INTERNATIONAL MONETARY FUND

IMF Country Report No. 13/287

PAKISTAN

September 2013

2013 ARTICLE IV CONSULTATION AND REQUEST FOR AN EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the combined discussion on the 2013 Article IV consultation with Pakistan and its request for an extended arrangement under the Extended Fund Facility, the following documents have been released and are included in this package:

- **Staff Report** for the 2013 Article IV consultation and Request for an Extended Arrangement Under the Extended Fund Facility, prepared by a staff team of the IMF, following discussions that ended on July 3, 2013, 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 August 22, 2013. 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.
- **Informational Annex** of August 20, 2013
- **Staff Supplement** of August 28, 2013, updating information on recent developments.
- **Press Release** summarizing the views of the Executive Board as expressed during its September 4, 2013 discussion of the staff report that concluded the Article IV consultation.
- **Statement by the Executive Director** for Pakistan.

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

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org Internet: http://www.imf.org

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

PAKISTAN

August 22, 2013

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION AND REQUEST FOR AN EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY

EXECUTIVE SUMMARY

Political and Economic Context: Recent Parliamentary elections resulted in a large victory for the Pakistan of Muslim League-Nawaz (PML-N) of Prime Minister Nawaz Sharif and led to the first democratic-to-democratic transition in Pakistan's history. This transition was reinforced by the July 30 election by legislators from the national parliament and the four provincial assemblies of a PML-N president, Mamnoon Hussain. The convincing win provides a strong mandate to implement a bold reform agenda required to lift Pakistan's growth potential, which deteriorated significantly over the past decade. This is due in part to the difficult regional security situation, which has discouraged investment, but it is also driven by periodic bouts of macroeconomic instability and long-standing structural impediments to growth—in particular energy bottlenecks.

Article IV Discussions: Discussions focused on macroeconomic policies to address vulnerabilities and reforms to promote robust inclusive growth. The authorities' ambitious economic program aims to reverse the current mix of large fiscal deficits, accommodative monetary policy, and low reserve coverage, which provides few buffers to absorb shocks. In this regard, staff and the authorities discussed immediate application of a package of short-term measures in fiscal and monetary policy aimed at reversing the unsustainable imbalances. The authorities acknowledged that these measures must be complemented by significant structural reforms in fiscal management, monetary and financial market institutions, the energy sector, public sector enterprises, the business climate, and trade policy. Staff advocated a substantial increase in targeted transfers to the poorest to compensate for the effect of fiscal consolidation and the reductions in untargeted subsidies.

Program Discussions: The authorities have requested a 36-month extended arrangement under the Extended Fund Facility (EFF) for SDR 4.393 billion (US$6.68 billion, 425 percent of quota). SDR 360 million ($540 million, 34.8 percent of quota) will become available upon Board approval, and the remainder will be evenly

phased thereafter subject to quarterly reviews. The Fund supported program aims to reduce the risk of a crisis in the short term and to address Pakistan's underlying medium-term problems to sustain higher and more inclusive growth. The authorities have already taken important measures to ensure a strong start and signal their commitment—including approving fiscal consolidation measures totaling 2 percent of the GDP, applying higher electricity tariffs as part of a comprehensive new energy policy, reorienting monetary policy to begin rebuilding foreign exchange reserves, and launching a new tax enforcement program. Quantitative Performance Criteria are set to reduce the government budget deficit to sustainable levels and reduce crowding-out of private investment, to recalibrate monetary policy to build reserves, and to reduce inflation over the medium-term. Structural conditionality is designed to strengthen the tax system, address energy bottlenecks, liberalize the trade regime, restructure or privatize public sector enterprises, improve the business climate, strengthen central bank operational independence, enhance financial sector stability, and protect the most vulnerable. The program carries significant implementation risks given Pakistan's track record, but they are mitigated by critical upfront actions and even phasing of Fund disbursements, as well as by the strong electoral mandate and commitment to reform of the new government.

Approved By
Daniela Gressani and Mark Flanagan

Discussions were held in Islamabad, Karachi, and Lahore during June 19-July 3, 2013. The staff team comprised Messrs. Franks (head), Salman, Shahmoradi (all MCD), Mr. Flores (FAD), Mr. Al-Hassan (MCM), and Ms. Das (SPR). Mr. Dailami (Resident Representative) assisted the mission. Ms. Gressani (MCD) and Mr. Sethi (OED) also participated in the discussions. The team met with Finance Minister Dar, State Bank of Pakistan Governor Anwar, Finance Secretary Khan, and other senior officials, as well as private sector and civil society representatives. Representatives from the World Bank and the Asian Development Bank took part in the discussions.

CONTENTS

FIGURES

TABLES

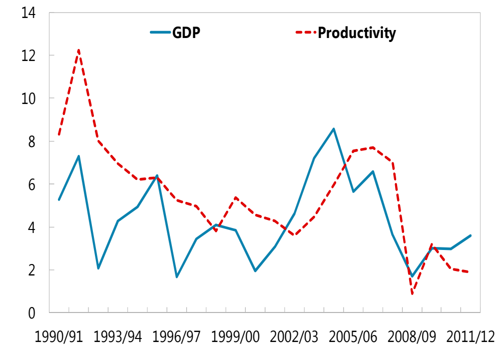
APPENDIX

ECONOMIC BACKGROUND

Macroeconomic imbalances, structural weaknesses, and security and political concerns have negatively impacted Pakistan's economy and kept growth below the level needed to reduce poverty and absorb the labor force.

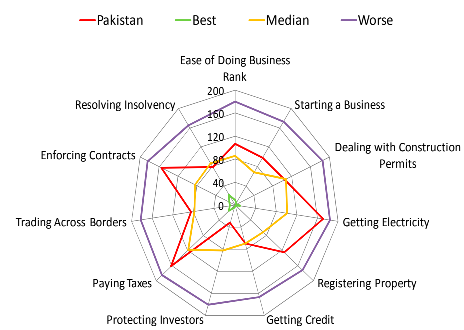
1. Economic performance in Pakistan has been substandard in recent years. GDP growth has averaged only 3 percent over the past five years, insufficient to significantly improve living standards or fully absorb the growing labor force. With the population still rising quickly, per capita income growth has lagged behind other South Asian economies (Figure 1). While reliable recent data on poverty is not available, in 2006 some 23 percent of the population lived on under US$1 a day. According the UNDP, 49.4 percent of the population lived in multidimensional poverty. Growth has also been more volatile in Pakistan, in part reflecting poor economic management. Severe problems with the electricity supply and a difficult security situation have been important factors in anemic growth. Productivity growth has fallen sharply over the past two decades, undermining the country's growth potential. International rankings also place Pakistan low in terms of business climate, governance, human development, and poverty, which also impair economic performance.

Pakistan: GDP and Productivity
(In y-o-y percent change)



Sources: Pakistani authorities; and IMF staff calculations.

Doing Business Rankings, 2013

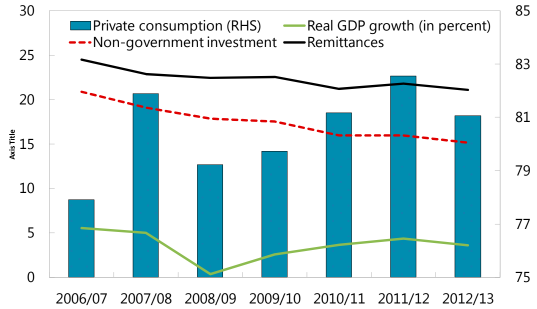


Sources: World Bank Doing Business indicators, 2013; and IMF staff calculations.

2. Private investment has fallen by nearly half over the past five years, reflecting sharp drops in both foreign and domestic investment. Domestic private investment dropped from 14 percent of GDP in 2007/08 to an estimated 10.9 percent of GDP in 2012/13 (Figure 2). Weak private sector credit growth has contributed to the decline—private credit has fallen in real terms in recent years, crowded out by rapidly rising public borrowing and a difficult macroeconomic environment. Foreign direct investment (FDI) peaked above 3 percent of GDP (well above other South Asia countries) in 2007/08, and has since fallen below ½ percent of GDP, putting further pressures on ailing international reserves. As a result, private consumption has been driving the aggregate demand, supported by workers' remittances and farm income.

Consumption and Investment

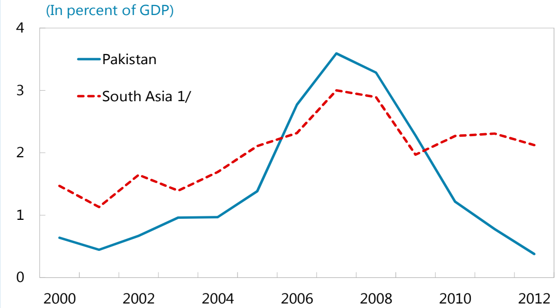
(In percent of GDP)



Sources: Pakistani authorities; and IMF staff calculations.

Foreign Direct Investment, 2000-2012

(In percent of GDP)



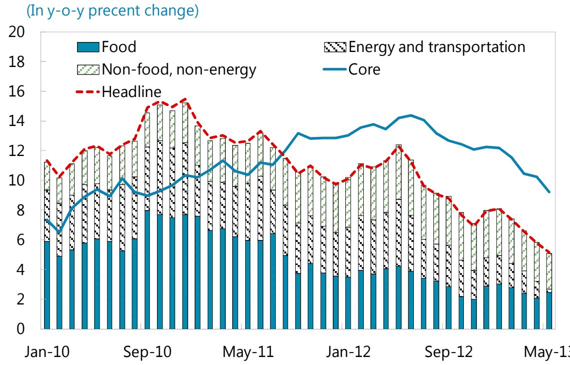
Sources: Pakistani authorities; and IMF staff calculations.

1/ South Asia countries include: Bangladesh, India, Indonesia, Malaysia, Nepal, Philippines, Sri Lanka, Thailand, and Vietnam.

3. **Headline inflation has fallen sharply in recent months, but underlying inflationary pressures remain**. Weak private sector demand, a gas tariff cut, and a good harvest helped the sharp decline in inflation. Annual headline inflation dropped from 11.3 percent in June 2012 to 5.9 percent in June 2013. Core inflation, measured by stripping food, energy and transportation components of the CPI, has also declined but remains above 9 percent. Broad money growth remains near 15 percent, driven in part by the State Bank of Pakistan's (SBP's) continued financing of the large fiscal deficit. A resurgence in inflation remains likely until fiscal deficits ease and money growth slows.

Contribution to CPI, January 2010–March 2013

(In y-o-y precent change)

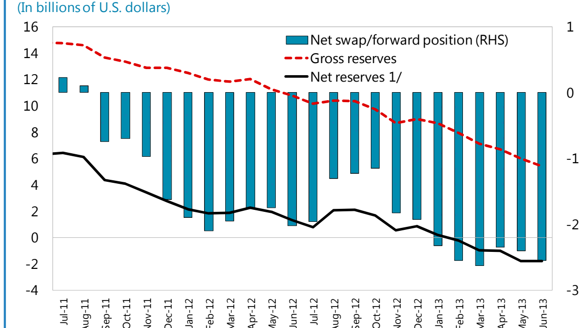


Sources: Pakistani authorities; and IMF staff calculations.

4. **The external position has weakened significantly and central bank reserves have declined to critical levels**. While the current account deficit in 2012/13[1] is estimated at under 1 percent of GDP, due to lower imports and strong revenues from remittances and bilateral inflows,[2] severe financial account shortfalls have produced the deterioration in reserves. Financial inflows have collapsed at the same time as debt service obligations (including to the Fund) have increased sharply (Tables 4, 8). Foreign direct investment has been meager and portfolio inflows have sunk. As a result, SBP gross reserves

SBP Net International Reserves and Net Swap/Forward Position, July 2011–June 2013

(In billions of U.S. dollars)



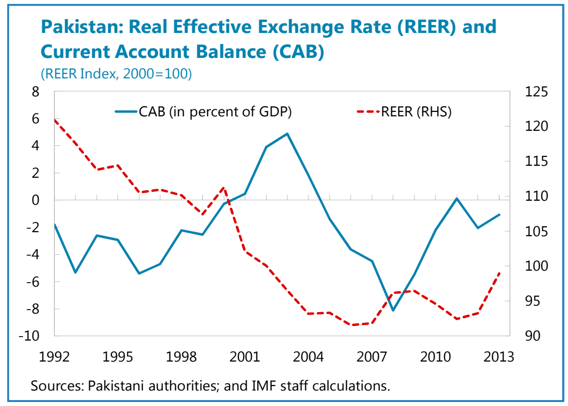
Sources: Pakistani authorities; and IMF staff calculations.

1/ Net reserves excludes IMF liabilities, net swap/forward positions, and currency swap with China.

[1] Pakistan's financial year runs from July 1 to June 30.

[2] The most prominent bilateral inflows were US$1.8 billion in U.S. Coalition Support Funds (CSF).

dropped to US$6 billion (under 1½ months of imports) as of end-June 2013. International reserves are now well below the Fund's reserve adequacy metric[3] and below 1½ months of imports cover.[4] Net reserves have become negative, as gross reserves include over US$7½ billion in borrowed resources, including a substantial net short-term forward/swap position in the domestic market, outstanding Fund credit, and a currency swap arrangement with China.[5]



5. The rupee depreciated by 5.3 percent against the dollar during 2012/13, leaving the real effective exchange rate roughly unchanged.[6] This relative stability of the currency carried a heavy price in reserves, however, particularly as the SBP intervened to hold the exchange rate roughly constant during the run-up to elections in the first half of 2013. Net SBP sales in the interbank market totaled about US$3.5 billion in FY2012/13. The real effective exchange rate remains somewhat stronger than what is suggested by fundamentals and desired policies. While several exchange rate assessment approaches[7] suggest only a modest overvaluation of the exchange rate (of 3–6 percent), financial account flows, extremely low and falling foreign exchange reserves, and a weak foreign asset position all point to a more significant problem with external stability (Box 1).

6. The fiscal deficit remained large. The 2012/13 fiscal deficit (excluding grants) is estimated to be over 8½ percent of GDP, well above the original budget target (4.7 percent of GDP) due to slippages on both revenues and expenditures. The revenue shortfall of 1¼ percent of GDP relative to the 2012/13 budget is largely explained by the underperformance in tax collections in the previous fiscal year, inadequate tax administration, and a slowdown in economic activity. Higher expenditures (2¾ percent of GDP) reflect higher energy subsidies. Moreover, the provincial surplus envisaged in the budget has not materialized. With very low external financing, the deficit has been almost entirely financed domestically. Pakistan's tax revenue-to-GDP ratio, at about 10 percent of GDP, remains among the lowest in the world among non-oil exporters.[8] Tax loopholes, exemptions and concession have left a small pool for taxation. For example, agriculture is mostly outside the tax net, and the number of taxpayers filing income tax returns is very small relative to the size of the population (about 1 percent).

---

[3] Under a floating exchange rate (the current de facto classification of the exchange rate regime), the metric level is $13.7 billion.

[4] This includes about US$871 million in currency swap with China.

[5] As of end-June 2013, gross reserves included US$871 million from a swap with China, US$2.3 billion in domestic swap/forward operations, and US$4.5 billion in outstanding Fund credit.

[6] Pakistan does not maintain any exchange restrictions or multiple currency practices subject to Fund jurisdiction.

[7] Namely, the macroeconomic balance, equilibrium real exchange rate, and external sustainability approaches were used to assess the degree of Pakistan's REER alignment.

[8] Flores, E., 2013, "The Case for Revamping Tax Revenues," Selected Issues paper.

Box 1. External Sector Assessment

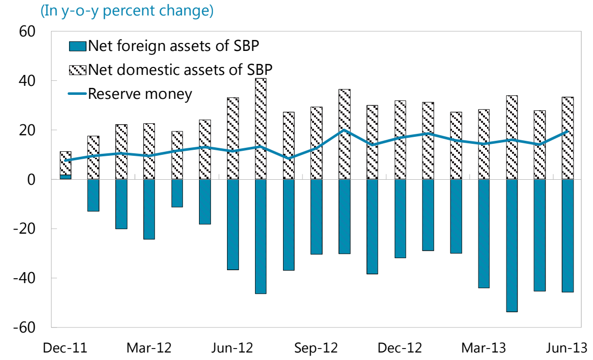
	Pakistan	Overall assessment
Current account	**Background.** Aside from an almost balanced current account in 2010/2011, Pakistan's current account has been in deficit for the last nine years, peaking at 8% of GDP in 2008 due to an increased import bill from an oil price shock that year. The current account balance as a share of GDP has been declining since then, due to lowered oil prices and official service credit inflows (Coalition Support Fund), reaching -1.0% of GDP for 2012/13. **Assessment.** A variety of approaches suggest Pakistan's current account is slightly weaker than the -0.1 to 0.1 of GDP implied by medium-term fundamentals.	The external position appears weaker than the level consistent with medium-term fundamentals and desirable policy settings. While the current account deficit is modest, the low level of reserves and weak capital and financial account make it difficult to finance. Reserves have fallen by 44% in the past year, in large part due to repayments to external official creditors. Reserves had previously declined by 40% in 2008, due to a large current account deficit and weak financial account, and then had recovered with the assistance of official credit. **Potential policy responses** The first step in decreasing the risk of a BoP crisis is for the central bank to accumulate reserves through purchases in the foreign exchange market. In the medium-term, a fiscal consolidation plan should help boost national saving, catalyze international support, and lead to an improvement of the financial account. In Structural reforms in the energy sector could increase the elasticity of demand for oil imports, reducing vulnerability to oil price shocks. Finally, in the longer term, diversification of the export sector toward higher value-added goods would decrease vulnerability to other commodity price volatility.
Real exchange rate	**Background**. Pakistan's real effective exchange rate (REER) has been relatively stable since the end of the 1990s despite significant variations in the current account balance. The REER depreciated by 4% since July 2012. **Assessment.** Model results suggest that the real exchange rate appears overvalued by 3% to 6%. Extremely low and falling foreign exchange reserves, however, point to a more significant imbalance. The exchange market pressure index, a sum of the nominal exchange rate depreciation and reserve loss percentages, was 37% in 2011/12 and increased to 53% in 2013/14.	
Capital account flows and measures	**Background.** Private capital inflows have dried up, with FDI decreasing by an average of 40% per year over the 4 years since the financial crisis, and almost no net portfolio inflows (less than 0.01% of GDP). **Assessment.** Pakistan has a low level of international financial integration and financial inflows are dominated by official multilateral and bilateral financing. Private financial flows are most responsive to political events. Structural measures to improve investor confidence should take priority, to increase the sensitivity of capital flows to economic factors.	
FX intervention and reserves	**Background.** Pakistan's exchange rate regime has been classified as a managed float since January 2008. The central bank regularly intervenes in the market, being a net seller of foreign exchange in the interbank market in each of the past 13 months. **Assessment.** The current level of foreign reserves is critically low at 5.4 billion US dollars, whereas the IMF's adequacy metric suggests a level of 14 billion US dollars for countries with a floating exchange rate and 23 billion US dollars for countries with a fixed exchange rate. The low level of reserves leaves the economy susceptible to a number of triggers that could result in a BoP crisis, similar to in 2008.	
Foreign asset and liability position	**Background.** As of end December 2012, Pakistan's net international investment position is about -30% of GDP, with assets at 10% and liabilities at 40% of GDP, respectively. External debt is at 27% of GDP, about 90% of which is to the official sector. **Assessment.** Vulnerabilities exist given the majority of liabilities are debt liabilities and there is a low level of foreign exchange reserves.	

7. Revenue sharing agreement continues to pose a challenge to fiscal consolidation (Box 2). Pakistan is a federation where most of the revenues are collected by the central government and redistributed to the provinces—which in turn transfer some funds to lower levels of government. Under successive constitutional amendments and decisions by the National Finance Commission (NFC), transfers to the provinces have increased sharply in recent years at a time when the federal government has struggled to address its large fiscal deficits.[9] Due to the nature of the revenue sharing arrangements, efforts by the federal government to increase most tax revenues would go into a common pool of which 57½ percent is automatically transferred to the provinces.

8. The energy sector is a major drag on economic activity. The sector remains saddled with considerable problems that have led to unreliable electricity supply and large fiscal costs, including price distortions, insufficient collections, costly and poorly targeted subsidies, inadequate governance and low efficiency in energy supply and distribution, regulatory inadequacies, and insufficient investment in new energy production and modernization. As a result, power outages ("load shedding") have averaged around 8–10 hours a day, constraining production and employment. Output losses are estimated at 2 percent of GDP annually. Energy-related subsidies reached 1¾ percent of GDP in 2012/13, and payments arrears ("circular debt")—estimated at 4 percent of GDP—continues to accumulate due to below cost recovery tariff rates, and delays in tariff determination and fuel cost adjustments. The government cleared 1.5 percent of GDP of this circular debt in June 2013 and is expected to clear an additional ¾ percent of GDP in the coming months.

9. Private sector credit has declined in real terms, while monetary aggregates continued to be driven mainly by the government's financing needs. Broad money increased by about 14½ percent in 2012/13, largely determined by budget support provided by the banking system, while private credit expanded by only 2.5 percent in nominal terms, the lowest level in recent years. Reserve money grew by 12½ percent, almost fully driven by direct fiscal borrowing from the SBP which more than offset the impact of a large decline in SBP net foreign assets (NFA). Since July 2012, the SBP has reduced its policy rate by a cumulative 300 basis points to 9 percent, citing declining inflation and the need to promote growth.

Pakistan: Composition of Reserve Money
(In y-o-y percent change)



Sources: Pakistani authorities; and IMF staff calculations.

[9] The NFC awards have steadily increased the provincial share of the divisible pool. It was only 37.5 percent in 1997, was increased to 45 percent in 2007, and reached 57.5 percent last year.

Box 2. Revenue Sharing Arrangements in Pakistan: A Challenge to Fiscal Consolidation

Revenue sharing in Pakistan is regulated by a series of constitutional amendments and NFC awards. Key elements are as follows:

- **The National Finance Commission (NFC)** is established by the Constitution and is chaired by the Federal Finance Minister, with the Provincial Finance ministers as members. Its main charter is to recommend the distribution of specified taxes between federal and provinces governments—and among provinces.
- **The 7th NFC Award**. The award increased the share of pool revenues that is transfer to the provinces to 56 percent in FY2010/11 and 57½ percent afterwards (from 45 percent in FY2009/10). This award will expire in FY2015/16 and a new award should be negotiated.[1]
- **The 18th Amendment.** A 2010 constitutional amendment devolved the functions of 18 ministries to the provinces, and states that future NFCs shall not reduce the share of resources allocated to the provinces by a previous commission.
- **The Council of Common Interest**. Established by the constitution, it consists of the Chief Ministers of the provinces and an equal number of ministers of the federal government (chaired by the Prime Minister). The 18th amendment strengthened its role as a mechanism for resolving conflicts.

To address that federal government's large fiscal imbalance, revenue mobilization will have to play an important role in restoring fiscal stability. The federal government will need to use additional revenues resulting from tax measures or improvements in tax administration to reduce the deficit. Lowering the share of resources, however, runs counter to the 7th NFC award and the 18thamendent of the Constitution. Options could include applying a lower provincial share of the pool only at the margin or—on a transitional basis—committing the Provinces to run surplus. Such cooperative outcomes could be pursued under the umbrella of the Council of Common Interest. Eventually, a revamp of the revenue-sharing formula will be required when the 8th NFC Award is negotiated over the next two years. A better match needs to be obtained between revenue and expenditure responsibilities which would not leave the federal government with chronic deficit, while the provinces run surpluses. A secondary objective of the new formula should be to better divide revenue responsibilities to facilitate an improved tax system. Currently, income tax responsibilities are divided by type of income and sales tax responsibilities are split between goods and services, which complicates tax administration.

[1] Mustafa, Usman, 2011, "Fiscal Federalism in Pakistan: The 7th National Finance Commission Award and Its Implications," *PIDE Working Papers* 2011: 73.

10. The financial system is dominated by banks that have been relatively healthy but nonperforming loans remain high. Overall capital adequacy remained well above the statutory minimum capital requirement (CAR), at 15.1 percent at end-March 2013. The banking system as a whole is liquid and profitable and deposit growth has remained strong (nearly 16 percent) in recent years. Nevertheless, nonperforming loans (NPLs) are high (14.7 percent), and a few banks operating below CAR. The high concentration of assets in public debt (around 37 percent of total assets) at a time of weak public finances is another source of risk. While NPLs are relatively well-provisioned for the system as a whole (over 70 percent), the slowdown in economic activity and pressures on the balance of payments continue to affect bank soundness.

OUTLOOK AND KEY RISKS

An unchanged policy mix would elevate overall vulnerabilities and crisis risks and cloud Pakistan's economic prospects.

11. Under unreformed policies, Pakistan's economic situation will continue to deteriorate, and near-term crisis risks are high. Low and declining SBP reserves leave the country vulnerable to a balance of payments crisis from even relatively minor external or domestic shocks (¶13). Domestic risks also emanate from the fiscal imbalance with the attendant high government debt rollover requirements (30 percent of GDP per year), a severe energy crisis, and security problems. On the fiscal side, staff's baseline scenario projects continued weak revenue collection and high energy subsidies would generate a budget deficit of around 8½ percent of GDP.[10] With continued monetization of fiscal deficits and further depreciation of the rupee, inflation will likely increase in the coming months and return to double digits. The current account deficit is projected to be around 1 percent of GDP by end-June 2014. However, the baseline balance of payments is expected to remain under pressure given weak export growth and large net capital outflows,[11] with reserves declining to around US$3.5 billion by end-June 2014 (0.8 months of imports), and the rupee is projected to continue depreciating against the U.S. dollar.

12. Over the medium term, Pakistan's economy will continue to underperform and vulnerabilities will remain high unless comprehensive reforms are implemented. With low savings and investment, high fiscal deficits, weak private credit, unresolved energy problems, core inflation in double digits, and ongoing security problems,[12] baseline real GDP growth is likely to remain around 3 percent with considerable potential volatility, well below the needed growth to *make a significant* dent on unemployment (Text table below). Credit to the private sector would

[10] However, fiscal measures included in the 2013/14 budget would lower this to around 6½ percent of GDP (¶20).

[11] Large repayments to the Fund are a key component of net capital outflows. Fund repayments peak during the next financial year, totaling nearly US$3.2 billion.

[12] According to the Uppsala Conflict Data Program, Pakistan has been classified as at war since 2008, but GDP growth has averaged about 3 percent annually.

continue to be crowded out, contributing to depressed private investment. The fiscal deficit would continue to deteriorate, requiring financial repression to maintain debt sustainability. The external position would be under increasing pressure despite low current account deficits by international standards. The international reserves cushion would become uncomfortably low (below one month of imports), despite assuming large unidentified inflows. Total debt would rise significantly over the medium term and government financing needs remain large and while external debts are sensitive to exchange rate shocks, domestic debts could deteriorate with adverse interest rate shocks.

Pakistan: Baseline and Reform Scenarios, 2013/14–2017/18

	2013/14	2014/15	2015/16	2016/17	2017/18
Baseline Scenario					
Real GDP at factor cost (percentage change)	3.3	3.1	3.0	3.0	3.0
Consumer prices (period average)	8.2	10.8	11.3	11.8	11.8
Budget balance excluding grants (in percent of GDP)	-8.1	-8.3	-9.0	-10.0	-10.5
Total public debt (in percent of GDP, including all obligations to the IMF) 1/	67.6	60.7	63.6	66.2	69.4
Current account (in percent of GDP)	-1.6	-1.1	-1.5	-1.6	-1.5
Gross reserves (in months of next year's imports)	0.5	0.4	0.4	0.4	0.4
REER (annual average, percentage change)	-6.5	-6.7	-6.4	-5.9	-1.9
Unemployment (percent) 2/	6.8	7.2	7.7	8.3	9.0
Reform Scenario					
Real GDP at factor cost (percentage change)	2.5	3.5	3.7	4.5	5.0
Consumer prices (period average)	7.9	9.0	7.0	6.0	6.0
Budget balance excluding grants (in percent of GDP)	-5.8	-4.7	-3.9	-3.6	-3.5
Total public debt (in percent of GDP, including all obligations to the IMF) 1/	66.6	63.5	60.5	58.7	56.9
Current account (in percent of GDP)	-0.6	-0.7	-1.1	-1.8	-1.9
Gross reserves (in months of next year's imports)	2.2	2.8	3.6	3.5	3.5
REER (annual average, percentage change)	-8.1	-3.6	-0.9	-0.7	0.4
Unemployment (percent) 2/	6.9	7.3	7.5	6.7	5.8

Sources: Pakistani authorities; and IMF staff estimates and projections.
1/ Debt in the baseline scenario do not include future circular debt that may need to be taken over by the government.
2/ Assumes average employment-growth elasticity of 0.51.

13. The risks to the medium-term outlook are tilted to the downside (Box 3). Without significant policy adjustments and support from the international community, large domestic and external vulnerabilities could well depress economic outcomes beyond the baseline. While, the fragile foreign reserves position is sensitive to external shocks and could negatively impact the macroeconomic stability, the internal shocks, in particular energy shortages and security concerns could further prevent private sector investment and stall growth. Key risks include the following:

- **Pakistan's energy crisis threatens the broader economy**. The sector is burdened with structural problems, price distortions, insufficient collection, theft, untargeted subsidies, inadequate supply, and poor governance. Long and unpredictable blackouts, reaching 16 hours/day in some areas, have been disruptive for businesses, while adding to dissatisfaction and frustration among the population.

- **Security concerns could increase economic risks**. Pakistan faces significant insurgency problems in the regions bordering Afghanistan, which could intensify with the drawdown of NATO forces there. Sectarian violence in Balochistan and other provinces has been another source of unrest, while street crime in Karachi adds to security concerns.

- **Vulnerability to oil price shocks has risen in recent years**. While oil imports declined from 33 percent of imports in 2001 to about 16 percent in 2004, they have risen each year since, and the oil vulnerability index has risen (Box 4). In contrast, food price vulnerability is about one-third of oil vulnerability and has been declining in recent years.

- **Pakistan is vulnerable to inward remittance spillovers**. While a decline in oil prices would lower import pressures, there might be adverse indirect effects on reduced remittances from workers in oil exporting countries (60 percent of Pakistan's remittances come from the Middle East).

- **A further global economic decline could impair Pakistan's exports**. A further downturn in Europe would have negative effects, as ¼ of Pakistan's exports go to Europe, and most non-Middle East remittances come from Europe. Although links to most emerging markets are weak and capital flows to Pakistan are small, slow growth in emerging markets could add to external sector risks.

- **The financial sector is not in imminent danger, but banks remain vulnerable to a further deterioration in the overall macro-economic environment**. The trend over the last decade confirms a close negative relationship between the performance of economy and buildup of NPLs (Figure 3). The balance sheets of commercial banks are also highly exposed to government securities, so a fiscal crisis—if it materialized—would have a large impact.

14. Reforms will substantially reduce Pakistan's vulnerability to crisis. A reform package including significant fiscal consolidation, a more flexible monetary and exchange rate policy, and comprehensive structural reforms would reduce crisis risks stemming from unsustainable fiscal and balance of payments positions. Reforms would also make the economy more resilient against shocks by increasing financial buffers, as the improved policy environment would likely attract significant international financial support.

Box 3. Pakistan: Risk Assessment Matrix 1/

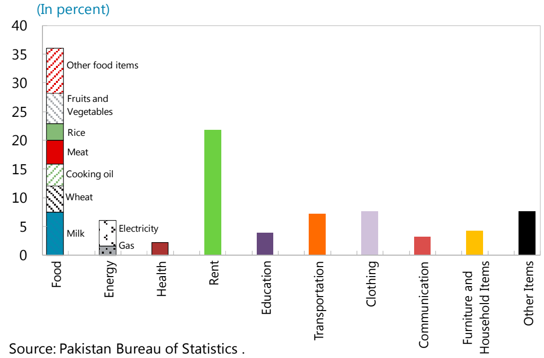
Timing	Risk	Relative Likelihood	Impact if Realized
Short-term	**BOP crisis** Debt repayments, and foreign exchange sales to stabilize exchange rate continue to put pressures on reserves and speed up the unwinding of foreign exchange swap/forward positions.	**High**	**High** This would result in significant decline in growth, depreciation in the nominal exchange rate, adjustment in the current account, deterioration in fiscal ratios and high inflation. Domestic debt servicing would be difficult due to increased premium and shortening maturities.
	Regional security concerns Continued insurgency at the Afghanistan border and domestic sectarian violence in the south may increase security concerns.	**High-Medium** The expected withdrawal of NATO troops from Afghanistan could increase the activities of Taliban's Pakistan wing. Sectarian in some provinces and street crimes in Karachi could add to security concerns.	**Medium** The security situation would further negatively impact the exchange rate, and an already weak private investment and FDI.
Medium-term	**Growth slowdown in GCC** This would cause slowdown in remittances inflows.	**Low,** With current projected oil prices and comfortable reserves, it is unlikely to witness a long-lasting slowdown in these countries	**High** Remittances play a key role in the external position, and if interrupted, the country would face difficulty meeting its external obligations
	Global oil shock triggered by geopolitical events (driving oil prices to $140 per barrel)	**Low** A sustained Spike in oil prices is unlikely.	**High** The external position is sensitive to oil imports and a prolonged rise in oil prices would require substantial adjustment, and would further put pressure on struggling energy sector and on the fiscal position.
	Slowdown of world economic activity Protracted period of slower European growth as a major export destination for Pakistan textile products.	**Medium** EU growth is expected to remain sluggish in 2013, before recovering in 2014 and beyond.	**Medium-Low** Pakistan economy could be affected through trade and indirectly through lower remittances. The euro area is key trading partner for Pakistan's textile industry.
	Domestic banking crisis A liquidity problem in medium and large banks can trigger a banking crisis.	**Low** While the banking system is liquid, a system-wide liquidity crunch through the drying up of funding and corporate withdrawals followed by government and household deposits may lead to decline in capital ratios and bank failures.	**High** The loss of confidence would lead to high dollarization, unwinding of the swap/forward position, and run on the banks, which could result in foreign reserves losses due to deposit outflows and turn into a severe BOP crisis.

[1] The Risk Assessment Matrix shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline. The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with authorities.

Box 4. Pakistan's Vulnerability to Food and Oil Price Shocks[1/]

Food, energy and transportation comprise about half of the consumer basket. Surprisingly, 20 percent of the food basket is taken by milk and milk products, while vegetables (14½ percent), wheat and bread (12½ percent), and cooking oil (10 percent) are the other major categories. As a whole, food items make up about 36 percent of the consumer basket, while energy and transportation constitute about 14 percent of the basket.

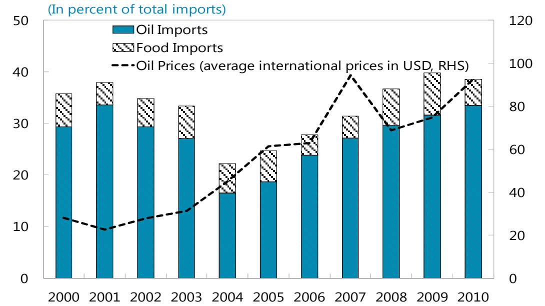
Composition of the Consumer Price Index Basket
(In percent)



Source: Pakistan Bureau of Statistics .

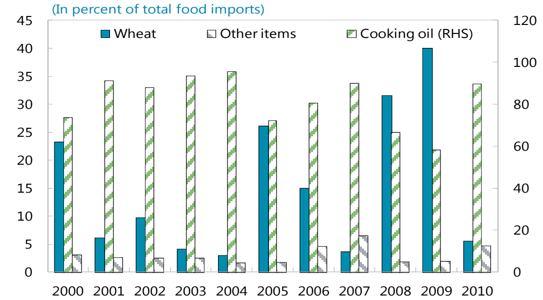
While food imports have been steady, oil imports have increased drastically. Wheat and cooking oil are the main subcomponents of food imports and together make up about 5 percent of total imports. While wheat imports fluctuate each year depending on the domestic harvest and government export policy, cooking oil imports has been hovering around 4 percent of total imports for the past decade. Pakistan's largest import item is oil, averaging 27 percent of total imports in the past decade. Oil imports declined from 33 percent of imports in 2001 to about 16 percent in 2004 but have risen each year since, while international oil prices increased and simultaneously electricity generation fuel mix has shifted toward oil.

International Oil prices and Food and Oil Imports
(In percent of total imports)



Sources: Pakistani authorities; and FAOSTAT.

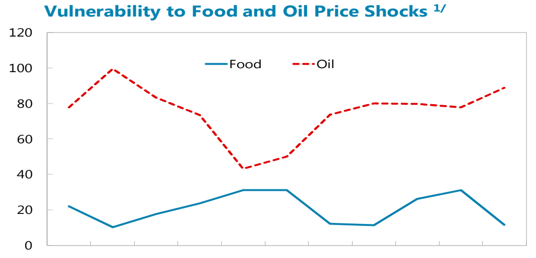
Imports of Food Items
(In percent of total food imports)



Sources: FAOSTAT; and IMF staff estimates.

Pakistan has become more vulnerable to oil price shocks in recent years. Growing oil demand for electricity production, coupled with rises in the international oil price, have increased Pakistan's vulnerability to oil price shocks. Oil now accounts for about one-third of electricity generation in Pakistan, a significant increase from the 2004 level of 16 percent. As a result, the oil price vulnerability index[2] has risen steadily since 2004 and reached its highest level in recent years. The food price vulnerability index is about a third of the magnitude of the oil index and has been declining in recent years. However, the food index is highly volatile and depends largely on factors related to wheat, such as the size of the domestic harvest and government trade policy.

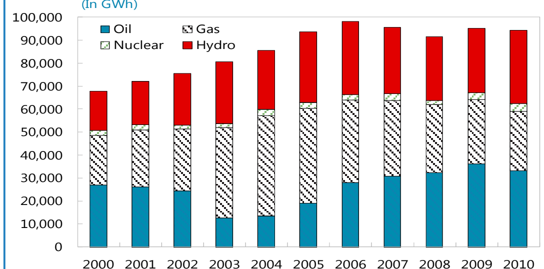
Vulnerability to Food and Oil Price Shocks 1/



Sources: Pakistani authorities; FAOSTAT; and IMF staff calculations.

1/ Index is normalized to 100 in 2000 and adjusted with import weights; the higher values indicate high vulnerability.

Electricity Generation
(In GWh)



Source: EIA.

[1] Prepared by Asghar Shahmoradi, with research assistance from Paul Zimand.

[2] We have used an index, developed by IMF staff, to measure how vulnerable Pakistan is to rising food or oil prices, "vulnerability to food and oil shocks indices." The index is a weighted combination of the ratio of oil/food imports to total household consumption (as an indicator of oil/food dependency); the ratio of food/oil imports to total merchandise imports (as an indicator of the burden of oil/food imports); and the inverse of the level of GDP per capita (which measures the capacity to provide oil/food safety nets for domestic consumers). Please see http://www.imf.org/external/pubs/ft/reo/2012/mcd/eng/mreo1112.htm for further details.

15. Adjustment would raise medium-term growth prospects. As these reforms take hold, savings and investment rates would increase, inflation would fall, real GDP growth would rise significantly, and unemployment would decline. Over the medium term and with fiscal deficits reduced to sustainable levels, debt levels would decline rapidly, lowering the country's vulnerability to exchange and interest rate shocks (text Table 1).

16. Adjustment policies also carry risks, but they can be mitigated by improved social protection. Fiscal consolidation would undoubtedly be contractionary in the near term,[13] but the negative effects can be mitigated by: (i) increasing targeted transfers to the most vulnerable population; (ii) increasing investment by improving private sector access to credit; and (iii) alleviating acute energy supply bottlenecks to increase productive capacity. In the short-run, immediate action to address financial imbalances, improve the energy sector fuel mix, and enhance governance could improve energy supplies sufficiently to contribute up to 1 percentage point to GDP growth.[14] Over 3 years, the positive effects of greater price stability and policy predictability on investment and consumption behavior together with pro-growth structural reforms—such as comprehensive energy reforms, trade liberalization, improvements in the investment climate—along with donor support would place the economy on a sustainably higher growth path.

Authorities' Views

17. The authorities share staff's concerns about short-term crisis risks, and are strongly committed to short-term adjustment measures together with structural reforms to boost medium-term growth. They are more optimistic than staff about the growth outlook under a reform scenario, however. The 2013/14 budget assumes a 4–4½ percent rise in GDP growth and the government envisages growth rising to around 7 percent in the medium-term, while staff view 5 percent as a more likely positive scenario. The SBP also retains a more sanguine view of inflation prospects than staff.

[13] Staff used econometrics models to estimate fiscal multipliers for total revenues and expenditures which are about one for Pakistan.

[14] Joint IMF and World Bank research suggests that a 30 percent increase in energy supply would generate a 2 percent increase in GDP. In staff's view, a 15 percent increase in effective energy supply could be obtained in the first year by increasing the allocation of gas to electricity production, improving administration in distribution companies to reduce losses, and tackling the circular debt problem, whereby production is lower due to financial constraints from unpaid bills

ARTICLE IV DISCUSSIONS: TOWARD HIGHER AND MORE INCLUSIVE GROWTH

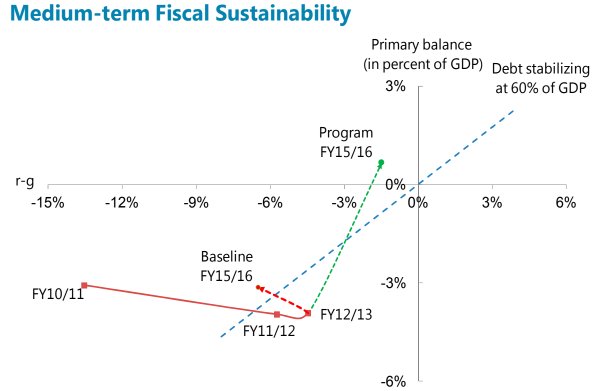
Policy discussions focused on macroeconomic policies and structural reforms needed to avoid a crisis and to improve sustainably Pakistan's medium-term growth outlook.

18. Pakistan's key economic challenge is to put the policies in place needed to alleviate large and persistent external vulnerabilities and to generate high, stable economic growth. This will involve short-term stabilization policies to reduce crisis dangers and restore fiscal and balance of payments sustainability, thus creating the preconditions for a recovery in investment. Simultaneously, efforts need to begin on profound structural reforms to boost growth potential over time. Together, these policy initiatives will help mitigate vulnerabilities, strengthen economic performance, creating jobs and reducing unemployment (Box 5). Stronger policies will help mobilize multilateral financial support from donors and encourage private sector capital inflows, which will help to address Pakistan's external stability problem.

A. Return to Fiscal Sustainability

19. The fiscal stance is not sustainable and requires significant consolidation to ensure sustainability. Over the past few years, declining tax revenues and increasing energy subsidies have worsened an already large fiscal deficit. Domestic financing of the fiscal deficit has produced severe crowding-out of private sector credit, and a reliance on negative real interest and direct financing from the SBP. Public debt has climbed above 60 percent of GDP with very short average maturity of domestic public debt, and increased vulnerability of external debt service to currency depreciation.

Medium-term Fiscal Sustainability



Sources: Pakistani authorities; and IMF staff calculations.
Note: The debt stabilizing primary balance is calculated assuming growth at 3 percent.

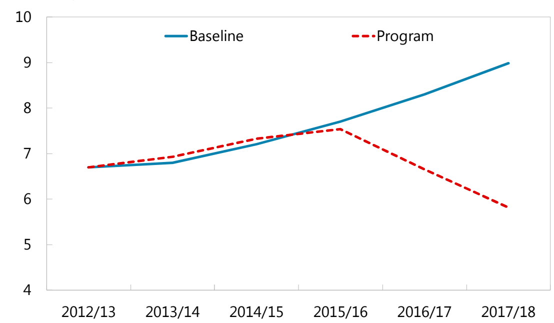
20. The 2013/14 federal budget represents an important initial step towards the needed fiscal consolidation. The budget targets a deficit of 6.5 percent of GDP. The tax package included in the budget is expected to raise revenues by about ¾ percent of GDP. However, in staff's view it makes only limited progress towards a more efficient and equitable tax system, and further efforts will be needed to reach the medium term targets envisaged by the government. Tax revenue will likely fall short of the budget target, but the authorities are willing to take action to compensate (¶50). Likewise, the reduction in subsidies envisaged in the budget will not fully materialize despite the authorities' strong plan to reduce the subsidies.

Box 5. Unemployment in Pakistan

The labor force is growing and providing employment opportunities remains challenging. Pakistan's population growth rate of 2.2 percent (annual average) over the last decade is among the highest in developing economies[1] with about 40 percent of the population below the age of 15. With participation rates also rising, the labor force is expected to grow by 3.5 percent in the coming years. High unemployment among the youth is particularly widespread,[2] and only 25 percent of employment is in the formal sector. Although, the official unemployment rate is about 6.7 percent in 2012/13, the rural unemployment rate (9.1 percent as of 2012Q3) is twice the urban rate (4.8 percent as of 2012Q3).

Without significant reform, unemployment will rise in the coming years. Weak macroeconomic policies and structural problems, particularly in the energy sector, would lead to low growth and high unemployment in the coming years. Under the baseline scenario, the projected GDP growth hovers around 3 percent over the medium term. According to staff calculations the unemployment rate will rise from 6.7 percent in 2012/13 to about 9.0 percent by 2017/18.[3]

Pakistan: Unemployment Rate Forecasts
(In percent of labor force)



Sources: Pakistan Bureau of Statistics; IMF Labor Market Template, and IMF staff estimates.

Under a Fund supported program, GDP growth will pick up and unemployment would decline gradually. The program envisages a mix of macroeconomic policy changes and structural reforms aiming to boost GDP growth over the course of the program. Although, GDP growth will initially decline due to fiscal contraction, it will steadily increase to about 5 percent. The unemployment rate will increase slightly in the first two years of the program, but it will decline to about 5.8 percent by 2017/18.

---

[1] Almost twice the average rate of emerging and developing economies.

[2] Youth unemployment rate was estimated to be above 10 percent in 2011, about almost twice as high as unemployment rate among adults aged over 25 years.

[3] Based on the template developed in the Middle East and Central Asia Department. The template uses estimates of employment-growth elasticities that have been produced using a variety of econometric methods including individual country time-series regressions and panel data estimation methods. For further details, see: "A Template for Analyzing and Projecting Labor Market Indicators," Technical Note Manual, IMF, 2012.

21. Policy actions should permanently strengthen the fiscal stance. Staff advocated a reduction of the deficit to around 3–3½ percent of GDP in the medium-term to ease crowding out and set the public debt on a firmly declining path—back below 60 percent of GDP by 2016/17. As shown in the Debt Sustainability Analysis (Table 11 and Figure 4), moderate shocks to the interest rate, growth, or the primary balance will result to debt levels above 65 percent—albeit stable, which highlights the need for reducing the debt ratio to well below the 60 percent of GDP envisaged in the Fiscal Responsibility Law. In staff's view, the 60 percent of GDP threshold remains too high for a country like Pakistan with a low tax-to-GDP ratio and exposure to significant external and internal shocks. The consolidation should begin aggressively with measures focusing on the revenue side and on energy subsidies, and continue until the medium-term targeted deficit is reached. In order to protect the neediest from the effects of the envisaged fiscal consolidation, targeted cash transfer programs need to be expanded (see ¶50). Among critical fiscal reforms are the following:

- **Tax policy**. Pakistan's tax to GDP ratio for 2012/13 was 9.7 percent of GDP—significantly less than the 11.4 percent of GDP in 2002/3—so fiscal consolidation will have to rely heavily on tax policy changes to broadening the tax base.[15] The implementation of a full Value Added Tax (VAT) remains the first-best option to raise tax revenue, but if this remains politically unfeasible, other permanent tax policy measures could be considered to come closer to it by wholesale reductions in exemptions and concessions, and by fully incorporating services into the tax net. The administrative authority to grant tax exemptions via Statutory Regulatory Orders (SROs) should be eliminated to prevent further degradation of the tax net. Income tax should integrate income from all sources, concessions and exceptions should be eliminated, withholding should be adjustable, with the minimum tax on turnover remaining as a control for deductions.

- **Tax administration**. In a country of nearly 180 million people, only 1.2 million individuals and firms file income tax returns, (of which half are corporate income tax filers). Some 118,000 entities are enrolled in the sales tax system but only 15,000 actually pay any tax, with 82 percent of total sales and federal excise revenue coming from only 100 companies. These low numbers reflect the long-standing failure of the Federal Board of Revenue (FBR) to efficiently administer the system and the inability of previous reform efforts to deliver sustained results. The authorities need to develop and implement a strategy to strengthen tax administration, with the technical assistance of the Fund and the World Bank. While key elements of the strategy will need to be defined, it should include significantly stepping-up the FBR's enforcement activities and improving its legal authority (such as to facilitate asset seizures for tax evaders and to presumptively bill taxpayers). The anti-money laundering framework will need to be fully applied in this effort.

- **Expenditure reforms**. The composition of public spending should shift to more growth friendly outlays, including infrastructure, health, and education, with the phasing out of untargeted energy and commodity subsidies, currently around 1.9 percent of GDP (Box 6). Targeted income

[15] Flores, E., 2013, "The Case for Revamping Tax Revenues," Selected Issues paper.

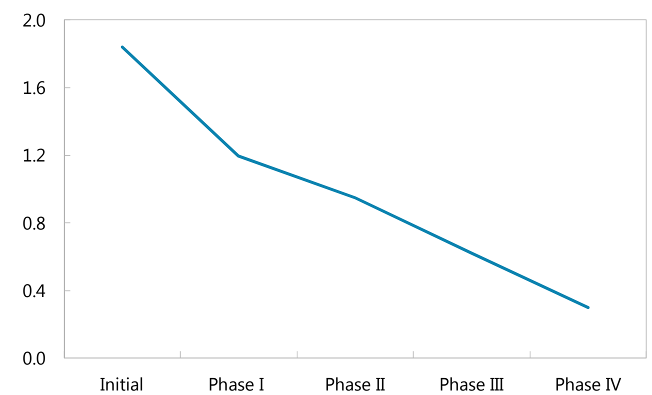
support programs should be strengthened. Civil service reform should also be considered, to improve the quality of the public service, reduce corruption, and contain the public wage bill.

Box 6. Reducing Energy Subsidies

The authorities have launched their plan to gradually eliminate most of the energy subsidies.[1] The four phase plan is expected to reduce the subsidies from about 1.8 percent of GDP to 0.3–0.4 percent of GDP in three years.

- **Phase I**. The first phase entailed the almost full elimination of the subsidy for industrial, commercial, bulk, and AJ&K[2] users, accomplished through an increase in tariff of about 50 percent at end--July. The majority of domestic consumers are excluded from increases at this stage.
- **Phase II**. The second phase entails the elimination of the subsidy for consumption over 200Kwh, SCARP[3], and others (public lighting, housing schemes, railways, HVTL[4]), and reducing the subsidy in agriculture by about 13 percent. The corresponding price increases have already been approved and notified—effective October 1st.

Energy subsidies
(In percent of GDP)



Sources: Pakistani authorities; and IMF staff calculations.

- **Phases III and IV**. In FY 2014/15 and FY 2015/16 the authorities will reduce the remaining subsidies (on agriculture and consumption below 200Kwh) in order to reduce the fiscal burden to 0.3-0.4 percent of GDP. By the end of Phase IV the subsidy for consumption above 200Kwh will be eliminated, and it will be reduced for those below 200Kwh. While most households will see price increases, subsidies will remain for the lowest level consumers and increases in targeted transfer programs will also protect the poorest.

Pakistan strategy is broadly consistent with the lessons learned from previous energy reforms. Their strategy addresses the six key elements usually linked with successful reforms: (i) they developed a comprehensive energy sector reform plan with long-term objectives, (ii) they have launched a communication strategy, (iii) the price increases are phased and sequence differently across energy products, (iv) they are strengthening their cash transfer program to protect the poor, (v) they are working towards improving the efficiency in state-own enterprises, and (vi) they are working towards improving the timeliness of the pricing mechanisms.

[1] Fuel price changes are passed through to electricity prices on a monthly basis.
[2] Azad Jammu and Kashmire.
[3] Salinity Control and Reclamation Program.
[4] High Volatge.

- **Fiscal federalism reforms**. The revenue sharing system needs to be reformed to increase provinces' incentives to rely less on federal transfers and more on their own revenue-raising efforts (Box 2). A mechanism needs to be put in place to set and implement statutory limits on provincial fiscal balances, supported by strengthened limits on provincial borrowing. In the short-run, a binding agreement should be negotiated between the provinces and the federal government, perhaps at the Council of Common Interest (CCI) to ensure that additional revenues raised under a fiscal consolidation plan are used for deficit reduction rather than to facilitate additional provincial spending. To the extent possible, this agreement should be supported by sanctions and by technical modifications of the revenue transfer system (i.e., a legislated "lock-box").

- **Public financial management reforms**. Commitment control systems for the general government need to be implemented for better public financial management. The authorities also need to strengthen their fiscal debt office to improve deficit financing through lengthening the maturity of domestic debt, building a longer yield curve, and eventually returning to external private markets for some fiscal financing (see also ¶33).

Authorities' Views

22. The new government feels strongly that the previous fiscal path was unsustainable and is committed to a process of fiscal consolidation. The authorities view the FY2013/14 budget, approved by parliament on June 27, 2013, as a significant step in that direction. The authorities are more optimistic than staff about the potential for short-term revenue gains via improvements in tax administration. While agreeing on the need to eliminate many SROs to reduce tax loopholes, they were less enthusiastic about eliminating the ability to issue new SROs, which they see as a flexible and quick-response tool for addressing tax policy needs. Staff noted that SRO authority could be eliminated for creating new concessions or exemptions, while retaining it for other policy purposes. On fiscal federalism reforms, the authorities noted that significant constitutional and political barriers exist to a wholesale overhaul of the system.

B. Realigning Monetary Policy for Macroeconomic Stability

23. The SBP has pursued an accommodative monetary policy to lift weak private investment and growth, in light of falling headline inflation. The policy rate has been cut repeatedly over the past two years by a cumulative 500 basis points to 9 percent. In addition, in FY2012/13, the SBP continued direct financing of the large fiscal deficit (accounting for almost all of the increase in reserve money). Open market operations and foreign currency swaps have also pumped additional liquidity into the market. As a result, despite falling net foreign assets, monetary aggregates expanded relatively quickly. However, this accommodative policy did not bear fruit in terms of private sector stimulus—private credit shrank in real terms.

24. Pakistan has arrived at a critical balance of payments situation through a combination of: (i) past current account deficits occasionally coupled with weak financial accounts; (ii) reliance on external official financing to deal with financing gaps while maintaining an emphasis on relative exchange rate stability; and (iii) the disappearance of even modest private financial inflows following the global financial crisis of 2008. The first step in decreasing the risk of a crisis is for the central bank to accumulate reserves through net purchases in the foreign exchange market. In the medium-term, a fiscal consolidation plan would help boost national saving, catalyze international support, and lead to an improvement of the financial account.

25. Prudent monetary and exchange rate policies are needed to address declining reserves and contain projected rebound in inflation.[16] Staff advised that monetary and exchange rate policies should focus on rebuilding foreign exchange reserves and maintaining price stability. The SBP should signal a clear policy shift to market participants through purchasing foreign exchange in the interbank market to bolster reserves. Staff reiterated that the SBP should refrain from further direct lending to the government and limit open market liquidity injections to the economy. Inflation reduction should be a top priority of the SBP, as inflationary pressures will likely materialize in the coming 12–18 months. The SBP's policy rate should be set prudently to contain expected inflationary pressures, to maintain positive real interest rates to attract deposits; and to help rebuild reserves.

26. The SBP continued to intervene in the foreign exchange market. The SBP's net sale of foreign exchange in the spot market totaled US$3.35 billion in 2012/13, almost 70 percent of total loss in reserves. Staff argued that the chief short-run challenge facing the SBP is to rebuild critically-low reserves, so a reversal of the exchange intervention policy was urgently needed. External competitiveness factors also suggest that a moderate weakening of the rupee would be appropriate (¶6, Box 1). Staff expressed concern about the SBP's heavy reliance on short-term currency swap/forward contracts to boost gross reserves, and recommended that they be gradually scaled back to limit risk.

27. Independence of the SBP remains inadequate. Staff urged the authorities to amend the SBP Act in order to establish an independent, decision-making monetary policy committee, which is a pre-requisite for an optimal design and implementation of monetary policy. Staff stressed that full Independence would help pave the way for improved price stability, as SBP's primary objective, and the elimination of future direct financing of fiscal deficits.

Authorities' Views

28. The SBP argued that the recent cuts in policy rates were justified given declining headline inflation and the need to stimulate growth. While acknowledging that inflationary risks remain and stressing that it would adjust the rates if circumstances change, the SBP added that the impacts on private sector credit could have been severe, had the rates not been cut. The SBP stressed that in addition to other structural factors, the banking system has not fully played its role of financial intermediation in providing credit to the private sector, resulting in negative real rates of private credit expansion. In addition, the SBP argued that in evaluating monetary policy in Pakistan other factors, like law and order, and security concerns should be taken into consideration. The SBP disagreed that capital flows to Pakistan are sensitive to interest rates in the current circumstances and pointed to other structural factors that prevented direct and portfolio investment. On exchange rate policy, the SBP firmly believed that its intervention policy was necessary to ensure the stability of the foreign exchange market and in avoiding any disruption in market sentiments, particularly during the sensitive election period. The SBP agreed that the reserves situation was challenging but asserted that it was manageable.

[16] Shahmoradi, A., 2013, "The Performance of Monetary Policy in Pakistan," Selected Issues paper.

C. Safeguarding Financial Sector Stability

29. Growth in banks' lending to private sector continues to be weak, while banks' holdings of government securities continue to expand. Financial intermediation to the private sector has declined significantly over the last few years. Despite strong domestic deposit growth, high capitalization and liquidity levels, and reductions of the policy interest rate and NPLs, lending to the private sector has been diminishing as a share of total lending from around 75 percent in 2005 to around 45 percent in 2012, as the fiscal deficit increased from less than 3 percent to around 8 percent. Staff emphasized the need to tackle this severe crowding-out of the private sector in a credible way in order to stabilize the economy and create the conditions for future growth. The envisaged reduction of the government's borrowing requirement and addressing NPLs should help stimulate private sector credit from the supply side, while greater macro stability and broader structural reforms should boost demand for private credit. These in turn would support the recovery of private sector investment, and thus employment and growth.

30. Staff urged the SBP to address the undercapitalization of a few banks. The SBP has already identified the capital shortfall for each bank that falls below CAR, where there are four noncompliant banks (excluding one state-owned bank that is under liquidation)—representing around 7 percent of the banking sector assets (with a total shortfall of less than 0.1 of GDP). Moreover, there are nine banks (six private and three state owned) that fall below the minimum capital requirement (MCR) but meet the CAR, representing 7.8 percent of the banking system assets. The SBP has provided extension to some banks for meeting MCR, subject to maintaining healthy CAR and presenting a timeline to meet the shortfall. Staff advised the authorities to develop a well-defined time bound Action Plan to deal with banks that are either below CAR or MCR, and restructure or merge few state-owned banks. Continued forbearance may pose a financial threat to financial system and have fiscal implications (e.g., in case of a need to recapitalize a state-owned bank).

31. Staff supported financial sector reforms to enhance the resilience of the financial system. In particular:

- **Introducing a bankruptcy law**: due to nonexistence of a bankruptcy law in Pakistan and the large volume of NPLs, staff underscored the need to complete the consultation with key stakeholders in order to finalize the draft Corporate Rehabilitation Act (CRA). At the moment, banking courts are understaffed, with years of long litigation and resolution process, as well as weak enforcement capacity of courts' decisions. This is not a conducive environment for banks to extend credit to the eligible borrowers. Therefore, there is a need to revamp the recovery mechanisms by speeding up judicial process and filling up vacancies in banking courts with the necessary skills to handle outstanding cases.

- **Setting up a deposit insurance scheme**: the SBP is preparing to introduce an explicit Deposit Protection Fund (DPF). Deposit protection is currently ambiguous in Pakistan, as under the Banks (Nationalization) Act of 1974, the government of Pakistan implicitly guaranteed the safety of all deposits, despite the fact that the Banks Act applies only to nationalized banks. Therefore, depositors widely anticipate that the government or the SBP will compensate their deposits in case of a bank failure. Banks also support the introduction of the DPF. As the draft DPF Act is being finalized, staff stressed the need to ensure that the necessary preconditions are in place before launching the DPF, such as achieving compliance of all banks with minimum capital requirements, appropriate regulation and effective supervision for a sound banking system, and a special resolution regime.

- **Enhancing consolidated supervision**: the SBP and the Securities and Exchange Commission of Pakistan (SECP) recognize that consolidated supervision of financial conglomerates is critical for financial stability. The regulatory framework is similar to a "twin peak" model, where the SBP is entrusted with regulating the banking system and the SECP with regulating nonbank financial sector. Given ownership inter-linkages in the financial sector, however, there is a challenge to regulate these financial conglomerates. The SBP and SECP signed a Memorandum of Understanding (MoU) to share information and monitor the financial risks on consolidated basis. A joint task force on financial conglomerates was also established in 2010 and it meets periodically to discuss regulatory concerns pertaining to consolidated supervision.

- **Strengthening the regulatory and supervisory framework**: the SBP has developed and introduced several prudential regulations (e.g., loan to value, loans to deposits, and exposure limits on individual borrowers and borrowing groups), aiming to address macro-prudential risk. It has also improved its macro stress testing framework substantially over the years; however, there remains no macroeconomic model that the SBP could use for generating baseline and adverse scenarios for the stress testing. The SBP has requested technical assistance from the IMF's Monetary and Capital Markets to assess its overall framework for contingency planning and crisis management. In addition, the SECP has revisited its legal framework—by drafting legislation that is under consideration by the government—to enhance its supervisory and enforcement powers, and to regulate futures markets. Staff also recommended that the government restore the SECP's budgetary autonomy.

32. After the collapse in 2008, there has been renewed buoyancy in the stock market. The Karachi Stock Exchange (KSE-100) set new records over the last 12 months to June 2013, outperforming many other emerging markets (Figure 3). Staff recommended that the authorities closely monitor any speculation and market manipulation to maintain confidence in the stock market. Looking ahead, the SECP will continue with its reforms to develop stock exchanges through attracting strategic foreign investors, introducing Shariah-compliant investment products, and establishing a central counter party to provide protection to investors by reducing credit risk.

33. Steps should be taken to develop debt markets. The corporate debt market is underdeveloped and small. For the government debt market, measures have been taken to develop an efficient and liquid market, by consolidating benchmark securities, automating the auction process, and pre-announcing the auction calendar for the next quarter. To further deepen the government debt market, the authorities need to: (i) continue aligning rates of returns on the National Saving Schemes (NSS) to equivalent government securities;[17] (ii) improve price discovery during the auction process by utilizing cut-off rates much less frequently and allowing market forces to determine the yield on government securities; (iii) build a more complete yield curve by extending maturities of government securities;[18] (iv) issue Sukuk instruments beyond 3-year maturity; (v) continue to broaden the investor base to include institutional investors, and (vi) list government debt instruments in the stock exchanges to increase secondary market liquidity.

34. Over the medium-run, the authorities should seek to further deepen the financial markets and develop capital markets.[19] The financial system of Pakistan remains shallow in terms of its inclusiveness, depth, efficiency, and stability. Though the system has grown over the last decade and is diversified, it remains small and largely bank-based. There is scope for further financial deepening by: (i) continuing to increase access to financial services through the Financial Inclusion Program and microfinance; (ii) stimulating credit to the private sector; (iii) addressing undercapitalization of a few banks; and (iv) developing capital markets to provide alternative means of financing investments and investment opportunities for investors. Financial deepening should, over the long term, sustain economic growth and increase the effectiveness of macroeconomic policies.

Authorities' views

35. The authorities stressed that the banking system continues to show strong indicators of financial soundness, with high liquidity, capitalization, and comfortable profitability. They noted the increasing exposure of banks balance sheets to the government due to high financing needs. They also acknowledged that there are three noncompliant banks in both CAR and MCR which are a source of concern, and they have actively engaged with each bank for ensuring full compliance. They believe that raising additional capital for meeting MCR is quite challenging in the current domestic and global environment. Moreover, the authorities asserted that the recent policy rate cuts would help stimulate private sector credit and reduce the debt burden on borrowers, and thereby lower NPLs.

36. To enhance the stability of the financial system, the authorities emphasized the importance of introducing key reforms. They would finalize the consultation with key stakeholders on the draft bankruptcy law (Corporate Rehabilitation Act) and seek to pass legislation on a deposit protection fund over the course of the next two years. The SBP and SECP supported staff's recommendations for reopening the issue of consolidated supervision, while noting the importance of the existing interagency coordination arrangements between them to stem any possible risks from the financial conglomeration.

---

[17] NSS rates are set at 95 percent of the cut-off of last auction.

[18] Banks remain reluctant to invest in long maturity beyond a five-year tenor, given uncertainty in the policy interest rate.

[19] Al-Hassan, A., 2013, "Financial Deepening in Pakistan," Selected Issues paper.

D. Structural Reforms for Fiscal Consolidation and Economic Growth

37. Structural reforms, especially in the energy sector, are crucial for fiscal consolidation and economic growth. The energy sector is saddled with considerable problems that have led to unreliable electricity supply and large fiscal costs, including price distortions, insufficient collections, costly and poorly targeted subsidies, inadequate governance and low efficiency in energy supply and distribution, regulatory inadequacies, and insufficient investment in new energy production (Box 7). As a result the output level is estimated to be depressed by some 2 percent.[20] Outside the energy sector, growth prospects are limited by the presence of loss-making public sector enterprises (PSE) in key economic activities, a poor business climate, and a distorted trade regime—all areas where Pakistan falls short of its peer countries.[21]

38. Initial actions on energy sector reform should concentrate on "quick wins" that contribute to fiscal adjustment and resolve energy sector bottlenecks to boost economic growth. Staff argued that the key to reform is making the energy system financially viable, including via clearance of circular debt, tariff adjustments, and a change to cheaper fuels. The mission welcomed the Prime Minister's announcement of a new Energy Policy to relieve short-term bottle necks and encourage long-term increases in electricity supply. In this respect, out of the Rs. 503 billion of payment arrears identified as of end-May 2013, Rs. 342 billion were cleared at end-June 2013, with the residual slated for resolution by end-August 2013. The arrears reduction will allow cash-constrained power producers to bring additional electricity supply to the system in the short-run and reduce load shedding by around three hours per day. Tariff adjustments will improve resource allocation and efficiency, and will encourage conservation. Staff stressed that phasing out subsidies is also an important component of fiscal adjustment; however, targeted income support programs should be used to protect the most vulnerable members of the society. Cost-cutting, improved collection from nonpayers, and efficiency measures are needed to reach full cost recovery in the electricity sector.

39. A key shortcoming of the current electricity sector has been the limited ability to collect for energy supplied, due in part to a lack of specific real-time data on energy flows, and which also results in inadequate compliance with usage restrictions. To address this, strengthened performance contracts needs to be signed with all power sector companies to tackle losses, raise payment compliance, and improve energy efficiency and service delivery. Staff stressed that pending amendments to the Penal Code 1860 and the Code of Criminal Procedures 1898 need to be accelerated to strengthen the legal framework in cases of electricity theft by enhancing investigation, prosecution, and penalties. However, a new electricity act is still needed to modernize governance of the sector.

---

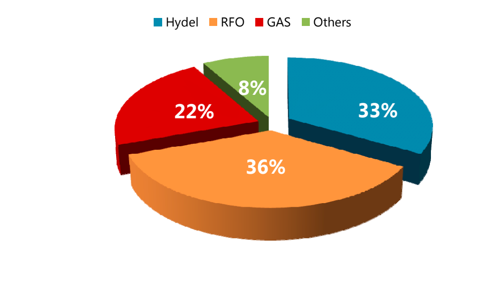
[20] Sahin, S. and F. Salman (2013) "Pakistan's energy issues in computable general equilibrium setting" unpublished mimeo.

[21] Salman, F. (2013) "Case Studies on Structural Reform in Pakistan" Selected Issues Paper, IMF.

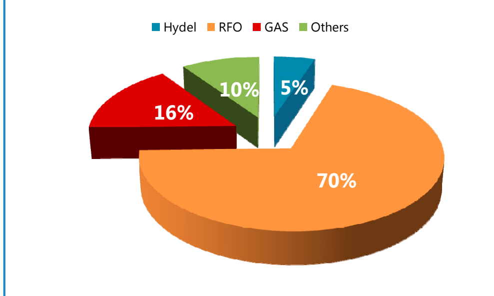
Box 7. Overview of Pakistan's Power Sector

Technical and financial problems in the energy sector have led to large-scale power outages which have depressed output. In the 2000–10 period, Pakistan increased energy supply by 11 percent in per capita GWh, lagging behind her peers[1] by almost one fourth. Energy supply has also lagged behind growing demand at notified prices which fell behind the cost recovery levels. The total installed capacity as of end FY12/13 reached around 23.5[2] GW, however net electrical output has been declining in the last three years due to drags created by the growing payment arrears, derated power plants, and insufficient supply of gas. The current generation falls short of estimated demand by 4–5 GW leading to 8–10 hours of load shedding in the system. Delays in tariff determination and low collection rates contributed to increasing arrears in the sector, which further depressed supply.[3] Transmission and distribution (T&D) losses hover around 22 percent of total supply triple high income economies and more than double the world average.[4] Load shedding in this period led to declining capacity utilization which is estimated to cost around 10 percent of GDP.[4,5]

Energy supply relies on costly fuel mix. Despite power sector's heavy reliance on gas as a generating fuel, the insufficient supply of gas led to the substitution to costly imported fuel. Growing allocation of gas to domestic users further elevated the shortage in the power sector. Fuel imports reach 36 percent of the total energy mix,[6] however it constitutes 70 percent of the total energy generation cost.



Sources: Pakistani authorities; and IMF staff calculations.



Sources: Pakistani authorities; and IMF staff calculations.

Pakistan consumes all of its domestic gas production, however due to lack of investment production is dropping. The current level of gas supply is just over one half of unconstrained demand due to low prices and insufficient investment.[7] The lack of infrastructure also makes it difficult to import gas. At current regulated domestic gas prices, quantity based allocations divert gas from the power sector to households, transport, fertilizer production and industry. Nevertheless, low user prices discourage new investment, promote inefficiency in gas use, and have the potential to generate fiscal cost from the gas sector. The current level of un-accounted for gas losses reached 11 percent—way above international benchmarks.

Fiscal subsidies reached almost 2 percent of GDP per year. The sector generates direct and indirect fiscal costs through untargeted direct subsidies to energy users and repeated bailouts of the recurrent costs in the sector. Pakistan's direct subsidies are more than double relative to median emerging market economy.[8] The delays in determination and notification of prices also increase uncertainty on predicting the cost of subsidies on budget.

Until recently, the increasing stock of circular debt posed to limit energy supply. The stock was estimated to reach 4 percent of GDP as of end-FY13. The debt emerges due to the gap between the actual cost of production and the revenues, and delayed payments by distribution companies to the Central Power Purchasing Agency (CPPA). T&D losses, delays in price determination and notification, delays in pass through of fuel price changes, poor revenue collections, courts interference to power sector governance, delays in subsidy payments by the government to distribution companies all contributed to the growing circular debt. In June 2013, the government cleared large portion of the circular debt, about 1.4 percent of GDP, which should help elevate electricity supply. However, until the underline issues are addressed in a systemic way the problem will emerge in the future.

---

[1] Median Emerging Market economy improved energy supply by 36 percent in the same period.
[2] NEPRA (2012) State of the Industry Report.
[3] DISCO losses reached 18.46 percent, 32.64 percent of losses at KESC (total 20.8 percent) from units purchased, and 2.8 percent of losses for NTDC from units received. The total losses of the system are around 22.37 percent of supply i.e. (NTDC+KESC+DISCO losses)/ Units received by NTDC +KESC purchased from own plants.
[4] http://wdi.worldbank.org/table/5.11#
[5] Sahin, S. and F. Salman, (2013), "Pakistan's energy issues in computable general equilibrium setting," unpublished.
[6] Sources: Pakistani Authorities.
[7] At current prices, supply of gas is around 60 percent of total demand in the system.
[8] IMF (2013) "Energy Subsidy Reform: Lessons and Implications"
[9] Planning Commission of Pakistan and USAID (2013) "The Causes and Impacts of Power Sector Circular Debt in Pakistan," March.

40. Conservation and energy efficiency are the cheapest and the fastest ways to alleviate the electricity shortage. Staff pointed out that pricing and other market based instruments to encourage energy conservation will significantly improve resource allocation and energy efficiency. Staff also urged authorities to promulgate the Pakistan Energy Efficiency and Conservation Act.

41. Current energy generation is tilted towards the use of costly fuel oil. Changes in the energy mix are required to decrease the production costs. The use of gas and coal rather than fuel oil needs to be prioritized. Moreover, the development of hydropower projects needs to continue for long-term sustainable supply.

42. Gas supply falls short of unconstrained estimated demand by half at current prices and investment is limited. To help tackle the gas shortages in the short-run, import of Liquefied Natural Gas (LNG) should be a priority, along with limiting further expansion of the gas distribution networks for domestic consumption and limiting the use of compressed natural gas to fuel vehicles. In the medium-term new investment in gas production should be a priority, both from existing fields and new exploration. Gradual price rationalization would encourage new production and would allocate gas consumption to the most efficient uses. Improvements in the business climate would also encourage new domestic and foreign investment in the sector.

43. Governance and regulatory improvements should be important components of energy sector reform. Half of current circular debt is caused by inefficiencies in tariff determination and notification. Staff urged authorities to minimize the time to determine and notify tariffs and to consolidate the process under the National Electric Power Regulatory Authority (NEPRA) while strengthening NEPRAs administrative capacity. Similarly fuel price adjustments need to be made on a timely basis. Finally, the institutional capacity of all energy sector PSEs needs to be strengthened to allow them to operate independently from the Government as efficient commercial entities.

44. Business climate reforms should initially tackle the major impediments to entry. Staff pointed out that liberalization of barriers to new business start-ups, simplification of legal and taxation requirements (such as a "one stop shop" for investors), strengthening anti-corruption efforts, and designing frameworks to improve contract enforcement would enhance the business climate and increase investment. Access to credit for small and medium enterprises (SME) remains very limited. In this respect, the State Bank of Pakistan's Financial Inclusion Program makes an important contribution.

45. Trade policy reforms would stimulate competition, facilitate innovation and encourage foreign investment. A decade ago, Pakistan had a relatively simple and flat import regime, with four tariff rates from 0 to 25 percent and few exceptions. This system has been subjected to numerous modifications which have made it complex and riddled with special conditions. According to a study by the Customs Budget Wing in 2012, 84 percent of traded tariff headings were subject to SROs modifying rates or granting exemptions. In staff's view, simplifying tariff rates, eliminating exemptions and SROs would deliver a much needed improvement in the competitive environment. Staff also suggested a return to the 2003 framework of 4 tariff "slabs" with 0 to 25 percent rates. Elimination of the negative list on trade with India and extending India most favored nation status, and shifting to "sensitive list" under SAFTA regime would increase regional trade. A strategy to take full advantage of trade preferences available from the EU—where currently autonomous trade preferences in 75 items is present—would also be advantageous.

46. **Reforming public sector enterprises will limit poor performance and help lift economic growth by improving resource allocation**. The authorities and staff agreed that comprehensive action was needed on some 65 PSEs. Initially, a stock taking of all major loss-making PSEs would be advisable to provide a diagnosis of the main problems. This could be followed by implementation of medium-term action plans to privatize firms, restructure those with prospects of profitability but which the government wishes to retain in the public sector, and close nonviable firms. Staff suggested that for those companies with shares already in private hands, privatization should go ahead with block sales, secondary public offerings for institutional and general public or international listings. On restructuring improved governance and corporatization should be essential components of reform.

Authorities' Views

47. **The authorities broadly agreed with staff on the priorities for structural reform**. They are committed to the elimination of subsidies, but stressed that they want to move gradually to match higher prices with increases in energy supply. To ease public resistance, they prefer initially to concentrate price increases on nonhousehold consumers. The authorities are pursuing projects to import gas, and recognize that bold actions on rationalization of gas prices are needed once they are able to tackle legal impediments. To improve electricity collections, the authorities are planning to introduce amendments to the penal and criminal codes before the end of the year. On PSE reform, the authorities proposed an even more ambitious agenda than that recommended by staff, while noting that sequencing should be calibrated to match market conditions and privatization IPOs and SPOs offered only after gauging investors' appetite and global market conditions. The authorities noted that the EU is currently considering their request for receiving GSP plus benefits (zero percent duty) among other trade facilitation actions. Finally, they agreed to identify the legal and bureaucratic impediments to doing business and will build the capacity of the Board of Investment to undertake the necessary reforms.

PROGRAM DISCUSSIONS

48. **Program discussions focused on a package of adjustment measures to reduce short-term persistent vulnerabilities and promote robust inclusive growth by addressing Pakistan's underlying structural problems**. The authorities and staff agreed on strong fiscal consolidation measures to address the unsustainable government deficit problem and contribute to easing external financing needs, as they would ease demand-side pressures, facilitate increased donor inflows, and eventually allow for private external deficit financing. Such policies will address the large and persistent problems in the external sector by paving the grounds for foreign exchange inflows through increased FDI and portfolio investment. Staff and the SBP agreed that fiscal measures need to be combined with an independent monetary policy aimed at rebuilding reserves and controlling

inflation in the medium-term. The policy mix also includes significant structural reforms to sustain the improved fiscal stance, boost investment and growth prospects and deliver better economic prospects for the poor through targeted support spending. The sizable fiscal consolidation should allow the government to transition to reliance on foreign and domestic private markets and normal project disbursements from donors to cover its future financing needs once the program ends. Structural reforms to improve growth, ease energy bottlenecks, and strengthen the investment climate should boost both foreign direct investment and portfolio inflows, making the balance of payments more sustainable.

49. The program has been designed with the lessons from Pakistan's previous arrangements with the Fund in mind. Staff noted that the Ex Post Evaluation (EPE) report on the 2008 program recommended the following key points for future engagement: (i) Strong ownership and broad-based buy-in and political support to implement ambitious structural reforms; (ii) Striking a balance between including critical reforms and avoiding overreach; and (iii) Close collaboration with other development partners. Consistent with this, program discussions centered on upfront conditionality focused on a limited number of permanent measures clearly aimed at Pakistan's long-standing challenges, and steps to secure broad political support for the program. Other donors were closely involved in program discussions, particularly in their areas of expertise and will be full participants in the overall reform program supported by the EFF. Structural conditionality will be focused on the most critical areas where the authorities themselves have strong ownership. Structural benchmarks are phased over time in recognition of constraints on the authorities' administrative implementation capacity, and significant technical assistance will be provided by the Fund and other donors (¶76). While program design has been adapted to incorporate the lessons of previous programs, full and timely implementation of program conditionality is ultimately the crucial factor in determining program success.

FISCAL POLICY

The Fund supported program contemplates around 4½ percent of GDP in fiscal consolidation over three years, of which 2 percent of GDP would be taken upfront.

50. Under the authorities' proposed program, the fiscal deficit would be reduced to around 3½ percent of GDP by FY2016/17 (MEFP ¶7–9). World Bank studies suggest that aggressively broadening the coverage of General Sales Tax (GST) and key taxes (income taxes and import tariffs) could yield up to 4½ percent of GDP over time, and increases in tax rates (such as GST or excises) could be considered, in addition to other potential measures (table below). On the expenditure side, current spending—mostly electricity subsidies—could be reduced by 1½–2 percent of GDP over the program period. Together, measures of this order of magnitude could deliver the desired deficit reduction while permitting increased spending on growth enhancing investment and social protection. Given the significant devolution of revenues to the provinces, the government will seek explicit agreement with the provinces to deliver the budgeted surpluses through saving additional revenue transfers.

51. The initial fiscal adjustment effort includes permanent deficit reduction measures of 2 percent of GDP, coming mainly from revenue increases and lower energy subsidies (MEFP ¶8). Tax measures included in the 2013/14 budget—including a one point hike in the GST rate—are expected to yield ¾ percent of GDP annually. Reduced energy subsidies will produce another ¾ percent of GDP in savings. The remainder will come from lower current expenditures (0.15 percent of GDP), savings of the PSDP budget, and (in the second half of the fiscal year) a new levy on natural gas expected to yield about 0.4 percent of GDP on an annualized basis. As a contingent strategy, the government will bring forward the measures identified for years two and three of the program.

52. The additional fiscal adjustment in years two and three of the program will be concentrated on efforts to broaden the tax base and to further reduce untargeted subsidies (MEFP ¶9, 10, and 13). On the revenue side, the authorities envisage measures yielding ¾ percent of GDP in each of the subsequent years. The focus will be on eliminating exemptions and concessions embedded in the Statutory Regulatory Orders (SROs) and in the law, as well as on eliminating the power of the executive to grant preferential tax treatment through SROs. These steps will facilitate gradually moving the GST to a full-fledged integrated VAT-style modern indirect tax system with few exemptions and to an integrated income tax by 2016/17. Tax administration reforms will also be critical to this revenue effort. On the income tax side, the authorities will focus on 300,000 potential taxpayers, through the national data warehouse. In addition to the 100,000 notifications for late return filing under section 114 envisaged for FY2013/2014, the authorities will pursue additional 100,000 in each of the following two years. If the tax payers fail to respond satisfactory, these notifications will be followed by a provisional assessment of income under section 122—which will become final if the taxpayer again fails to respond satisfactorily—and measures to collect the tax liability (including attachment of bank accounts). The authorities will also develop plans to strengthen the administration of customs, sales and excise taxes (structural benchmark). On the expenditure side, further subsidy reductions of around 0.4 percent of GDP per year are envisaged under the authorities' comprehensive energy plan.

Annualized Yield of Key Measures under the Program
(In percent of GDP)

	2013/14	2014/15	2015/16
Total	**2.08**	**1.20**	**1.06**
Tax measures included in the budget	0.74	…	…
Tax measures to be identified	…	0.75	0.75
New levy on natual gas	0.40	0.00	0.00
Reduction of energy subsidies	0.79	0.45	0.31
Savings on current non-wage spending	0.15	0.00	0.00
Memorandum			
Increase in BISP	0.06	0.11	0.05

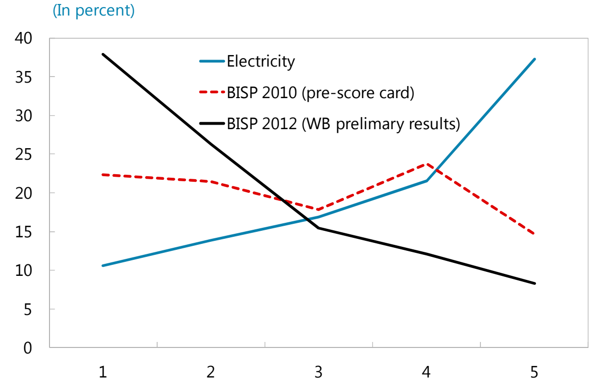
53. The provinces will contribute to the consolidation effort (MEFP ¶14). In 2013/14, the provinces—through the Council of Common Interests—have agreed to deliver the required fiscal surpluses through saving the additional revenue transfers. To encourage compliance, the SBP will begin to pay interest on deposits held by the provinces. However, stronger institutional arrangements will be needed in the future to ensure the sustainability of the envisaged fiscal consolidation. In 2014/15 and beyond, negotiations will take place on a new NFC award which the authorities plan to use to adjust the revenue sharing arrangements to provide a better balance between revenue and spending responsibilities.

Federal and Provincial Fiscal Balances
(In percent of GDP)

	2012/13	2013/14	2014/15	2015/16
Overall balance	**-8.5**	**-5.5**	**-4.4**	**-3.6**
Provincial balance	**-0.1**	**0.5**	**1.0**	**1.4**
Share in federal revenue	5.2	5.7	6.2	6.6
Net other	-5.3	-5.2	-5.2	-5.2
Federal balance	**-8.4**	**-6.0**	**-5.4**	**-5.0**

54. Targeted assistance schemes will be expanded significantly during the program to protect the most vulnerable members of society [22] (MEFP ¶13). The main program, the Benazir Income Support Program (BISP), reaches 4.8 million families in the two poorest quintiles of the population.[23] For FY2013/14, the budget allocated to BISP has risen so as to increase the level of benefits from PRs.1000 to PRs. 1200 per family per month and expand coverage to 5.7 million families. Additional resources will also provide conditional cash transfers (CCTs) to primary education, supporting 560,000 families with a benefit of Rs. 200 per child per month attending school. Coverage of the BISP and CCTs would continue to rise under the program, reaching 6.6 million families by 2015/16 with benefits scaled up to cover inflation.

Quintile Share of Aggregate Spending or Transfers
(In percent)



Sources: Pakistani authorities; and IMF staff calculations.

[22] According to World Bank and UK-DFID, the Benazir Income Support Program (BISP) reaches out to the most vulnerable members of the society through cash transfers. The current allocation provides cash assistance to 4.8 million families, which constitutes almost 16 percent of the population (almost 40 percent of the population below the poverty line).

[23] Source: World Bank and UK-DFID.

MONETARY POLICY

Rebuilding reserves will be the priority short-term policy objective, with maintaining low and stable inflation taking on greater importance later on. Enhanced SBP independence and ending SBP direct financing of the fiscal deficit will be crucial.

55. **Staff and the SBP agreed that monetary and exchange rate policies should be adjusted to address declining reserves and a projected rebound in inflation** (MEFP ¶17). In the short-term, monetary and exchange rate policies should focus on rebuilding foreign exchange reserves. As a first step, to signal a shift in policy and to begin attracting capital inflows, the SBP has begun net purchases of foreign exchange in the interbank spot market. Reserves accumulation will be guided by a tight NIR target under the program. The SBP will allow greater exchange rate flexibility, limiting intervention in the exchange market to that needed to build reserves, cushion major shocks, and strengthen competitiveness over time. The authorities also agreed to gradually reduce the SBP's short swap/forward foreign exchange position to a more sustainable level. Inflation will be contained to around 8 percent in 2013/14, aided by the effects of fiscal consolidation in limiting domestic demand growth and easing fiscal pressures on the money supply.

56. **Beginning in 2014/15, monetary policy should aim to reduce inflation while continuing to rebuild foreign exchange reserves** (MEFP ¶16, and 18). To guide inflation reduction efforts, a target on NDA of the SBP envisages a reduction in money supply growth over time to rates consistent with the inflation objective of 6–7 percent. Monetary accommodation of fiscal deficits will be scaled back considerably, while maintaining a positive real policy interest rate will help anchor inflation expectations. The SBP has also halted further direct lending to the government, reflected by a continuous ceiling on total SBP credit to the government (which will fall over time and will help lowering the reserve money growth).

57. **Enhanced central bank independence will improve monetary policymaking** (MEFP ¶19). In the near term the authorities agreed to work toward approval of amendments to the SBP law to give greater operational independence in the central bank's pursuit of price stability as its primary objective. Among other things, the amendments will establish an independent, decision-making monetary policy committee to design and implement monetary policy and will prohibit any form of new direct lending to the government from the SBP.

FINANCIAL POLICIES

58. **The SBP will prepare detailed plans to assure that all banks come into compliance with minimum capital adequacy requirements** (structural benchmark, MEFP ¶21). The plan will cover both state-owned and private banks and will include contingency measures in case of slippages, indicating clearer alternatives in case banks are unable to raise expected capital.

59. **Consultations are already underway with key stakeholders on the new bankruptcy law (Corporate Rehabilitation Act) to revamp the recovery mechanisms** (MEFP ¶22). The new law will facilitate the legal framework for rehabilitating viable corporate and financial entities while

speeding up the process of liquidation of unviable entities. The authorities also plan to approach key stakeholders to address the concerns regarding creditor and debtor protection.

60. A deposit insurance scheme will be introduced once preconditions are in place (MEFP ¶23). The scheme is expected to boost confidence in the banking system, which will encourage additional growth in deposits. The authorities agreed to pass legislation on deposit insurance scheme and fully implement this legislation over the course of the next three years where necessary preconditions are met such as capital adequacy, effective supervisory and regulatory framework, and a special resolution framework.

61. Revising the regulatory and supervisory frameworks is critical for financial stability (MEFP ¶24). The Securities and Exchange Ordinance, 1969 "SEO 69" lacks a proper structure and suffers from numerous inconsistencies and gaps due to several amendments made over years. The authorities will undertake several initiatives during the program period:

- The draft Securities Bill will enhance the supervisory and enforcement power of the regulator.
- Regulatory power of the Securities and Exchange Commission of Pakistan (SECP) will be enhanced with a new draft bill.
- A comprehensive framework for the futures markets will be prepared.
- Better coordination between SBP and SECP will be implemented to effectively regulate and supervise banking groups.

STRUCTURAL POLICIES

Critical structural measures in the energy sector together with targeted transfers to protect the most vulnerable will be a priority under the new Fund-supported program. Other reforms will also be important components of the arrangement, such as trade liberalization, reforms of public sector enterprises (PSEs), and improvements to the business climate, which will kick start growth.

62. The authorities have launched a comprehensive energy policy (MEFP ¶26). The policy to be implemented during the program will cover all elements of the energy supply chain, demand management, and pricing policies for better functioning of the sector:

- ***Electricity sector*** (MEFP ¶27, and 32). Tariff rationalization has already begun, and the elimination of payables arrears in the power sector is a positive development. However, more is needed to limit the recurrence of arrears in the future. During the program period Tariff Differential Subsidies (TDS) will be phased out and tariffs will be brought to cost recovery levels. Tariff adjustments will improve resource allocation and efficiency, and will encourage conservation. Cost-cutting and efficiency measures will also be undertaken in both generation and distribution companies. Legal changes will be undertaken to tackle electricity theft by enhancing investigation, prosecution, and penalties. High priority will be given to improve energy sector governance and transparency. Additional electricity production projects will be accelerated.

- ***Gas sector*** (MEFP ¶34). The authorities will prepare a gas price rationalization plan to accompany the electricity price rationalization already underway. In the short-run, they will administratively allocate gas to uses with higher economic value (e.g., energy production) while preparing to let price mechanisms take over the allocation function in the future. They will develop facilities to import gas, and will increase incentives for higher domestic production.

63. The authorities agreed to move forward with business climate reforms to help increase foreign and domestic private investment (MEFP ¶36). The Corporate Rehabilitation Act, Alternative Dispute Resolution (ADR) Mechanisms, setting up a one-stop shop (including the human resource and funding needs), and identifying the required changes in the regulations and administration will be required to tackle the impediments to doing business. In this respect, the Board of Investment, in coordination with SECP, Federal Bureau of Revenue, provincial governments, and other concerned agencies, will develop a plan to further simplify procedures and reduce costs for setting-up businesses in Pakistan.

64. Trade policy and PSE reforms will be important components of the program (MEFP ¶37). These reforms will increase consumer welfare, stimulate growth via increased competition, and improve public resource allocation. The authorities will prepare a three-year program to return to a simplified import tariff regime, with 4 tariff rates ranging from 0-25 percent with few exceptions. The elimination of SROs will also remove the source of many distortions to the trade regime. The authorities will embark on a stock-taking of all major loss-making PSEs. This shall be followed by implementation of medium-term action plans to privatize firms, restructure those with prospects of profitability but which the government wishes to retain in the public sector, and close nonviable firms.

65. Enhanced and better-targeted assistance for the poorest households is necessary (MEFP ¶13). The poor and most vulnerable segments of the society will be protected from the direct and indirect impacts of fiscal consolidation and tariff adjustments. The Benazir Income Support Program (BISP) is the largest targeted social assistance mechanism directly reaching 4.8 million families (16 percent of the population) within the two poorest quintiles. As savings from tariff adjustments and fiscal space are realized, the authorities agreed to expand its coverage and increase the benefit amount to protect the real purchasing power of the beneficiaries.

PROGRAM MODALITIES

66. *Access, Duration, Phasing*: An extended arrangement under the EFF would be appropriate to meet Pakistan's medium-term financing needs, build reserve buffers from their current level of US$5.4 billion, and put the economy on a sustainable, higher-growth path. Access of 425 percent of quota (SDR 4,393 million, equivalent to US$6.68 billion) is based on Pakistan's external financing needs (Box 8). The required fiscal adjustment, outstanding credit, and record of using Fund resources are also used to determine access. The proposed arrangement will be within normal access limits for an extended arrangement under the EFF, even after the implementation of the 14th quota review and possible changes to normal access limits.[24] Even phasing over the program would imply net repayments to the Fund in the first four quarters of the program. The first disbursement would be at program approval and the remaining purchases would be contingent on completing quarterly reviews.

67. ***Support from other donors***. Staff has worked in close coordination with the World Bank, the Asian Development Bank, and key bilateral donors in developing policy recommendations (particularly for structural reforms). There are firm commitments from donors to fill the entire financing gap for the first 12 months of the arrangement, and good prospects that there will be adequate multilateral and bilateral financing for the remainder of the program. Financial support from these partners is expected to reach US$6 billion during the program period, with strong technical assistance also provided, particularly in tax administration and the energy sector.

68. **Prior actions**: The following prior actions were undertaken by the authorities to kick start reforms and signal commitment to the necessary adjustment policies:

- Implementation of a series of fiscal adjustment measures (including those in 2013/14 budget) totaling 2 percent of GDP on an annualized basis.
- Elimination of tariff differential subsidies in industrial, commercial and bulk users and reduction of subsidies to high levels of consumption totaled 0.75 percent of GDP in annualized savings.
- Sustained purchases of foreign exchange by the SBP.
- An agreement at the Council of Common Interest on respecting the 2013/14 fiscal balances for the provinces under the program.
- Issuance of 10,000 collection notices to individuals not registered to pay taxes based where indirect methods suggest large potential income tax liabilities.

69. ***Quantitative and Continuous Performance Criteria***: The program will be monitored with quarterly performance targets on the general government fiscal balance (consolidated federal and provincial), net foreign assets, net domestic assets, SBP lending to the government, the SBP's forward/swap position, the accumulation of domestic arrears, and the standard continuous performance criterion on the nonaccumulation of external arrears.

[24] Pakistan's quota will increase from 1033.7 million SDR to 2031 million SDR after the quota review. Table 8 indicates the level of credit outstanding under existing arrangements and the proposed EFF.

70. ***Structural Benchmarks***: Beyond the prior actions in the structural area, benchmarks on structural reforms are also set. Benchmarks in the fiscal sector are designed to secure the fiscal consolidation and distribute the burden to wider groups of tax payers. Monetary policy benchmark is aimed at bringing more independence to the SBP through changing the composition of the Board, extending the tenure of the Governor and eliminating SBP lending to the Government. Financial sector benchmarks focus on initially to mitigate short-term risks posed by undercapitalized banks and ensure that necessary institutions are set up to protect medium-term financial stability. Finally, benchmarks in the structural policies are intended to address the long-standing problems in the energy sector and loss making public sector enterprises which constitute critical constraints on growth and have generated or have the potential to generate large fiscal cost.

71. ***Risks***: Program implementations risks are high given Pakistan's track record, particularly political constraints and the limited technical capacity to implement reforms simultaneously across a wide range of activities. These risks are mitigated by critical upfront actions as well as the strong electoral mandate and commitment to reform of the new government. Strong technical assistance support from the international community should help ease risks that implementation will lag due to weak technical capacity. The recent record of interventions by the Supreme Court in economic and administrative issues may be another source of uncertainty. The governing party may lack political support in provinces outside of Punjab, complicating provincial-federal financial agreements. Endorsement of the 2013/14 budget parameters and medium-term program objectives from other provinces is expected to mitigate this danger. Delays or shortfalls in financing from public or private sources are another program risk. Public funding risks should be eased by the strong commitments of support from the World Bank, ADB, and key bilateral partners. Private financing risks may be reduced by the authorities' strong privatization program (flows from which have been very conservatively estimated).

Box 8. BOP Projections and External Financing Requirement

The BOP position is sustainable with significant adjustment and new financing. While the current account deficit is not particularly large, foreign exchange reserves are under downward pressure from three factors: (i) weak gross financing inflows; (ii) large expected financing outflows (including repayments to the Fund); and (iii) the possible unwinding of the SBP's short forward position (currently at US$2.2 billion). Fiscal measures of 2 percent of GDP and Fund financing will stop reserve loss and maintain the stability of the external position.

Reserves are projected to reach adequate levels within the program period to handle unforeseen shocks (see Table below). Under the program scenario, reserves are projected to reach to around US$15.5 billion by the fourth quarter of 2015/16 (three months of imports). This projection incorporates the following assumptions: the latest WEO assumptions on commodity prices and external demand; additional inflows from the Coalition Support Fund (US$3 billion), PTCL privatization (US$0.85 billion), and sales of 3G licenses (US$1.2 billion); and Fund financing of US$6.6 billion to close the remaining financing gap. The program is expected to stabilize the economy and catalyze external official (US$6 billion) and private financial inflows. FDI is expected to return gradually to its former levels as a share of GDP, driven by privatization revenues and improved business climate.

Medium-term projections are subject to significant downside risks. First, Pakistan's BOP is very sensitive to volatile commodity prices. A US$10 per barrel increase in the oil price raises the import bill by about US$600 million. Second, some capital inflows that are expected in 2013/14 may not materialize. Third, the program scenario assumes that Pakistan will regain modest access to international capital markets in 2015/16. Finally, SBP's short forward foreign exchange positions may unwind faster than envisaged in the program.

Pakistan: Gross Financing Requirements and Sources, 2011/12–2015/16

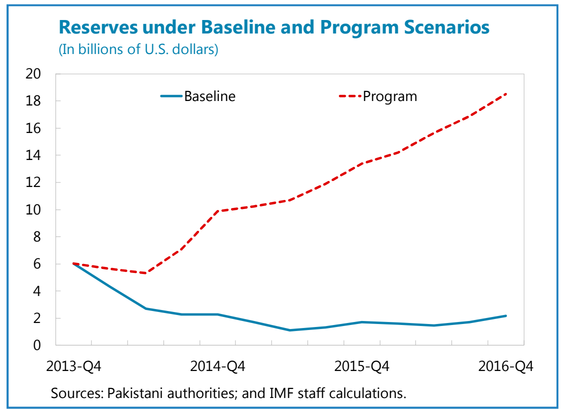
(In millions of U.S. dollars; unless otherwise specified)

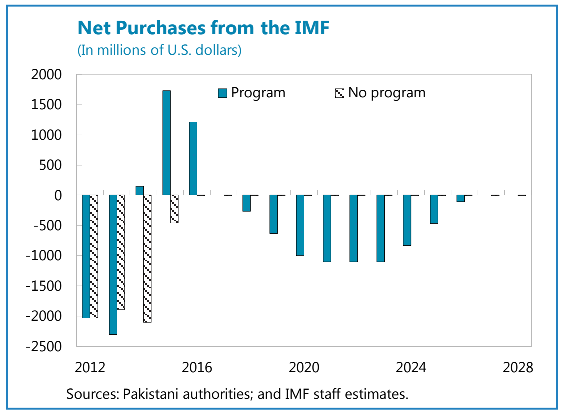
	2011/12	2012/13	2013/14				2013/14	2014/15	2015/16
	FY	FY	Q1	Q2	Q3	Q4	FY	FY	FY
		Est	Program					Program	
Gross external financing requirements	**7,834**	**7,582**	**2,482**	**2,821**	**874**	**901**	**7,077**	**5,948**	**6,284**
Current account deficit (if surplus = -) 1/	4,658	2,299	904	994	-246	-334	1,318	1,719	2,723
Of which: Interest payments (if net receipts = -)	1,589	1,182	222	321	219	296	1,057	1,128	1,155
Of which: CSF	0	1,806	300	300	300	300	1,200	1,200	600
Amortization of medium- and long-term debt	3,076	4,892	1,420	1,315	1,120	1,235	5,090	3,729	3,262
To external private creditors	444	478	117	111	123	116	468	529	1,222
To external official creditors	2,632	4,414	1,303	1,204	997	1,119	4,623	3,199	2,040
IMF	1,155	2,162	849	1,014	625	600	3,089	1,272	57
To other official creditors	1,477	2,252	453	190	372	519	1,534	1,927	1,983
Maturing short-term debt	100	391	157	512	0	0	669	500	300
Available financing	**7,834**	**7,582**	**1,939**	**2,239**	**-203**	**-177**	**3,797**	**1,479**	**1,633**
Net FDI (including privatization receipts)	744	1,229	319	663	365	981	2,327	3,166	3,960
Medium- and long-term borrowing	3,070	1,973	606	589	702	760	2,658	1,296	1,827
From external private creditors	437	137	161	184	191	215	751	816	1,571
Borrowing by domestic private sector	437	137	161	184	191	215	751	816	1,071
Borrowing by domestic public sector	0	0	0	0	0	0	0	0	500
From external official creditors (non-IMF, currently identified)	2,633	1,836	445	405	511	545	1,906	480	257
Roll-over of short-term debt	0	295	50	150	150	150	500	300	300
Other net capital inflows	-410	-471	395	276	-51	-250	370	580	648
Reserve Assets (decrease = +)	**4,430**	**4,556**	**569**	**561**	**-1,370**	**-1,819**	**-2,058**	**-3,863**	**-5,103**
Remaining financing gap	0	0	543	581	1,077	1,078	3,280	4,469	4,652
Program Financing		0	543	581	1,077	1,078	3,280	4,469	4,652
Borrowing from IMF (gross)		0	543	544	545	546	2,177	2,191	2,203
Loans and Grants from other official creditors		0	0	38	533	533	1,103	2,278	2,449
Of which: WB				0	225	225	450	800	900
Of which: ADB				0	133	133	267	533	533
Of which: Bilateral and other				38	174	174	386	945	1,016
Memorandum items									
Gross official reserves in US$ billions	10.8	6.0	5.6	5.3	7.2	9.6	9.6	13.4	18.5
In months of imports	2.7	1.4	1.3	1.2	1.6	2.2	2.2	2.8	3.6
Total gross external debt in percent of GDP	29.1	27.0	26.7	26.4	26.3	26.2	27.0	25.2	23.4

Sources: State Bank of Pakistan, and Fund staff estimates and projections.

1/ Excludes program related budgetary grants

72. Capacity to Repay the Fund: Pakistan's capacity to repay the Fund is strengthened by the new program as it will help Pakistan restore its external stability and should catalyze new capital inflows from donors and from the private sector. With an extended arrangement under the EFF, the net repayment profile to the Fund eases significantly, while still lowering the Fund's exposure to Pakistan during the first two years of the program. The new program will enhance the capacity to repay in two main ways: (i) the balance of payments is expected improve significantly (Box 8) due initially to consolidation and official inflows, but later due to higher private capital inflows; and (ii) reserves will be significantly higher under the program scenario, reducing the Fund's exposure to only around 1/3 of reserves by the end of program period despite new disbursements.[25] In the absence of a new program, the repayment burden would constitute a substantial strain on Pakistan's balance of payments. While the authorities' determination to repay is not in doubt, at end-June 2013 the Fund's exposure to Pakistan stood at roughly US$4.5 billion (74 percent of gross official reserves). Repayments are concentrated in the remainder of 2013 and during 2014 (roughly US$4 billion). In addition, baseline risks to the balance of payments are tilted to the downside, and Pakistan's ability to regain access to international capital markets is limited without reforms. Materialization of these risks would further erode Pakistan's capacity to repay the Fund. While sensitive to real depreciation shocks, Pakistan's total external debt remains broadly sustainable (Table 10).





73. Safeguards: A safeguards assessment update will be completed no later than the first review under the new extended arrangement under the EFF.

[25]Net repayments to the Fund will also be significantly reduced in 2013/2014 and future repayments will be spread out more smoothly over a period of years.

OTHER ISSUES

74. Outreach. As part of the Article IV consultation discussions, the mission held meetings with business and banking leaders in Karachi and Lahore and with journalists and opinion leaders in Islamabad. Meetings were held with the diplomatic community and with key multilateral and bilateral donors. At the conclusion of the mission, a joint press conference was held with Minister of Finance Dar. While direct meetings with civil society are somewhat circumscribed by security concerns, Pakistan is a pilot case for outreach via social media, with an active twitter account (@imf_pakistan). Further outreach efforts are planned upon Board approval of the program.

75. Although the authorities have taken steps toward improving Pakistan's AML/CFT regime in the context of the Financial Action Task Force (FATF) initiative against noncooperative jurisdictions, some strategic deficiencies remain. The amendments to the Anti-Terrorism Act enacted earlier this year have addressed part of the concerns expressed by the FATF. However, the authorities still need to further amend the Act, in particular with regard to the identification and freezing of terrorist assets. Pakistan's current listing by the FATF creates costs on financial intermediation because of heightened due diligence requirements by international financial institutions. In addition, the effective implementation of the AML/CFT framework could support the authorities' efforts in fighting against tax evasion and corruption.

76. Exchange rate regime. Pakistan has accepted the obligations of Article VIII, Sections 2, 3, and 4. Pakistan's exchange rate regime has been classified as floating since January 2008.

77. Data quality. Macroeconomic statistics are broadly adequate for surveillance and program monitoring. The authorities are progressing towards closing gaps in the real sector and strengthening the quality of fiscal and social (especially poverty) data to better inform policy decisions and monitor outcomes. Recently, the authorities have rebased the national account statistics and will publish quarterly national accounts starting from November 2013 in line with the Special Data Dissemination Standard (SDDS). Before the end of the year, they are also planning to extend the new series back to FY1999/2000.

78. Technical Assistance. A comprehensive solution to Pakistan's fiscal problems will require technical assistance from the Fund and other donors. The highest priority is a tax administration diagnostic mission, followed by support on public financial management and on federal-provincial fiscal arrangements. Staff also pointed out that SBP can benefit from technical assistance on foreign exchange auctions, citing Turkey and Mexico as good examples. TA is also required to help improve banking supervision. The authorities have also requested assistance for applying BPM6.

STAFF APPRAISAL

79. Pakistan is facing serious economic challenges. Overall vulnerabilities and crisis risks are high, with subpar growth and unsustainable fiscal and balance of payments positions. Lack of reliable electricity supply and a difficult security situation in large parts of the country have contributed to the deterioration.

80. The risks to the outlook are on the downside and strong policy action is required. Domestic risks emanate from the fiscal imbalance with the attendant high government debt rollover requirements, a worsening energy crisis, and security problems, all of which could seriously damage growth prospects. On the external side, there are significant downside risks to the balance of payments. Besides international oil and food price volatility, the economy also remains highly vulnerable to adverse global spillovers through trade and remittances channels.

81. Pakistan's newly elected government has a strong mandate to stabilize the economy and address critical constraints on growth. The authorities have made in important start in their first months in office. They have approved a FY2013/14 budget with measures to boost revenues, reduce energy subsidies, and cut the fiscal deficit. To prepare for a new extended arrangement under the EFF with the Fund, they have undertaken additional fiscal measures. They have implemented significant energy price adjustments and launched a comprehensive energy reform policy. They are also preparing important reforms in the gas sector, trade policy, PSEs, and the business climate. They have launched a new enforcement program to improve tax collections and have appointed new senior staff in the FBR. Together, these steps to mitigate near-term vulnerabilities and foster inclusive growth over the medium term will generate a turnaround in the economy once fully implemented. The extended arrangement under the EFF support from the Fund is aimed at providing sufficient resources and traction to help the authorities to pursue this homegrown program.

82. To ensure fiscal sustainability further consolidation is needed. While the reduction in the headline deficit from 8.8 percent of GDP in 2012/13 to 5.8 percent of GDP in 2013/14 is an important achievement, further efforts will be needed in subsequent years to secure medium-term fiscal sustainability. In particular, the tax-to-GDP ratio must be raised significantly to allow for needed social and investment expenditures while lowering the deficit. This must involve broadening the tax base via an ambitious reduction in exemptions and concessions, and efforts to extend taxation to areas currently not fully covered by the tax net. It will also require an overhaul of tax administration, including by boosting training, transparency, and enforcement capabilities. Full fiscal sustainability can only be achieved if the provinces are full partners in the adjustment effort.

83. Monetary and exchange rate policies must be geared to rebuilding external buffers and to maintaining price stability over time. In the short-run, the SBP must prioritize stabilizing its foreign exchange reserves, making use of program disbursements, financial support from other donors, foreign exchange intervention, and exchange rate flexibility. The net international reserve targets under the program reflect this objective. Once reserves cushions begin to be restored, the

SBP should increasingly focus its attention on maintaining low and stable inflation (in the 5-7 percent range). To achieve this objective, direct lending to the government must cease and liquidity injections should be exclusively through open market operations calibrated to achieve the program's NDA targets. In the medium-term, full operational independence will help the SBP improve monetary policymaking and achieve the needed inflation reduction.

84. Continued financial sector stability and steps to deepen financial markets will contribute to boosting economic growth. While systemic risks to the banking sector are not particularly high at this time, the authorities need to promptly address those banks below the minimum CAR or below the MCR to avoid future dangers. Development of additional tools to strengthen the financial health of the system, such as deposit insurance, consolidated supervision, and enhanced legislation on nonbank financial activities are important. Steps to deepen financial markets will facilitate increased private investment and growth over time.

85. Structural reforms are key to sustained and inclusive growth. The authorities' energy policy is geared to address the long-standing problems in the sector which constitute the most critical constraint on growth and have generated large fiscal costs. Staff anticipates a boost in GDP on the order of 2 percentage points over the coming years as the energy crisis is resolved. Reforms in other areas are also critical for higher growth. As the authorities liberalize the trade regime, restructure or privatize public sector enterprises, and take measures to improve the business climate, rent-seeking behaviors will decline and productive investment—both foreign and domestic—will rise sharply, boosting medium-term growth prospects.

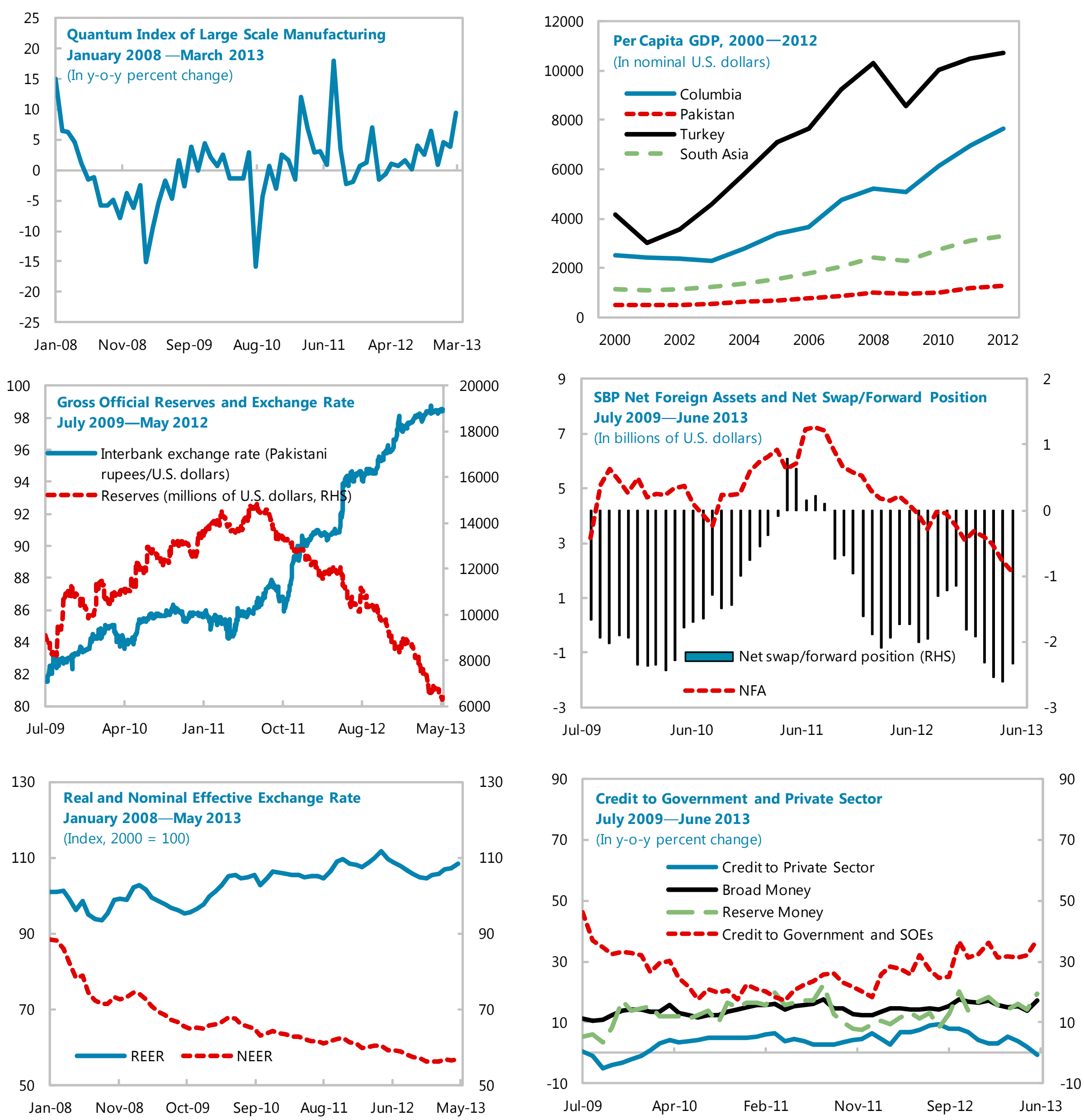
86. Protecting the most vulnerable from the direct and indirect impacts of fiscal consolidation and price adjustments should be a priority. Staff welcomes the authorities' firm commitment to boosting targeted income support programs, as signaled by the inclusion of an indicative floor on such spending in the program targets. Coverage and benefits of these programs are slated to gradually increase as savings from tariff adjustments and fiscal space are realized.

87. While there are implementation risks under the proposed extended arrangement under the EFF, the authorities' commitment is strong. Pakistan's track record is spotty on sustained adherence to IMF programs, and this will be a relatively high risk arrangement. Possible external shocks will continue to pose risks to Pakistan's fragile balance of payments until well into the second year of the program when reserves will finally rise above critical levels. The delicate security situation could also pose risks. The authorities may also encounter constraints on their legal, administrative, or technical abilities to implement such an ambitious reform agenda simultaneously in several governance areas. However, the new government has demonstrated considerable political will in undertaking as a prior action around 45 percent of the total 4½ percent of GDP fiscal adjustment required in the three-year program. They have also taken increases in sensitive energy prices upfront. These early steps bode well for success in implementation of future program conditionality. Ownership of the program is strong, as emphasized by the authorities' own reform initiatives even before program discussions began, and the government has a majority in the national assembly to take needed actions.

88. The proposed level of access of 425 percent of quota is consistent with medium-term external and debt sustainability provided the program is implemented as envisaged and any unforeseen shocks are addressed swiftly. However, additional resources from donors will be an important component of program financing. There are firm commitments from donors to fill the remaining financing gap for the first 12 months of the arrangement, and good prospects that there will be adequate multilateral and bilateral financing for the remaining program period beyond those first 12 months. Donors are expected to provide around US$6 billion of additional resources over the next three years.

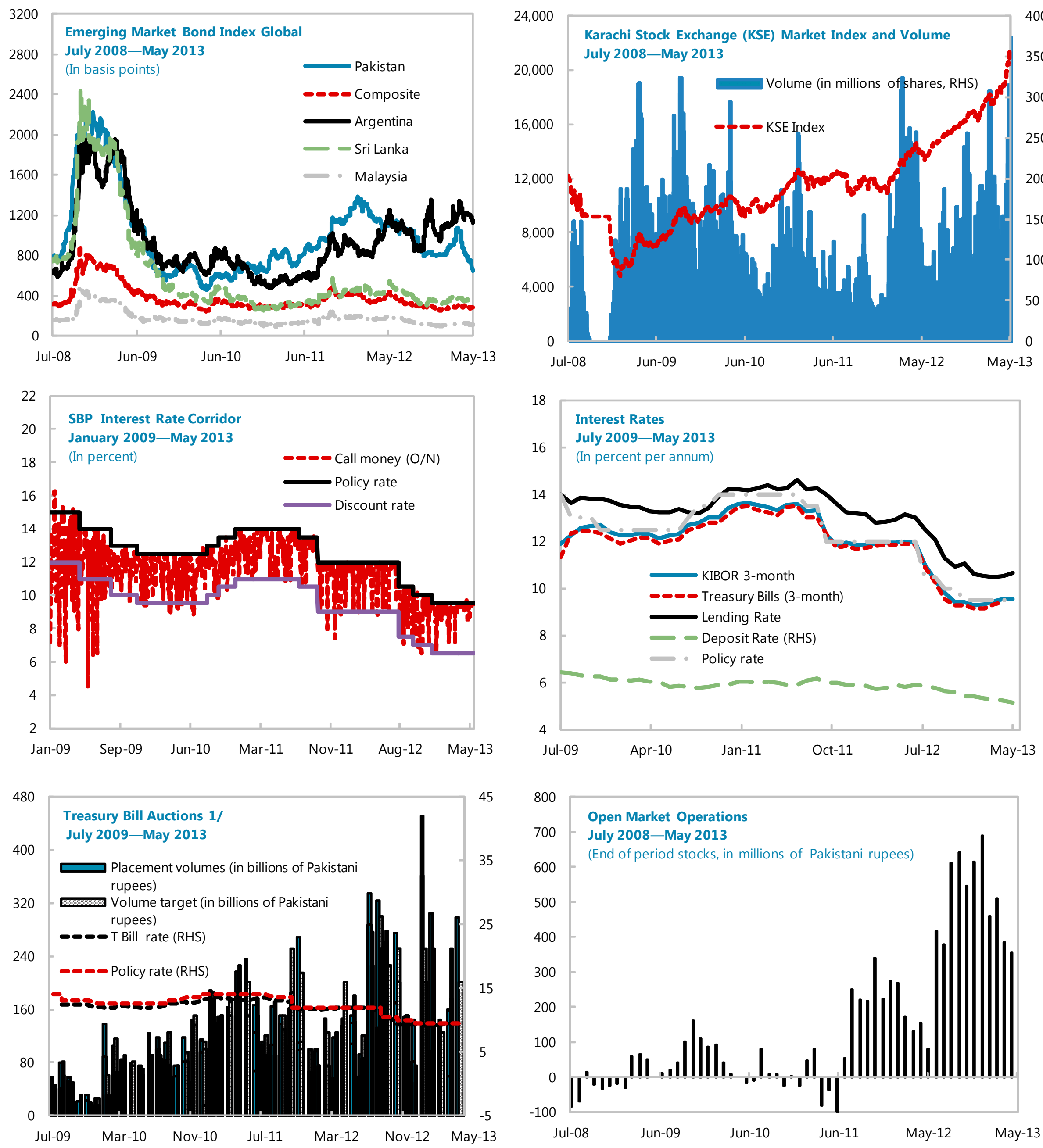
89. In view of Pakistan's balance of payments needs and the comprehensive package of adjustment measures proposed by the authorities, staff supports the authorities' request for an extended arrangement under the EFF in the amount equivalent to SDR 4.393 billion (425 percent of quota). Staff recommends that the next Article IV Consultation with Pakistan take place on the 24-month cycle.

Figure 1. Pakistan: Selected Economic Indicators, 2008–13



Sources: Pakistani authorities; and IMF staff calculations.

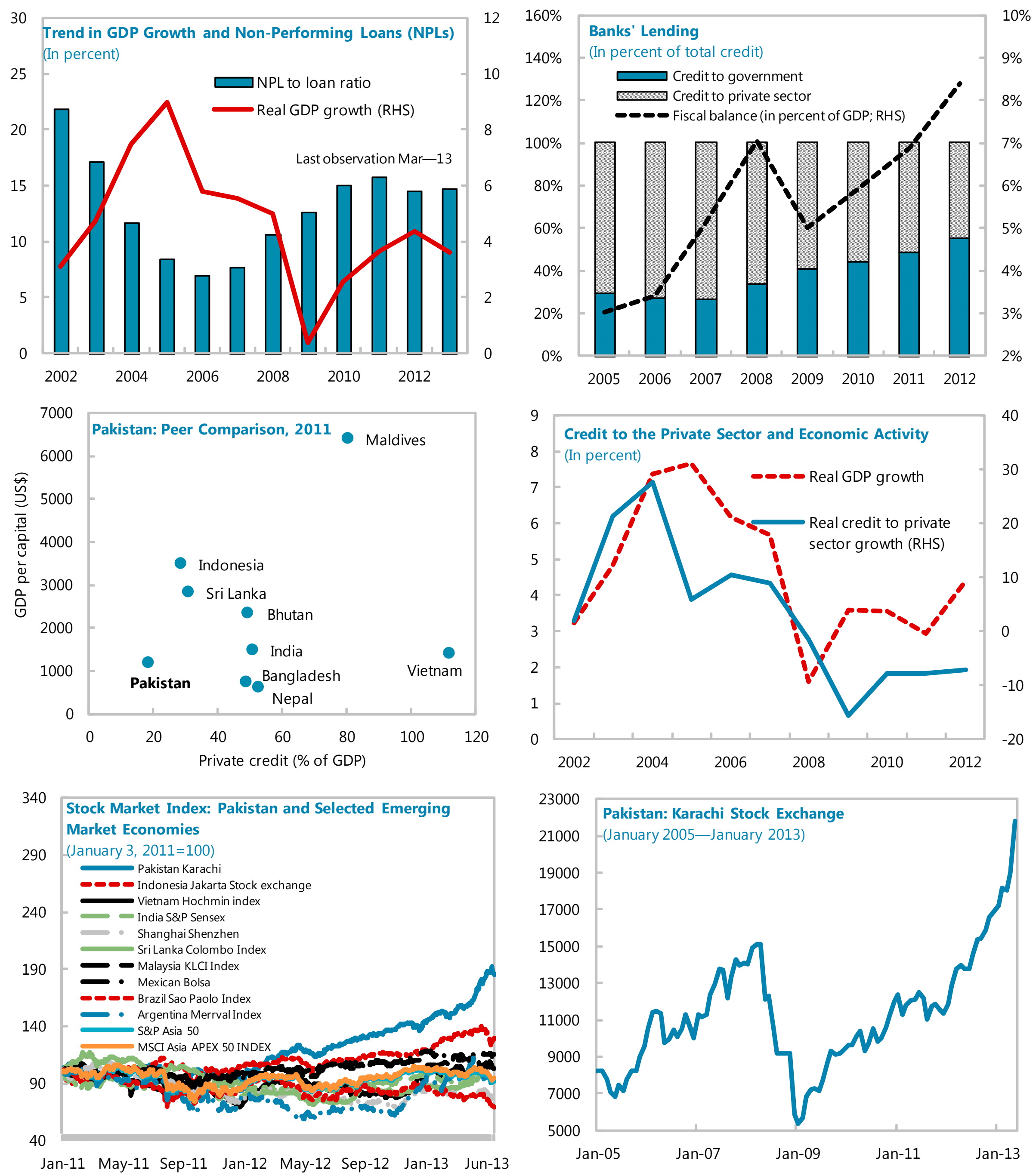
Figure 2. Pakistan: Selected Financial Indicators, 2008–13



Sources: Pakistani authorities; Bloomberg; and IMF staff calculations.

1/ Placement volumes are for all maturities and the Treasury Bill rate is a weighted average.

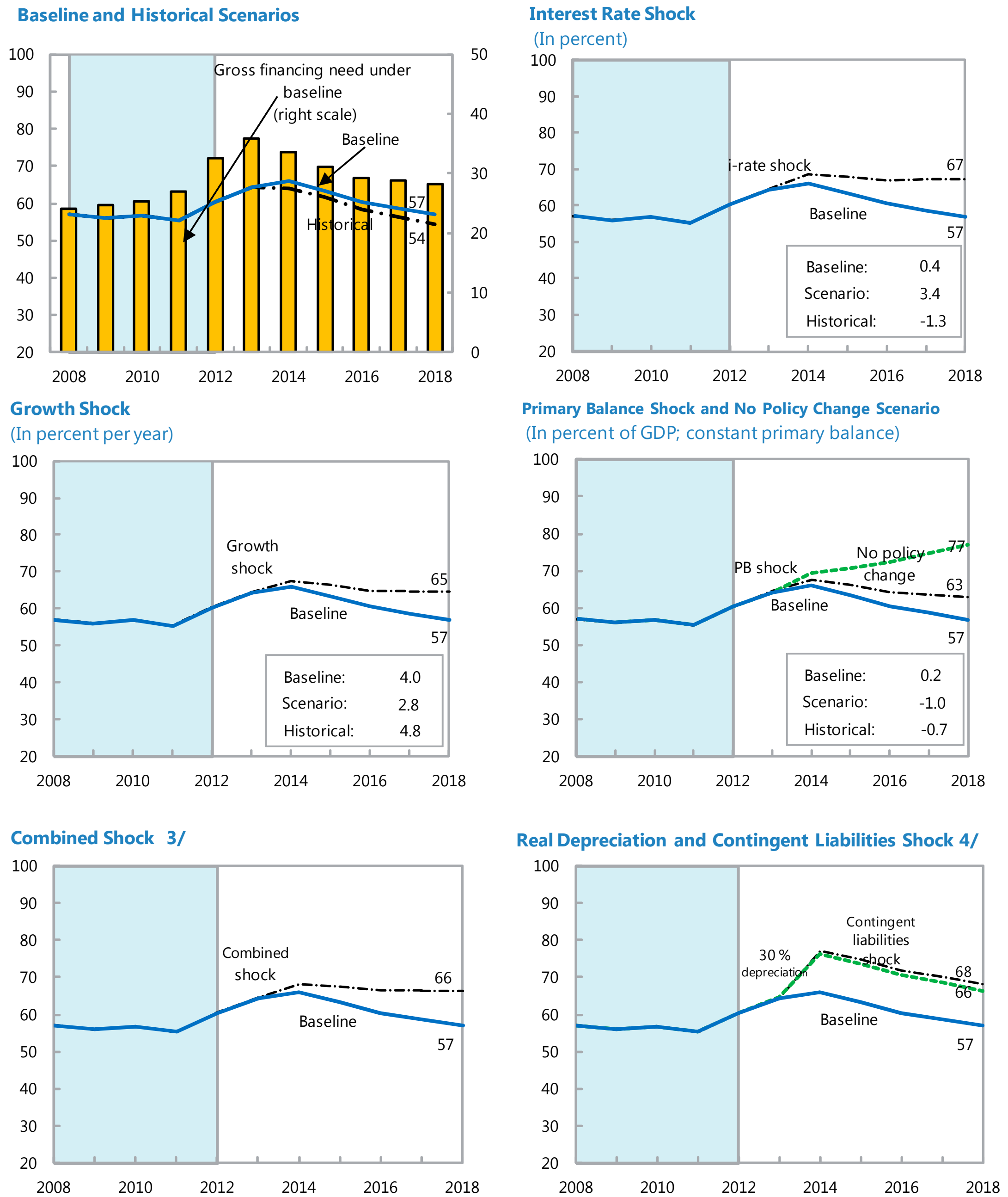
Figure 3. Pakistan: Selected Banking and Financial Indicators



Sources: Pakistani authorities; and IMF staff calculations.

Figure 4. Pakistan: Public Debt Sustainability: Bound Tests 1/ 2/

(Public debt in percent of GDP)



Sources: Pakistani authorities; and IMF staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

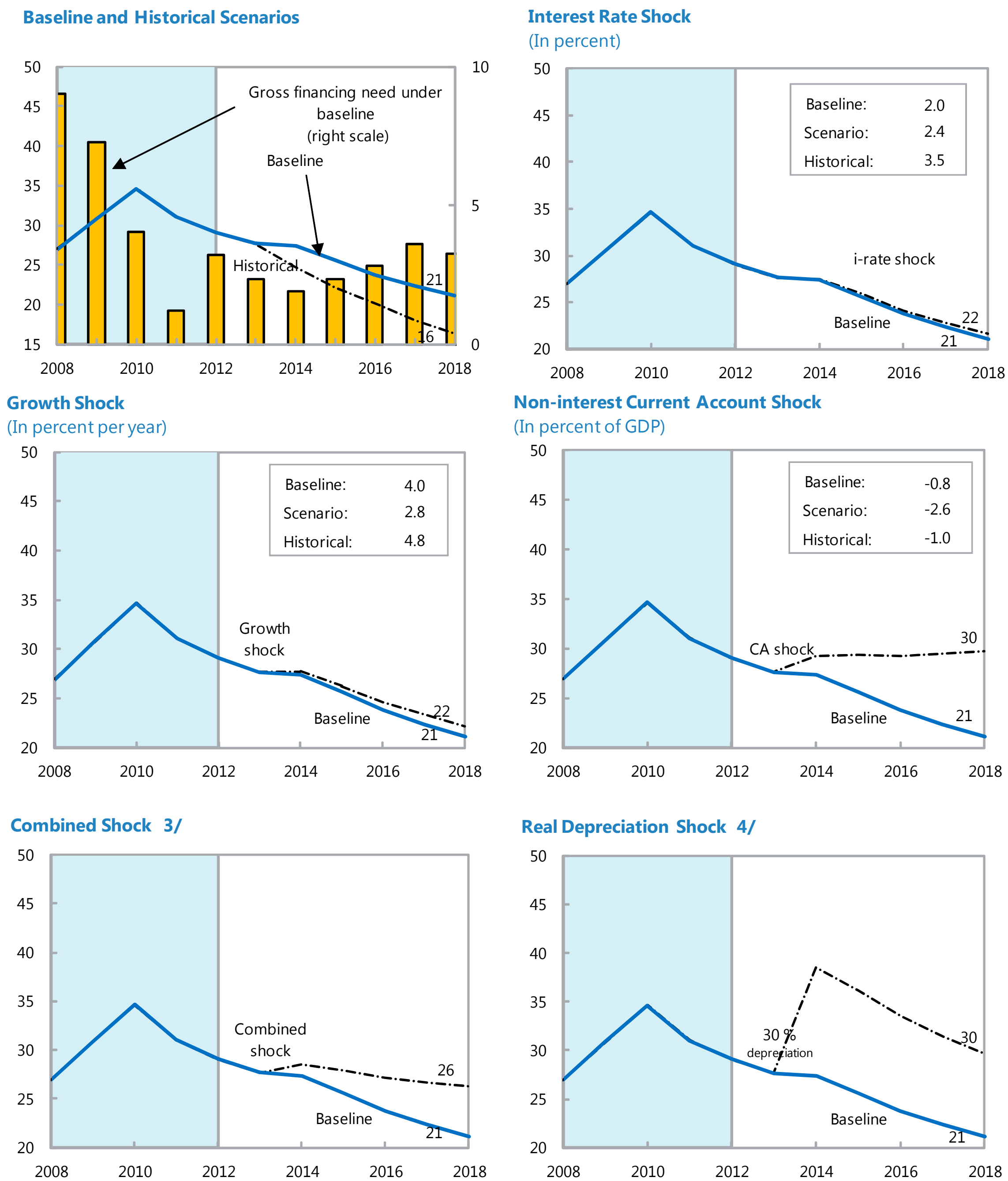
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

4/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2014, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Figure 5. Pakistan: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: Pakistani authorities; and IMF staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2013/4.

Table 1. Pakistan: Selected Economic Indicators, 2009/10–2013/14 1/

Population: 178.9 million (2011/12)
Per capita GDP: US$1,228 (2011/12)
Poverty rate: 17.2 percent (2007/08)
Main exports: Textiles ($9.9 billion)
Unemployment: 5.95 percent (2010/11)

				Estimates	Baseline	Program
	2009/10	2010/11	2011/12	2012/13	2013/14	
			(Annual percentage change)			
Output and prices						
Real GDP at factor cost	2.6	3.7	4.4	3.6	3.3	2.5
GDP deflator at factor cost	10.7	19.5	5.3	7.5	7.9	7.9
Consumer prices (period average) 2/	10.1	13.7	11.0	7.4	8.2	7.9
Consumer prices (end of period) 2/	11.8	13.3	11.3	5.9	10.5	10.0
Pakistani rupees per U.S. dollar (period average)	7.6	2.2	4.1	8.7	…	…
			(In percent of GDP)			
Saving and investment						
Gross saving	13.6	14.2	12.9	13.3	12.5	14.3
Government	-2.4	-4.2	-5.1	-5.2	-4.5	-2.2
Nongovernment (including public sector enterprises)	16.0	18.4	17.9	18.4	16.9	16.5
Gross capital formation 3/	15.8	14.1	14.9	14.2	14.1	14.9
Government	3.5	2.5	3.3	3.3	3.3	3.3
Nongovernment (including public sector enterprises)	12.3	11.6	11.6	10.9	10.8	11.6
Public finances						
Revenue and grants	14.3	12.6	13.1	13.2	13.0	14.4
Expenditure (including statistical discrepancy)	20.2	19.5	21.5	21.7	20.8	19.9
Budget balance (including grants)	-5.9	-6.9	-8.4	-8.5	-7.8	-5.5
Budget balance (excluding grants)	-6.2	-7.1	-8.8	-8.8	-8.1	-5.8
Primary balance	-1.6	-2.9	-4.0	-3.9	-3.0	-0.9
Total general government debt 4/	61.5	59.5	63.8	66.6	69.2	66.6
External general government debt	30.2	26.6	25.8	24.1	23.2	24.1
Domestic general government debt	31.3	32.9	38.0	42.5	46.1	42.5
			(Annual changes in percent of initial stock of broad money, unless otherwise indicated)			
Monetary sector						
Net foreign assets	0.5	4.1	-3.8	-3.4	-0.7	3.9
Net domestic assets	11.9	11.8	17.9	19.3	18.4	12.2
Broad money (percent change)	12.5	15.9	14.1	15.9	17.7	13.8
Reserve money (percent change)	11.4	17.1	11.3	15.9	14.2	13.4
Private credit (percent change)	3.9	4.0	7.5	-0.6	8.0	8.5
Six-month treasury bill rate (period average, in percent)	12.3	13.3	12.3	10.1	…	…
External sector						
Merchandise exports, U.S. dollars (percentage change)	2.9	28.9	-2.6	0.2	9.6	11.4
Merchandise imports, U.S. dollars (percentage change)	-1.7	14.9	12.8	-1.6	7.3	6.9
Current account balance (in percent of GDP)	-2.2	0.1	-2.1	-1.0	-1.6	-0.6
			(In percent of exports of goods and services, unless otherwise indicated)			
External public and publicly guaranteed debt	178.5	153.4	160.3	157.3	147.8	143.7
Debt service	21.5	13.0	16.0	20.6	22.5	19.4
Gross reserves (in millions of U.S. dollars) 5/	12,958	14,784	10,799	6,008	2,283	9,566
In months of next year's imports of goods and services	3.6	3.6	2.7	1.4	0.5	2.2
Memorandum items:						
Real effective exchange rate (annual average, percentage change)	0.9	6.1	2.7	-6.2	-4.8	-7.7
Terms of trade (percentage change)	1.8	7.0	-9.6	-0.4	1.0	-0.1
Real per capita GDP (percentage change)	0.5	1.5	2.3	1.5	1.3	0.5
GDP at market prices (in billions of Pakistani rupees)	14,867	18,285	20,091	22,909	25,415	25,351
GDP at market prices (in billions of U.S. dollars)	177.6	213.7	225.6	236.5	235.6	229.9

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

1/ Fiscal year ends June 30.
2/ Inflation after 2009/10 based on new CPI weights, recalculated in September 2011.
3/ Including changes in inventories. Investment data recorded by the Pakistan Bureau of Statistics are said to underreport true activity.
4/ Excludes military debt, and commercial loans.
5/ Excluding gold and foreign currency deposits of commercial banks held with the State Bank of Pakistan.

Table 2. Pakistan: Medium-Term Baseline Macroeconomic Framework, 2009/10–2017/18

				Estimates	Baseline Projections				
	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
	(Annual changes in percent)								
Output and prices									
Real GDP at factor cost	2.6	3.7	4.4	3.6	3.3	3.1	3.0	3.0	3.0
Consumer prices (period average)	10.1	13.7	11.0	7.4	8.2	10.8	11.3	11.8	11.8
	(In percent of GDP)								
Saving and investment balance	-2.2	0.1	-2.1	-1.0	-1.6	-1.1	-1.5	-1.6	-1.5
Government	-5.9	-6.7	-8.4	-8.5	-7.8	-8.0	-8.7	-9.8	-10.4
Non-government (including public sector enterprises)	3.7	6.8	6.3	7.5	6.2	6.9	7.2	8.3	8.9
Gross national saving	13.6	14.2	12.9	13.3	12.5	12.3	11.7	11.5	11.6
Government	-2.4	-4.2	-5.1	-5.2	-4.5	-4.8	-5.5	-6.6	-7.1
Non-government (including public sector enterprises)	16.0	18.4	17.9	18.4	16.9	17.1	17.1	18.1	18.7
Gross capital formation	15.8	14.1	14.9	14.2	14.1	13.3	13.2	13.0	13.0
Government	3.5	2.5	3.3	3.3	3.3	3.2	3.2	3.2	3.2
Non-government (including public sector enterprises)	12.3	11.6	11.6	10.9	10.8	10.1	9.9	9.8	9.8
	(In billions of U.S. dollars, unless otherwise indicated)								
Balance of payments									
Current account balance	-3.9	0.2	-4.7	-2.3	-3.8	-2.5	-3.5	-3.6	-3.5
Net capital flows 1/	5.2	2.3	1.4	-0.1	3.2	3.2	4.0	3.5	3.3
Of which: foreign direct investment 2/	2.2	1.6	0.8	1.4	2.1	2.2	2.8	2.6	2.7
Gross official reserves	13.0	14.8	10.8	6.0	2.3	1.7	2.2	2.0	1.8
In months of imports 3/	3.6	3.6	2.7	1.4	0.5	0.4	0.4	0.4	0.4
External debt (in percent of GDP)	34.7	31.1	29.1	26.9	26.0	25.9	26.5	26.8	25.7
	(In percent of GDP)								
Public finances									
Revenue and grants	14.3	12.6	13.1	13.2	13.0	12.8	12.7	12.1	12.1
Of which: tax revenue	10.1	9.5	10.3	9.7	9.8	9.8	9.8	9.8	9.8
Expenditure (incl. stat. discr.), *of which:*	20.2	19.5	21.5	21.7	20.8	20.8	21.4	22.0	22.5
Current	16.7	16.5	17.8	17.0	17.4	17.6	18.2	18.7	19.2
Development (incl. net lending)	3.8	2.6	3.4	4.7	3.3	3.2	3.3	3.3	3.3
Primary balance 4/	-1.6	-3.1	-4.0	-3.9	-3.0	-3.1	-3.1	-3.8	-3.8
Overall fiscal balance 4/	-5.9	-6.9	-8.4	-8.5	-7.8	-8.0	-8.7	-9.9	-10.4
Total public debt (including obligations to the IMF)	61.5	59.5	63.8	66.6	69.2	71.9	75.5	79.9	82.2

Sources: Pakistani authorities for historical data; and Fund staff estimates and projections.

1/ Difference between the overall balance and the current account balance.
2/ Including privatization.
3/ In months of next year's imports of goods and services.
4/ Including grants.

Table 3. Pakistan: Medium-Term Program Macroeconomic Framework, 2009/10–2017/18

				Estimates	Program				
	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
				(Annual changes in percent)					
Output and prices									
Real GDP at factor cost	2.6	3.7	4.4	3.6	2.5	3.5	3.7	4.5	5.0
Consumer prices (period average)	10.1	13.7	11.0	7.4	7.9	9.0	7.0	6.0	6.0
				(In percent of GDP)					
Saving and investment balance	-2.2	0.1	-2.1	-1.0	-0.6	-0.7	-1.1	-1.8	-1.9
Government	-5.9	-6.7	-8.4	-8.5	-5.5	-4.4	-3.6	-3.5	-3.5
Non-government (including public sector enterprises)	3.7	6.8	6.3	7.5	4.9	3.6	2.5	1.7	1.6
Gross national saving	13.6	14.2	12.9	13.3	14.3	14.5	15.1	15.1	15.5
Government	-2.4	-4.2	-5.1	-5.2	-2.2	-1.3	-0.4	-0.1	0.0
Non-government (including public sector enterprises)	16.0	18.4	17.9	18.4	16.5	15.9	15.5	15.2	15.5
Gross capital formation	15.8	14.1	14.9	14.2	14.9	15.3	16.2	16.9	17.4
Government	3.5	2.5	3.3	3.3	3.3	3.1	3.2	3.4	3.5
Non-government (including public sector enterprises)	12.3	11.6	11.6	10.9	11.6	12.2	12.9	13.5	13.9
				(In billions of U.S. dollars, unless otherwise indicated)					
Balance of payments									
Current account balance	-3.9	0.2	-4.7	-2.3	-1.3	-1.7	-2.7	-4.8	-5.4
Net capital flows 1/	5.2	2.3	1.4	-0.1	4.3	4.7	5.7	5.4	5.8
Of which: foreign direct investment 2/	2.2	1.6	0.8	1.4	2.3	3.2	4.0	3.8	4.7
Gross official reserves	13.0	14.8	10.8	6.0	9.6	13.4	18.5	19.3	19.7
In months of imports 3/	3.6	3.6	2.7	1.4	2.2	2.8	3.6	3.5	3.5
External debt (in percent of GDP)	34.7	31.1	29.1	27.0	27.0	25.2	23.4	22.0	20.8
				(In percent of GDP)					
Public finances									
Revenue and grants	14.3	12.6	13.1	13.2	14.4	14.8	15.3	15.2	15.2
Of which: tax revenue	10.1	9.5	10.3	9.7	10.8	11.8	12.4	13.0	13.0
Expenditure (incl. stat. discr.), *of which:*	20.2	19.5	21.5	21.7	19.9	19.2	18.9	18.7	18.7
Current	16.7	16.5	17.8	17.0	16.6	16.1	15.7	15.3	15.1
Development (incl. net lending)	3.8	2.6	3.4	4.7	3.3	3.1	3.3	3.4	3.5
Primary balance 4/	-1.6	-3.1	-4.0	-3.9	-0.9	0.1	0.7	0.5	0.4
Overall fiscal balance 4/	-5.9	-6.9	-8.4	-8.5	-5.5	-4.4	-3.6	-3.5	-3.5
Total public debt (including obligations to the IMF)	61.5	59.5	63.8	66.2	66.6	63.5	60.5	58.7	56.9

Sources: Pakistani authorities for historical data; and Fund staff estimates and projections.

1/ Difference between the overall balance and the current account balance.
2/ Including privatization.
3/ In months of next year's imports of goods and services.
4/ Including grants.

Table 4. Pakistan: Balance of Payments, 2009/10–2017/18

(In millions of U.S. dollars; unless otherwise indicated)

	2009/10	2010/11	2011/12	Estimates 2012/13	Program 2013/14 Q1	Q2	Q3	Q4	End-Year	2014/15	2015/16	2016/17	2017/18
Current account	-3,946	214	-4,658	-2,299	-904	-994	246	334	-1,318	-1,719	-2,723	-4,770	-5,391
Balance on goods	-11,536	-10,516	-15,765	-15,056	-3,904	-4,070	-3,616	-3,393	-14,984	-14,713	-15,494	-16,786	-18,475
Exports, f.o.b.	19,673	25,356	24,696	24,745	6,407	6,739	6,856	7,559	27,561	29,061	31,085	33,240	35,577
Imports, f.o.b.	31,209	35,872	40,461	39,801	10,311	10,809	10,473	10,952	42,545	43,774	46,580	50,025	54,053
Services (net)	-1,690	-1,940	-3,192	-1,139	-604	-523	-8	-8	-1,143	-2,748	-3,820	-5,113	-5,935
Services: credit	5,229	5,768	5,035	6,619	1,536	1,651	2,180	2,292	7,659	6,695	6,504	6,352	6,848
Of which: Coalition Support Fund	1,294	743	0	1,806	300	300	300	300	1,200	1,200	600	0	0
Of which: 3G Licenses	0	0	0	0	0	0	600	600	1,200	0	0	0	0
Services: debit	6,919	7,708	8,227	7,758	2,140	2,174	2,188	2,300	8,802	9,443	10,323	11,465	12,783
Income (net)	-3,282	-3,017	-3,245	-3,724	-693	-896	-689	-912	-3,191	-3,214	-3,516	-4,061	-3,644
Income: credit	561	716	826	490	114	132	121	149	517	711	631	578	733
Income: debit	3,843	3,733	4,071	4,214	808	1,028	811	1,061	3,707	3,925	4,147	4,640	4,377
Of which: interest payments	1,650	1,408	1,589	1,182	222	321	219	296	1,057	1,128	1,155	1,214	1,365
Of which: income on direct investment	2,180	2,065	2,177	2,713	586	707	592	765	2,650	2,797	2,992	3,426	3,012
Balance on goods, services, and income	-16,508	-15,473	-22,202	-19,919	-5,202	-5,489	-4,313	-4,313	-19,318	-20,676	-22,830	-25,961	-28,055
Current transfers (net)	12,562	15,687	17,544	17,620	4,298	4,496	4,559	4,647	18,000	18,956	20,107	21,191	22,663
Current transfers: credit, *of which:*	12,672	15,863	17,686	17,706	4,337	4,536	4,599	4,687	18,159	19,115	20,266	21,350	22,822
Official	606	845	658	433	67	150	183	183	583	733	733	367	200
Workers' remittances	8,906	11,201	13,186	13,920	3,512	3,552	3,482	3,644	14,191	14,979	16,055	17,390	18,897
Other private transfers	3,160	3,817	3,842	3,353	758	833	934	859	3,385	3,403	3,478	3,593	3,725
Current transfers: debit	110	176	142	86	40	40	40	40	159	159	159	159	159
Capital account	175	161	189	227	77	80	94	98	349	390	390	390	390
Capital transfers: credit	180	161	186	231	77	80	94	98	349	390	390	390	390
Of which: official capital grants	157	160	180	215	77	80	94	98	349	390	390	390	390
Capital transfers: debit	5	0	3	4	0	0	0	0	0	0	0	0	0
Financial account	5,097	2,103	1,275	-90	565	823	1,110	1,441	3,938	4,274	5,289	5,045	5,428
Direct investment abroad	-76	-44	-77	-218	0	0	0	0	0	0	0	0	0
Direct investment in Pakistan	2,151	1,636	821	1,447	319	663	365	981	2,327	3,166	3,960	3,842	4,668
Of which: privatization receipts	0	1	0	0	0	266	0	534	800	1,000	1,000	0	0
Portfolio investment (net), *of which:*	-65	339	-149	27	85	88	91	94	358	406	454	1,252	2,550
Financial derivatives (net)	0	0	0	0	0	0	0	0	0	0	0	0	0
Other investment assets	-11	-920	9	-309	-80	-104	-48	-54	-286	-266	-246	-242	-226
Monetary authorities	0	0	0	0	0	0	0	0	0	0	0	0	0
General government	-6	-3	3	9	0	0	0	0	0	0	0	0	0
Banks	386	-63	-91	-212	-53	-58	-63	-68	-242	-222	-202	-198	-182
Other sectors	-391	-854	97	-106	-27	-46	15	14	-44	-44	-44	-44	-44
Other investment liabilities	3,098	1,092	671	-1,037	241	176	702	420	1,539	968	1,121	193	-1,565
Monetary authorities	1,257	-10	-105	717	0	0	0	-100	-100	0	0	0	0
General government, *of which:*	1,961	298	998	-481	-115	-110	822	709	1,305	631	722	-480	-1,844
Disbursements	4,134	2,377	2,633	2,131	495	592	1,193	1,228	3,509	3,059	3,006	1,788	1,080
Amortization	2,250	1,957	1,577	2,643	611	702	372	519	2,203	2,427	2,283	2,268	2,924
Banks	-226	52	220	-897	13	13	13	13	50	50	50	50	50
Other sectors	106	752	-442	-376	344	273	-132	-201	284	287	349	623	230
Net errors and omissions	-60	14	-81	-232	0	0	0	0	0	0	0	0	0
Reserves and related items	-1,266	-2,492	3,275	2,394	262	91	-1,450	-1,873	-2,969	-2,945	-2,957	-665	-426
Reserve assets	-4,063	-2,225	4,430	4,556	569	561	-1,370	-1,819	-2,058	-3,863	-5,103	-778	-426
Use of Fund credit and loans	2,174	-267	-1,155	-2,162	-306	-470	-80	-54	-911	919	2,146	112	0
Memorandum items:													
Current account (in percent of GDP)	-2.2	0.1	-2.1	-1.0					-0.6	-0.7	-1.1	-1.8	-1.9
Current account (in percent of GDP; excluding fuel imports)	3.7	5.9	4.3	5.3					6.1	5.8	5.3	4.5	4.3
Exports f.o.b. (growth rate, in percent)	2.9	28.9	-2.6	0.2					11.4	5.4	7.0	6.9	7.0
Imports f.o.b. (growth rate, in percent)	-1.7	14.9	12.8	-1.6					6.9	2.9	6.4	7.4	8.1
Oil imports (in million US$, cif)	10,463	12,317	14,368	14,783					15,327	15,350	15,976	16,795	17,726
Terms of trade (growth rate, in percent)	1.8	7.0	-9.6	-0.5					-0.1	0.3	0.1	0.0	0.0
External debt (in millions of U.S. dollars)	61,567	66,366	65,562	63,942					61,979	59,684	58,583	58,802	60,237
Gross external financing needs (in millions of U.S. dollars) 1/	7,363	2,408	6,960	6,052					4,586	5,243	6,994	9,496	9,336
End-period gross official reserves (millions of U.S. dollars) 2/	12,958	14,784	10,799	6,008	5,640	5,328	7,198	9,566	9,566	13,430	18,532	19,310	19,737
(In months of next year's imports of goods and services)	3.6	3.6	2.7	1.4	1.3	1.2	1.6	2.2	2.2	2.8	3.6	3.5	3.5
GDP (in millions of U.S. dollars)	177,622	213,725	225,558	236,518					229,927	236,414	250,053	267,205	290,045

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

1/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

2/ Excluding foreign currency deposits held with the State Bank of Pakistan (cash reserve requirements) and gold.

Table 5a. Pakistan: General Government Budget, 2008/09–2013/14
(In billions of Pakistani rupees)

	2008/09	2009/10	2010/11	2011/12	Estimates 2012/13	Budget 2013/14	Program 2013/14
Revenue and grants	1,870	2,130	2,306	2,642	3,031	3,676	3,643
Revenue	1,851	2,079	2,261	2,567	2,969	3,616	3,579
Tax revenue	1,331	1,500	1,738	2,076	2,227	2,803	2,726
Federal	1,285	1,445	1,673	1,969	2,077	2,633	2,556
FBR revenue	1,157	1,329	1,558	1,881	1,943	2,475	2,345
Direct taxes	440	529	602	732	740	976	892
Federal excise duty	116	121	137	122	123	167	151
Sales tax/VAT	452	517	633	809	842	1,053	1,014
Customs duties	148	161	185	218	238	279	287
Petroleum surcharge	112	89	83	60	115	120	122
Gas surcharge and other	16	28	32	27	16	35	86
Provincial	46	55	65	107	150	170	170
Nontax revenue	520	579	523	491	742	813	853
Federal	436	512	461	443	682	743	783
Provincial	84	68	62	48	60	70	70
Grants	19	51	46	75	63	60	64
Expenditure	2,531	3,008	3,566	4,326	4,980	5,297	5,042
Current expenditure	2,093	2,482	3,012	3,579	3,898	4,135	4,200
Federal	1,547	1,855	2,227	2,611	2,785	2,950	2,976
Interest	638	642	698	889	1,052	1,154	1,176
Domestic	559	578	630	821	975	1,065	1,063
Foreign	79	64	68	68	77	89	113
Other	909	1,213	1,529	1,722	1,733	1,797	1,800
Defense	330	375	450	507	570	627	627
Other	579	838	1,078	1,215	1,163	1,169	1,173
Of which: subsidies 1/	244	227	493	556	377	270	324
Of which: grants	136	361	259	291	367	428	418
Provincial	546	627	786	968	1,113	1,185	1,224
Development expenditure and net lending	404	558	469	681	1,083	1,162	842
Public Sector Development Program	398	519	462	669	765	1,155	834
Federal	196	260	216	293	370	540	420
Provincial	202	258	246	375	395	615	414
Net lending	7	39	7	12	318	8	8
Statistical discrepancy ("+" = additional expenditure) 2/	34	-32	46	67	0	0	0
Overall Balance (excluding grants)	-680	-929	-1,306	-1,760	-2,012	-1,681	-1,463
Overall Balance (including grants)	-661	-878	-1,260	-1,685	-1,949	-1,621	-1,398
Financing	695	878	1,260	1,685	1949	0	1398
External	75	138	62	53	-50	168	232
Of which: privatization receipts	1	0	0	0	0	0	88
Of which: IMF	0	0	0	0	0	0	0
Domestic	621	740	1,198	1,631	1999	1482	1166
Bank	393	304	727	1,102	1512	976	933
Nonbank	227	436	471	529	487	507	233
Memorandum items:							
Primary balance (excluding grants)	-77	-287	-608	-871	-960	-527	-287
Primary balance (including grants)	-58	-236	-562	-796	-897	-468	-223
Total security spending	424	568	585	645	570	627	627
Total government debt	7,387	8,448	10,112	12,130	14,709	16,648	16,733
Domestic debt	3,860	4,654	6,014	7,638	9,604	10,749	10,770
External debt 3/	3,527	3,794	4,098	4,492	5,105	5,899	5,963
Total government debt including IMF obligations	7,805	9,138	10,879	12,822	15,162	17,101	16,889
Nominal GDP (market prices)	13,200	14,867	18,285	20,091	22,909	26,001	25,351

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

1/ Includes Rs 391 billion in FY2011/12 for the payment of energy and food subsidies delivered in previous years.

2/ The statistical discrepancy is believed to arise mainly from double-counting of spending at the provincial level.

3/ Excludes obligations to the IMF except budget financing, military debt, commercial loans, and short-term debt.

Table 5b. Pakistan: General Government Budget, 2009/10–2013/14

(In percent of GDP; unless otherwise indicated)

	2009/10	2010/11	2011/12	Estimates 2012/13	Budget 2013/14	Program 2013/14
Revenue and grants	14.3	12.6	13.1	13.2	14.1	14.4
Revenue	14.0	12.4	12.8	13.0	13.9	14.1
Tax revenue	10.1	9.5	10.3	9.7	10.8	10.8
Federal	9.7	9.1	9.8	9.1	10.1	10.1
FBR revenue	8.9	8.5	9.4	8.5	9.5	9.3
Direct taxes	3.6	3.3	3.6	3.2	3.8	3.5
Federal excise duty	0.8	0.8	0.6	0.5	0.6	0.6
Sales tax/VAT	3.5	3.5	4.0	3.7	4.0	4.0
Customs duties	1.1	1.0	1.1	1.0	1.1	1.1
Petroleum surcharge / Carbon tax	0.6	0.5	0.3	0.5	0.5	0.5
Gas surcharge and other	0.2	0.2	0.1	0.1	0.1	0.3
Provincial	0.4	0.4	0.5	0.7	0.7	0.7
Nontax revenue	3.9	2.9	2.4	3.2	3.1	3.4
Federal	3.4	2.5	2.2	3.0	2.9	3.1
Provincial	0.5	0.3	0.2	0.3	0.3	0.3
Grants	0.3	0.2	0.4	0.3	0.2	0.3
Expenditure	20.2	19.5	21.5	21.7	20.4	19.9
Current expenditure	16.7	16.5	17.8	17.0	15.9	16.6
Federal	12.5	12.2	13.0	12.2	11.3	11.7
Interest	4.3	3.8	4.4	4.6	4.4	4.6
Domestic	3.9	3.4	4.1	4.3	4.1	4.2
Foreign	0.4	0.4	0.3	0.3	0.3	0.4
Other	8.2	8.4	8.6	7.6	6.9	7.1
Defense	2.5	2.5	2.5	2.5	2.4	2.5
Other	5.6	5.9	6.0	5.1	4.5	4.6
Of which: subsidies 1/	1.5	2.7	2.8	1.6	1.0	1.3
Of which: grants	2.4	1.4	1.4	1.6	1.6	1.6
Provincial	4.2	4.3	4.8	4.9	4.6	4.8
Development expenditure and net lending	3.8	2.6	3.4	4.7	4.5	3.3
Public Sector Development Program	3.5	2.5	3.3	3.3	4.4	3.3
Federal	1.8	1.2	1.5	1.6	2.1	1.7
Provincial	1.7	1.3	1.9	1.7	2.4	1.6
Net lending	0.3	0.0	0.1	1.4	0.0	0.0
Statistical discrepancy ("+" = additional expenditure) 2/	-0.2	0.3	0.3	0.0	0.0	0.0
Overall Balance (excluding grants)	-6.2	-7.1	-8.8	-8.8	-6.5	-5.8
Overall Balance (including grants)	-5.9	-6.9	-8.4	-8.5	-6.2	-5.5
Financing	5.9	6.9	8.4	8.5	0.0	5.5
External	0.9	0.3	0.3	-0.2	0.6	0.9
Of which: privatization receipts	0.0	0.0	0.0	0.0	0.0	0.3
Of which: IMF	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	5.0	6.6	8.1	8.7	5.7	4.6
Bank	2.0	4.0	5.5	6.6	3.8	3.7
Nonbank	2.9	2.6	2.6	2.1	1.9	0.9
Memorandum items:						
Primary balance (excluding grants)	-1.9	-3.3	-4.3	-4.2	-2.0	-1.1
Primary balance (including grants)	-1.6	-3.1	-4.0	-3.9	-1.8	-0.9
Total security spending	3.8	3.2	3.2	2.5	2.4	2.5
Total government debt 3/	56.8	55.3	60.4	64.2	64.0	66.0
Domestic debt	31.3	32.9	38.0	41.9	41.3	42.5
External debt 3/	25.5	22.4	22.4	22.3	22.7	23.5
Total government debt including IMF	61.5	59.5	63.8	66.2	65.8	66.6
Nominal GDP (market prices, billions of Pakistani rupees)	14,867	18,285	20,091	22,909	26,001	25,351

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

1/ Includes 1.8 percent of GDP in FY2011/12 for the payment of energy and food subsidies delivered in previous years.

2/ The statistical discrepancy is believed to arise mainly from double-counting of spending at the provincial level.

3/ Excludes obligations to the IMF except budget financing, military debt, commercial loans, and short-term debt.

Table 5c. Pakistan: General Government Budget, 2011/12–2013/14
(In billions of Pakistani rupees)

		Estimates	Program				
	2011/12	2012/13	2013/14				
			Q1	Q2	Q3	Q4	End-Year
Revenue and grants	2,642	3,031	693	852	881	1,218	3,643
Revenue	2,567	2,969	679	838	863	1,200	3,579
Tax revenue	2,076	2,227	503	649	645	929	2,726
Federal	1,969	2,077	468	604	605	879	2,556
FBR revenue	1,881	1,943	436	561	542	807	2,345
Direct taxes	732	740	166	213	206	307	892
Federal excise duty	122	123	28	36	35	52	151
Sales tax/VAT	809	842	189	242	234	349	1,014
Customs duties	218	238	53	69	66	99	287
Petroleum surcharge	60	115	22	34	28	37	122
Gas surcharge and other	27	16	9	9	34	34	86
Provincial	107	150	35	45	40	50	170
Nontax revenue	491	742	177	189	218	270	853
Federal	443	682	162	170	201	250	783
Provincial	48	60	14	19	16	21	70
Grants	75	63	14	15	18	18	64
Expenditure	4,326	4,980	1,098	1,301	1,189	1,455	5,042
Current expenditure	3,579	3,898	973	1,140	975	1,113	4,200
Federal	2,611	2,785	726	841	682	727	2,976
Interest	889	1,052	301	297	278	300	1,176
Domestic	821	975	276	266	255	266	1,063
Foreign	68	77	25	32	23	34	113
Other	1,722	1,733	425	543	404	428	1,800
Defense	507	570	130	169	167	161	627
Other	1,215	1,163	295	374	237	267	1,173
Of which: subsidies 1/	556	377	82	116	56	70	324
Of which: grants	291	367	105	150	73	90	418
Provincial	968	1,113	247	299	293	386	1,224
Development expenditure and net lending	681	1,083	125	161	214	342	842
Public Sector Development Program	669	765	124	160	212	339	834
Federal	293	370	51	80	122	167	420
Provincial	375	395	73	80	90	171	414
Net lending	12	318	1	1	2	3	8
Statistical discrepancy ("+" = additional expenditure) 2/	67	0	0	0	0	0	0
Overall Balance (excluding grants)	-1,760	-2,012	-418	-463	-326	-255	-1,463
Overall Balance (including grants)	-1,685	-1,949	-405	-448	-308	-237	-1,398
Financing	1,685	1949	405	448	308	237	1398
External	53	-50	-11	16	4	223	232
Of which: privatization receipts	0	0	0	0	0	0	88
Of which: IMF	0	0	0	0	0	0	0
Domestic	1,631	1999	416	432	304	14	1166
Bank	1,102	1512	293	308	141	191	933
Nonbank	529	487	123	124	163	-177	233
Memorandum items:							
Primary balance (excluding grants)	-871	-960	-117	-166	-49	45	-287
Primary balance (including grants)	-796	-897	-104	-151	-31	63	-223
Total security spending	645	570	130	169	167	161	627
Government Arrears	1,427	1,627					1,800
Total government debt	12,130	14,709					16,733
Domestic debt	7,638	9,604					10,770
External debt 3/	4,492	5,105					5,963
Total government debt including IMF obligations	12,822	15,162					16,889
Nominal GDP (market prices)	20,091	22,909					25,351

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

1/ Includes Rs 391 billion in FY2011/12 for the payment of energy and food subsidies delivered in previous years.

2/ The statistical discrepancy is believed to arise mainly from double-counting of spending at the provincial level.

3/ Excludes obligations to the IMF except budget financing, military debt, commercial loans, and short-term debt.

Table 6. Pakistan: Monetary Survey, 2009/10–2013/14

	2009/10	2010/11	2011/12	Estimates 2012/13	Program 2013/14 Q1	Q2	Q3	Q4
	(in billions of Pakistani rupees, unless otherwise indicated)							
Monetary survey								
Net foreign assets (NFA)	545	780	527	270	242	232	395	616
Net domestic assets (NDA)	5,232	5,915	7,115	8,589	9,377	9,672	9,256	9,470
Net claims on government, *of which: 1/*	2,403	2,983	4,197	5,629	6,045	6,477	6,782	6,796
Budget support, *of which:*	1,935	2,523	3,667	5,125	5,587	6,020	6,324	6,338
Banks	763	1,369	2,005	2,957	2,897	3,460	3,934	4,098
Commodity operations	413	397	436	468	458	458	458	458
Credit to nongovernment	3,389	3,547	3,653	3,664	3,563	3,965	3,838	3,502
Private sector	3,037	3,159	3,395	3,376	3,475	3,727	3,799	3,664
Public sector enterprises	352	388	257	288	88	238	38	-162
Privatization account	-3	-3	-3	-3	-3	-3	-3	-3
Other items, net	-557	-612	-732	-701	-228	-768	-1,360	-825
Broad money	5,777	6,695	7,642	8,859	9,619	9,904	9,651	10,086
Currency outside scheduled banks	1,295	1,501	1,674	1,939	2,261	2,344	2,416	2,574
Rupee deposits	4,136	4,819	5,528	6,405	6,800	6,983	6,674	6,925
Foreign currency deposits	345	375	440	515	559	576	561	586
State Bank of Pakistan (SBP)								
NFA	379	614	389	134	127	145	364	650
NDA	1,301	1,352	1,800	2,402	2,877	2,901	2,571	2,227
Net claims on government	1,187	1,184	1,665	2,156	2,640	2,510	2,350	2,200
Of which: budget support	1,171	1,155	1,662	2,168	2,690	2,560	2,390	2,240
Claims on nongovernment	-6	-6	-5	-6	-6	-10	-10	-10
Claims on scheduled banks	313	315	289	301	301	310	150	80
Privatization account	-3	-3	-3	-3	-3	-3	-3	-3
Other items, net	-190	-139	-146	-46	-56	94	84	-40
Reserve money, *of which:*	1,679	1,966	2,189	2,536	3,004	3,046	2,935	2,877
Banks' reserves	290	349	396	476	506	520	497	516
Currency	1,383	1,606	1,784	2,050	2,498	2,526	2,438	2,361
	(Annual percentage change, unless otherwise indicated)							
Broad money	12.5	15.9	14.1	15.9	25.0	20.0	15.9	13.8
NFA, banking system (in percent of broad money) 2/	0.5	4.1	-3.8	-3.4	-3.9	-3.8	0.3	3.9
NDA, banking system (in percent of broad money) 2/	11.9	11.8	17.9	19.3	28.9	23.8	15.6	9.9
Budgetary support (in percent of broad money) 2/	5.9	10.2	17.1	19.1	23.0	21.7	21.6	13.7
NFA, banking system	5.4	43.1	-32.5	-48.8	-55.5	-57.8	6.5	128.2
NDA, banking system	13.2	13.1	20.3	20.7	31.1	25.5	16.3	10.3
Budgetary support	18.7	30.4	45.3	39.7	46.3	42.5	39.8	23.7
Private credit	3.9	4.0	7.5	-0.6	5.0	6.5	7.5	8.5
Currency	12.4	15.9	11.5	15.9	28.8	27.8	25.7	32.7
Reserve money	11.4	17.1	11.3	15.9	33.0	25.4	20.3	13.4
NFA, SBP (in percent of reserve money) 2/	3.6	14.0	-11.5	-11.6	-11.6	-7.8	5.5	20.3
NDA, SBP (in percent of reserve money) 2/	7.8	3.0	22.8	27.5	46.1	35.7	14.9	-7.2
Net claims on government (in percent of reserve money) 2/	2.9	-7.3	24.5	22.4	63.9	46.3	31.9	1.7
Memorandum items:								
Velocity	2.6	2.7	2.6	2.6	2.7	2.6	2.6	2.6
Money multiplier	3.4	3.4	3.5	3.5	3.2	3.3	3.3	3.5
Currency to broad money ratio (percent)	22.4	22.4	21.9	21.9	23.5	23.7	25.0	25.5
Currency to deposit ratio (percent)	28.9	28.9	28.0	28.0	30.7	31.0	33.4	34.3
Foreign currency to deposit ratio (percent)	7.7	7.2	7.4	7.4	7.6	7.6	7.8	7.8
Reserves to deposit ratio (percent)	6.5	6.7	6.6	6.9	6.9	6.9	6.9	6.9
Budget bank financing (change from the beginning of the fiscal year; in Rs billions), *of which:*	305	589	1,144	1,457	463	895	1,199	1,213
By commercial banks	263	606	636	952	-59	503	977	1,141
By SBP	42	-17	508	506	522	392	222	72
NFA of SBP (change from beginning of the year; in billions of U.S. dollars) 3/	0.6	2.7	-3.0	-2.8	-0.1	0.0	1.9	4.2
NFA of commercial banks (millions of U.S. dollars)	1,951	1,937	1,464	1,326	1,083	786	274	-289
NDA of commercial banks (billions of Pakistani rupees)	3,931	4,563	5,315	6,187 0	6,501	6,771	6,685	7,243

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

1/ Difference between monetary and fiscal tables on banking sector claims on government and bank financing in 2011/12 reflects Rs391 billion in electricty payments.

2/ Denominator is the stock of broad (reserve) money at the end of the previous year.

3/ Includes valuation adjustments.

Table 7. Pakistan: Medium-Term Fiscal Framework, 2009/10–2017/18

(In percent of GDP; unless otherwise indicated)

				Estimates	Program				
	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
Revenue and grants	14.3	12.6	13.1	13.2	14.4	14.8	15.3	15.2	15.2
Tax revenue	10.1	9.5	10.3	9.7	10.8	11.8	12.4	13.0	13.0
Of which: Federal Board of Revenue	8.9	8.5	9.4	8.5	9.3	10.2	10.8	11.4	11.4
Nontax revenue	3.9	2.9	2.4	3.2	3.4	2.7	2.6	2.1	2.1
Grants	0.3	0.2	0.4	0.3	0.25	0.31	0.29	0.14	0.07
Expenditure	20.2	19.5	21.5	21.7	19.9	19.2	18.9	18.7	18.7
Current expenditure	16.7	16.5	17.8	17.0	16.6	16.1	15.7	15.3	15.1
Interest	4.3	3.8	4.4	4.6	4.6	4.4	4.3	4.0	3.9
Other federal	8.2	8.4	8.6	7.6	7.1	6.8	6.6	6.5	6.4
Provincial	4.2	4.3	4.8	4.9	4.8	4.8	4.8	4.8	4.8
Development expenditure	3.5	2.5	3.3	3.3	3.3	3.1	3.2	3.4	3.5
Net-lending	0.3	0.0	0.1	1.4	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy	-0.2	0.3	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Unidentified measures (net, cumulative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Of which: new measures									
Overall balance									
Excluding grants	-6.2	-7.1	-8.8	-8.8	-5.8	-4.7	-3.9	-3.6	-3.5
Including grants	-5.9	-6.9	-8.4	-8.5	-5.5	-4.4	-3.6	-3.5	-3.5
Financing	5.9	6.3	8.6	8.5	5.5	4.4	3.6	3.5	3.5
External	0.9	0.3	0.3	-0.2	0.9	0.7	0.5	-0.2	0.1
Of which: privatization receipts	0.0	0.0	0.0	0.0	0.3	0.4	0.4	0.0	0.0
Domestic	5.0	5.9	8.3	8.7	4.6	3.7	3.1	3.7	3.4
Memorandum items:									
Primary balance									
Excluding grants	-1.9	-3.3	-4.3	-4.2	-1.1	-0.2	0.4	0.4	0.4
Including grants	-1.6	-3.1	-4.0	-3.9	-0.9	0.1	0.7	0.5	0.4
Interest payments/revenue (ratio)	30.9	30.9	34.6	35.4	32.9	30.6	28.6	26.6	25.9
Public debt 1/	56.8	55.3	60.4	64.2	66.0	63.4	60.5	58.7	56.9
External	25.5	22.4	22.4	22.3	23.5	22.1	20.1	18.6	17.4
Domestic	31.3	32.9	38.0	41.9	42.5	41.3	40.4	40.1	39.5
Public debt (including obligations to the IMF)	61.5	59.5	63.8	66.2	66.6	63.5	60.5	58.7	56.9
Change in government debt	0.9	-1.5	5.1	3.8	1.8	-2.6	-2.9	-1.8	-1.8
Implicit interest rate (in percent) 2/	8.7	8.0	8.5	8.4	8.0	7.6	7.5	7.4	7.4
External	1.8	1.1	1.0	0.9	2.2	1.9	1.8	1.9	1.9
Domestic	15.0	13.5	13.7	12.8	11.1	10.8	10.6	10.1	10.0
Provincial balance	...	...	...	...	0.47	1.04	1.42	1.78	1.81
Nominal GDP (billions of Pakistani rupees)	14,867	18,285	20,091	22,909	25,351	28,600	31,738	35,159	39,133

Sources: Pakistani authorities for historical data; and Fund staff for estimates and projections.

1/ Excludes obligations to the IMF except military debt and commercial loans.

2/ Calculated by dividing interest expenditure by the outstanding debt stock at the end of the previous period.

Table 8. Pakistan: Financial Soundness Indicators for the Banking System (December 2007–March 2013)

	Dec. 2007	Dec. 2008	Dec. 2009	Dec. 2010	Dec. 2011	Dec. 2012	Mar. 2013
Capital adequacy							
Regulatory capital to risk-weighted assets	12.3	12.2	14.0	13.9	15.1	15.4	15.1
Tier I capital to risk-weighted assets	10.0	10.1	11.6	11.6	13.0	12.8	12.7
Capital to total assets	10.5	10.0	10.1	9.8	9.6	9.0	8.9
Asset composition and quality							
Nonperforming loans (NPLs) to gross loans	7.6	10.5	12.6	14.9	15.7	14.5	14.7
Provisions to NPLs	86.1	69.6	69.9	66.7	69.3	71.8	71.9
NPLs net of provisions to capital	5.6	19.4	20.4	26.7	23.1	19.4	19.9
Earnings and profitability							
Return on assets (after tax)	1.5	0.8	0.9	1.0	1.5	1.4	1.2
Return on equity (after tax)	15.4	7.8	8.9	9.6	15.1	14.9	13.9
Net interest income to gross income	68.2	70.3	72.4	74.7	76.0	71.1	71.7
Noninterest expenses to gross income	43.2	50.1	51.2	52.7	51.1	53.9	57.5
Liquidity							
Liquid assets to total assets	33.6	28.2	32.7	36.1	45.5	47.4	47.4
Liquid assets to total deposits	45.1	37.7	44.5	47.1	59.5	63.3	63.8

Source: State Bank of Pakistan.

Table 9. Pakistan: Indicators of Fund Credit, 2012/13–2017/18 [1/]
(In millions of SDR unless otherwise specified)

	Estimates	Projections				
	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
	(Projected Level of Credit Outstanding based on Existing Drawings)					
Total	2,916.9	873.7	37.1	0.0	0.0	0.0
Of which:						
ECF Arrangements	68.9	17.2	0.0	0.0	0.0	0.0
Stand-By Arrangements and ENDA	2,848.0	856.5	37.1	0.0	0.0	0.0
In percent of GDP	1.9	0.6	0.0	0.0	0.0	0.0
In percent of end-period gross official reserves	73.5	13.9	0.4	0.0	0.0	0.0
	(Projected Debt Service to the Fund based on Existing Drawings)					
Total	1,983.7	2,066.7	842.9	37.7	0.0	0.0
Of which:						
Principal	1,917.8	2,043.2	836.6	37.1	0.0	0.0
Interest and charges	66.0	23.5	6.3	0.6	0.0	0.0
ECF						
Principal	120.6	51.7	17.2	0.0	0.0	0.0
Interest and charges	0.0	0.0	0.0	0.0	0.0	0.0
Stand-By Arrangements and ENDA						
Principal	1797.2	1991.5	819.4	37.1	0.0	0.0
Interest and charges	66.0	23.5	6.3	0.6	0.0	0.0
In percent of GDP	1.3	1.4	0.5	0.0	0.0	0.0
In percent of end-period gross official reserves	50.0	32.8	9.6	0.3	0.0	0.0
	(Projected Level of Credit Outstanding based on Existing Drawings and Prospective EFF)					
Total	2,916.9	2313.7	2917.1	4320.0	4393.0	4333.0
In percent of GDP	1.9	1.5	1.9	2.6	2.5	2.3
In percent of end-period gross official reserves	73.5	36.7	33.1	35.7	35.1	33.8
	(Projected Debt Service to the Fund under Existing Drawings and Prospective EFF)					
Total 2/	1983.7	2078.6	870.2	78.7	47.1	137.2
Memorandum items						
Quota (millions of SDRs)	1,033.70	…	…	…	…	…
GDP (millions of U.S. dollars)	236,518	229,927	236,414	250,053	267,205	290,045
Gross official reserves (millions of U.S. dollars)	6,008	9,566	13,430	18,532	19,310	19,737

Source: IMF staff projections.
1/ Including purchase under the ENDA.
2/ Excludes GRA surcharges. Excludes current year obligation paid up to June 30, 2013.

Table 10. Pakistan: Selected Vulnerability Indicators, 2009/10–2017/18

				Estimate	Program				
	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
Key economic and market indicators									
Real GDP growth (factor cost, in percent)	2.6	3.7	4.4	3.6	2.5	3.5	3.7	4.5	5.0
CPI inflation (period average, in percent) 1/	10.1	13.7	11.0	7.4	7.9	9.0	7.0	6.0	6.0
Emerging market bond index (EMBI) secondary market spread (basis points, end of period)	603	857	1,136	...	...	...	...	...	...
Exchange rate PRs/US$ (end of period)	85.4	85.8	94.3	...	...	...	...	...	...
External sector									
Current account balance (percent of GDP)	-2.2	0.1	-2.1	-1.0	-0.6	-0.7	-1.1	-1.8	-1.9
Net FDI inflows (percent of GDP)	1.2	0.7	0.3	0.5	1.0	1.3	1.6	1.4	1.6
Exports (percentage change of U.S. dollar value; GNFS)	7.2	25.0	-4.5	5.5	12.3	1.5	5.1	5.3	7.2
Gross international reserves (GIR) in billions of U.S. dollars	13.0	14.8	10.8	6.0	9.6	13.4	18.5	19.3	19.7
GIR in percent of ST debt at remaining maturity (RM) 2/	236.0	332.8	250.8	131.5	199.3	273.5	407.1	460.6	467.2
GIR in percent of ST debt at RM and banks' foreign exchange (FX) deposits 2/	135.9	167.8	120.3	62.6	89.6	122.8	169.5	175.8	170.0
Total gross external debt (ED) in percent of GDP, *of which:*	34.7	31.1	29.1	27.0	27.0	25.2	23.4	22.0	20.8
ST external debt (original maturity, in percent of total ED)	1.4	1.0	0.6	1.6	2.0	1.8	1.8	1.8	1.8
ED of domestic private sector (in percent of total ED)	1.4	1.0	0.6	1.6	2.0	1.8	1.8	1.8	1.8
ED to foreign official sector (in percent of total ED)	98.6	99.0	99.4	98.4	98.0	98.2	98.2	98.2	98.2
Total gross external debt in percent of exports	247.2	213.2	220.5	203.9	176.0	166.9	155.9	148.5	142.0
Gross external financing requirement (in billions of U.S. dollars) 3/	7.4	2.2	6.7	5.4	4.0	4.7	6.2	8.7	9.6
Public sector 4/									
Overall balance (including grants)	-5.9	-6.9	-8.4	-8.5	-5.5	-4.4	-3.6	-3.5	-3.5
Primary balance (including grants)	-1.6	-3.1	-4.0	-3.9	-0.9	0.1	0.7	0.5	0.4
Debt-stabilizing primary balance 5/	-1.2	-7.9	1.3	-1.5	1.5	-1.2	-1.2	-1.3	-1.8
Gross PS financing requirement 6/	25.4	26.9	32.5	35.8	33.6	31.2	29.2	28.8	28.2
Public sector gross debt 7/	56.8	55.3	60.4	64.2	66.0	63.4	60.5	58.7	56.9
Public sector net debt 8/	53.3	52.0	57.1	61.5	63.5	61.2	58.5	56.9	55.3
Financial sector 9/									
Capital adequacy ratio (in percent)	13.9	15.1	15.4	...	...	...	...	...	...
Nonperforming loans (NPLs) in percent of total loans	14.9	15.7	14.5	...	...	...	...	...	...
Provisions in percent of NPLs	66.7	69.3	71.8	...	...	...	...	...	...
Return on assets (after tax, in percent)	1.0	1.5	1.4	...	...	...	...	...	...
Return on equity (after tax, in percent)	9.6	15.1	14.9	...	...	...	...	...	...
FX deposits held by residents (in percent of total deposits)	7.7	7.2	7.4	...	...	...	...	...	...
Government debt held by FS (percent of total FS assets)	41.6	44.6	54.9	...	...	...	...	...	...
Credit to private sector (percent change)	3.9	4.0	7.5	...	...	...	...	...	...
Memorandum item:									
Nominal GDP (in billions of U.S. dollars)	177.6	213.7	225.6	236.5	229.9	236.4	250.1	267.2	290.0

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

1/ Inflation after 2009/10 based on new CPI weights, recalculated in September 2011.
2/ Debt at remaining maturity is defined as maturing short-, medium-, and long-term external official debt.
3/ Current account deficit plus amortization of external debt.
4/ Public sector covers general (consolidated) government.
5/ Based on the end of period debt stock in year t-1, and the baseline assumptions for the relevant variables (i.e., growth, interest rates, inflation, exchange rates) in year t.
6/ Overall balance plus debt amortization.
7/ Excludes obligations to the IMF except budget financing, military debt, commercial loans, and short-term debt.
8/ Net debt is defined as gross debt minus government deposits with the banking system.
9/ Financial sector includes all commercial and specialized banks; for government debt also includes nonbanks, but excludes State Bank of Pakistan.

Table 11. Pakistan: External Debt Sustainability Framework, 2008-2018
(In percent of GDP, unless otherwise indicated)

	Actual							Program						
	2008	2009	2010	2011	2012	10-Year Historical Average	10-Year Standard Deviation	2013	2014	2015	2016	2017	2018	Debt-stabilizing non-interest current account 6/
Baseline: External debt	27.0	30.8	34.7	31.1	29.1			**27.7**	**27.4**	**25.7**	**23.8**	**22.4**	**21.1**	**-3.0**
Change in external debt	0.5	3.9	3.8	-3.6	-2.0			-1.4	-0.3	-1.7	-1.8	-1.4	-1.3	
Identified external debt-creating flows (4+8+9)	1.4	4.2	-0.5	-6.9	0.2			-0.6	-1.5	-1.6	-1.5	-0.7	-0.9	
Current account deficit, excluding interest payments	6.8	4.2	1.3	-0.8	1.4			0.5	0.1	0.3	0.6	1.4	1.4	
Deficit in balance of goods and services	-40.6	-36.8	-35.5	-35.0	-34.8			-34.1	-38.3	-38.2	-38.4	-38.4	-38.3	
Exports	14.0	13.7	14.0	14.6	13.2			13.6	15.6	15.4	15.3	15.1	14.9	
Imports	-26.5	-23.1	-21.5	-20.4	-21.6			-20.6	-22.7	-22.9	-23.1	-23.4	-23.4	
Net non-debt creating capital inflows (negative)	-3.1	-2.2	-1.2	-0.7	-0.3			-0.5	-1.1	-1.5	-1.7	-1.6	-1.7	
Automatic debt dynamics 1/	-2.3	2.2	-0.7	-5.4	-0.8			-0.5	-0.4	-0.4	-0.4	-0.5	-0.6	
Contribution from nominal interest rate	1.2	1.3	0.9	0.7	0.7			0.5	0.5	0.5	0.5	0.5	0.5	
Contribution from real GDP growth	-1.1	-0.1	-0.7	-1.0	-1.2			-1.0	-0.9	-0.9	-0.9	-1.0	-1.0	
Contribution from price and exchange rate changes 2/	-2.4	1.0	-0.9	-5.0	-0.4									
Residual, incl. change in gross foreign assets (2-3) 3/	-0.9	-0.4	4.4	3.3	-2.2			-0.8	1.2	-0.1	-0.3	-0.7	-0.4	
External debt-to-exports ratio (in percent)	192.2	225.3	247.2	213.2	220.5			203.9	176.0	166.9	155.9	148.5	142.0	
Gross external financing need (in billions of US dollars) 4/	15.4	12.3	7.2	2.6	7.2			5.4	4.3	5.4	7.0	9.5	9.3	
in percent of GDP	9.0	7.3	4.0	1.2	3.2			2.3	1.9	2.3	2.8	3.6	3.3	
Scenario with key variables at their historical averages 5/								**27.7**	**24.8**	**22.2**	**20.2**	**18.0**	**16.4**	**-3.1**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	4.7	0.4	2.5	3.6	4.0	11.0	20.2	3.6	3.2	3.5	3.7	4.5	5.0	
GDP deflator in US dollars (change in percent)	10.1	-3.6	2.9	16.9	1.2	3.1	11.7	-1.1	-5.2	-0.7	2.0	2.2	3.4	
Nominal external interest rate (in percent)	5.4	4.5	3.2	2.3	2.4	3.5	0.9	1.8	1.7	1.8	1.9	2.1	2.3	
Growth of exports (US dollar terms, in percent)	12.1	-3.3	7.2	25.0	-4.5	10.8	10.0	5.5	12.3	1.5	5.1	5.3	7.2	
Growth of imports (US dollar terms, in percent)	28.7	-13.7	-2.8	14.3	11.7	16.6	17.1	-2.3	8.0	3.6	6.9	8.1	8.7	
Current account balance, excluding interest payments	-6.8	-4.2	-1.3	0.8	-1.4	-1.0	3.8	-0.5	-0.1	-0.3	-0.6	-1.4	-1.4	
Net non-debt creating capital inflows	3.1	2.2	1.2	0.7	0.3	1.6	1.0	0.5	1.1	1.5	1.7	1.6	1.7	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Table 12. Pakistan: Public Sector Debt Sustainability Framework, 2008-18
(In percent of GDP, unless otherwise indicated)

	Actual							Program						
	2008	2009	2010	2011	2012			2013	2014	2015	2016	2017	2018	**Debt-stabilizing primary balance 9/**
Baseline: Public sector debt 1/	57.1	56.0	56.8	55.3	60.4			**64.2**	**66.0**	**63.4**	**60.5**	**58.7**	**56.9**	**-1.6**
o/w foreign-currency denominated	27.2	29.9	30.2	26.6	25.8			24.3	24.1	22.1	20.1	18.6	17.4	
Change in public sector debt	32.9	-1.1	0.9	-1.5	5.1			3.8	1.8	-2.6	-2.9	-1.8	-1.8	
Identified debt-creating flows (4+7+12)	6.4	-0.4	1.0	-3.5	6.3			2.3	-0.8	-2.7	-2.2	-2.4	-2.5	
Primary deficit	2.5	0.1	1.6	3.1	4.0			3.9	0.9	-0.1	-0.7	-0.5	-0.4	
Revenue and grants	14.4	14.2	14.3	12.6	13.1			13.2	14.4	14.8	15.3	15.2	15.2	
Primary (noninterest) expenditure	16.8	14.3	15.9	15.7	17.1			17.1	15.3	14.8	14.6	14.7	14.7	
Automatic debt dynamics 2/	3.2	-0.3	-1.0	-7.0	2.0			-1.5	-2.0	-3.1	-2.0	-1.9	-2.1	
Contribution from interest rate/growth differential 3/	0.8	-5.0	-2.4	-7.1	-0.4			-1.5	-2.0	-3.1	-2.0	-1.9	-2.1	
Of which contribution from real interest rate	1.7	-4.8	-1.1	-5.5	1.6			0.5	-0.1	-1.0	0.2	0.6	0.6	
Of which contribution from real GDP growth	-1.0	-0.2	-1.2	-1.7	-2.0			-2.0	-1.9	-2.0	-2.1	-2.5	-2.6	
Contribution from exchange rate depreciation 4/	2.4	4.7	1.4	0.1	2.4									
Other identified debt-creating flows	0.7	-0.2	0.3	0.4	0.3			-0.1	0.3	0.4	0.4	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0			0.0	0.3	0.4	0.4	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	
Other (specify, e.g. bank recapitalization)	0.7	-0.2	0.3	0.4	0.3			-0.1	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	26.5	-0.7	-0.1	2.0	-1.2			1.6	2.6	0.1	-0.7	0.6	0.7	
Public sector debt-to-revenue ratio 1/	396.9	393.4	396.6	438.4	459.2			485.2	459.3	427.3	394.8	385.2	374.7	
Gross financing need 6/	24.2	24.6	25.4	26.9	32.5			35.8	33.6	31.2	29.2	28.8	28.2	
in billions of U.S. dollars	41.4	41.8	45.0	57.5	73.2	10-Year	10-Year	84.7	77.2	73.7	73.1	77.0	81.8	
Scenario with key variables at their historical averages 7/								**64.2**	**64.0**	**61.5**	**58.3**	**56.3**	**54.3**	**-3.6**
Scenario with no policy change (constant primary balance) in 2013-2018						Historical	Standard	**64.2**	**69.3**	**70.7**	**72.3**	**74.8**	**77.0**	**-2.2**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline						Average	Deviation							
Real GDP growth (in percent)	4.7	0.4	2.5	3.6	4.0	11.0	20.2	3.6	3.2	3.5	3.7	4.5	5.0	
Average nominal interest rate on public debt (in percent) 8/	21.9	10.5	8.7	8.3	8.8	8.9	4.9	8.7	8.0	7.6	7.5	7.4	7.4	
Average real interest rate (nominal rate minus change in GDP deflator, ir	9.0	-10.2	-2.1	-11.3	3.5	1.9	11.8	1.1	0.1	-1.4	0.5	1.4	1.4	
Nominal appreciation (increase in US dollar value of local currency, in pe	-10.0	-16.9	-5.0	-0.6	-8.9	-4.2	6.1							
Inflation rate (GDP deflator, in percent)	12.9	20.7	10.7	19.5	5.3	7.1	12.6	7.5	7.9	9.0	7.0	6.0	6.0	
Growth of real primary spending (deflated by GDP deflator, in percent)	10.9	-12.4	12.8	1.4	13.8	13.3	22.3	6.3	-8.8	0.2	2.9	4.9	5.3	
Primary deficit	2.5	0.2	1.6	3.1	4.0	0.7	2.4	3.9	0.9	-0.1	-0.7	-0.5	-0.4	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.
2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).
5/ For projections, this line includes exchange rate changes.
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Derived as nominal interest expenditure divided by previous period debt stock.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Table 13. Pakistan: Schedule of Reviews and Purchases

Date	Amount of Purchase		Conditions
	Millions of SDRs	Percent of Quota	
September 4, 2013	360	35	Approval of arrangement
December 2, 2013	360	35	First review and end-September 2013 performance/continuous criteria
March 2, 2014	360	35	Second review and end-December 2013 performance /continuous criteria
June 2, 2014	360	35	Third review and end-March 2014 performance /continuous criteria
September 2, 2014	360	35	Fourth review and end-June 2014 performance /continuous criteria
December 2, 2014	360	35	Fifth review and end-September 2014 performance /continuous criteria
March 2, 2015	360	35	Sixth review and end-December 2014 performance /continuous criteria
June 2, 2015	360	35	Seventh review and end-March 2015 performance /continuous criteria
September 2, 2015	360	35	Eighth review and end-June 2015 performance /continuous criteria
December 2, 2015	360	35	Ninth review and end-September 2015 performance/continuous criteria
March 2, 2016	360	35	Tenth review and end-December 2015 performance /continuous criteria
June 2, 2016	360	35	Eleventh review and end-March 2016 performance /continuous criteria
August 1, 2016	73	7	Twelfth review and end-June 2016 performance /continuous criteria
Total	4393	425	

Source: IMF staff estimates.

PAKISTAN

Table 14. Pakistan: Quantitative Performance Criteria and Indicative Targets for FY2013/14 1/
(In billions of rupees, at program exchange rates, unless otherwise specified)

	FY2012/13	FY2013/14			
	end-June	end-September	end-December	end-March	end-June
	Act.	Program		Projections	
Performance Criteria					
Floor on net international reserves of the SBP (millions of US dollars)	-2,437	-2,499	-2,090	-141	2,532
Ceiling on net domestic assets of the SBP (stock, billions of Pakistani rupees)	2,402	2,877	2,901	2,571	2,227
Ceiling on overall budget deficit (cumulative, excluding grants, billions of Pakistani rupees) 2/	2,012	419	882	1,209	1,464
Ceiling on SBP's stock of net foreign currency swaps/forward position (millions of US dollars)	2,255	2,255	2,005	2,005	1,755
Ceiling on net government borrowing from the SBP (including provincial governments, stock, billions of Pakistani rupees) 3	2,168	2,690	2,560	2,390	2,240
Continuous Performance Criterion					
Accumulation of external public payment arrears by the general government (continuous)	0	0	0	0	0
Indicative Targets					
Cumulative floor on Targeted Cash Transfers Spending (BISP) (billions of Pakistani rupees)	54	19	38	56	75

Sources: Pakistani authorities; and Fund staff estimates.

1/ All items as defined in the TMU. Fiscal year runs from July 1 to June 30.
2/ Excluding grants, FY2012/13 overall budget deficit is a stock.
3/ FY 2012/13, total stock of government debt as of June 30, 2013.

Table 15. Pakistan: Prior Actions and Structural Benchmarks Under Extended Fund Facility

Item	Measure	Time Frame (by End of Period)
Prior Actions (implemented before Board consideration of the program)		
1	Net purchase of $125 million by the SBP in the foreign exchange spot market from July 1, 2013.	5 days prior to the Board meeting
2	Develop and approve a three-year plan by the Government for phasing out Tariff Differential Subsidies (TDS), and implement the first step by: (i) the notification of new tariffs for FY2012/13; (ii) increasing the weighted average tariffs by 50 percent on industrial, commercial, bulk, and AJ&K consumers' electricity consumption; and (iii) announcing a reduction of the subsidy on second group of consumers (as defined in the TMU) through increasing the weighted average notified tariffs by 30 percent that will be in effect from October 1st, 2013.	5 days prior to the Board meeting
3	Implement a series of fiscal adjustment measures (including those in the 2013/14 budget) totaling 2 percent of GDP on an annualized basis.	5 days prior to the Board meeting
4	Impose a balanced budget requirement on provinces and agree with provinces to save additional revenues generated by the program.	5 days prior to the Board meeting
5	Issue 10 thousand notices based on large potential fiscal liabilities.	5 days prior to the Board meeting
Structural Benchmarks		
Fiscal sector		
1	Develop and launch initiatives to enhance revenue administration for sales tax, excises, and customs similar to that prepared for income tax.	end-December 2013
2	Announce a rationalization plan for gas prices which will involve a levy to generate 0.4 percent of GDP fiscal savings by end-December 2013.	end-December 2013
Monetary sector		
3	Enact the amendments to the SBP law to give SBP autonomy in its pursuit of price stability as its primary objective, while strengthening its governance and internal control framework, in line with Fund staff advice.	end-March 2014
Financial sector		
4	Prepare detailed plans to achieve compliance of all banks that fall below minimum capital adequacy, including specific actions, end dates, and contingency arrangements. Also detail a plan for recapitalization, consolidation or liquidation of 9 banks that fall below the minimum capital requirement but not CAR.	end-December 2013
5	Enact the Deposit Protection Fund Act, in line with Fund staff advice	end-September 2014
6	Enact the Securities Bill, in line with Fund staff advice.	end-December 2014
Structural Policies		
7	Develop and approve PSE reform strategy for thirty firms among the 65 PSEs approved for privatization by the Council of Common Interest (CCI).	end-September 2013
8	Hire a professional audit firm to conduct a technical and financial audit of the system to identify the stock and flow of payables at all levels of the energy sector (including Power Sector Holding Company Limited).	end-November 2013
9	Make Central Power Purchasing Agency (CPPA) operational by separating it from the National Transmission and Despatch Company (NTDC), hire key staff, issue CPPA rules and guidelines, and initiate the payment and settlement system.	end-December 2013
10	Enact the amendments to the Pakistan Penal Code 1860 and the Code of Criminal Procedures 1898.	end-December 2013
11	Privatize 26 percent of PIA's shares to strategic investors.	end-June 2014

Appendix I. Letter of Intent

August 19, 2013

Ms. Christine Lagarde

Managing Director

International Monetary Fund

Washington, D.C. 20431

Dear Ms. Lagarde:

Over the past several years, Pakistan has faced considerable challenges that have adversely affected the economy's performance: a difficult external environment, high international oil prices, two major floods, and continued security problems. These problems have been exacerbated by poor macroeconomic management during the previous government and by long-standing structural problems which have not been addressed. Falling capital inflows have been insufficient to finance even a modest current account deficit, leading to a large reduction in international reserves.

As a result of the recent elections providing the first democratic transition in Pakistan's history, the new government has a majority in parliament and a strong mandate to implement ambitious economic reforms to stabilize the economy and put our country on the path to growth and prosperity. For this, we have developed an economic program covering 2013/14–2015/16, as described in the attached Memorandum of Economic and Financial Policies (MEFP). The program focuses on strengthening macroeconomic and structural policies to shore up confidence, reduce economic imbalances, and foster sustained inclusive growth and employment generation.

In support of our economic program, we request a 36-month extended arrangement under the Extended Fund Facility (EFF) from the International Monetary Fund in the amount equivalent to SDR 4,393 million (equivalent to 425 percent of Pakistan's quota, about US$6.6 billion at current exchange rates). The extended arrangement under the EFF will provide needed external financing and signal our determination to implement sound policies, thereby bolstering market confidence and catalyzing additional financial support from other development partners and private sources.

Progress in the implementation of our program will be assessed through quarterly reviews, quantitative performance criteria, indicative targets, and agreed structural benchmarks, as described in the attached Tables 1-2 and the Technical Memorandum of Understanding (TMU). We expect the first purchase in the amount equivalent to SDR 360 million (34.8 percent of quota, about US$540 million) to become available upon approval of the extended arrangement under the EFF by the IMF Executive Board.

The Government of Pakistan and the State Bank of Pakistan (SBP) will provide the Fund with such information as the Fund may request in connection with Pakistan's progress in implementing its economic and financial policies. The government and SBP believe 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 necessary for this purpose. 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 consultations.

Please let us also reassure you that the policies underlying this program have the firm support of Prime Minister Sharif, the cabinet and provincial government leaders as indicated by the recent decision to this effect by the Council of Common Interest.

Sincerely yours,

/s/
Ishaq Dar
Minister of Finance
Pakistan

/s/
Yaseen Anwar
Governor of the State Bank of Pakistan
Pakistan

Attachment I. Memorandum on Economic and Financial Policies for 2013/14–2015/16

1. The Government of Pakistan has adopted a comprehensive program to address vulnerabilities and boost inclusive growth through macroeconomic stabilization and structural reforms. This memorandum sets out Pakistan's economic and financial policies for August 2013–July 2016, to be supported by the International Monetary Fund (IMF) under a 36-month extended arrangement under the Extended Fund Facility (EFF).

Economic Context

2. Pakistan's economy faces significant challenges. Growth has slipped to an estimated 3.6 percent in 2012/13. Productivity growth has fallen sharply and private investment has fallen by half in the past six years, undermining future growth prospects. Lack of reliable electricity supply and a difficult security situation in large parts of the country have been important factors behind this poor performance. Nevertheless, Pakistan remains a country with abundant potential, given its rich natural and human resources and its important geographical location.

3. Macroeconomic imbalances and vulnerabilities have built-up. The fiscal deficit has widened from 5 percent of GDP in 2008/09 to about 8.8 percent of GDP in 2012/13, driven by weak tax collections, energy sector subsidies, and increased provincial government spending. Deficit financing has crowded out private sector borrowing and has contributed to inflation. Headline inflation has recently declined sharply, but it is expected to rebound. While the current account balance has improved significantly since 2008/09—due in part to rising remittances and transfer payments—capital inflows have collapsed at the same time as debt service obligations are increasing significantly, producing a steep fall in foreign exchange reserves. The State Bank of Pakistan (SBP) has also intervened in support of the currency, causing a further drop in reserves. Over the last 12 months, the SBP's reserves have fallen around 40 percent to US$6.0 billion in end-June 2013.

4. Longstanding structural impediments to growth have prevented a full realization of Pakistan's potential. Structural problems, particularly in the energy sector, security concerns, and a difficult investment climate have combined with adverse shocks to undermine economic performance. GDP growth has only averaged 3 percent over the past few years, well below that is needed to provide jobs for the rising labor force and reduce poverty. Technical and financial problems in the energy sector have led to large-scale power outages which have depressed output and have imposed hardship on the public at large. A difficult business climate has contributed to a sharp fall in private investment. Weak performance in large public enterprises in key industries constitutes a further drag on the public finances and on growth.

Medium-Term Macroeconomic Scenario

5. **The government's economic program aims to improve the medium-term growth outlook and move toward sustainable fiscal and external positions**. The program envisages consolidation to reach a sustainable fiscal deficit with a declining debt-to-GDP ratio, prudent monetary and exchange rate polices, strengthened financial stability, and structural reforms to reduce macroeconomic risks and boost inclusive growth over time. In the short run, fiscal adjustment would temper economic growth. However, the adverse impacts will be mitigated by: (i) sharply increasing public investment and improving private sector access to credit to boost private investment; (ii) alleviating acute energy supply bottlenecks to increase productive capacity and (iii) increasing targeted transfers to the most vulnerable population. Improved macroeconomic stability—together with the serious structural reforms contemplated under the program—would improve growth significantly over the medium term.

6. **Macroeconomic stability will be secured and economic performance will improve over time**. Growth will initially remain modest (about 2½-3 percent) in 2013/14 due to the necessary fiscal consolidation, but will then strengthen to around 4½-5 percent in the outer years as structural reforms are implemented and the investment climate improves. Inflation will initially increase, due in part to some weakening of the rupee as reserves are rebuilt. However, monetary policy will likely be tightened in later years to help bring inflation down to the 6-7 percent range by the end of the program period. Fiscal consolidation will bring the fiscal deficit from the baseline of 8.8 percent of GDP (excluding grants) in FY2012/13 to around 3½ percent in FY2016/17. In the early stage of the program, the current account deficit will narrow reflecting fiscal consolidation and exchange rate depreciation. Subsequently, with growth strengthening and private investment rising because of structural reforms, the current account deficit is projected to widen to around 2 percent of GDP, which will be fully financed by capital inflows. Over the course of the program, the SBP's foreign exchange reserves will improve to US$18 billion equivalent to over 3 months of imports of goods and services.

Economic Program

A. Fiscal Policy

7. **Fiscal consolidation is needed to put debt on a declining path and foster sustainable growth**. Fiscal consolidation of around 4-4½ percent of GDP over the three year program will lower the fiscal balance to around 3½ percent of GDP and place the debt-to-GDP ratio on a firmly declining path. Moreover, a more efficient and equitable tax system would foster competition, while providing the needed resources to finance infrastructure and support the poor through targeted programs. An upfront adjustment of near 2 percent of GDP aims at restoring policy credibility (prior action). The negative impact on economic activity will be ameliorated by structural reforms to boost growth and a somewhat more accommodative monetary policy stance early in the program than would normally be required given the inflation outlook.

8. The initial consolidation effort relied mainly on the revenue side given the chronically low tax revenue-to-GDP ratio. The government is taking a series of measures aimed at strengthening tax revenues by over 1 percent of GDP on an annualized basis. The tax measures contained in the 2013 Finance Bill seek to increase revenues by 0.75 percent of GDP, and included: (i) an increase in the GST rate; (ii) an increase in the corporate minimum tax rate; (iii) higher personal income tax rates for the top income brackets; (iv) higher excises on cigarettes; (v) increases in several withholding rates; (vi) introduction of several withholding rates; and (vii) imposition of new levy on movable assets. Moreover, by end-December 2013 we will implement a new gas levy that will increase tax revenue by 0.4 percent of GDP on an annualized basis. This package is a first step towards a more efficient and equitable tax system.

9. On the expenditure side, the government has initiated a plan to phase out electricity subsidies over the life of the program. The federal government has approved at the highest level, with support of the provinces, an energy policy entailing periodic increases in the average tariff, aiming at eliminating the tariff differential subsidy for all consumers except the very lowest over the next three years. The first adjustments to commercial, industrial, bulk, and large consumers (¶27) reduced subsidies by 0.75 percent of GDP on an annualized basis (prior action). However, for the first year we will maintain tariffs for consumers between 0-200 kWh consumption. For the second and third years, we will further reduce subsidies by roughly 0.4 percent of GDP per year to reach a maximum of 0.3 percent of GDP thereafter. As part of our initial adjustment package, we have also undertaken significant cuts in ministries' nonwage current expenditures an across the board reduction of 30 percent from the budget allocations—amounting about 0.15 percent of GDP—by ministerial decision), have scaled back the budgeted increase in capital spending, and will delay some of the remaining capital spending until new revenues from the gas levy materialize.

10. Tax administration reforms will gradually deliver further improvements in revenue collections. An initiative to incorporate three hundred thousand new taxpayers into the income tax net was launched in July. The 2013 Finance Bill granted the FBR access to bank information enhancing the scope and quality of information in its databases. The first step has been taken with the issuance of ten thousand notices based on large potential fiscal liabilities by end-July (prior action), and will be followed by a provisional assessment, collection procedures, and penal and prosecution proceedings. The income tax initiative will be complemented with initiatives to enhance revenue administration for sales, excises and customs, to be developed and launched by end-December 2013 (structural benchmark). These efforts will be further assisted by increasing the number of risk-based tax audits to 4.2 percent of declarations (from 2.2 percent). We will also continue to seek technical assistance on tax administration from our international partners.

11. To ameliorate risks to the program, several contingent measures have been identified and will be implemented in case the expected fiscal adjustment falls short of objectives. These measures include reduced expenditure allocations in the first 9 months of the year compared to the budget to create a reserve against any shortfall and use of reserves built into the capital expenditure budget if needed. These could yield savings amounting to 0.5 percent of GDP. In addition, we stand ready to take any other measures needed to assure compliance with our fiscal target.

12. Beyond the current fiscal year, further revenue and expenditure measures will be implemented to achieve a sustainable deficit of around 3½ percent of GDP by 2016/17. This will require further fiscal consolidation of about 1¼ percent of GDP per year in the coming 2 fiscal years. Roughly half of the adjustment could come from the revenue side, mainly through further widening of the tax base with some contribution from improved tax administration. Among the initiatives to widen the tax base we will finalize a comprehensive plan to separate existing statutory regulatory orders (SROs) either by eliminating those granting exemptions or concessions through SROs by end-December 2013. We will introduce the remaining to FY14/15 finance bill by end-June 2014. The government has already stopped issuing any new tax concessions or exemptions (including customs tariffs) through SROs except by an act of Parliament, and will also approve by end-December 2015 legislation to permanently prohibit the practice. We will also quantify the remaining tax expenditures and publish a detailed list in the budget in future years. These steps will facilitate gradually moving the GST to a full-fledged integrated modern indirect tax system with few exemptions and to an integrated income tax by 2016/17. On the expenditure side, further reductions in untargeted subsidies will be undertaken in 2014/15 and 2015/16, along with steps to streamline wage and salary costs via civil service reforms.

13. The program envisages enhanced and better-targeted assistance for the poorest households. The poor and most vulnerable segments of the society must be protected from the direct and indirect impacts of fiscal consolidation and tariff adjustments. The Benazir Income Support Program (BISP) is the largest targeted social assistance mechanism directly reaching 4.8 million families (16 percent of the population) within the two poorest quintiles. For FY2013/14, we have approved an increase in the budget allocated to BISP to PRs. 75 billion. This translates into an increase in the level of benefits from PRs.1000 to PRs. 1200 per family per month reaching 5.7 million families and will provide conditional cash transfers (CCTs) to primary education, supporting 560,000 families in 20 districts with a benefit of Rs. 200 per child per month attending school. As savings from tariff adjustments and fiscal space are realized, we will further expand the coverage of the program and increase the benefit amount to protect the real purchasing power of the beneficiaries. In FY2014/15, we envisage expanding coverage of basic cash payments to 6.3 million families, and by FY 2015/16 to 6.6 million families (24 percent of the population) and expansion of CCTs in at least 80 districts. In the meantime, we will phase-out the non-targeted subsidies and strengthen the technology based platform linked with National ID database for effective delivery of cash benefits. We are committed to exploring evidence based income generation schemes that enables graduation of the most vulnerable including microfinance and youth training, skills developments and asset transfer schemes.

14. Provincial governments will play an important role in the fiscal reform process. Under successive constitutional amendments (most recently the 18th), Pakistan has moved decisively to a more decentralized federal system of government. The most recent National Finance Commission (NFC) award grants 57.5 percent of most revenues to the provinces, along with a substantial devolution of spending responsibilities and taxation authority in agriculture, property and services which left the federal government with a severe imbalance between its remaining expenditure responsibilities and its revenue. Since under the NFC award, the bulk of the additional revenue generated by the program will be distributed to the provinces, an agreement has been reached at the level of the Council of Common Interest to assure that it is used for deficit reduction or saved. In addition, the government has tightened the balanced-budget requirement on provinces, and provided incentives for them to maintain surpluses (prior action). Before the end of FY 2013/14, negotiations will begin on a new NFC award and the new agreement will adjust the terms of fiscal decentralization to be consistent with the imperatives of macroeconomic stability.

15. Public debt management will be strengthened over the program period. The large fiscal deficit and a weak institutional setting have hindered public debt management. Treasury bills amount to over half of domestic debt and National Savings Schemes account for almost a quarter, while outstanding bonds amount to only 20 percent of domestic debt. Out of the total domestic debt (including SBP Market Related Treasury Bills), around 60 percent of debt has a maturity of less than a year. Pakistan Investment Bonds, the prime longer-term debt instrument, have an average duration of around 3½ years. Moreover, debt management operations are fragmented across several agencies and the Debt Policy Coordination Office has only an advisory role. The fiscal consolidation envisaged will reduce government domestic financing and will facilitate developing a strategy to increase duration, lowering interest rates and rollover risks, and broadening the investor base. In this context, during the program we plan to revamp the Debt Policy Coordination Office into a debt management unit with enhanced authority to independently administer the government's financial obligations and cash flows. The unit will ensure the government's financing at the lowest possible cost given risk exposure parameters, and will seek to improve the benchmarking of issues to develop a deeper financial market. We will seek technical assistance (TA) from the IMF and the World Bank to develop a Medium Term Debt Strategy (MTDS).

B. Monetary and Exchange Rate Policies

16. The SBP has pursued an accommodative monetary policy to stimulate the economy, in view of sustained weak private investment and declining headline inflation. Over the past two years, the SBP has reduced the policy rate by a cumulative 500 basis points to 9 percent. In addition, in FY2012/13, the SBP continued direct financing for the large fiscal deficit (about 20 percent of the reserve money) and open market operations and foreign currency swaps have also pumped additional liquidity into the market. As a result, despite falling net foreign assets (NFA), monetary aggregates have expanded relatively quickly; however, private credit has shrunk in real terms.

17. To address declining reserves and a projected rebound in inflation, the SBP will adjust monetary and exchange rate policies. Monetary and exchange rate policies will focus on rebuilding foreign exchange reserves and maintaining price stability. As a first step, to signal a shift in policy, the SBP began net purchases of foreign exchange in the interbank market, which since July 1 have totaled US$125 million (prior action). The SBP will refrain from further net direct lending to the government, and limit open market liquidity injections to the economy to those consistent with the program. Inflation reduction will not be a primary focus of the first year of the program so as to mitigate the impact of the envisaged fiscal contraction.

18. Beginning in 2014/15, monetary policy will aim to reduce inflation while continuing to rebuild foreign exchange reserves. To ease some of fiscal adjustment effects, the program initially envisages a moderate monetary policy, with policy tightening in years two and three, as exchange rate pressure eases, to bring inflation down to the 6-7 percent range. To reduce inflation, monetary accommodation of fiscal deficits will be scaled back considerably and policy rates will be set prudently to ensure positive real interest rates. To protect the external position, the SBP will allow greater exchange rate flexibility, limiting intervention in the exchange market to that needed to build reserves, cushion major shocks, and strengthen competitiveness over time. Reserve losses exceeding $500 million in any 30-day period during the program will trigger consultation with IMF staff. The program envisages no further direct financing of the budget by the SBP including purchases of government papers on the primary market (continuous PC) and limits on Net Domestic Assets of the SBP. The SBP's short swap/forward foreign exchange position will be gradually scaled back to US$1.25 billion by the end of the program.

19. Enhanced central bank independence will improve monetary policymaking. Amendments to the SBP law will be enacted to strengthen the autonomy of the SBP, including full operational independence in its pursuit of price stability as its primary objective, complemented with enhanced governance structure including strong internal controls, by end-March 2014 (structural benchmark). Among other things, the amendments will establish an independent, decision-making monetary policy committee to design and implement monetary policy. The amendments will also prohibit any form of new direct lending from the SBP.

C. Financial Sector

20. The banking system is generally well-capitalized, profitable, and liquid. While NPLs remain high, they have come down since September 2011, as successive policy rate cuts have reduced the interest burden on borrowers. Despite this improvement, growth in banks' lending to private sector continues to be weak while banks' holdings of government securities continue to expand. On the funding side, bank deposits continue to grow strongly, supported in part by recent initiatives including branchless (i.e., mobile phone and internet) banking and a floor on deposit rates. As of end-March 2013, there are four small banks (one state-owned and three private) comprising 6.7 percent of banking system assets that fall below the minimum capital adequacy requirement (CAR) of 10 percent of risk-weighted assets. To comply with this requirement, the immediate capital needs of these institutions are Rs. 12.6 billion (less than 0.1 percent of GDP), but could rise if conditions were to deteriorate significantly.

21. The SBP will prepare a more detailed plan by end December 2013 to achieve compliance of all banks that fall below minimum capital adequacy (structural benchmark). The plan will include contingency measures in case of slippages and will indicate clearer alternatives in case banks are unable to raise expected capital.

- ***State-Owned Banks***: the SBP will require completion of the recapitalization of the state-owned bank that is slightly below the CAR by end-December 2014 after having received substantial capital injections over the past two years. The bank has returned to profitability and is gaining deposits, but more capital is needed for full compliance.

- ***Private Banks***: Of the three private banks that fall below the CAR, the SBP has indicated capital subscription from a private foreign investor for one to fill part of the shortfall, capital raising plans via issuance of non-cumulative perpetual preferred stock for another, and is exploring merger or acquisition by a foreign investor for the third bank. All three banks are asked to provide an approved capital plan with specific timelines, where banks are expected to complete required capital formation by end-December 2014.

22. In revamping the recovery mechanisms, consultations on the new bankruptcy law (Corporate Rehabilitation Act) are ongoing with key stakeholders. The new law will facilitate the legal framework for rehabilitating viable corporate and financial entities speeding up the process of liquidation of unviable entities. The MoF, along with the SBP and SECP, will approach the key stakeholders to address the concerns regarding creditor and debtor protection. The draft law is expected to be finalized by end-September 2014 and enacted by end-December, 2015.

23. To strengthen the long-term stability of the banking system, Ministry of Finance in consultation with the SBP plans to introduce a deposit insurance scheme. The proposed initial coverage limit is Rs. 100,000 per depositor per bank, covering 72 percent of depositors and 40 percent of total insurable deposits. The deposit insurance scheme will be managed by a Deposit Protection Fund, established as a subsidiary of SBP, with its own governance structure and funded by flat premium payments from banks. The draft act for the Fund is being finalized and is expected to be enacted by end-September 2014 (structural benchmark) and the scheme would begin operations by end-December 2015.

24. Revising the regulatory and supervisory frameworks is critical for financial stability. The Securities and Exchange Ordinance, 1969 "SEO 69" lacks a proper structure and suffers from numerous inconsistencies and gaps due to several amendments made over years. Several initiative will address these difficulties:

- The draft Securities Bill will enhance the supervisory and enforcement power of the regulator. It will be submitted to Parliament by end-March 2014, and will be enacted by end-December 2014 (structural benchmark).

- In terms of enhancing the regulatory power of the SECP, the Securities and Exchange Commission of Pakistan Act "SECP Act,"1997, did not enable the Commission to act as an integrated regulator and to act promptly, despite several amendments. In order to remove this redundancy, the Securities and Exchange Commission of Pakistan (Regulation and Enforcement) Bill has been drafted which will be sent to parliament by March 2014.

- Future markets are currently being regulated by certain amendments to SEO 69. In order to have a comprehensive framework for the futures markets, a Futures Trading Bill has been drafted and will be placed before the Parliament for expected approval by end-December 2014.

- Finally, as banks broaden their business into non-banking financial activities, it presents a challenge to the SBP and SECP to effectively regulate and supervise these entities. Therefore, the SBP and SECP have agreed on a Memorandum of Understanding (MoU) for sharing information and regulatory assistance, and will seek technical assistance from the IMF and World Bank to develop a legal framework for consolidated supervision, to be prepared by end-December 2015.

D. Structural Reforms

25. Pakistan's growth potential has deteriorated significantly over the past decade. Average growth has fallen from around 5 percent from 1995-2005 to around 3 percent since 2008. This is due in part to the difficult regional security situation which has discouraged investment. However, the secular growth decline is also driven by periodic bouts of macroeconomic instability and long-standing structural impediments to growth. We are committed to boosting long-term growth by comprehensively tackling the problems of the energy sector, which we estimate has lowered output by up to 2 percentage points per year. We will also undertake growth-promoting initiatives to improve the investment climate, liberalize and simplify the international trade regime, and reform and/or privatize public sector enterprises in key economic areas.

Energy Sector Reforms

26. We will implement a comprehensive energy policy covering all elements of the energy supply chain, demand management, and pricing policies for better functioning of the sector. The energy sector is saddled with considerable problems, including price distortions, insufficient collections, costly and poorly targeted subsidies, governance and regulatory deficiencies, low efficiency in energy supply and distribution, inadequate attention to planning as a tool for optimal decision making (particularly with regard to location, fuel choices, etc.), and insufficient investment in new energy production. We finalized an energy policy identifying priority steps for the short-term stabilization and the medium- and long-term viability of the sector to anchor the reform agenda at end-July 2013. The policy was approved by the federal government at the highest level and supported by the provincial governments to signal their buy-in to reform in the sector. We have established an energy committee chaired by the Prime Minister with participation of relevant federal ministries, provincial representatives, and key stake holders, which will meet regularly and take all key decisions on a timely basis to implement the energy policy.

27. Price Adjustments. Energy sector reform should initially concentrate on "quick wins" and short-term measures that contribute to alleviation of energy bottlenecks and fiscal adjustment. In this respect, we have developed a three-year plan for phasing out the Tariff Differential Subsidies (TDS) and bringing tariffs to cost recovery level, along with cost-cutting and efficiency measures to reach full cost recovery in the electricity sector. Tariff adjustments will improve resource allocation and efficiency, and will encourage conservation. The plan will be approved by the Government of Pakistan and will begin with: (i) the notification of NEPRA determined tariffs for FY2012/13; (ii) phasing-out immediately the subsidy on industrial consumers and moving to minimum determined tariff on, commercial, bulk and AJ&K consumers' electricity consumption through increasing the weighted average notified tariffs by 50 percent; and (iii) announce the elimination and reduction of the subsidy on second group of consumers (as defined in the TMU) through increasing the weighted average notified tariffs by 30 percent that will be in effect from October 1st, 2013. The plan, together with implementation of the first step should be undertaken by August 1, 2013 to kick start the reform (prior action). In addition, the costs of servicing the syndicated term credit finance facility which was issued to cover some past losses will be incorporated into the notified base tariff by end-December 2013. In the years two and three of the program, we will generate around 0.4 percent of GDP of savings per year through reduction in subsidies to 0.3-0.4 percent of GDP at the end of the program. Tariffs for consumption between 0-200 kWh will be retained for now, and income support programs will cushion the impact of future tariff increases on the most vulnerable segments of the population. In years 2 and 3 of the program, subsidies will be phased out for users above 200 kWh and reduced for all but the lowest consumers in the 0–200 kWh range.

28. ***Arrears***. Beyond adjusting tariffs and reducing costs to reach full cost recovery, we are implementing a plan to resolve the difficult legacy of circular debt arrears. The plan is aimed at making the sector viable and removing barriers to new investment. In this respect, out of the Rs. 503 billion of payment arrears identified as of end-May 2013, we paid off Rs. 342 billion at end-June 2013 and will be resolving the residual by end-August 2013. Such arrears reduction will alleviate cash constrained power producers and allow them to bring additional electricity supply to the system and reduce load shedding by around three hours. We will also hire a professional audit firm to conduct a technical and financial audit of the system to identify the stock and flow of payables at all levels of the energy sector (including Power Sector Holding Company Limited) by end-November 2013 (structural benchmark), and based on the findings of the report we will design a roadmap to prevent the accumulation and recurrence of payables arrears.

29. **Monitoring and Enforcement**. A key shortcoming of the current electricity sector has been the limited ability to collect for energy supplied, due in part to a lack of specific real-time data on energy flows, and which also results in inadequate compliance with usage restrictions. To address this, we are going to sign strengthened performance contracts with all power sector companies to tackle losses, raise payment compliance, and improve energy efficiency and service delivery. In cases of failure to comply with the performance contracts, we will invoke remedial measures for management and the Boards as specified in the Companies' Ordinance. The government will enact the pending amendments to the Penal Code 1860 and the Code of Criminal Procedures 1898 to strengthen the legal framework in cases of electricity theft by enhancing investigation, prosecution, and penalties by end-December 2013 (structural benchmark). In parallel, we are drafting a new Electricity Act to modernize governance of the sector. The act will establish investigation systems and a fast track judicial mechanism to improve enforcement. We are also empowering the distribution companies (DISCOs) to take commercial decisions on power allocations and allowing them to impose differential outages on neighborhoods with low payment rates (as is already done in Karachi). This new legislation, along with the installation of smart or pre-paid metering trees, will allow better load management in the national grid and will reduce losses. Such legislation will also decrease the unscheduled load-shedding, which is particularly damaging to economic productivity. In the short-run, we will move to a web-based reporting portal to monitor electricity draws to reduce overdraws and improve information flows. The metering at the incoming and outgoing 11kv feeders will be completed by end-August 2013. To minimize losses in fuel delivery to generation companies (GENCOs), we will lease the fuel storage and delivery facilities to Pakistan State Oil (PSO) by end-December 2013.

30. ***Demand Side Management***. Conservation and energy efficiency are the cheapest and the fastest ways to alleviate the electricity shortage. Pricing (¶27) and other market based instruments to encourage energy conservation will significantly improve resource allocation and energy efficiency. In addition, we will place the Pakistan Energy Efficiency and Conservation Act before the Parliament for expected approval by end-September 2013. Equipment performance standards will be enforced through strengthened mechanisms, and would cover key electrical and gas equipment and appliances, which are not yet covered.

31. ***Supply Side Management***. Current energy generation is tilted towards the use of costly fuel oil. Changes in the energy mix are required to decrease the production costs. We are now prioritizing the use of gas and coal rather than fuel oil. In the short-run, increasing the allocation of natural gas to the power sector will deliver savings in production costs. However, quantity-based allocations distort market conditions. We are committed to making allocations through pricing mechanisms in the medium term. We will encourage the conversion of fuel oil-based GENCOs and Independent Power Producers (IPPs) to coal-based plants, which could substantially reduce the fuel component of electricity production costs. To further improve supply, we will continue to rehabilitate generation plants, while continuing to upgrade electricity transmission and distribution facilities to reduce technical losses. We are initiating regular efficiency testing of GENCOs by end-September 2013 to facilitate savings. The current round of three rehabilitations should be completed by end-December 2013 with 500 MW capacity recovery and a 1–2 percent increase in efficiency. Moreover, to enhance energy supply, we will continue with the development of hydropower projects—the cheapest source of supply. Policies should also promote private investment for power generation through both the entry of new players as well as expanding existing capacity of those IPPs systematically adhering to energy mix targets and least cost generation plans. The expansions are expected to generate additional 2000 MW by 2016.

32. ***Governance, Regulatory, and Transparency Improvements***. We have placed high priority on improving energy sector governance and transparency. To enhance governance, we will augment the independence, accountability, and administrative capacity of the regulatory body, the National Electric Power Regulatory Authority (NEPRA). To reduce circular debt accumulation, the period for NEPRA's determination of the base tariff will be reduced from 8–10 months to 90 days by the next determination cycle. Specifically, for FY2013/14 DISCOs will submit the tariff petitions by end-July 2013, and NEPRA will issue the determined tariff by end-October 2013. The government will notify new determined tariffs within 15 days, and over time determination and notification of tariffs will be consolidated with NEPRA. There is also currently a lag of 7 months for the application of fuel price adjustments (FPAs) dictated by NEPRA because of court injunctions. We intend to address these injunctions through the legal system to ensure timely adjustments and to revise the monthly application of FPAs to reflect next quarter's prices to minimize price distortions and improve predictability by end-November 2013. To enhance transparency, a web-based reporting of dispatching, merit order of all power plants, and payment records to stakeholders will be introduced by end-July 2013. Second, the Central Power Purchasing Agency (CPPA) should be made operational by separating it from the National Transmission and Dispatch Company (NTDC), hiring key staff, issuing CPPA rules and guidelines, and taking over the payment and settlement system by end-December 2013 (structural benchmark). Dissolution of PEPCO should also be finalized by end-December 2013 and its remaining functions should be devolved.

33. ***Energy public sector enterprise (PSE) reform***. The institutional capacity of all energy sector PSEs needs to be strengthened to allow them to eventually operate independently from the Government as efficient commercial entities. We will transfer governance of DISCOs and the NTDC to new boards of directors and management by end-2013. We are committed to building the institutional capacity of the Water and Power Development Authorities (WAPDA) through continued corporatization and commercialization, and we will strengthen WAPDA's financial capacity by allowing the tariff to incorporate capital investment plans and ensure timely payments by NTDC/CPPA for all power purchased from WAPDA. In the medium term, we are committed to introduce competitive pricing and direct contracting between power producers and wholesale customers in the power sector. We will endeavor to incorporate this transition into future phases of solicitation for new IPPs.

34. ***Oil and Gas Sector***. The current level of gas supply is barely one half of unconstrained demand due to low prices and insufficient investment. To help tackle the gas shortages, we will facilitate the import of Liquefied Natural Gas (LNG) and through pipelines and limit further expansion of the gas distribution networks for domestic consumption. We will also accelerate new investment in existing fields, which is projected to increase supply by some 7 percent by end-December 2013. We will retain the priority ranking of the power sector to second (after households) and we have diverted an additional 16 percent of gas to the most efficient power plants. Last year we announced the new Petroleum Exploration and Production Policy 2012 to offer higher gas prices for enhanced production from existing and new fields. As new production comes on line, the cost of this gas will be fully reflected in the base tariff on a semiannual basis. We will gradually rationalize gas prices to continue encouraging new investment, promote efficiency in gas use, and assure that there will continue to be no fiscal cost from the gas sector. We will announce a rationalization plan and introduce the new gas levy by end-December 2013 (structural benchmark). The current level of unaccounted for gas losses (UFG) is on average 11 percent due to commercial and technical losses. We have already directed companies to reduce losses benchmarking international standards through investment measures, managerial and administrative improvements, and through building the capacity of the gas distribution companies. We are committed to enhancing the capacity of Oil and Gas Regulatory Authority (OGRA) and Ministry of Petroleum and Natural Resources.

Improving the business climate, liberalizing trade, and reforming state-owned firms

35. Sustainably boosting economic growth in Pakistan will require a sharp increase in foreign and domestic private investment. Achieving macroeconomic stability and addressing the energy sector bottlenecks will do much to encourage renewed investment, but improvements in the business climate, the trade regime, and PSEs will also be essential, as Pakistan currently falls short of its peer countries in these areas.

36. *Business Climate*. Impediments in the legal framework for creditors' rights and contract enforcement, barriers to new business start-ups, complicated legal and taxation requirements, and impaired access to finance hamper the business climate and investment.

- *Contract enforcement*. We will consult with key stakeholders to finalize a new draft bankruptcy law (Corporate Rehabilitation Act) which we will submit for public consultation by end-September 2013 (¶22) and will send to parliament by end-September 2014. While the draft is prepared, we will undertake a diagnostic of needs to speed up rehabilitation of weak but viable corporate entities, and will expedite the liquidation of the insolvent entities. In addition, we will provide the Alternative Dispute Resolution (ADR) Mechanism, which is already functional in Karachi.

- *Start-ups*. We will establish a "one stop shop" (OSS) for registering limited liability companies (LLC), including the human resource and funding needs by end-December 2013. We continue to engage with the World Bank on this through technical assistance and capacity building. The OSS will enable firms to complete all legal formalities at a centralized location grouping Federal Board of Revenue (FBR), Securities and Exchange Commission of Pakistan (SECP), and other Government departments such as Employees Old Age Benefits Institute. In parallel, we will build capacity to set up the OSS and strengthen the Board of Investment (BOI) in facilitating implementation of investment friendly regulations. By end-September 2013, the BOI, in coordination with SECP, FBR, provincial governments and other concerned agencies, will develop a plan to further simplify procedures and costs for setting-up businesses in Pakistan.

- *Access to credit*. Accessing credit for small and medium enterprises (SME) remains very limited. We will build on the State Bank of Pakistan's Financial Inclusion Program to enhance access of micro and small enterprises to financial services. This will encompass building on regulatory reforms, product innovation, and improved delivery mechanisms, financial literacy and consumer protection.

37. *Trade Policy*. Trade policy reforms would increase consumer welfare and stimulate growth via increased competition. Simplifying tariff rates, eliminating the statutory regulatory orders (SROs) that establish special rates and/or nontariff trade barriers in some 4,000 product areas, and normalizing trade relations should deliver the much needed competitive environment.

- *Tariff simplification*. We will begin working on simplifying the tariff structure to return to the 2003 framework, with 4 slabs and 0 to 25 percent rates. Design of the new system would be completed by end-December 2013, with application of the revised tariff rates and begin the phase-out of trade SROs by June 2014 (see also ¶12 on SROs). Implementation of the new trade framework would be completed by end-June 2016.

- *Normalizing trade relations*. We are moving forward with eliminating the negative list on trade with India and extending India most favored nation status, and shifting to "sensitive list" under SAFTA regime to facilitate increased regional trade. We will also develop a strategy to take full advantage of trade preferences available from the EU where we have autonomous trade preferences in 75 items. In addition, the EU is currently considering our request for receiving GSP plus benefits (zero percent duty) from January 1, 2014 on exports.

38. ***Public Sector Enterprises***. We will step up efforts to reform public sector enterprises, focusing on limiting poor performance and improving public sector resource allocation. We are working on a time bound strategy for 65 PSEs approved for privatization by the Council of Common Interest (CCI) to facilitate decisions to either privatize firms, restructure those with prospects of profitability but which the government wishes to retain in the public sector, or close nonviable firms. The strategy will include information on the financial statements of these firms with detailed information on government liabilities.

- ***Privatization***. The strategy for 30 firms will be announced by end-September 2013 (structural benchmark), with plans for the remainder will be completed by end-December, 2013.

- ***Restructuring***. We have already begun the process of hiring professional chief executives and board members for those enterprises with a corporate structure in line with the corporate governance rules. We are developing medium-term action plans to restructure Pakistan International Airlines (PIA), Pakistan Steel Mill and Pakistan Railways. The action plans include partial privatization of companies through initial or secondary public offerings. Specifically:

- *Pakistan International Airlines*. Aging equipment, outstanding loans, and incomplete pass-through of fuel costs weigh on the profitability of the firm. Our restructuring plan includes stripping the nonviable components of PIA under a separate public sector enterprise—PIA2—by end-December2013. We will service the guaranteed past loans of PIA2, apply a voluntary "handshake" plan for the excess work force and liquidate by end-June 2014. The PIA will retain some liabilities that it can service, streamline workforce and will receive capital injection from the government. We plan to privatize 26 percent of PIA's shares to strategic investors by end-June 2014 (structural benchmark). In the meantime, PIA will continue contracting leases on more efficient airplanes and rationalizing routes. Shifting non-flight activities to a new subsidiary company could be among the options in order to focus on core activities.

- *Pakistan Steel Mill*. To restore operations, hit hard by the collapse in steel prices during the global recession, we have appointed a professional board and secured a commercial credit line mostly from private banks to pay for loans, wages, and raw materials. The privatization commission and Cabinet Committee on Restructuring will fast track the decision-making process to approve a new comprehensive restructuring plan by end-September 2013, with implementation to begin immediately thereafter.

- *Pakistan Railways*. Aging and shortage of equipment, overstaffing, and large debts continue to weigh on railway operations. By end-March 2014 we will develop a comprehensive restructuring plan for Pakistan railways, and the railways company will be converted from a government department to a state-owned limited liability company.

- *Other companies*. We have identified a number of other companies that can quickly be privatized in the financial and energy sectors. The strategy will include plans for block sales, secondary public offerings for institutional and general public, or international listings. We will hire transaction advisors by end-December 2013 to sell residual shares in two major companies with already in private hands. The sequence will be calibrated to match market conditions. Minority stakes of two blue chip companies will be sold after gauging investors' appetite and global market conditions. In this regard, we will hire transaction advisors by end-December 2013 to undertake the operation. In the medium-term energy companies can also be included among the companies to be privatized.

Financing

39. **In addition to our request for a financial arrangement with the IMF, we have commitments for grants and loans from other bilateral and multilateral partners to fully close the anticipated financing shortfall**. We have firm commitments that financing will be in place for the first 12 months of the arrangement. Current projections suggest a financing gap of US$15 billion through June 2016, almost half of which will be filled by the extended arrangement under the EFF. Roughly US$3.5 billion will be met by the estimated improvement in the balance of payments due to the adjustment measures under the program. In addition, we expect additional external financing assurances over the program period from the World Bank ($1.5 billion), Asian Development Bank ($1.6 billion), the United Kingdom ($0.5 billion), the United States ($0.4 billion), and others ($1.5 billion).

Program Issues

40. **There are important risks to the program**. Pakistan is highly vulnerable to increases in oil prices, and our high reliance on textile exports means that volatility in international cotton prices is a key source of risk. In addition, a further economic slowdown in trading partner countries—including in Europe—would adversely affect Pakistan's exports while a scaling back of workers' remittances would undermine the external position further. We have consulted with the provincial governments and are collectively committed to the key points of the adjustment program outlined in this memorandum.

41. **Program monitoring**. The program will be subject to quarterly reviews, quarterly performance criteria and continuous performance criteria as set out in the TMU. Completion of the first two reviews scheduled for December 2, 2013 and March 2, 2014 will require observance of the quantitative performance criteria for end-September 2013 and end-December 2013, respectively, and continuous performance criterion as specified in Table 1. To facilitate program monitoring, we are committed to providing detailed statistical information as specified in the TMU. We will also continue to improve our economic statistics, including by beginning to produce quarterly national accounts data and by improving the coverage and organization of fiscal data.

42. An updated safeguards assessment of the SBP will be conducted in the context of the first review.

43. The government authorizes the IMF to publish the Letter of Intent, its attachments, and the related staff report.

Table 1. Pakistan: Quantitative Performance Criteria and Indicative Targets for FY2013/14 1/
(In billions of rupees, at program exchange rates, unless otherwise specified)

	FY2012/13	FY2013/14			
	end-June	end-September	end-December	end-March	end-June
	Act.	Program		Projections	
Performance Criteria					
Floor on net international reserves of the SBP (millions of US dollars)	-2,437	-2,499	-2,090	-141	2,532
Ceiling on net domestic assets of the SBP (stock, billions of Pakistani rupees)	2,402	2,877	2,901	2,571	2,227
Ceiling on overall budget deficit (cumulative, excluding grants, billions of Pakistani rupees) 2/	2,012	419	882	1,209	1,464
Ceiling on SBP's stock of net foreign currency swaps/forward position (millions of US dollars)	2,255	2,255	2,005	2,005	1,755
Ceiling on net government borrowing from the SBP (including provincial governments, stock, billions of Pakistani rupees) 3/	2,168	2,690	2,560	2,390	2,240
Continuous Performance Criterion					
Accumulation of external public payment arrears by the general government (continuous)	0	0	0	0	0
Indicative Targets					
Cumulative floor on Targeted Cash Transfers Spending (BISP) (billions of Pakistani rupees)	54	19	38	56	75

Sources: Pakistani authorities; and Fund staff estimates.

1/ All items as defined in the TMU. Fiscal year runs from July 1 to June 30.
2/ Excluding grants, FY2012/13 overall budget deficit is a stock.
3/ FY 2012/13, total stock of government debt as of June 30, 2013.

Table 2. Pakistan: Prior Actions and Structural Benchmarks Under Extended Fund Facility

Item	Measure	Time Frame (by End of Period)
Prior Actions (implemented before Board consideration of the program)		
1	Net purchase of $125 million by the SBP in the foreign exchange spot market from July 1, 2013.	5 days prior to the Board meeting
2	Develop and approve a three-year plan by the Government for phasing out Tariff Differential Subsidies (TDS), and implement the first step by: (i) the notification of new tariffs for FY2012/13; (ii) increasing the weighted average tariffs by 50 percent on industrial, commercial, bulk, and AJ&K consumers' electricity consumption; and (iii) announcing a reduction of the subsidy on second group of consumers (as defined in the TMU) through increasing the weighted average notified tariffs by 30 percent that will be in effect from October 1st, 2013.	5 days prior to the Board meeting
3	Implement a series of fiscal adjustment measures (including those in the 2013/14 budget) totaling 2 percent of GDP on an annualized basis.	5 days prior to the Board meeting
4	Impose a balanced budget requirement on provinces and agree with provinces to save additional revenues generated by the program.	5 days prior to the Board meeting
5	Issue 10 thousand notices based on large potential fiscal liabilities.	5 days prior to the Board meeting
Structural Benchmarks		
<u>Fiscal sector</u>		
1	Develop and launch initiatives to enhance revenue administration for sales tax, excises, and customs similar to that prepared for income tax.	end-December 2013
2	Announce a rationalization plan for gas prices which will involve a levy to generate 0.4 percent of GDP fiscal savings by end-December 2013.	end-December 2013
<u>Monetary sector</u>		
3	Enact the amendments to the SBP law to give SBP autonomy in its pursuit of price stability as its primary objective, while strengthening its governance and internal control framework, in line with Fund staff advice.	end-March 2014
<u>Financial sector</u>		
4	Prepare detailed plans to achieve compliance of all banks that fall below minimum capital adequacy, including specific actions, end dates, and contingency arrangements. Also detail a plan for recapitalization, consolidation or liquidation of 9 banks that fall below the minimum capital requirement but not CAR.	end-December 2013
5	Enact the Deposit Protection Fund Act, in line with Fund staff advice	end-September 2014
6	Enact the Securities Bill, in line with Fund staff advice.	end-December 2014
<u>Structural Policies</u>		
7	Develop and approve PSE reform strategy for thirty firms among the 65 PSEs approved for privatization by the Council of Common Interest (CCI).	end-September 2013
8	Hire a professional audit firm to conduct a technical and financial audit of the system to identify the stock and flow of payables at all levels of the energy sector (including Power Sector Holding Company Limited).	end-November 2013
9	Make Central Power Purchasing Agency (CPPA) operational by separating it from the National Transmission and Despatch Company (NTDC), hire key staff, issue CPPA rules and guidelines, and initiate the payment and settlement system.	end-December 2013
10	Enact the amendments to the Pakistan Penal Code 1860 and the Code of Criminal Procedures 1898.	end-December 2013
11	Privatize 26 percent of PIA's shares to strategic investors.	end-June 2014

Attachment II. Technical Memorandum of Understanding

August 19, 2013

1. For the purposes of monitoring under the program, all assets and liabilities as well as debt contracted, denominated in SDRs or in currencies other than the U.S. dollar, will be converted into U.S. dollars at the program exchange rates. Net external budget financing and external cash grants will be converted into Pakistani rupees at the program exchange rate. The program exchange rate of the Pakistani rupee to the U.S. dollar is set at 99.66 rupee per one U.S. dollar. Gold is valued at 35 SDR (US$52.5) per fine troy ounce. The cross-rates for other foreign currencies are provided in Table 1.

A. Quantitative Targets

2. The program sets performance criteria and indicative targets for defined test dates (Table 1 in the LOI). The program sets the following performance criteria:

Performance criteria

- Floor on the net international reserves (NIR) of the State Bank of Pakistan (SBP) (millions of U.S. dollars);
- Ceiling on the net domestic assets (NDA) of the SBP (stock, billions of Pakistani rupees);
- Ceiling on the overall budget deficit excluding grants (cumulative flows, billions of rupees);
- Ceiling on net borrowing from the SBP by the government (including provincial governments, stock, billions of rupees);
- Ceiling on SBP's stock of net foreign currency swap/forward contracts (millions of U.S. dollars);

Continuous performance criteria

- Ceiling on the accumulation of external payment arrears by the general government;

Indicative targets

- Floor on targeted cash transfers spending (BISP) (cumulative, billions of Pakistani rupees)

B. Definitions of Monitoring Variables

3. **The net international reserves (stock)** of the (SBP) are defined as the dollar value of the difference between usable gross international reserve assets and reserve-related liabilities, evaluated at the program exchange rates. On July 1, 2013, the NIR of Pakistan amounted to US$-2,437 million (in equivalent).

4. Usable gross international reserves of the SBP are those external assets that are readily available to and controlled by the monetary authorities for meeting balance of payments financing needs, for intervention in exchange markets to affect the currency exchange rate, and for other related purposes. Excluded from usable reserves, inter alia, are: (i) claims on residents; (ii) assets in nonconvertible currencies; (iii) illiquid assets; (iv) assets that are pledged, collateralized, or otherwise encumbered, unless there is also a reserve-related liability associated with it.

5. Reserve-related liabilities of the SBP include outstanding IMF credits to Pakistan, foreign exchange deposits with the SBP of foreign governments, foreign central banks, foreign deposit money banks, international organizations, and foreign nonbank financial institutions, as well as domestic financial institutions. Foreign liabilities also include commitments to sell foreign exchange by the SBP arising from derivatives (such as futures, forwards, swaps, and options).

6. Aggregate net position in the foreign exchange derivatives is defined as the aggregate net positions in forward and futures in foreign currencies of the SBP vis-à-vis the domestic currency (including the forward leg of currency swaps). The SBP's aggregate position was US$–2.2 billion at end-June 2013.

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

8. Net domestic assets of the SBP are defined as RM minus NIR, minus other assets not included in gross official international reserves, minus commercial bank required and excess reserves at the SBP in foreign currency, plus medium and long-term liabilities (i.e., liabilities with a maturity of one year or more) of the SBP, plus other foreign liabilities not included in official reserve liabilities, minus the balance of outstanding Fund purchases credited to the government account at the SBP. NDA is composed of net SBP credit to the general government plus outstanding credit to domestic banks by the SBP (including overdrafts) minus liabilities not included in RM and other items net.

9. Net SBP credit to the government (including provincial governments) is defined as SBP claims on the government minus government deposits with the SBP. SBP claims on the government include government securities, treasury bills, treasury currency, and debtor balances. SBP claims on the government exclude accrued profits on government securities. Government deposits with the SBP exclude the Zakat Fund (Table 4).

10. Net purchase of foreign exchange is defined as outright purchase of foreign exchange minus outright sale of foreign exchange in the foreign exchange spot market as net addition to the stock of NIR of the SBP by using foreign exchange market intervention.

11. External public debt arrears are defined as all unpaid debt-service obligations (i.e., payments of principal and interest) of the general government (government, SBP, and state-owned enterprises) to non-residents arising in respect of public sector loans, debt contracted or guaranteed, including unpaid penalties or interest charges associated with these obligations that are beyond 30 days after the due date. The definition of debt, for the purposes of the EFF, is set out in Point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Executive Board Decision No. 6230–(79/140), last amended by Executive Board Decision No. 14416–(09/91), adopted August 31, 2009).The ceiling on external payment arrears is set at zero.

12. The overall budget deficit (excluding grants) will be monitored quarterly under the cash balance of the general government balance, excluding grants, including the operations of district governments financed from local funds. It will be measured below the line and will include:

- **Net external financing**, excluding valuation gains and losses.

- **Change in net domestic credit from the banking system**, excluding valuation gains and losses from deposits denominated in foreign currency.

- **Change in the net domestic nonbank financing**, excluding valuation gains and losses. These include (i) domestic privatization receipts transferred from the privatization accounts to the budget, (ii) the stock of issued government securities held outside the general government and the banking system, net of valuation changes, (iii) net deposits and reserves received by the government (public accounts deposits), (iv) any other government borrowing from domestic nonbank sources net of repayments, minus (v) government deposits with nonbank financial institutions.

- **Total external grants to the federal and provincial governments**. These are defined as the sum of project grants, cash external grants for budgetary support, capital grants reflecting the principal amounts of external debt cancellation or swaps, and other grants.

13. Net external program financing is defined to include external privatization receipts; budget support grants; budget support loans from multilateral (other than the IMF, but including World Bank and Asian Development Bank (ADB) budget support and program loans), official bilateral budget support loans, and private sector sources (e.g., bonds); rescheduled government debt service and change in stock of external debt service arrears net of government debt amortization due on foreign loans, the latter including any accelerated amortization including related to debt swaps or debt cancellation recorded as capital grants. It also includes foreign loans on lent to financial institutions and companies (public or private) and emergency relief lending. Program financing excludes all external financing counted as reserve liabilities of the SBP (defined above). Amounts projected for net external program financing and external grants are provided in Table 3.

14. Net external budget financing is defined as net external program financing minus privatization receipts, minus budget support grants, plus all other external loans for the financing of public projects or other federal or provincial budget expenditures, plus transfers of external privatization receipts from the privatization account to the budget.

15. Electricity Tariff Pricing Formulas and Definitions (¶27 of the Letter of Intent)

(i) The increase in the weighted average tariffs by 50 percent on industrial, commercial, bulk and AJ&K consumers' electricity consumption is defined as follows

Weighted Average Notified Tariff for industrial, commercial, bulk and AJ&K consumers =

(Changes in the Industrial Users Tariff Rate for each category x DISCO's estimated sales to Industrial Users for each category

+ Change in the Commercial Users Tariff Rate for each category x DISCO's estimated sales to Commercial Users for each category

+ Change in the Bulk users' Tariff Rate for each category x DISCO's estimated sales to Bulk Users for each category)

+ Change in the AJ&K users' Tariff Rate for each category x DISCO's estimated sales to AJ&K Users for each category)

/ DISCO's total sales to Industrial, Commercial, Bulk, and AJ&K Users

= 50 percent

(ii) Elimination and reduction of the subsidy on second group of consumers by October 1, 2013 through increasing the weighted average notified tariffs by 30 percent.

- Second group of consumers is defined as the following users; (i) those with consumption levels above 200kWh, (ii) Salinity Control & Reclamation Programme (SCARP), (iii) Agricultural tube wells consumers and (iv) Other customers (public lighting, housing schemes, railways, HVTL).

Weighted Average Notified Tariff for second group of consumers =

- (Change in the Tariff Rate of users whose consumption levels are above 200kWh x Revenue from users whose consumption levels are above 300kWh
- + Change in the Tariff Rate of users in SCARP x DISCO's estimated sales to users in SCARP
- + Change in the Tariff Rate of users in Agricultural tube wells x DISCO's estimated sales to users in Agricultural tube wells
- + Change in the Tariff Rate of Other users x DISCO's estimated sales to Other customers)

- / DISCO's total estimated sales to users whose consumption levels are above 200kWh, SCARP, Agricultural tube wells and other consumers.

- = 30 percent

C. Adjustors

16. The floor on NIR will be adjusted upward (downward) by the cumulative excess (shortfall) of multilateral and bilateral creditors, Coalition Support Fund (CSF), and bond issuance relative to projected inflows (Table 2). Gross cumulative inflows are defined as external disbursements (including grants) from official multilateral creditors (World Bank, Asian Development Bank, Islamic Development Bank), official bilateral creditors (UK-DFID, USAID), and external bond placements that are usable for the financing of the central government budget.

17. The ceiling on NDA will be adjusted downward (upward) by the cumulative amount of any excess (shortfall) of budget support loans or budget support grants compared to the program amounts (Table 3) and Euro bond issuance or project grants compared to projected inflows (Table 2). Budget support grants to the public sector are defined as grants received by the government (including provincial governments) for direct budget support from external donors and not related to the projected financing. Budget support loans to the public sector are defined as disbursements of loans from bilateral and multilateral donors for budget support (including provincial governments).

18. The ceiling on the consolidated overall budget deficit (excluding grants) will be adjusted upward for the cumulative excess in net external program financing in rupee terms for up to PRs 25.0 billion at end-December 2013, PRs 42.0 billion at end-March 2014, and 50 billion at end-June 2014. The ceiling will be adjusted downward for any shortfall in federal PSDP spending below PRs 25 billion in September-2013, PRs 80 billion in December 2013, PRs 243 billion in March 2014 and PRs. 410 in June 2014; and for any shortfall in the targeted cash transfers (BISP) from their indicative target.

D. Program Reporting Requirements

19. Performance under the program will be monitored from data supplied to the IMF by the SBP, Ministry of Finance and Ministry of Water Power as outlined in the table below. The authorities will transmit promptly to IMF staff any data revisions as well as other information necessary to monitor the arrangement with the IMF.

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
State Bank of Pakistan (SBP)	SBP balance sheet	Summary	Weekly	First Thursday of the following week
	SBP balance sheet	Summary at program exchange rates; and by official exchange rates	Monthly	Within 15 days of the end of each month
	Monetary survey	Summary banking system balance sheet for the central bank at both program exchange rates and by chart of accounts at actual official exchange rates; the consolidated balance sheet of commercial banks at actual official exchange rates	Monthly	Within the first three days of the following month
	International reserves	By (i) program exchange rates; and (ii) at actual official exchange rates	Daily	The following working day
	Foreign exchange market	Market exchange rates (buying and selling); weighted average customer exchange rate; daily trade volume, and weighted average exchange rate of the interbank, the KERB market.	Daily/Monthly	Within one day/ monthly within 6 working day
	Foreign exchange market	SBP foreign exchange operations, and intervention,(average exchange rate, volume)	Daily	Within one day
	Foreign exchange market	SBP operation against the domestic currency in swap/forwards by average exchange rate, maturity, volume.	Daily	Within one day
	Foreign exchange market	Outstanding swap/forward positions by maturity buckets.	Monthly	Third working day of the following month
	Interbank money market	Daily interbank repo volume and interest rate of trades	Daily	Within one day
	SBP operations	Repo (reverse repo) operations, open market operations, standing facility, deposit facility.	Weekly	First Monday of the following week
	Bank liquidity	Excess reserves, in local currency	Bi-weekly	With a lag of 15 days
	T-bill and coupon bond financing, SBP securities	Auction data: date, original and remaining maturities, issuance volume, allocation, average yield and coupon yield (if available)	Bi-Weekly	Last working day of the fortnight
	Banking data	Sectoral distribution of loans and deposits; dollarization of loans and deposits; deposit and lending rates, by maturity;	Monthly	Within 25 days of the end of each month.
		Loan maturities	Quarterly	Within 45 days of the following quarter
	Banking indicators	Capital adequacy; asset composition and quality; profitability; liquidity; open FX positions;	Quarterly	Within 45 days of the following quarter
	Banking sector stress tests	Results of stress tests on exchange rate, liquidity, and credit risk	Quarterly	Within first week of the following quarter
	CPI	Index of core inflation	Monthly	Within 21 days of the end of each month

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
	Transfers	Noncommercial transfers of individual, including workers' remittances.	Monthly	Within 25 days of the following month
	Other monetary data	IFS format	Monthly	Within 45 days of the end of each month
	Balance of payments	Detailed export and import data Detailed balance of payments data	Monthly	Within 28 days of the end of each month
Ministry of Finance (MOF)	Revenue collection FBR	Total revenue collected separately by the tax administration and customs administration, including revenue by individual tax, and social contributions.	Monthly	Within 7 days of the end of each month
	Domestic expenditure arrears	All unpaid claims outstanding at the end of the month which includes wages, social contributions (including for pensions), family allowances, and amortization and domestic interest payments	Monthly	Within 45 days of the end of each month for government arrears
	Privatization receipts	Balance on the SPA; gross inflows into and outflows from the SPA during the month, specifying the nature of each transaction	Quarterly	Within seven days of the end of each month
	External debt	Disbursements and stock of outstanding short-term and contracting or guaranteeing and outstanding stock of medium-and long-term external debt of the government, the SBP, and state-owned companies; any stock of arrears on external debt service and outstanding stock of government guarantees and external arrears.	Monthly	Within 25 days of the following month
	Consolidated federal government	State budget	Monthly	Within 30 days of the end of each month
	Consolidated general government	Federal and provincial governments, including further sub-national levels	Quarterly	Within 60 days of the end of each quarter
	Consolidated general government	Federal and provincial governments, including further sub-national levels	Annual	Within 180 days of the end of each year
	Budget execution	All cash receipts, cash expenditures, including domestic and external debt-service payments, external and domestic borrowing operations, and inflow of grants to the central government; expenditure data will be provided according to both economic and functional classifications.	Monthly	Within one month following the end of each quarter.
Pakistan Bureau of Statistics	SPI, CPI, WPI	Detailed monthly price indices	Monthly	Within five days of the following month

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
(PBS)				
Federal Bureau of Statistics (FBR)	Tax arrears	By category	Quarterly	Within five days of the end of each month
		By type of tax	Quarterly	Within 30 days of the end of each quarter (monthly data provided on a quarterly basis)
	Tax credits	For or the 30 largest debtors and for all major companies in the energy, water, and irrigation sectors	Quarterly	Within 30 days of the end of each quarter
	VAT refund claims in arrears	Detailed data, by type of tax, of outstanding tax credits for all types of tax revenues	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
		Detailed data on VAT refunds in arrears which include all outstanding VAT refunds that have not been accepted (and refunded), or offset (in full or in part), or rejected (in full or in part) after the 90 day statutory processing period. Number of refund applications processed per month.	Quarterly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
	Large taxpayers	Data on the number of taxpayers and amount of taxes managed by the large tax inspectorate	Monthly	Within 45days after the end of each month
	Import data	1. Total value of recorded imports, breaking out raw diamond imports; 2. Total value of non-duty free recorded imports; 3. Number of total transactions involving recorded imports; 4. Number of total transactions involving non-duty free recorded imports 6. Value of non-duty free recorded imports where customs value was assessed using transaction prices; 7. Number of transactions involving recorded imports where customs value was assessed using transaction prices; 8. Number of transactions involving non duty free recorded imports where customs value was assessed using transaction prices	Quarterly	Within 30 days of the end of each quarter
	Automated VAT	Number of refunds that were processed	Monthly	Within 45 days of the

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
	refunds	automatically (share of total refunds); total value of automated and automatic refunds and offsets; average waiting time (days) to receive refund		end of each month (monthly data provided on a quarterly basis)
	Risk-based selection approach	Percentage of selected companies chosen on the basis of risk-based approach, identified revenue from risk-based audits	Quarterly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
Ministry of Water and Power		Key Power Sector Statistics (Please see the attached template) Cumulative Monthly Subsidy Position (Rs. Billion) PEPCO Month End Payables and Receivables Positions And Aging Schedule, Rs. Billion Receivables Positions - Total and DISCO-wise Break-up CPPA/PEPCO Month-wise Consolidated Cash Flow AT&C Statistics Monthly TDS Claims by DISCOs and Total	Monthly	Within 30 days
		Inter Corporate Circular Debt Sheet Prepared by Ministry of Finance DISCOs Consolidated Income Statement Net Electrical Output & Power Purchase Price by Source, GWh Generation, Demand and Shortfall for FY10 to date Net Electrical Output (MkWh) Plant and Fuel-wise Detail Working Capital Loans For each loan type	Quarterly	Within 30 days
		Determined and Notified Tariff's for each User and User Group (Please see template)	Annual	Within 30 days of determination and notification

Table 1. Exchange Rates of the SBP

(As of June 28, 2013 in U.S. dollars per currency)

Currency	Rupee per Currency	Dollars per Currency
EUR	130.18	1.31
JPY	1.01	0.01
CNY	16.24	0.16
GBP	151.80	1.52
AUD	92.11	0.92
CAD	95.04	0.95
THB	3.21	0.03
MYR	31.54	0.32
SGD	78.77	0.79
INR	1.68	0.02

Table 2. Projected Disbursements to Pakistan

(In millions of US dollars)

	Sep-13	Dec-13	Mar-14	Jun-14
Gross Inflows	939	1,388	2,371	2,943
Multilateral and bilateral disbursement	639	822	1,471	1,509
of which: project grants	77	80	94	98
Bond issuance	0	0	0	0
Coalition Support Fund	300	300	300	300
Other 1/	0	266	600	1,134
Debt service	820	1,013	583	809
Memorandum items				
Gross International Reserves	5,640	5,328	7,198	9,566
Net International Reserves	-2,499	-2,090	-141	2,532

1/ includes privatization and 3G licenses.

Table 3. External Inflows to the General Government

(In millions of U.S. dollars)

	Sep-13	Dec-13	Mar-14	Jun-14
Non Tax Revenue	300	300	900	900
Coalition Support Fund	300	300	300	300
3G Licenses	0	0	600	600
Grants	67	150	183	183
External interest payments	209	311	211	291
Net external debt financing	-115	-110	722	1109
Disbursements	495	592	1093	1628
of which budgetary support	0	0	75	575
Amortization	611	702	372	519
Privatizations	0	266	0	534
Memorandum item				
Program financing	67	416	308	842

Table 4. Government Sector (Budgetary Support)

(End-of-period stocks/Rs. in Millions)

Item	30-Jun-12	Prov. 30-June-13
A. Central Government	**4,064,537**	**5,561,908**
Schedule Bank	**2,360,271**	**3,320,870**
Government Securities	829,485	1,117,115
Treasury Bills	1,928,287	2,611,512
Government Deposits	-397,501	-407.757
State Bank	**1,704,266**	**2,241,037**
Government Securities	3,131	3,111
Accrued Profit on MRTBs	43,935	44,888
Treasury Bills	1,759,696	2,275,184
of which: MTBs created replenishments of cash balances	1,759,187	2,274,675
Treasury Currency	8,653	8,653
Debtor Balances (Excl. Zakat Fund)		
Government Deposits (Excl. Zakat and Privatization Fund)	-116,611	-96,260
Payment to HBL on a/c of HC&EB	-287	-287
Adjustment for use of Privatization Proceeds for Debt Retirement	5,749	5,749
B. Provincial Governments	**-264,620**	**-315,607**
Scheduled Banks	**-266,362**	**-287,393**
Advances to Punjab Government for Cooperatives	1,024	1,024
Government Deposits	-267,386	-288,417
State Bank	**1,742**	**-28,214**
Debtor Balances (Excl. Zakat Fund)	26,737	13,715
Government Deposits (Excl. Zakat Fund)	-24,996	-41,930
C. Net Govt. Budgetary Borrowings from the Banking system	**3,799,917**	**5,246,300**
D. Through SBP	**1,706,008**	**2,212,823**
Through Scheduled Banks	**2,093,909**	**3,033,477**
Memorandum Items		
Accrued Profit on SBP holding of MRTBs	**43,935**	**44,888**
Scheduled banks' deposits of Privatization Commission	**-4,287**	**-5,433**
Outstanding amount of MTBs (Primary market; discounted value)	**1,835,265**	**2,529,412**
Net Govt. Borrowings (Cash basis)		
From Banking System	**3,667,246**	**5,124,746**
From SBP	**1,662,073**	**2,167,935**
From Scheduled Banks	**2,005,173**	**2,956,811**

INTERNATIONAL MONETARY FUND

PAKISTAN

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION AND REQUEST FOR AN EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY—INFORMATIONAL ANNEX

August 20, 2013

Prepared By

Middle East and Central Asia Department
(In Consultation with Other Departments)

CONTENTS

RELATIONS WITH THE FUND

(As of June 30, 2013)

Membership Status:

Joined: 07/11/1950; Article VIII

General Resources Account

	SDR Million	Percent Quota
Quota	1.033.70	100.00
Fund Holdings of Currency	3,881.53	375.50
Reserve Tranche Position	0.12	0.01

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	988.56	100.00
Holdings	573.07	57.97

Outstanding Purchases and Loans

	SDR Million	Percent of Quota
Stand-by Arrangements	2,550.96	246.78
Emergency Assistance 1/	296.98	28.73
ECF Arrangements 2/	68.91	6.67

1 / Emergency Assistance may include ENDA, EPCA, and RFI.

2/ Formerly PRGF.

Latest Financial Arrangements

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-by	11/24/2008	09/30/2011	7,235.90	4,936.04
ECF	12/06/2001	12/05/2004	1,033.70	861.42
Stand-by	11/29/2000	09/30/2001	465.00	465.00

Projected Payments to Fund

(SDR million; based on existing use of resources and present holdings of SDRs)

			Forthcoming		
	2013	2014	2015	2016	2017
Principal	1,234.52	1,379.29	303.04		
Charges/Interest	14.94	13.10	2.21	0.34	0.34
Total	1,249.46	1,392.39	305.26	0.34	0.34

Current Status of Safeguards Assessment

An update of the March 2009 safeguards assessment was completed in March 2010 in relation to the augmentation of access under the Stand-By Arrangement. The assessment found that: (i) efforts are continuing to strengthen the safeguards framework at the State Bank of Pakistan (SBP), including improved transparency and a more proactive role by the Audit Committee; (ii) the SBP's legal framework continues to present a safeguards risk due to unclear timetable for enacting amendments to the SBP Act; and (iii) the treatment and use of Fund resources for budgetary support has been clarified in an agreement between the SBP and the Ministry of Finance. The authorities have implemented some recommendations, but the latest amendment to the SBP Act does not cover safeguards risks raised in the previous assessments.

Exchange Rate Arrangement

On May 19, 1999, the dual exchange system was unified, with all international transactions conducted at the interbank market exchange rate (FIBR). The de facto exchange rate arrangement is classified as "floating". De Jure exchange rate arrangement is managed floating with no predetermined path. The SBP does not make any explicit or implicit commitment with respect to an exchange rate target or path. The SBP intervenes in the foreign exchange market, but does not publish information regarding its interventions. Pakistan has accepted the obligations of Article VIII, sections 2, 3, and 4. Pakistan is maintaining an exchange system free of restrictions on the making of payments and transfers for current international transactions.

Last Article IV Consultation

The last Article IV consultation (Country Report 12/35) was discussed by the Executive Board on January 23, 2012.

FSAP Participation and ROSCs

FSAP. The last FSAP was conducted in September 2008, however, the report was not published. The previous FSAP was conducted in February and April 2004. The report has been published and is available on the web through the following link:
http://www.imf.org/external/pubs/ft/scr/2004/cr04215.pdf

Monetary and Financial Policy Transparency and Data Dissemination. Data Module, Reassessment of Monetary Statistics and Detailed Assessment Using Quality Assessment Framework were completed in November 2006. The report has been published and is available on the web through the following link: http://www.imf.org/external/pubs/ft/scr/2007/cr0774.pdf. The previous data dissemination monetary and financial policy transparency ROSCs were conducted in December 2004 and July 2004, respectively.

Fiscal Transparency. The last updated report of the fiscal module on Observance of Standards and Codes for Pakistan was prepared in April 2008. The report has been published and is available on the web through the following link: http://www.imf.org/external/pubs/ft/scr/2008/cr08129.pdf. The original fiscal ROSC was conducted in November 2000 with a subsequent update in December 2004.

Resident Representative

A new resident representative, Mr. Mansoor Dailami, has started the assignment in Islamabad in January 2013.

Recent Technical Assistance

FAD

January 2002: Fiscal data management, quality, and transparency.

January 2003: Tax administration.

February/March 2003: Customs administration.

April 2004: Fiscal reporting.

April 2007: Public financial management.

July and November 2009: Valued Added Tax law.

July 2010: Review of Budgeting Accounting and Reporting System.

MCM

November/December 2004: Public debt reform and capacity building program (joint with World Bank).

March/April 2005: Development of the Insurance Sector.

December 2006: Monetary policy framework.

April 2007: Monetary policy framework, the SBP's balance sheet, and the Banking Services Corporation.

April 2011: Capital markets development issues.

October 2011: Stress testing framework.

November 2012: Stress testing framework.

June 2013: Stress Testing the Banking System.

STA

February 2002: External sector statistics/SDDS subscription.

April/May 2005: National accounts and consumer price statistics.

May 2007: Statistics on the international investment position.

October 2009: Multisector statistics (remote technical assistance).

March 2011: Price statistics.

January 2012: SDDS Assessment mission.

LEG

July 2008: Deposit Protection Fund.

July 2008: Central Bank Law.

August 2008: Banking Law.

RELATIONS WITH THE WORLD BANK

(As of June 30, 2013)

1. Pakistan is among the largest recipients of World Bank financial assistance. The World Bank Group program in Pakistan consists of an integrated package of financial support, including IBRD lending, concessional IDA credits, Trust Funds and Grants administered by the Bank on behalf of other development partners, Multi-Donor Trust Fund (MDTF) for Khyber Pakhtunkhwa (KP), Federally Administered Tribal Areas (FATA) and Balochistan, IFC investments, and MIGA guarantees, along with complementary analytical and advisory services.

2. The Country Partnership Strategy (CPS) outlines the Bank's strategic approach to helping Pakistan achieve its development goals over a four year period. The Bank Group's Board of Directors endorsed a Country Partnership Strategy for Pakistan on July 8, 2010, covering fiscal years 2010 through 2013. The goal of the strategy is to help steer Pakistan's economy back onto a path of high growth by addressing key long-term constraints to growth: weak revenue mobilization, unreliable energy supply, and a fragile security situation.

3. A CPS Progress Report was presented to the World Bank's Board on December 20, 2011. The Progress Report extended the CPS implementation period by one year, to cover FY 2010 through 2014. The Report confirms that the overall strategic goal remains valid and consistent with the priorities of the Government of Pakistan as articulated in its New Framework for Growth Strategy (NFGS). The partnership remains centered on the existing strategic pillars of the CPS: economic governance; human development and social protection; infrastructure; and security and conflict risk reduction. It was agreed with the Government to extend the CPS period to include FY14.

4. The four strategic pillars of the CPS are described below:

- Improving Economic Governance. Addressing the shortcomings of Pakistan's economic management is critical not only for restoring macroeconomic stability but also for reducing the likelihood of reversals leading to another cycle of growth giving way to stagnation. Enhancing domestic revenue mobilization is an urgent priority for the Bank during the CPS period. Strengthening public expenditure management at all levels of government will complement this focus. The strategy also focuses on governance of markets with a view to strengthening Pakistan's competitiveness by addressing barriers to competition, and factor market rigidities (including constraints in access to finance).

- Improving Human Development and Social Protection. Improvement in human development, including social protection, is critical to the goal of building resilience at the level of families and individuals. The focus of Bank Group efforts is to support increased spending on human development along with reforms to improve governance and accountability in the provision of services. In education, the Bank supports government programs that combine supply side interventions and demand-side measures to improve access to education with a focus on equity to address regional and gender imbalances. In social protection, the Bank is supporting the Benazir Income Support Program (BISP), the country's national safety net program with a focus on increasing its targeting efficiency and strengthening its operation. The Bank aims to scale up support to strengthen health management systems and improve service delivery. Given increased frequency of natural disasters, the Bank will bring additional focus and assistance on the Disaster Risk Management (DRM) agenda.

- Improving Infrastructure to Support Growth. Supply expansion and improving reliability and efficiency of power and gas systems are central to Pakistan's growth and development. At present, power is the most pressing need in infrastructure and the Bank Group supports adoption of policies that bring about financial sustainability, expansion of generation in a least cost manner, and improvement in the efficiency of transmission and distribution.

- Improving Security and Reducing the Risk of Conflict. The persistence of conflict in KP and FATA poses a threat to some of the most vulnerable and marginalized populations in Pakistan, while also challenging economic stability across the country. The Bank is seeking to help Pakistan cope with the consequences of conflict while reducing the prospects of future conflicts. The MDTF for KP, FATA and Balochistan is the Bank's principal instrument for strategic engagement in crisis hit regions in partnership with other development partners.

5. IFC is an integral part of the World Bank Group's program in Pakistan. The IFC strategy in Pakistan seeks to continue expanding investments in the sectors with the highest potential development impact and opportunities, including infrastructure (e.g. renewable energy, ports), financial markets (e.g. SME support through access to finance, housing finance), and manufacturing and services (e.g. agribusiness, technical education). IFC is also focused on successful implementation of its advisory programs designed to improve the business enabling environment, strengthen financial markets, and support development of small businesses.

6. Pakistan is also a focus country for MIGA, where it has already provided guarantees in hydropower and microfinance. Going forward, MIGA's strategy seeks to support investments into IDA countries, South-South investments, complex infrastructure projects, and investments into conflict-affected areas.

7. The Bank's key principles of engagement in Pakistan include (i) delivering fewer but larger operations to allow the Bank to focus its limited resources on strategic areas where the needs are the greatest; (ii) increasing the use of performance-based instrument; (iii) strengthening attention to implementation, results and communications; (iv) deepening the engagement with the provinces, which will require significant attention to capacity support; (v) leveraging partnerships for shared objectives; and (vi) for MDTF, start small and scale up success. The Bank would not be able to provide policy support unless the macro-economic conditions improve, but will remain engaged in the critical issues of revenue mobilization and power through analytical work, ongoing projects and exploring results based operations.

8. The current CPS implementation period is ending in June 2014. The Bank has started preparation for the new Country Partnership Strategy in parallel to avoid a gap between the two strategies. The new CPS covering the five-year period from 2015-19, is scheduled for Board presentation in June 2014. Implementation of this new strategic framework will start from July 1, 2014.

9. IBRD/IDA financial operations since FY2006 are summarized below:

Pakistan: World Bank Group Financial Operations

US$ million		FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13
Commitments	IBRD	315	100	174	0	0	261	500	0
	IDA	1183	885	371	1610	300	1292	1290	744
Disbursements	IBRD	252	254	56	91	86	35	92	85
	IDA	1555	1716	267	1333	963	772	565	447
Repayments	IBRD	297	273	295	273	225	172	157	162
	IDA	117	170	143	181	165	169	190	182

RELATIONS WITH THE ASIAN DEVELOPMENT BANK

(As of June 30, 2013)

1. Pakistan is a major recipient of financial support from the Asian Development Bank. Since 1968, the ADB has provided more than $20 billion in assistance through the highly concessional Asian Development Fund (ADF) window and the Ordinary Capital Resources (OCR) window.

2. The ADB's Board of Directors endorsed the Country Partnership Strategy (CPS) covering the years 2009-2013 in January 2009. Consistent with the ADB's long-term strategic framework (Vision 2020), the CPS has the overarching objective of supporting sustainable and inclusive growth in Pakistan as a means of reducing the incidence of poverty and improving welfare. The CPS outlines the ADB's strategic approach to assisting Pakistan in achieving its development goals over the five year period by facilitating structural change, investment and institutional effectiveness.

3. The main areas of current ADB operations in Pakistan reflect the CPS 2009-2013: (i) energy; (ii) infrastructure investments in transport, logistics and irrigation; (iii) reforms in key sectors including energy, finance, agriculture and industry; and (iv) urban services, including water, waste management and transport.

4. Much of ADB lending is under the multi-tranche financing facility (MFFs). At present, there are 8 active MFFs: energy (4, $2.89 billion total); transport (2, $1.67 billion total); irrigation (1; $700 million) and urban services (1, $300 million). Of the total $5.76 for all eight MFFs, $2.5 billion has been committed for subprojects and tranches, with $3.0 billion available for new projects in these sectors. For 2012, we have also approved three more periodic finance requests (PFR) in the power, irrigation and urban services sectors, for a combined amount of $417 million.

5. The current portfolio is comprised entirely of projects, with a total value of about $3.0 billion, with energy accounting for the largest share ($1.1 billion), followed by emergency assistance (floods $650 million), agriculture and irrigation ($611 million), transport ($400 million), and other ($138 million).

6. A new CPS for 2014-2018 is being prepared, that will outline ADB's strategic approach to assisting Pakistan over the next five year period. ADB will continue to focus on inclusive growth through infrastructure development, reforms n key sectors including energy, finance and urban services.

7. In addition to its activities in the areas outlined above, the ADB has provided trade finance support to nine Pakistani banks under its Trade Finance Facilitation Program (TFFP). To date, the TFFP has supported over $2.0 billion in trade in Pakistan through the provision of guarantees, working through 13 participating and 3 issuing banks in Pakistan.

8. Co-Chair of the Friends of Democratic Pakistan Water Sector Task Force which produced the report A Productive and Water-Secure Pakistan: Infrastructure, Institutions, Strategy (2012).

Asian Development Bank contact:

Dawn Elizabeth Rehm

Senior Economist

Asian Development Bank-Pakistan Resident Mission

Tel +92 51 208 7300 x345

Fax +92 51 208 7397 & 98

derehm@adb.org

STATISTICAL ISSUES

As of June 30, 2013

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings, but broadly adequate for surveillance.
National Accounts: In 2013, the Federal Bureau of Statistics (FBS) completed rebasing and revising of the national accounts statistics from fiscal year 1999/2000 to 2005/06 to bring them in line with the concepts and definitions of the 2008 System of National Accounts (2008 SNA). The methodology better captures concepts measurement of value-added at basic prices (instead of factor cost), double deflation, and Financial Intermediation Services Indirectly Measured (FISIM). PBS has compiled national accounts based on basic prices instead of factor cost. The finance and insurance sectors have been revamped in the new methodology and the coverage of transport, storage and communication sector has been expanded. The current national accounts series goes back only to 2005/06 and the FBS is currently working to produce backward linking of series to 1999-2000 by December 2013, It also intends to producing quarterly national accounts (QNA), which would be completed by November 2013. With respect to labor market statistics, the FBS has now compiled and started releasing quarterly employment/ unemployment data, the first release being in February 2011 and included 5 years of historical data and is investigating the feasibility of disseminating data on wages/salaries. **Price statistics:** The FBS produces three price indices: the CPI, the wholesale price index (WPI), and the sensitive price indicator (SPI). The CPI and WPI are compiled on a monthly basis. The SPI is compiled on a weekly basis and consists of 46 essential commodities that are consumed by the lowest income group. The concepts and definitions of the CPI and WPI follow international guidelines. FBS introduced the classification of individual consumption by purpose (COICOP) with rebasing of the indices to 2007/08 in August 2011. Aside from the implementation of COICOP, changes to the CPI included updated weights, and expanded item and geographic coverage. These changes reflect international recommendations and best practices. Plans have been made to complete the work to develop a Producer Price Index (PPI); IMF is providing technical assistance in this regard.
Government finance statistics: The concepts and definitions used in compiling government finance statistics are broadly based on the GFSM 1986, except that privatization proceeds are included below the line. The scope of central government data is further limited because it does not cover the activity of extra budgetary funds. Classification and sectorization in source data follow GFSM 1986 standards to a limited extent. The classification of expenditure deviates from GFSM 1986 methodology because the economic and functional classifications are mixed in reporting, in particular, with defense and government administration expenditures not clearly identified according to economic classification. The basis of recording GFS is on, or close to, a cash basis. Transactions are recorded on a gross basis. Corrective transactions are not necessarily made in the original period, as required by GFSM 1986. The authorities have indicated their intent to adopt the methodology of GFSM 2001 over the medium term, and in line with the Board decision (No 14656

of October 2010) to strengthen fiscal analysis, they have compiled with staff assistance fiscal table in GFSM 2001 presentation. However, further improvements in government finance statistics are needed and the authorities are making progress toward that objective in the context of the Project for the Improvement of Financial Reporting and Auditing (PIFRA). Budgetary central government operations data are regularly reported for publication in the GFS Yearbook, and use the GFSM 2001 framework. However, no data are reported on transactions in nonfinancial and financial assets and liabilities. The authorities do not report higher frequency data for inclusion in the IFS.
Monetary statistics: The ROSC mission found that the scope of the monetary statistics is comprehensive. The classification and sectorization of the monetary survey compiled by the State Bank of Pakistan's (SBP) Statistics Department for reporting to the IMF and for internal use are broadly in line with the *Monetary and Financial Statistics Manual (MFSM)*. The basis for recording flows and stocks is largely consistent with the *MFSM*, and the SBP has indicated its intention to adopt the *MFSM* in order to further improve monetary statistics. The ROSC mission that conducted the reassessment of monetary statistics in November 2006 found that the authorities had implemented the *MFSM* guidelines on the sectorization of institutional units, classification of financial instruments, and the recording of securities repurchase agreements (repos). Also, a new reporting framework for other depository corporations has been designed and is being implemented. Progress has been made in resolving discrepancies in the data on interbank positions between the SBP and scheduled banks. The SBP has reported the Standardized Report Forms for central bank (1SR), other depository corporations (2SR), and monetary aggregates (5SR) to the Fund for publication in the IFS.
Balance of payments: Starting in the third quarter of 2003 (July–September), Pakistan's balance of payments statements have been prepared according to the methodology of the Balance of Payments Manual, fifth edition (BPM5). A 2007 Fund technical assistance mission made recommendations to more closely align some recording practices with the BPM5, including in the areas of residency, sectorization, and consistency across related data sets. Based on these recommendations, a number of improvements have been made. Differences between the two sources of trade data (customs records for FBS and exchange records for SBP) for exports and imports have been widening. Most of the differences can be reconciled ex post (see SBP's Second Quarterly Report for FY2006), and the authorities are working to narrow these differences before the publication of the data. **International investment position**: Annual international investment position data are compiled and published on the SBP website. Since 2010 SBP has also started publishing quarterly data on international investment position. Annual data are available back to 2003.

II. Data Standards and Quality	
Pakistan participates in the General Data Dissemination System (GDDS) since 2003, meeting the recommendations for the coverage, periodicity, and timeliness of most GDDS data categories. Authorities are keen to subscribe to the Special Data Dissemination Standard (SDDS), and an SDDS assessment mission is scheduled in January 2012. For subscription to the SDDS,	The Report on the Observance of Standards and Codes (ROSC)—Data Module, a Response by the Authorities, and a Detailed Assessment Using the Data Quality Assessment Framework (DQAF) were published on the IMF website in December 2004. A ROSC reassessment focusing on monetary statistics was conducted in November 2006 and published on the IMF website in

Pakistan will need to disseminate (a) monthly data on central government operations with a timeliness of one month; (b) quarterly data on the national accounts, employment and unemployment, wages/earnings, and external debt, all with a timeliness of one quarter; (c) more detailed breakdown of data on central government debt and external debt; and (d) update and expand the metadata on compilation and dissemination practices.	February 2007. An update to the ROSC on fiscal transparency was published on the IMF website in April 2008.

PAKISTAN: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

AS OF DECEMBER, 2011

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]	Memo: Data Quality – Methodological Soundness[7]	Memo: Data Quality Accuracy and Reliability[8]
Exchange Rates	real time	real time	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	May. 2013	June. 2013	M	M	M		
Reserve/Base Money	May. 2013	June. 2013	M	M	M	O, O, O, LO	O, O, O, O, LO
Broad Money	May. 2013	June. 2013	M	M	M		
Central Bank Balance Sheet	May. 2013	June. 2013	M	M	M		
Consolidated Balance Sheet of the Banking System	May. 2013	June. 2013	M	M	M		
Interest Rate[2]	June. 2013	July, 2013	M	M	M		
Consumer Price Index	June.2013	July,2013	M	M	M	O, LO, LO, O	O, LO, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	June.2013	July, 2013	Q	Q	Q	LO, LO, LNO, LO	O, O, LO, LO, LO
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	June.2013	July, 2013	Q	Q	Q		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	May. 2013	June, 2013	Q	Q	Q		
External Current Account Balance	June.2013	July, 2013	M	M	M	LO, LO, LO, O	O, O, O, O, LNO
Exports and Imports of Goods and Services	June.2013	July, 2013	M	M	M		
GDP/GNP	2012/13	July, 2013	A	A	A	LO, LNO, LO, LO	LNO, LNO, O, LNO, O
Gross External Debt	Oct.2011	Nov.2011	M	M	M		
International Investment Position[6]	Mar.2011	Aug. 2011	A/Q	A/Q	A/Q		

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market-based and officially determined, including discounts rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing. Only Federal Board of Revenue's outcome is received on monthly basis

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); or Not Available (NA).

[8] Reflects the assessment provided in the data ROSC published in December 2004 and its update published in February 2007, and based on the findings of the missions that took place during December 1–16, 2003 for the dataset corresponding to the variable in each row, and during November 1–15, 2006 for monetary statistics, respectively. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

[9] Same as Footnote 8, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

INTERNATIONAL MONETARY FUND

PAKISTAN

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION AND REQUEST FOR AN EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY—SUPPLEMENTARY INFORMATION

August 28, 2013

Approved By
Daniela Gressani and Mark Flanagan

Prepared By
Middle East and Central Asia Department

1. **This supplement provides an update on economic and policy developments since the issuance of the staff report on August 22, 2013**. The additional information does not change the thrust of the staff appraisal.

2. **Headline inflation rebounded from 5.9 in June to 8.3 percent in July**. This rate was slightly higher than staff projections, reflecting the impact of energy and transportation price increases. At the same time, core inflation remained at 9.3 percent.

3. **Gross official reserves are at US$4.8 billion as of August 27, 2013 in line with Staff's projections**. SPB continued to purchase foreign exchange in the spot market consistent with program objectives. Payments to the Fund (US$392 million) and unwinding of the swap/forward contracts (US$150 million) are the main reasons behind the decline in reserves.

4. **Provisional figures point to 8 percent of GDP budget deficit for 2012/13**. The deficit is ½ percent of GDP better than originally estimated. This is mainly due to lower interest, defense and grant expenditures.

5. **The authorities have completed the five prior actions**: (i) The government implemented a series of fiscal adjustment measures reaching 2 percent of GDP; (ii) Electricity prices were raised on certain groups of consumers as a part of the new Energy Policy; (iii) The Council of Common Interest (including representatives of the provinces) ratified the fiscal commitments under the program; (iv) The Federal Bureau of Revenue launched an income tax enforcement scheme by issuing over 10 thousand notices to suspected high income individuals and firms who did not file returns; and (v) The State Bank of Pakistan purchased net US$125 million in the foreign exchange spot market.

Table 2. Pakistan: Prior Actions and Structural Benchmarks Under Extended Fund Facility

Item	Measure	Time Frame (by End of Period)
Prior Actions (implemented before Board consideration of the program)		
1	Net purchase of $125 million by the SBP in the foreign exchange spot market from July 1, 2013.	Met
2	Develop and approve a three-year plan by the Government for phasing out Tariff Differential Subsidies (TDS), and implement the first step by: (i) the notification of new tariffs for FY2012/13; (ii) increasing the weighted average tariffs by 50 percent on industrial, commercial, bulk, and AJ&K consumers' electricity consumption; and (iii) announcing a reduction of the subsidy on second group of consumers (as defined in the TMU) through increasing the weighted average notified tariffs by 30 percent that will be in effect from October 1st, 2013.	Met
3	Implement a series of fiscal adjustment measures (including those in the 2013/14 budget) totaling 2 percent of GDP on an annualized basis.	Met
4	Impose a balanced budget requirement on provinces and agree with provinces to save additional revenues generated by the program.	Met
5	Issue 10 thousand notices based on large potential fiscal liabilities.	Met
Structural Benchmarks		
Fiscal sector		
1	Develop and launch initiatives to enhance revenue administration for sales tax, excises, and customs similar to that prepared for income tax.	end-December 2013
2	Announce a rationalization plan for gas prices which will involve a levy to generate 0.4 percent of GDP fiscal savings by end-December 2013.	end-December 2013
Monetary sector		
3	Enact the amendments to the SBP law to give SBP autonomy in its pursuit of price stability as its primary objective, while strengthening its governance and internal control framework, in line with Fund staff advice.	end-March 2014
Financial sector		
4	Prepare detailed plans to achieve compliance of all banks that fall below minimum capital adequacy, including specific actions, end dates, and contingency arrangements. Also detail a plan for recapitalization, consolidation or liquidation of 9 banks that fall below the minimum capital requirement but not CAR.	end-December 2013
5	Enact the Deposit Protection Fund Act, in line with Fund staff advice	end-September 2014
6	Enact the Securities Bill, in line with Fund staff advice.	end-December 2014
Structural Policies		
7	Develop and approve PSE reform strategy for thirty firms among the 65 PSEs approved for privatization by the Council of Common Interest (CCI).	end-September 2013
8	Hire a professional audit firm to conduct a technical and financial audit of the system to identify the stock and flow of payables at all levels of the energy sector (including Power Sector Holding Company Limited).	end-November 2013
9	Make Central Power Purchasing Agency (CPPA) operational by separating it from the National Transmission and Despatch Company (NTDC), hire key staff, issue CPPA rules and guidelines, and initiate the payment and settlement system.	end-December 2013
10	Enact the amendments to the Pakistan Penal Code 1860 and the Code of Criminal Procedures 1898.	end-December 2013
11	Privatize 26 percent of PIA's shares to strategic investors.	end-June 2014

Press Release No.13/322
FOR IMMEDIATE RELEASE
September 4, 2013

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves 3-Year, US$6.64 Billion Extended Arrangement for Pakistan

The Executive Board of the International Monetary Fund (IMF) approved today a 3-year arrangement under the Extended Fund Facility (EFF) for Pakistan in an amount equivalent to SDR 4.393 billion (US$6.64 billion[1], or 425 percent of Pakistan's quota) to support the country's economic reform program to promote inclusive growth. The Executive Board's approval enables an initial disbursement by the IMF of an amount equivalent to SDR 360 million (about US$544.5 million), and the remaining amount will be evenly disbursed over the duration of the program, subject to the completion of quarterly reviews.

Despite the challenges it faces, Pakistan is a country with abundant potential, given its geographical location and its rich human and natural resources. The authorities' program is expected to help the economy rebound, forstall a balance of payments crisis and rebuild reserves, reduce the fiscal deficit, and undertake comprehensive structural reforms to boost investment and growth. Adherence to the program is also expected to catalyze the mobilization of resources from other donors.

Following the Executive Board discussion on Pakistan, Ms. Nemat Shafik, Deputy Managing Director and Acting Chair, issued the following statement:

"Pakistan is facing serious economic challenges. Overall vulnerabilities and crisis risks are high, with subpar growth and unsustainable fiscal and balance of payments positions. In this context, the authorities' comprehensive economic program is timely and welcome.

"The authorities' 2013/14 federal budget represents an important initial step towards the needed fiscal consolidation. However, to ensure medium-term fiscal sustainability and create fiscal space for social and investment spending, it is important to raise the tax-to-GDP ratio, including by broadening the tax base through a reduction in exemptions and concessions and extending taxation to areas currently not fully covered by the tax net. An overhaul of tax administration is also required, and provinces should contribute fully to the adjustment effort.

[1] Please note changes in US Dollar amounts adjusted to today's exchange rate.

"Monetary and exchange rate policies should be geared to rebuilding external buffers, direct lending to the government should cease and efforts to improve independence of monetary policy need to be stepped up to pave the way for improved price stability. Risks to the banking sector are manageable, although the undercapitalization of vulnerable banks needs to be addressed.

"To achieve sustained and inclusive growth, short-term macroeconomic measures must be complemented by significant structural and governance reforms. The recently announced energy policy will address the long-standing problems in the sector, which constitute the most crucial constraint on growth and have generated large fiscal costs. In addition, the trade regime needs to be liberalized, public sector enterprises need to be restructured or privatized, and the business climate needs to be improved.

"Protecting the most vulnerable from the direct and indirect impacts of fiscal consolidation and price adjustments is a priority. Coverage and benefits of these programs should be expanded as savings from tariff adjustments and fiscal space are realized."

ANNEX

Recent Developments

Pakistan's growth trajectory has borne the tolls of both internal security and macroeconomic imbalances, as well as an uncertain global and regional environment. These factors, along with the country's longstanding structural problems, mainly in the energy sector, have kept growth below the level needed to reduce poverty and absorb the growing labor force. Power outages, resulting from many years of financial and governance problems and averaging about 8-10 hours a day, together with devastating floods and a difficult security situation have contributed to the anemic growth. GDP growth has averaged only 3 percent over the past five years. Private domestic investment has dropped from 14 percent of GDP in 2007/08 to around 11 percent of GDP in 2012/13 due to a difficult business climate. With capital flows virtually drying up, central bank reserves have declined to critical levels, falling by some 45 percent in the past year alone. As of end June 2013, reserves stood at US$6 billion. Much effort is needed to boost confidence in order to attract foreign direct investment in line with Pakistan's long-term growth potential.

Program Summary

The authorities have put in place an ambitious economic reform program aimed at reversing the current large fiscal deficits, fostering inclusive growth and addressing Pakistan's short and medium term problems. They have already implemented key measures to ensure a strong start, including fiscal consolidation measures totaling 2 percent of GDP, adjusting electricity tariffs as part of a new comprehensive energy policy, reorienting monetary policy to rebuild foreign exchange reserves, in addition to reducing inflation, and launching a decisive tax enforcement program. These measures are expected to reduce the government budget deficit to sustainable levels, reduce crowding-out of private investment, and containing inflation over the medium-term.

Medium-term elements of the program:

- Raising growth gradually to near 5 percent by 2015/16 as macroeconomic stability is entrenched and structural reforms are pursued.
- Bringing inflation down to 6-7 percent range by 2015/16, from the current level of 8.3 percent.
- Increasing central bank reserves to over 3 ½ months of imports by 2015/16.
- Reducing the fiscal deficit to 3 ½ percent of GDP by 2015/16 from an estimated 8.0 percent in 2012/13, with provincial governments contributing their fair share of the fiscal consolidation process.
- Liberalizing the trade regime and reforming public sector enterprises through restructuring and/or privatization.
- Improving the business climate.
- Strengthening the tax system.
- Protecting the most vulnerable from the direct and indirect impacts of reform measures.

Pakistan: Selected Economic Indicators, 2009/10–2013/14 1/

Population: 178.9 million (2011/12)
Per capita GDP: US$1,228 (2011/12)
Poverty rate: 17.2 percent (2007/08)
Main exports: Textiles ($9.9 billion)

				Estimates	Baseline	Program
	2009/10	2010/11	2011/12	2012/13	2013/14	
	(Annual percentage change)					
Output and prices						
Real GDP at factor cost	2.6	3.7	4.4	3.6	3.3	2.5
GDP deflator at factor cost	10.7	19.5	5.3	7.5	7.9	7.9
Consumer prices (period average) 2/	10.1	13.7	11.0	7.4	8.2	7.9
Consumer prices (end of period) 2/	11.8	13.3	11.3	5.9	10.5	10.0
Pakistani rupees per U.S. dollar (period average)	7.6	2.2	4.1	8.7	…	…
	(In percent of GDP)					
Saving and investment						
Gross saving	13.6	14.2	12.9	13.3	12.5	14.3
Government	-2.4	-4.2	-5.1	-5.2	-4.5	-2.2
Nongovernment (including public sector enterprises)	16.0	18.4	17.9	18.4	16.9	16.5
Gross capital formation 3/	15.8	14.1	14.9	14.2	14.1	14.9
Government	3.5	2.5	3.3	3.3	3.3	3.3
Nongovernment (including public sector enterprises)	12.3	11.6	11.6	10.9	10.8	11.6
Public finances						
Revenue and grants	14.3	12.6	13.1	13.1	13.0	14.4
Expenditure (including statistical discrepancy)	20.2	19.5	21.5	21.0	20.8	19.9
Budget balance (including grants)	-5.9	-6.9	-8.4	-7.9	-7.8	-5.5
Budget balance (excluding grants)	-6.2	-7.1	-8.8	-8.0	-8.1	-5.8
Primary balance	-1.6	-2.9	-4.0	-3.6	-3.0	-0.9
Total general government debt 4/	61.5	59.5	63.8	66.6	69.2	66.6
External general government debt	30.2	26.6	25.8	24.1	23.2	24.1
Domestic general government debt	31.3	32.9	38.0	42.5	46.1	42.5
	(Annual changes in percent of initial stock of broad money, unless otherwise indicated)					
Monetary sector						
Net foreign assets	0.5	4.1	-3.8	-3.4	-0.7	3.9
Net domestic assets	11.9	11.8	17.9	19.3	18.4	12.2
Broad money (percent change)	12.5	15.9	14.1	15.9	17.7	13.8
Reserve money (percent change)	11.4	17.1	11.3	15.9	14.2	13.4
Private credit (percent change)	3.9	4.0	7.5	-0.6	8.0	8.5
Six-month treasury bill rate (period average, in percent)	12.3	13.3	12.3	10.1	…	…
External sector						
Merchandise exports, U.S. dollars (percentage change)	2.9	28.9	-2.6	0.2	9.6	11.4
Merchandise imports, U.S. dollars (percentage change)	-1.7	14.9	12.8	-1.6	7.3	6.9
Current account balance (in percent of GDP)	-2.2	0.1	-2.1	-1.0	-1.6	-0.6

	2009/10	2010/11	2011/12	Estimates 2012/13	Baseline 2013/14	Program 2013/14
	(In percent of exports of goods and services, unless otherwise indicated)					
External public and publicly guaranteed debt	178.5	153.4	160.3	157.3	147.8	143.7
Debt service	21.5	13.0	16.0	20.6	22.5	19.4
Gross reserves (in millions of U.S. dollars) 5/	12,958	14,784	10,799	6,008	2,283	9,566
In months of next year's imports of goods and services	3.6	3.6	2.7	1.4	0.5	2.2
Memorandum items:						
Real effective exchange rate (annual average, percentage change)	0.9	6.1	2.7	-6.2	-4.8	-7.7
Terms of trade (percentage change)	1.8	7.0	-9.6	-0.4	1.0	-0.1
Real per capita GDP (percentage change)	0.5	1.5	2.3	1.5	1.3	0.5
GDP at market prices (in billions of Pakistani rupees)	14,867	18,285	20,091	22,909	25,415	25,351
GDP at market prices (in billions of U.S. dollars)	177.6	213.7	225.6	236.5	235.6	229.9

Sources: Pakistani authorities; and IMF staff estimates and projections.
1/ Fiscal year ends June 30.
2/ Inflation after 2009/10 based on new CPI weights, recalculated in September 2011
3/ Including changes in inventories. Investment data recorded by the Pakistan Bureau of Statistics are said to underreport true activity.
4/ Excludes military debt, and commercial loans.
5/ Excluding gold and foreign currency deposits of commercial banks held with the State Bank of Pakistan.

Press Release No. 13/337
FOR IMMEDIATE RELEASE
September 12, 2013

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Concludes the 2013 Article IV Consultation with Pakistan

On September 4, 2013, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV Discussions with Pakistan[1] and approved a three-year arrangement under the Extended Fund Facility (EFF) for Pakistan in support of the authorities' structural reform and growth program (see Press Release No. 13/322).

Economic performance in Pakistan has been substandard in recent years. GDP growth has averaged only 3 percent over the past five years, which is insufficient to significantly improve living standards or fully absorb the growing labor force. Severe problems with the electricity supply, a difficult security situation, the presence of loss-making public sector enterprises in key economic activities, a poor business climate, and a distorted trade regime have been important factors in anemic growth.

Headline inflation has fallen sharply in recent months, but underlying inflationary pressures remain. The external position has weakened significantly and central bank reserves have declined to US$6 billion (below 1½ months of imports) as of end-June 2013. The rupee depreciated around 5 percent against the dollar during the Fiscal Year 2012/13 (July-June), leaving the real effective exchange rate roughly unchanged.

The 2012/13 fiscal deficit (excluding grants) is estimated to be 8 percent of GDP, well above the original budget target of 4.7 percent of GDP due to slippages on both revenues and expenditures. The revenue shortfall is largely explained by the underperformance in tax collections in the previous fiscal year, inadequate tax administration, and a slowdown in economic activity. Higher expenditures reflect higher energy subsidies, including clearing the power sector arrears. Moreover, the provincial surplus envisaged in the budget has not

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

materialized. With very low external financing, the deficit has been almost entirely domestically financed.

Monetary policy continued to be accommodative to lift weak private investment and growth, in light of falling headline inflation. In 2012/13, the policy rate has been cut repeatedly by a cumulative 300 basis points to 9 percent, while direct financing of the large fiscal deficit continues to drive growth in monetary aggregates. However, this accommodative policy did not bear fruit in terms of private sector stimulus—private credit shrank in real terms.

The financial system is dominated by banks that have been relatively healthy as capital and liquidity indicators continue to be boosted by large holdings of government securities. Nevertheless, nonperforming loans remain high at 14.7 percent at end-March 2013 with few banks falling below minimum capital adequacy requirements.

Executive Board Assessment

Executive Directors noted that Pakistan's economic vulnerabilities and crisis risks are high, with subpar growth and unsustainable fiscal and balance of payments positions. A lack of reliable electricity supply and a difficult security situation in large parts of the country have contributed to the deterioration.

Against this backdrop, Directors welcomed the authorities' ambitious economic program aiming to reverse the current mix of large fiscal deficits, accommodative monetary policy, and low reserve coverage, and to foster sustained and inclusive growth. They stressed that short-term measures must be complemented by significant reforms in fiscal management, the monetary policy framework and financial markets, the energy sector, public sector enterprises, the business climate, and trade policy.

Directors highlighted that further consolidation will be required to ensure fiscal sustainability. While the 2013/14 federal budget represents an important initial step, a more efficient and equitable tax system is needed, and a significant increase in the tax-to-GDP ratio will be key to create room for social and investment spending while lowering the deficit. This will involve broadening the tax base through a reduction in exemptions and concessions, the extension of taxation to areas not fully covered by the tax net, and an overhaul of tax administration. Directors underscored that fiscal sustainability can only be achieved if the provinces are full partners in the adjustment effort.

Directors emphasized that monetary and exchange rate policies must be geared to rebuilding external buffers and to maintaining price stability over time. They stressed the need to cease direct lending to the government and underscored the importance of monetary policy independence in paving the way for improved price stability.

Directors underlined that continued financial sector stability and steps to deepen financial markets will contribute to boosting economic growth. They considered that risks to the banking sector are manageable, but encouraged the authorities to promptly address the undercapitalization of a few banks and to monitor closely non-performing loans.

Directors welcomed the authorities' new energy policy, which is geared to addressing long-standing problems that constitute the most critical constraint on growth and have generated large fiscal costs. They encouraged the authorities to work closely with donors and secure broad-based support for the continued strong implementation of their energy sector strategy. Directors also called for efforts to liberalize the trade regime, restructure or privatize public sector enterprises, and improve the business climate to reduce rent-seeking behaviors and increase both foreign and domestic productive investment.

Directors stressed that protecting the most vulnerable from the impact of fiscal consolidation and price adjustments is a priority. They commended the authorities for their firm commitment to boosting targeted income support programs, and encouraged a gradual expansion of coverage and benefits as savings from energy tariff adjustments and fiscal space are realized.

Directors recognized the risks to the program from a delicate security situation, a further deterioration in the external environment, and potential constraints in legal, administrative, or technical capacity and resistance from vested interests to the reforms. They welcomed the authorities' considerable efforts in undertaking prior actions, signaling their commitment to the program's objectives and their willingness to take additional measures if necessary. They emphasized the importance of close collaboration with development partners, including through technical assistance, and continued strong political will and ownership for the program's success.

Pakistan: Selected Economic Indicators, 2009/10–2013/14 1/

	2009/10	2010/11	2011/12	Estimates 2012/13	Baseline 2013/14	Program 2013/14
Real Economy (change in percent)						
Real GDP	2.6	3.7	4.4	3.6	3.3	2.5
Total domestic demand	11.1	22.0	12.9	12.1	12.6	11.6
Private consumption	13.3	25.2	11.8	12.0	12.9	11.8
Gross fixed investment 2/	0.3	8.4	16.9	8.1	9.5	16.4
Foreign balance						
Merchandise exports, U.S. dollars (percent change)	2.9	28.9	-2.6	0.2	9.6	11.4
Merchandise imports, U.S. dollars (growth rate; in percent)	-1.7	14.9	12.8	-1.6	7.3	6.9
Consumer prices (period average)	10.1	13.7	11.0	7.4	8.2	7.9
Consumer prices (end of period)	11.8	13.3	11.3	5.9	10.5	10.0
Unemployment rate (average, in percent)	5.6	6.0	6.5	6.7	6.8	6.9
Gross domestic investment (percent of GDP)	15.8	14.1	14.9	14.2	14.1	14.9
Gross domestic saving (percent of GDP)	13.6	14.2	12.9	13.3	12.5	14.3
General government (percent of GDP)						
Overall balance	-6.2	-7.1	-8.8	-8.0	-8.1	-5.8
Primary balance	-1.6	-2.9	-4.0	-3.7	-3.0	-0.9
Debt	61.5	59.5	63.8	66.2	69.2	66.6
Money and credit (end period, percent change)						
Broad money	12.5	15.9	14.1	15.9	17.7	13.8
Lending to private sector	3.9	4.0	7.5	-0.6	8.0	8.5
Interest rates (percent)						
Policy rate	12.5	14.0	12.0	…	…	…
T-bill yield (6-month, average)	12.3	13.3	12.3	…	…	…
Balance of payments						
Goods and services, and income balance(percent of GDP)	-9.3	-7.2	-9.8	-8.4	-9.3	-8.4
Current account (percent of GDP)	-2.2	0.1	-2.1	-1.0	-1.6	-0.6
Reserves (in billions of U.S. dollars) 3/	12,958	14,784	10,799	6,008	2,283	9,566
Exchange rate						
Rupees per U.S. dollar(period average, percent change)	7.6	2.2	4.1	…	…	…
Real effective exchange rate (annual average, percent change) 4/	0.9	6.1	2.7	…	…	…
Quota at the Fund			SDR 1033.7 million			

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

1/ Fiscal year ends June 30.
2/ Including changes in inventories.
3/ Excluding gold, foreign deposits held with the State Bank of Pakistan, and net of outstanding short-term foreign currency swap and forward contracts.
4/ An increase is a real appreciation.

Statement by Jafar Mojarrad, Executive Director for Pakistan and Muhammad Sethi, Senior Advisor to Executive Director
September 4, 2013

Our Pakistani authorities are appreciative of staff hard work and constructive discussions under the Article IV consultation and program negotiations, which have yielded consensus on how to address the macroeconomic imbalances and foster growth over the medium term. The authorities are fully aware of the challenges and are determined to press ahead with critical reforms to boost growth and restore macroeconomic stability, thereby setting the stage for a more vigorous momentum of reforms that will help shore up confidence, mobilize external support, and attract foreign and domestic investment. In support of their program, the authorities have requested a 36-month arrangement under the Extended Fund Facility (EFF), which they believe is appropriate to provide financing over a sufficiently long period to meet stabilization and structural reform needs.

As clearly laid out in the Memorandum of Economic and Financial Policies (MEFP) and the staff report, a difficult regional security environment, the devastating effects of the floods, domestic political challenges, and external shocks over the past several years have adversely impacted growth and macroeconomic stability in Pakistan. In this context, and despite its best efforts, the previous government was not able to stay the course of stabilization and reform and complete the last reviews under the 2008 SBA, which expired in September 2011, and discussions on a new program could not be finalized. In the meantime, the overall macroeconomic situation continued to deteriorate, with rising fiscal and current account deficits, and increased pressure on reserves reflecting the unfavorable external and domestic environment compounded by weaknesses in policy implementation.

The successful democratic transition, the first from an elected government in the country's history, has brought to power a government at the center of the political spectrum with strong parliamentary majority. The new government has a clear mandate and the political support to pursue economic reforms involving difficult policy choices, which are critical for correcting macroeconomic imbalances and putting the economy on a high and inclusive growth path.

The overall economic program is comprehensive and well calibrated to achieve macroeconomic stability and improve growth prospects over the medium-term. The envisaged policy mix of fiscal consolidation, prudent monetary policy, and appropriate exchange rate policy will help secure macroeconomic stability, while the planned structural reforms, along with a strengthening of the social safety net, will help improve the business climate, boost investment, and soften the impact of fiscal consolidation on growth and the poor. The authorities agree that downside risks are high, as indicated in the report, but believe that their strong determination to implement the envisaged reforms, as evidenced by the upfront actions taken, offers an important upside. The authorities look forward to the program catalyzing adequate and timely donor support to fill any remaining financing gap.

Fiscal consolidation

Based on past experience, the authorities are aware that the outcome of the reform program critically hinges on their ability to achieve fiscal consolidation to put public debt on a sustainable trajectory, increase fiscal space for priority social and infrastructure investment, and release resources for private sector development. Under the proposed program, the authorities aim at reducing the fiscal deficit to around 3½ percent of GDP by FY 2016/17, entailing a fiscal consolidation of about 4–4 ½ percent of GDP over three years. In this regard, as indicated by staff, the new government has implemented upfront measures towards fiscal adjustment of 2 percent of GDP, including measures envisaged in the 2013/14 budget. On the revenue side, these include among others a new levy on natural gas, higher rates of GST, corporate minimum tax, and personal income tax for higher income bracket, as well as increases in excises and fees. Furthermore, building on earlier efforts, tax administration reform will be strengthened through improved Federal Board of Revenue access to information, an increase in the number of risk-based tax audits, and enhanced assessment, collection, and prosecution procedures. In this regard, the issuance of 10,000 tax notices based on large potential fiscal liabilities (prior action), is an important first step in this area. In addition, further measures aimed at widening the tax base will be implemented during the program period, including by reducing tax exemptions and restricting the use of statutory regulatory orders (SROs).

A major leap forward on the expenditure side is the commitment to phase out electricity subsidy over the life of the program, along with the strengthening of the social safety net. The first round of adjustment has been achieved by eliminating tariff differential subsidy amounting to 0.75 percent of GDP through increasing weighted average tariff for commercial, industrial, bulk and large consumers. Further tariff subsidy reductions are envisaged in the following years to reach a maximum subsidy of 0.3 percent of GDP, as indicated in the MEFP. In addition, nonwage current expenditures have been reduced through a 30 percent across the board cut from this year's budget allocations, equivalent to 0.15 percent of GDP. While some scaling back of the budgeted increase in capital spending is envisaged this year, the authorities intend to preserve investment expenditure as fiscal space is realized. The ratification of the fiscal commitments by the Council of Common Interest, which includes representatives of the provinces (implemented as a prior action), will ensure full contribution of all levels of Government to fiscal consolidation.

With regard to spending on social programs under the 2013/14 budget, the authorities have increased allocation for Benazir Income Support Program (BISP, the largest targeted social assistance program) to enable an extended outreach to over 5.7 million families through conditional cash transfers for primary education. It is expected that by the end of the program, 24 percent of the population (6.6 million families) would be covered under the basic cash transfer program.

Monetary and exchange rate policies

Monetary policy has been a subject of intense discussion between the authorities and staff. While the authorities recognize the importance of adjusting the policy rate as needed to mitigate inflation risks, they firmly believe that the recent cuts were warranted by the declining headline inflation and the need to support growth. In the same vein, the authorities' intervention policy in the foreign exchange market has been motivated by the need to smooth out exchange rate volatility and strengthen market confidence by further building reserves. In this regard, and as a prior action, the SBP has purchased US$125 million in the foreign exchange market on a net basis since July1.

In view of the uncertainty surrounding the macroeconomic environment, adequate flexibility will be needed in calibrating the monetary and exchange rate measures and their timing to specific circumstances in the future, which cannot be predicted with a reasonable degree of certainty. The SBP has also expressed reservations on the methodology used by Fund staff for the calculation of core inflation, and look forward to further consideration of the issue in the context of the first review of the EFF.

The Selected Issue Paper on the performance of monetary policy in Pakistan makes interesting reading, but regrettably has not benefited from a thorough review and comments from the SBP before its circulation to the Board. The authorities have reservations about the methodology used and the accuracy of the assessment underlying the paper's main conclusions, and will be sending detailed comments to staff, which they hope will be taken into consideration before finalizing the paper for publication. If needed, the authorities stand ready to have extensive discussions with staff on these and related issues at an appropriate time.

Structural reforms

The authorities are cognizant of the fact that in the long run, structural reforms hold the key to stronger growth, both by enhancing the overall efficiency of the economy and supporting long term fiscal sustainability. Energy sector reform remains the top priority, in view of its poor performance and the significant adverse costs to the economy and the budget. The first major step taken in this regard has been the preparation of a comprehensive energy policy, which addresses structural, governance, and regulatory issues. The Prime Minister chairs a high level national committee on energy which meets regularly to take stock of progress made under this policy. In the short term, the supply gap is being tackled by clearing payment arrears and improving governance of the power transmission and distribution system that currently records high losses due to poor infrastructure, mismanagement and theft of electricity. The long term plans focus on generating affordable electricity for commercial and industrial use by improving the energy mix and building generation capacity that can sustain Pakistan's needs in the future while promoting a culture of energy conservation and responsibility.

Providing a conducive and business friendly environment for investment is also high on the list of government priorities. The "one stop shop" will provide easy access to a number of government departments and agencies under one roof. The authorities continue to engage with other development partners in strengthening the Board of Investment and streamlining procedures for establishing businesses in Pakistan. Implementation of the ambitious program of restructuring and privatization of public enterprises, along with further trade liberalization and improved SMEs' access to financing under the SBP's Financial Inclusion Program, would further strengthen private sector role, increase competitiveness, and enhance growth potential.

Financial sector reform

As indicated in the report, the banking sector is generally well capitalized and liquid. A few banks representing less than 7 percent of the system face financial pressures. These are being addressed through fresh injections of equity or mergers. Introduction of a deposit insurance scheme is under consideration to further stabilize the banking system. Besides, a new legislation for corporate rehabilitation is also under discussion with relevant stakeholders to improve the recovery mechanism. The authorities recognize the need for close monitoring of the financial system and are in the process of further strengthening the supervisory and enforcement power of the regulator.

Conclusion

The incoming government led by Prime Minister Mian Nawaz Sharif is fully committed to stay the course of prudent policies and bold structural reforms under the proposed EFF-supported program. The authorities are cognizant of the challenges they are facing but are confident that the difficult but necessary path of adjustment and reform that they have chosen will help them achieve their ambitious goals of higher growth and employment with macroeconomic stability. They are committed to taking the necessary measures as required to ensure the achievement of their program objectives. They look forward to the continued support from management and the Board.