the pressures for appreciation have subsided.

The overall fiscal deficit in the first half of 2003/04 was much lower than targeted, reflecting improved revenue collection and lower spending. Nonetheless, social- and poverty-related expenditures (under the program definition) are well on track to reach their annual target of 4.2 percent of GDP. The higher-than-projected growth of monetary aggregates originated mainly from higher net credit to the private sector, which is an encouraging sign that financial intermediation is strengthening and supporting economic growth across all sectors. Of particular note is the successful return of Pakistan to the international capital markets with a Eurobond issue which was hugely oversubscribed, thus taking the first step of a smooth transition from PRGF to market financing as the current arrangement expires.

Solid progress was made in implementing structural reforms. Except for some technical delays, all structural performance criteria and benchmarks under the program were met. Habib Bank Limited was privatized, and more than 75 percent of the banking sector is now in private hands. Returns on National Savings Schemes certificates were adjusted in line with Pakistan Investment Bond yields in January 2004, and a simplified and more transparent alignment formula has been prepared to become effective as of July 2004. A medium-term budget framework is being developed, with pilot costing and projection exercises in the health and the population welfare ministries. The new accounting model will be used for the 2004/05 federal budget. KESC and WAPDA are well on track to meet their respective financial improvement plan targets, and NEPRA determined electricity tariffs have been implemented. Progress has been made towards the unbundling of WAPDA, and a regional electricity tariff framework has been announced. A report on the benami practice was prepared, and the authorities are now in the process of drafting a law that would limit the enforceability of benami transactions and holdings. The PRSP, which was published in December 2003 after a widespread consultation process, has outlined the future reform agenda envisioned to achieve high and sustained growth and substantially reduce poverty over the medium term.

### **Financial System Stability Assessment (FSSA)**

My authorities appreciate the open and constructive discussions during the Financial Sector Assessment Program mission that finally took place after several delays. The FSSA documents the many reform achievements in the financial sector, in particular the successful transformation of a state-dominated and weak banking system into one that is predominantly privately owned and characterized by significantly improved financial soundness indicators. As a result of the reforms, the financial system shows improved resilience to risks. Many of

the issues raised in the FSSA to consolidate reform gains are being addressed in the authorities' reform program.

### **The outlook for FY 2004/05**

The authorities intend to continue fiscal prudence and envisage some further modest tightening of monetary policy to maintain the low inflation environment. Against this background and with increasing private and public investment, they are more optimistic than staff and expect the current growth momentum to continue in 2004/05 and accelerate over the medium term.

Fiscal policy will be geared towards further debt reduction, while raising social and poverty-related spending as well as public investment to remove infrastructure bottlenecks, which is crucial for sustained high growth. Central Board of Revenue collection is being strengthened through base broadening, elimination of additional income and sales tax exemptions, and further improvement in administrative efficiency. Falling interest expenditures would provide additional fiscal space. The authorities decided to buffer the impact of the recent dramatic increase in oil prices through a temporary reduction in petroleum tax rates. This became necessary to safeguard growth and to insulate vulnerable groups from dramatic cost of living increases. With oil prices falling somewhat from their peak, tax rates have been increased again and will eventually be restored. Any possible revenue loss will be offset within the budget envelope, while social and poverty related expenditures will be protected.

Monetary policy will aim at maintaining low inflation. Weak import prices of most nonenergy products, the strong Pakistani rupee, and the positive outlook for agricultural products are expected to limit further increases in inflation. Nevertheless, in light of the rapid pace of monetary expansion, the low level of short-term interest rates, and average inflation close to target, the authorities will continue to closely monitor inflation developments. The process of gradual and modest tightening will continue for some time and will be accelerated in case inflationary pressures do not subside. The authorities will limit foreign exchange interventions to smoothing short-term fluctuations and will not resist exchange rate appreciation which should reduce the rate of monetary expansion from NFA accumulation.

The authorities remain committed to pursuing their structural reform agenda in order to strengthen the economy's growth potential and resilience to shocks. Several public enterprises, including KESC, are slated for privatization in light of growing investor interest as security concerns subside. The authorities are working closely with the World Bank to draw up a medium-term financial recovery plan for WAPDA that will curb demands on the budget while improving service delivery at competitive tariff rates. WAPDA's unbundling and the regional tariff framework will significantly contribute to this process.

In the financial sector, the FSSA recommendations will be taken up in the authorities' reform strategy. In particular, anti-money laundering legislation will be submitted to parliament soon. The authorities are also preparing the broad parameters of a private pension

scheme. Over the medium term, the National Savings Schemes will be transformed into a modern savings institution, probably in the form of a mutual fund.

## **Conclusion**

Pakistan has come a long way in a short time. Some five years after a debt crisis and a serious slowdown in economic growth, the country is emerging under the PRGF-supported program with a stronger economy, set for continued high and sustained growth that will translate into durable reduction of poverty. Macroeconomic performance has improved markedly, external vulnerabilities have been reduced, and Pakistan has regained access to private capital markets. Fund's advice and financial assistance have been important and highly valued inputs in the reform process.

As announced during the discussions under the sixth and seventh reviews, and as reiterated during the Budget Speech, the authorities remain strongly committed to exiting from Fund-supported programs once the current arrangement expires. However, they have repeatedly stated that exit from Fund arrangements does not mean abandoning the orderly and disciplined economic management painfully achieved. Indeed, they see that inconsistency and disruptive policy changes in the past were the major factors hindering Pakistan's ability to exploit its full potential. My authorities are grateful for the Fund's support and hope that they could continue to draw on its advice through regular consultation and technical assistance. They look forward to the Board discussion and advice as well as support for their request for waiver of non-observance of structural performance criteria, modification of one performance criterion, and completion of the eighth review under the PRGF arrangement.