

**Pakistan: First Review Under the Stand-By Arrangement and Request for Waiver and Modification of Performance Criteria—Staff Report; Staff Statement; News Brief on the Executive Board Discussion; and Statement by the Authorities of Pakistan**

In the context of the first review under the Stand-By Arrangement, the following documents have been released and are included in this package:

- the staff report for the First Review Under the Stand-By Arrangement and Request for Waiver and Modification of Performance Criteria, prepared by a staff team of the IMF, following discussions that ended on **February 25, 2001**, 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 March 19, 2001.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of **March 28, 2001**, updating information on recent economic developments.
- a News Brief summarizing the views of the Executive Board as expressed during its **March 30, 2001**, discussion of the staff report that completed the review.
- a statement by the authorities of Pakistan.

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

Letter of Intent by the authorities of the member country\*

Memorandum of Economic and Financial Policies by the authorities of the member country\*

Technical Memorandum of Understanding\*

\*May also be included in Staff Report.

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INTERNATIONAL MONETARY FUND  
PAKISTAN

**First Review Under the Stand-By Arrangement and  
Request for Waivers and Modification of Performance Criteria**

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

(In consultation with other departments)

Approved by P. Chabrier and M. T. Hadjimichael

March 19, 2001

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### List of Acronyms

AsDB	Asian Development Bank
CBR	Central Board of Revenue
CDNS	Central Directorate of National Savings
DBC	Dollar Bearer Certificate
DSC	Defense Savings Certificate
EFS	Export Finance Scheme
FCD	Foreign currency deposit
FIBs	Federal Investment Bonds
FIBR	Floating Interbank Market Exchange Rate
FPSC	Federal Public Services Commission
FSAP	Financial Sector Assessment Program
GFS	Government Finance Statistics
GST	General Sales Tax
HUBCO	Hub Power Corporation
IDB	Islamic Development Bank
IFIs	International Financial Institutions
IPPs	Independent Power Producers
KAPCO	Kot Addu Power Corporation
KESC	Karachi Electricity Supply Corporation
MEFP	Memorandum on Economic and Financial Policies
NBP	National Bank of Pakistan
NCBs	Nationalized Commercial Banks
NEPRA	National Electric Power Regulatory Authority
NDA	Net domestic assets
NFC	National Finance Commission
NSS	National Savings Schemes
NTN	National Taxpayer Number
NWFP	North Western Frontier Province
OGDC	Oil and Gas Development Corporation
PIFRA	Pakistan Improvement of Financial Reporting and Accounting
PSDP	Public Sector Development Program
PTCL	Pakistan Telecommunications Company Limited
SBP	State Bank of Pakistan
SNGPL	Sui Northern Gas Pipeline Limited
SSGCL	Sui Southern Gas Company Limited
WAPDA	Water and Power Development Authority

## I. INTRODUCTION AND BACKGROUND

1. The discussions for the first review under the Stand-By Arrangement were held in Islamabad during February 7–25, 2001.<sup>1</sup> The arrangement, amounting to SDR 465 million (45 percent of quota) was approved on November 29, 2000, on which occasion the Executive Board concluded the last Article IV consultation.<sup>2</sup> In the attached letter dated March 18, 2001, the authorities request the completion of the first review under the Stand-By Arrangement and seek waivers for the nonobservance of one quantitative and one structural performance criteria for end-December 2000, as well as modifications of two quantitative performance criteria for end-March 2001. The accompanying Memorandum on Economic and Financial Policies (MEFP)—which updates and supplements the Memorandum dated November 4, 2000—describes economic developments and policy implementation during the first half of 2000/01 (fiscal year ending June 30) and the authorities' policy intentions for the remainder of the fiscal year, and specifies quantitative aspects of the program that were to be agreed upon in the context of the present review.

2. In approving the arrangement, Executive Directors observed that the key policy challenges in the period ahead would be to maintain macroeconomic discipline and improve the competitiveness of the economy and public debt dynamics. They agreed that fiscal consolidation—especially an improved revenue effort—was essential for restoring macroeconomic stability. Moreover, they stressed that continued progress with structural reform will be necessary for attracting private investment, achieving high growth, and alleviating poverty. They identified enhancing governance, broadening of the tax base, strengthening of tax administration, and improving the financial position of public enterprises and banks, as particularly important structural reform areas. Directors concluded that the successful implementation of the program and the finalization of major structural reform plans could pave the way over time for medium-term financial support from the Fund under the Poverty Reduction and Growth Facility.

3. Following Board approval, Pakistan purchased the equivalent of SDR 150 million under the Stand-By Arrangement. The second purchase in an amount of SDR 105 million will become available upon completion of the first program review. As of end-February 2001, total Fund credit and loans outstanding to Pakistan amounted to SDR 1,164 million (112.5 percent of quota).

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<sup>1</sup> The staff met with the Finance Minister, the Governor of the State Bank of Pakistan (SBP), the Secretary General and Secretary Finance, and other senior officials. Mr. Ahmed (OED) participated in the discussions. The staff team consisted of Ms. Eken (Head), Messrs. Enders, Helbling and Le Dem (MED); Taube (FAD); and Ronci (PDR). Mr. Panzer (World Bank) participated in the work of the mission, which was assisted by Mr. Mansur, the Fund's senior resident representative. The mission coordinated its work with overlapping energy and banking sector missions of the World Bank

<sup>2</sup> See EBS/00/230 and Supplements 1 and 2, and SM/00/261. Pakistan's relations with the Fund are described in Appendix I.

## II. PERFORMANCE AND POLICIES IN JULY–DECEMBER 2000 AND EARLY 2001

4. Economic performance during the first half of 2000/01 was better than envisaged under the program with regard to inflation, the overall budget deficit, and the external current account position. However, economic growth was lower than projected and revenue performance fell short of the program objectives. Demand for currency and private credit was much stronger than projected but monetary targets were met through unorthodox measures at end-December 2000. Implementation of the ambitious program of structural reforms was broadly on track.

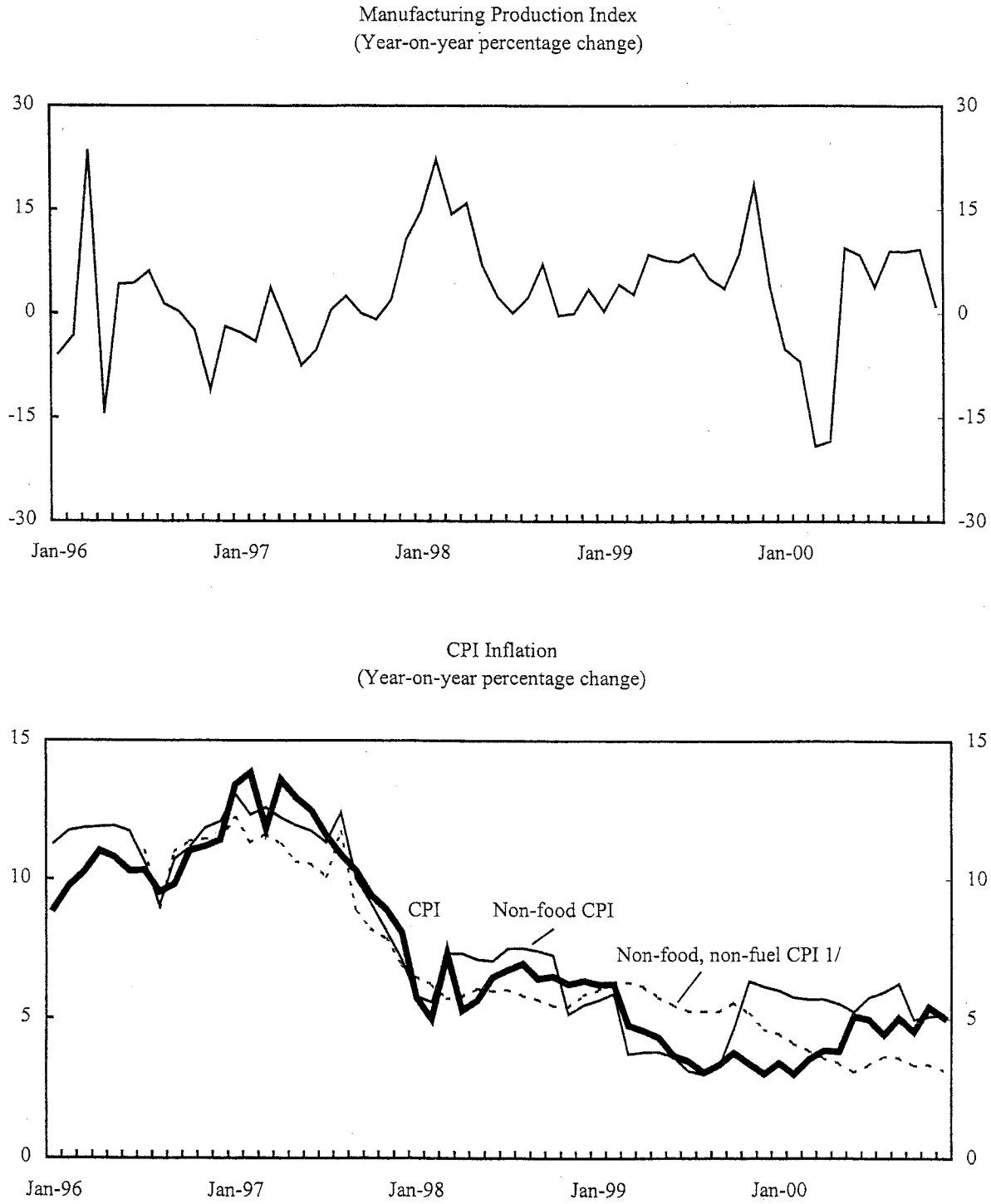
5. **Agricultural output was adversely affected by below-average rainfall but the industrial upswing was confirmed and the inflation performance was better than expected.** Rainfall during late fall and the winter season has remained well below average and intensified the already prevalent drought. This led to a contraction of the cotton crop, currently estimated at 10.4 million bales, about 7.5 percent lower than last year's bumper crop. Some other crops have also suffered and the forthcoming wheat crop is now estimated at 18.7 million tons, a 10 percent decrease compared to last year's harvest. Nevertheless, the cotton crop was sufficient to sustain continued output growth in the textile sector. The available data also confirm the expected broad-based upswing in the industrial sector after last year's cotton-based recovery. On the inflation front, developments in December–January were more favorable than expected, reflecting mostly lower-than-projected food prices but also what appears to be a smaller-than-expected pass-through effect of the recent exchange rate adjustment. In January 2001, the twelve-month inflation rate as measured by the CPI was contained at 4.5 percent (Chart 1). Wholesale price inflation began to accelerate during October–January, largely on account of rising raw material prices, especially cotton and energy prices. In January, the 12-month average rate reached 4.8 percent.

6. **The underlying external current account position was broadly in line with the program projections but program financing and foreign direct investment were weaker than envisaged during the first half of 2000/01.**<sup>3</sup> Lower exports and larger profit transfers were compensated by lower-than-expected non-oil imports and higher workers' remittances (Table 2). The shortfall in export receipts was due to lower unit values for textile products; volumes increased as programmed, with strong growth in non-traditional exports and many

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<sup>3</sup> The apparent improvement in the capital account during July–December 2000 was largely due to an increase in short-term private capital inflows resulting from short-term foreign currency swaps between the SBP and domestic commercial banks. The latter borrowed the foreign exchange from their branches abroad. These swaps were unwound in early January 2001.

**Chart 1. Pakistan: Output and Inflation, 1996–2001**



Source: Data provided by the Pakistan authorities

1/ This excludes the Food, Fuel & Lighting, and Transportation & Communications Groups.

categories of textile products. Despite lower-than-projected foreign direct and portfolio investment inflows and shortfalls in Asian Development Bank (AsDB) and Islamic Development Bank (IDB) disbursements, gross official reserves (excluding foreign currency deposits held with the State Bank of Pakistan (SBP), and short-term swaps and forwards) amounted to US\$735 millions at end-December (equivalent to 3.2 weeks of imports of goods and nonfactor services); this was a substantial improvement compared with the US\$390 million in early October, and was in line with the program projection (Chart 2).<sup>4</sup>

**7. Renewed pressures on reserves emerged in January and February 2001 despite increased nominal exchange rate flexibility.** In January, reserves started again to decline despite continued SBP purchases of foreign exchange in the kerb market, as the SBP sold foreign exchange to the interbank market for debt service payments and petroleum imports. The value of the rupee in the interbank market, which had depreciated by 12 percent during the first quarter of the fiscal year against the U.S. dollar and then stabilized during the second quarter, depreciated by another 4 percent in January and February 2001 (Chart 3). During July–December 2000, the real effective rate fell by almost 6 percent. Since the onset of the move to a market-based exchange rate system, daily and weekly exchange rate volatility has increased while the spread between kerb and interbank rates has been close to 5 percent.

**8. Monetary developments were more expansionary than expected in the second quarter of the fiscal year with higher-than-programmed demand for currency and private sector credit.** Currency in circulation increased by 15.4 percent during July–December 2000 instead of decreasing by 5.9 percent as programmed (Table 3 and Chart 4). The above-trend demand appears to have reflected: (a) an increased cash preference related to the tax survey; (b) a higher demand in rural areas because of the much larger value of the cotton crop; and (c) rising demand for Pakistani rupee in Afghanistan as well as by the rising number of Afghan refugees in Pakistan following the recent tightening of the UN sanctions and intensified drought conditions. In addition, currency demand was boosted by temporary factors related to the Ramadan period and the coincidence of its end-period festivities with other official holidays at end-December. The increase in currency in circulation accounted for more than 70 percent of the 5.4 percent rise in broad money during July–December (programmed at 2.2 percent).<sup>5</sup> Private sector credit grew by 11.1 percent during the same

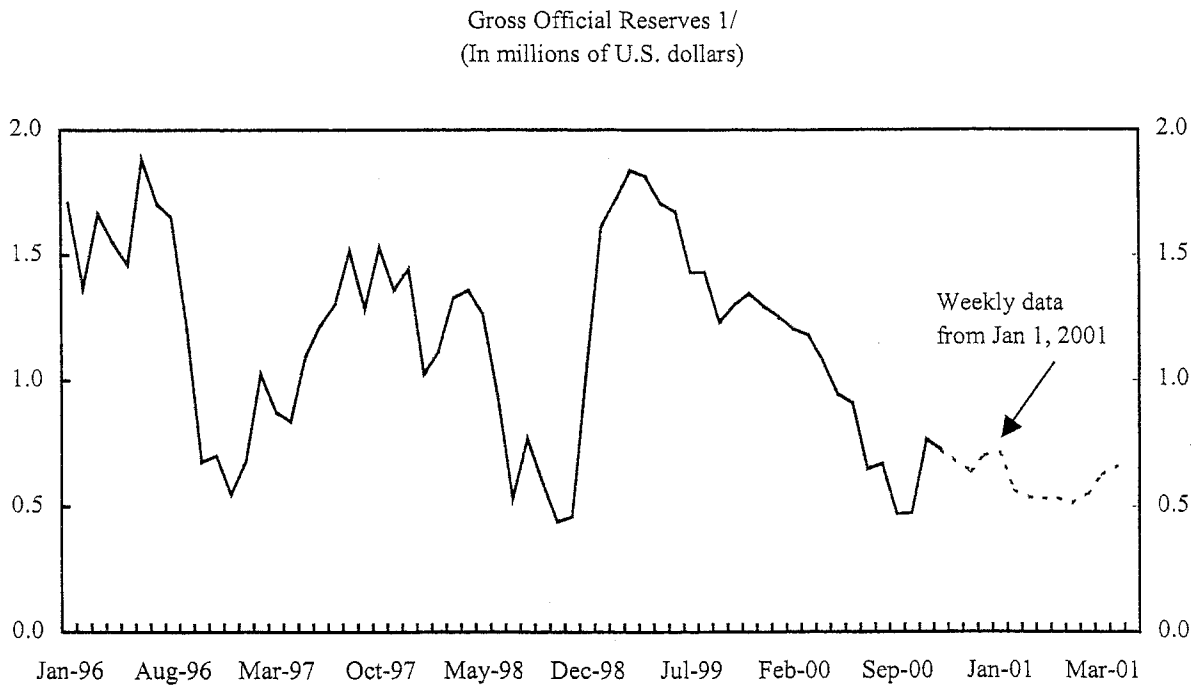
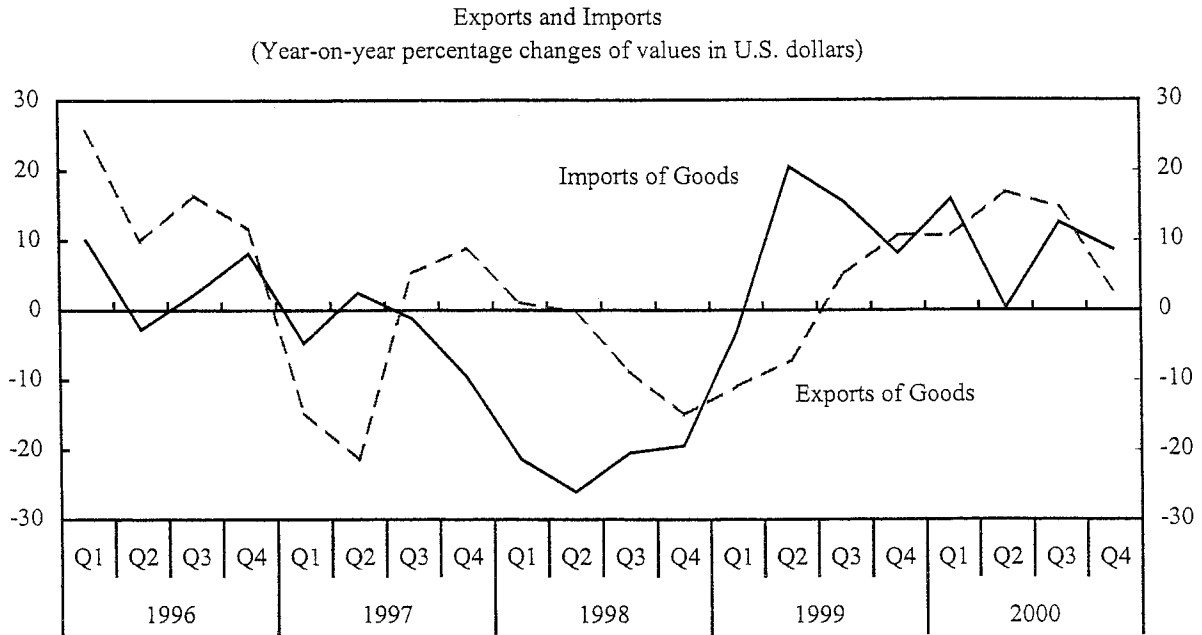
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<sup>4</sup> The overperformance in the SBP's net foreign assets (NFAs) exceeds the overperformance of gross usable official reserves primarily because of the shortfall in external financing but also because of a larger-than-expected reduction of SBP liabilities and changes in the maturity composition of foreign exchange swaps.

<sup>5</sup> On a 12-month basis, broad money, currency in circulation, and rupee deposits expanded by 12.1 percent, 20.0 percent, and 10.4 percent, respectively.



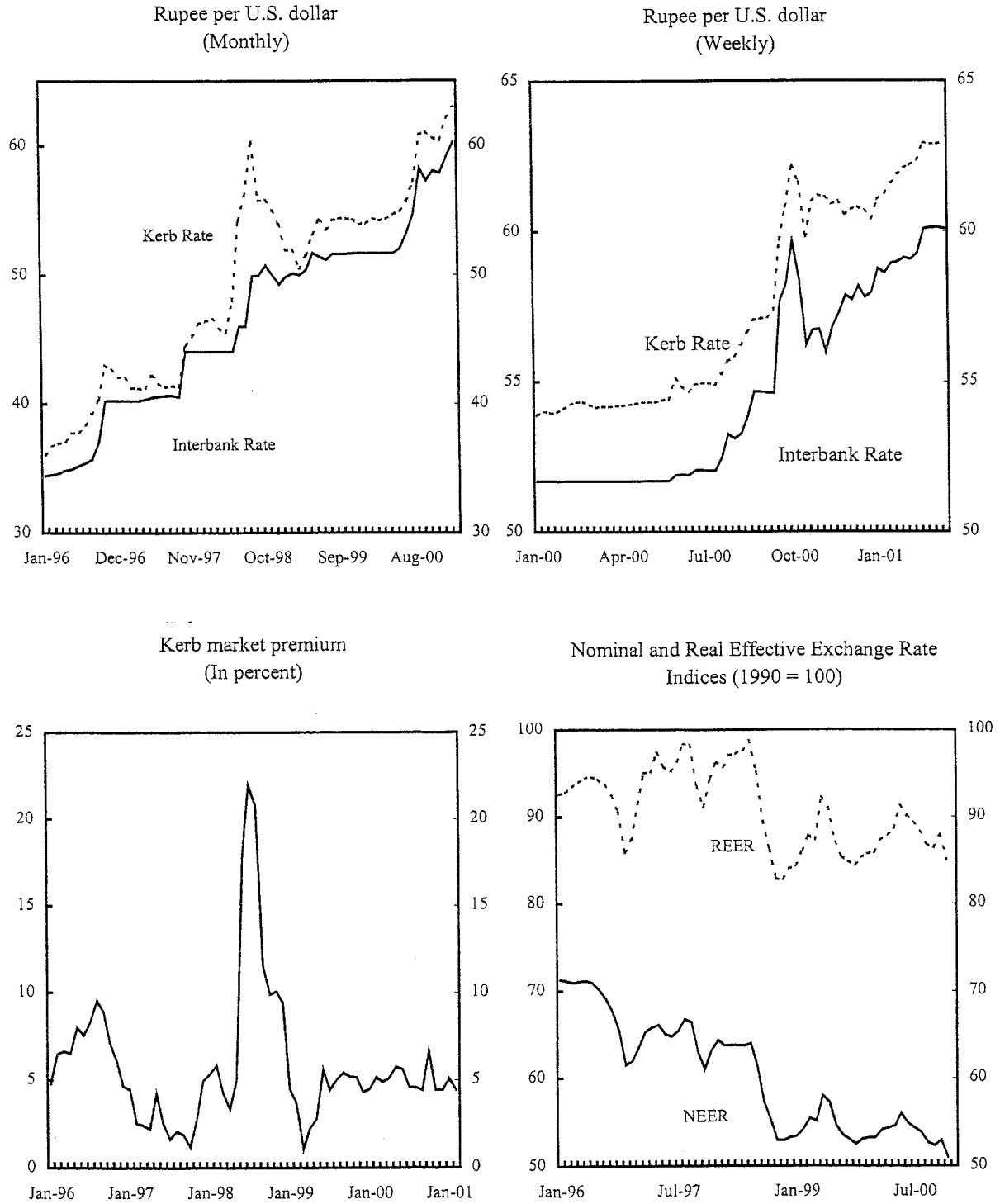
**Chart 2. Pakistan: External Sector Developments, 1996–2001**



Source: Data provided by the Pakistan authorities.

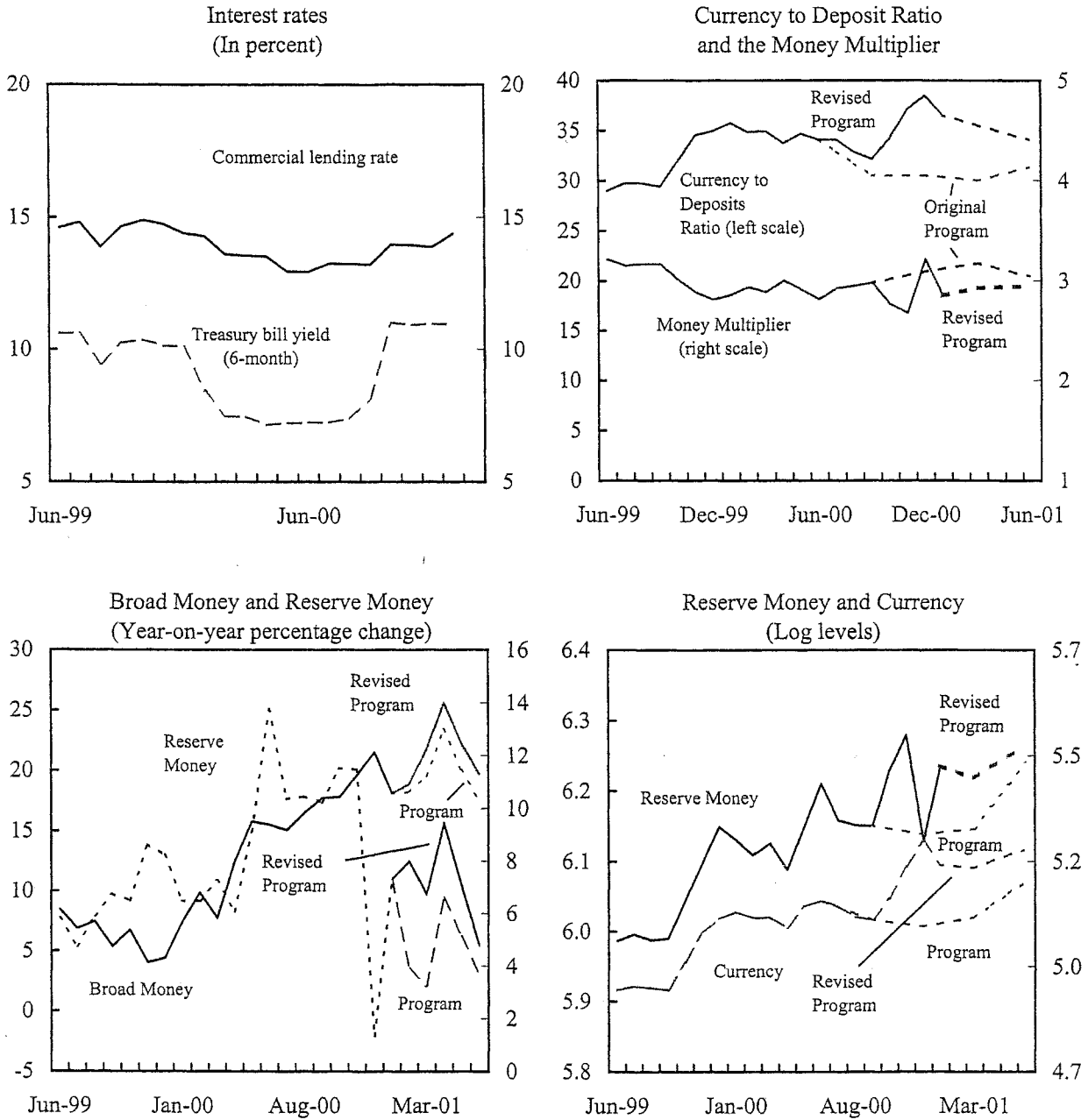
1/ Excluding foreign currency deposits held with the SBP (State Bank of Pakistan) and short-term foreign currency swaps.

**Chart 3. Pakistan: Exchange Rate Developments, 1996–2001**



Source: Data provided by Pakistan authorities; and staff estimates.

**Chart 4. Pakistan: Monetary Developments, 1999–2001**



Source: Data provided by the Pakistan authorities.

period, roughly twice the growth that was projected in the program. This mainly reflected the much higher financing needs of the textile sector following sharp rises in cotton prices, but also the refinancing needs related to the buoyant leasing activity for consumer and equipment goods.

9. **The end-December NDA target was met.** During the second quarter of the fiscal year, commercial banks' liquidity position was hit by a strong demand for private credit. In the circumstances, banks reduced their treasury bill holdings, including through reverse repos with the SBP, and resorted to the SBP's discount window to obtain liquid funds. In addition, several banks engaged in foreign exchange swaps with the SBP to increase their rupee liquidity in December. Against these developments, the targeted 1.1 percent decrease in reserve money under the program would have required a drastic tightening of the monetary policy stance. The SBP managed to avoid this tightening, yet formally met the performance criterion on its NDA through several unorthodox steps (see paragraph 5 of the MEFP for details). Adjusted for these temporary measures,<sup>6</sup> which were fully reversed in January 2001, reserve money increased by an estimated 15 percent over the last twelve months, which suggests that the underlying monetary stance was substantially more expansionary than indicated by the actual end-December data (decrease of 2.1 percent) (Table 4). In January, broad money growth receded to the program path, while currency holdings remained substantially above the program path with a seven-month growth rate of 8.9 percent.

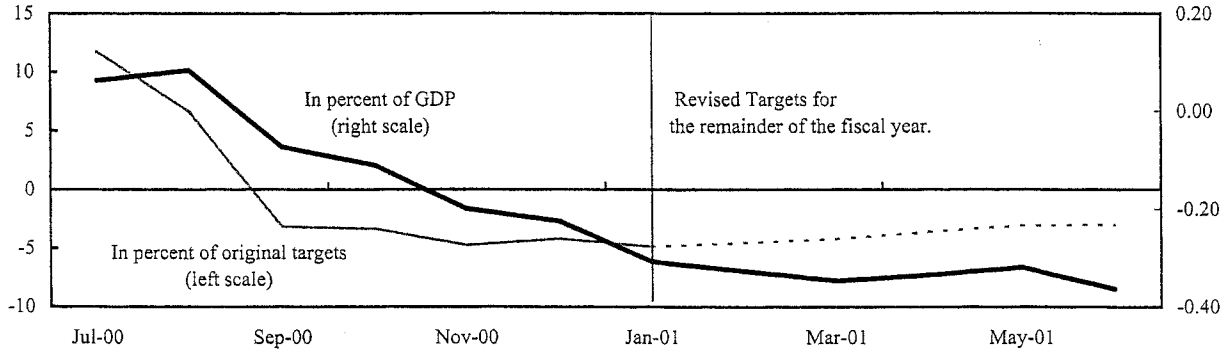
10. **The budget deficit was lower than programmed in the first half of 2000/01 despite shortfalls in CBR revenue** (Table 5). The consolidated government deficit amounted to 2.2 percent of annual GDP, 0.7 percentage points of GDP lower than programmed. Shortfalls in tax revenue were more than offset by stronger-than-expected expenditure restraint and, to a lesser extent, higher non-tax revenue. The target for CBR revenue for the first half of 2000/01 was missed by PRs 8 billion (5.2 percent of the target, or 0.2 percent of annual GDP), and the corresponding quantitative performance criterion for end-December 2000 was breached (Chart 5). Nevertheless, CBR revenue increased by 13.5 percent over the corresponding period of last year. Shortfalls arose mainly in sales and income tax receipts and reflected primarily persistent weaknesses in tax administration.

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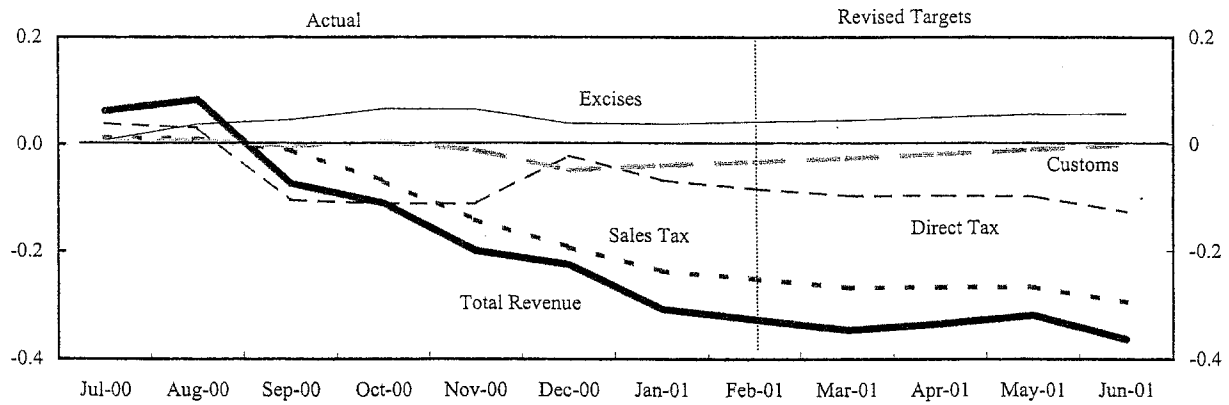
<sup>6</sup> The temporary measures included primarily the conversion of the rupee counterpart of rescheduled institutional nonresident foreign currency deposits (FCDs) held in special deposits at the SBP into one-month treasury bills (PRs 40 billion) and the reduction of the daily cash reserve requirement (CRR) in December from 4 percent to 3 percent and its subsequent waiver on December 30 (PRs 40 billions). In addition, when the weekly CRR was reduced from 7 to 5 percent on December 15, banks were encouraged to hold the released funds as special treasury bills (PRs 20 billions). This measure had, however, little impact on the banks, since these bills contributed to the Statutory Liquidity Requirement (SLR), which requires banks to hold at least 15 percent of their deposits in public sector securities. In the calculation of the adjusted reserve money stock, the PRs 80 billion reduction generated by the first two measures was added to the actual reserve money stock.

**Chart 5. Pakistan: Revenue Developments, 2000/2001**

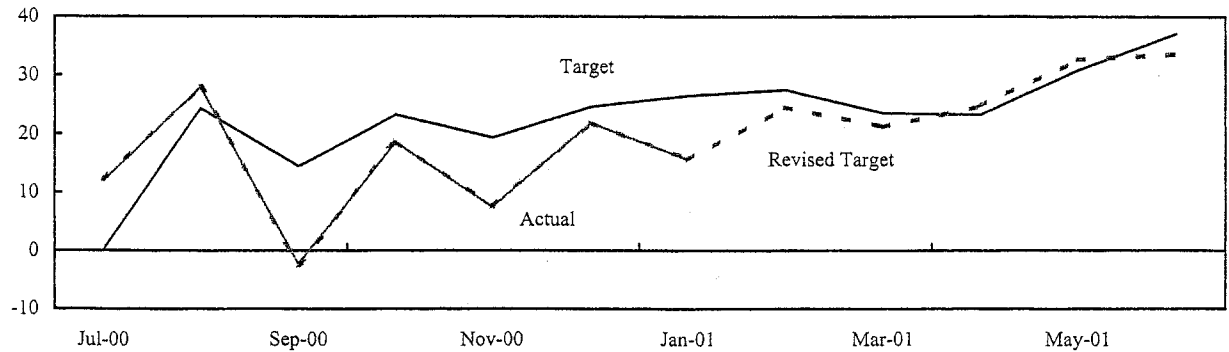
Total CBR Revenue Gap Against Original Target  
(Cumulation from July 1, 2000)



Contribution to Cumulative CBR Revenue Gap Against Original Target by Tax Category (In percent of GDP /1)



Total CBR Revenue  
(Year on year percentage change)



Source: Data provided by Pakistan Authorities.  
1/ Program GDP for 2000/2001 is 3543 PRs billion.

The diversion of staff resources from regular tax activities to the tax survey was a major problem in this regard, reducing audit capacity and adversely affecting collection enforcement.<sup>7</sup> In addition, sales tax revenue remained behind expectations because of lower-than-projected imports. After widening to PRs 11 billion in January 2001, the cumulative shortfall in CBR revenue stabilized in February.

11. **Total expenditure and net lending was nearly 1 percentage point of annual GDP lower than programmed**, despite the advance payment of January wages in December, because of the coincidence of end-Ramadan holidays with other official holidays. The savings on the expenditure side reflect lower current and capital spending at the provincial levels, which in turn was the result of deliberate expenditure restraint and better enforcement of accountability and governance standards (Appendix II). The latter also explains why, despite full release of budgeted appropriations at the beginning of the year, poverty-reducing expenditure fell short of program objectives by about PRs 13 billion (or 0.4 percent of annual GDP). Defense expenditure remained on track.<sup>8</sup>

12. **Structural reforms gained momentum in a number of areas, including governance, and structural benchmarks and performance criteria were met** (attached MEFP, Table 2), except for a short delay in adjusting petroleum prices in December, for which the government is requesting a waiver as explained in paragraph 7 of the attached MEFP. The 3½-year long tariff dispute between Hub Power Corporation (HUBCO) and the Water and Power Development Authority (WAPDA) was settled, the financial situation of WAPDA is slowly improving, and cross-arrears between WAPDA and the budget are being cleared. New medium- and long-term government bonds, the Pakistan Investment Bonds (PIB), were launched as scheduled. So far, about PRs 30 billion in 3–10-year bonds have been auctioned at yields ranging from 12.5 percent to 13.5 percent. The restructuring of the financial sector has continued with the ongoing closure of unprofitable branches of major nationalized commercial banks. The authorities' governance reform agenda is broadly on track (Appendix III). In particular, the drive to improve accounting, reconciliation and reporting of public finances continued, as detailed in paragraph 9 of the MEFP. Significant steps have been made in the area of civil service reform, including the enactment of an ordinance in November 2000 that limits political interference in hiring and promoting civil servants. However, progress in improving fiscal data quality and transparency at the provincial level has been slower than envisaged under the program.

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<sup>7</sup> Weaknesses in tax administration have been reflected in sharp increases in the amount of sales tax arrears and the number of sales tax nonfilers as well as in fewer completed audits.

<sup>8</sup> Close to PRs 20 billion of consolidated government expenditures (about 0.5 percent of GDP) in the first semester of 2000/01 have so far been classified as unidentified expenditure because they have not yet been fully reconciled. The authorities are of the view that these expenditures must fall mostly into the category of development spending, including transfers to the provinces. Current expenditures of the federal government (including defense) are fully reconciled and thus already correctly classified.

### III. REPORT ON THE DISCUSSIONS

13. The discussions covered developments thus far under the program, the somewhat weaker macroeconomic prospect for the remainder of 2000/01 and its implications for macroeconomic policies, the specification and modification of quantitative program targets, program monitoring issues, and a review of the structural policy agenda in collaboration with the World Bank. The authorities remain committed to implementing the structural reform agenda laid out in the original MEFP of November 4, 2000, which is a crucial part of their strategy to revive the economy and to address the many distortions that had impeded higher sustainable growth and contributed to a trend of growing poverty. Improving governance is one of the pillars of the agenda. Indeed, a large number of reforms throughout all sectors aim directly at, or contribute indirectly to, enhancing governance and transparency.

#### A. Macroeconomic Objectives and Policies for the Remainder of 2000/01

14. **Lower growth and shortfalls in external financing have weakened macroeconomic prospects for 2000/01.** Real value added in the agricultural sector is projected to increase by only 0.3 percent (compared with the 2.6 percent projected in September), as the drought conditions have intensified. Consequently, growth as measured by real GDP at factor cost is now forecast at 3.8 percent, compared with 4.5 percent as under the original program (Table 1). Inflation, as measured by the annual average change in the CPI, is now expected at 5 percent, 1 percent less than in the original projections, even after taking into account anticipated pressures on food prices, programmed increases in electricity and gas tariff rates, and some additional pass-through effects. With the envisaged policy mix as detailed below, the current account deficit for 2000/01 is still estimated at 1.6 percent of GDP. However, with the expected shortfall in external financing, the reserves target for end-June was reduced by about US\$100 million to US\$1.6 billion (equivalent to 6.6 weeks of imports).

15. **The fiscal policy stance is to remain broadly unchanged, but achieving the revised reserve targets will require the tightening of monetary policy even with further flexibility of the exchange rate.** The authorities agreed that the fiscal policy stance should remain essentially unchanged. However, reflecting developments in the first seven months of 2000/01, some revisions to targets for revenue and expenditure levels and composition were undertaken (see below). The March and June 2001 targets for SBP NDA were somewhat eased, because demand for currency is unlikely to revert in the near future to the levels that were programmed originally. Nevertheless, compared with the underlying monetary policy stance during October 2000 to February 2001, monetary policy will need to be tightened in the next few months, notably in support of the revised foreign exchange reserves targets.

16. **Fiscal revenue targets are reduced but remain appropriately ambitious.** The annual and quarterly targets for overall and CBR tax revenue were revised, since the cumulative revenue shortfall in the first seven months cannot realistically be expected to be reversed during the remainder of the fiscal year notwithstanding the determined short-term corrective actions, and considering the now somewhat lower annual growth rate for imports. For the fiscal year as a whole, the overall revenue target has been reduced by PRs 16 billion

(3.3 percent of original target or 0.5 percent of GDP), of which PRs 13 billion is on account of CBR revenue. Nevertheless, the revised targets remain appropriately ambitious, implying improvements in overall tax revenue of 16 percent and in CBR revenue of 20 percent over the last year. To avoid further shortfalls, the government has adopted and started to implement a short-term action plan for improving tax administration prepared with FAD technical assistance (see attachment to the MEFP). Important elements of the plan include measures to ensure more rigorous and timely enforcement of action on the stock of tax arrears and reported sales tax nonfilers, with emphasis on the largest defaulters; intensification of sales tax audit activity through resource redeployment and improved auditor productivity; imposition of penalties for nonfiling and late payment significantly above market interest rates; and a public commitment by the government to no further amnesty-type arrangements. In view of the remedial measures that have been put in place to prevent further slippages in CBR revenue performance and the expenditure control measures that are being implemented to ensure the achievement of the original budget deficit target, the government requests a waiver for the nonobservance of the end-December 2000 performance criterion and modification of the end-March 2001 performance criterion on CBR revenue.

17. **In tandem with revenue objectives, the target for total expenditure has been reduced by PRs 15 billion.** The reduction will be achieved primarily through cuts in low-priority development spending, lower net lending due to the higher-than-expected repayments of government loans by the Oil and Gas Development Corporation (OGDC), and improved financial control. Cuts in the public sector development program (PSDP) will reduce primarily expenditure on low-priority projects, including of the National Highway Authority, Pakistan Railways, and WAPDA. The containment of expenditures will also be facilitated by the package of measures to strengthen WAPDA's finances (discussed below). The objective of increasing social and poverty-related spending by at least 0.4 percent of GDP remains unchanged.

18. **Adjusted monetary targets aim at accommodating higher-than-initially-expected currency demand and supporting the targets for the accumulation of reserves.** The authorities and the mission agreed that the original March and June targets for the SBP's NDA would be excessively tight since the demand for currency was unlikely to revert to trend levels in the near future. The authorities argued that the above trend expansion of currency holdings since early 2000 has proved to be more permanent than expected and that this money demand shock should be largely accommodated in an environment of low inflation. They also argued that the special factors underlying the above-trend expansion of currency demand are likely to have reduced its interest sensitivity. The mission maintained that the underlying monetary policy stance had been insufficiently tight in view of the low levels of available foreign reserves, nominal interest rates should have been increased more aggressively to signal a more restrictive stance and prevent foreign exchange outflows, and that monetary policy would need to be more supportive of the external sector targets. The monetary policy stance implied by the proposed revisions of the NDA targets strikes a balance between the concerns of the authorities and of the mission. Reserve money growth on a year-on-year basis is now programmed to slow to 9.7 percent by end-March 2001 and 5.5 percent by end-June 2001.



Compared to the current stance, these targets require a gradual tightening of the monetary policy stance in the next few months. The three-month treasury bill rate was increased by 50 basis points on February 21, and a further increase is expected soon. In light of the above considerations and commitments, the government requests a modification of the March performance criterion on the NDA of the SBP.

19. **Risks of instability in key monetary policy parameters remain high.** The authorities recognize that in view of the risks of further unexpected shifts in the cash to deposit ratio, the money multiplier and market sentiments, vigilance is needed to ensure that the monetary policy stance remains sufficiently tight to achieve the reserves target and to keep inflation under control. They are also committed to relying on indirect instruments of monetary policy to achieve the monetary targets and to refrain from using the weekly and daily CRRs as a day-to-day instrument to affect monetary conditions.<sup>9</sup>

20. **Move toward a market-based exchange rate system to achieve the external sector objectives will continue.** The authorities reiterated their commitment to continue the passage to more exchange rate flexibility. To sustain the momentum during the remainder of the fiscal year, the SBP will stop providing foreign exchange to the interbank market to finance petroleum imports, and limit its interventions to smoothing out the temporary effects of bulky transactions in the thin interbank market, while reducing its total purchases in the kerb market in 2000/01.<sup>10</sup> The targeted build up in reserves by end-June reflects largely the expected disbursements from International Financial Institutions in the second half of 2000/01, amounting to about US\$875 million. Nevertheless, a careful coordination of foreign exchange interventions with monetary policy would be essential to prevent unsettled conditions in the foreign exchange market. Indeed, with the recent increase in interest rates, official reserves were built up to US\$660 million by mid-March.

## **B. Structural Reforms and Social Policies**

21. **Measures are being put in place to strengthen the tax buoyancy and tax administration.** The authorities feel that the tax survey has been successful in many respects, in particular by extending the tax net to many new taxpayers, including a number of large taxpayers. They acknowledged, however, that the payoff in terms of revenue has so far fallen short of expectations and that regular tax administration activities have suffered. In the circumstances, the aforementioned short-term action plan to improve tax administration has been adopted and is being implemented. At the same time, progress on the fundamental reform of the CBR and its operations has remained somewhat behind expectations. The task

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<sup>9</sup> An automatic adjustor has been added to the programmed NDA target to take into account any change in the base or in the rate of the CRR.

<sup>10</sup> The authorities reiterated that all legitimate current account transactions were allowed to go through the interbank market.

force on tax administration has delayed the submission of its report to the government until end-March 2001 because of technical reasons and some resistance from the CBR to the reform effort. However, the government remains committed to a strategy that will start restructuring the CBR with the next budget. The planned reforms of the General Sales Tax (GST) and the income tax are on track. The GST will be extended to pesticides and urea fertilizers on March 31, 2001 and to all remaining agricultural inputs by September 1, 2001. The government has publicly reiterated its intention to make GST compulsory at the retail level (for turnovers exceeding PRs 5 million) as planned on July 1, 2001; a campaign to prepare retailers for the associated filing and documentation requirements is underway. Preparations for the overhaul of the income tax have advanced; the report of the relevant committee and a draft law will be submitted to the cabinet by end-March 2001. The new law is to be promulgated with the next budget. Progress on the agricultural income tax has been slower than expected, as rules and regulations that would allow for the collection in 2001/02 of taxes on agricultural income earned this year have not yet been finalized by the provinces.

22. **Role of market-based pricing in the energy sector is enhanced.** With regard to public enterprises, the focus now is on steps to improve the financial situation of major enterprises through further moves toward market-based pricing policies, greater efficiency through labor shedding and reduction in subsidization and cross-subsidization, and settlement of arrears. To pave the way for privatization and foreign direct investment in the production and distribution of natural gas, the authorities have decided first to achieve and then to maintain parity of gas prices with world market prices through biannual adjustments. A first adjustment of 14.4 percent was implemented in mid-March 2001. More generally, the process of deregulation of the energy sector is continuing. The authorities have decided to deregulate the import of high speed diesel fuel from April 2001 and to start with the gradual dismantling of the residual freight pool for petroleum products.

23. **Resolution of disputes with Independent Power Producers (IPPs) requires urgent measures to address the financial implications for WAPDA.**<sup>11</sup> Following the settlement of all tariff disputes with IPPs, WAPDA has to absorb an increase in payments to IPPs (fixed capacity charges and electricity purchases) of about PRs 15 billion compared with the path of payments implied by the court orders issued during the dispute (Table 6). As the revised capacity charges remain frontloaded, the authorities intend to mobilize the needed financial resources with a combination of measures rather than through tariff adjustments alone. Nevertheless, tariff adjustments remain important for WAPDA's medium-term financial viability, and the independent National Electric Power Regulatory Authority (NEPRA) is expected to authorize WAPDA to raise its tariffs by at least an additional 4.5 percent in March 2001, in addition to the 4.9 percent rise that became effective in January 1, 2001. The increase would be effected in conjunction with a rationalization of its tariff structure and the

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<sup>11</sup> While measures in the energy sector fall outside the Fund's core areas of responsibility, they are included as part of structural conditionality under the program because of their critical importance in achieving the macroeconomic objectives of the program.

introduction of an automatic fuel price adjustment clause in electricity tariffs. Other measures include the rationalization of WAPDA's operational and development expenditure. Agreement has now been reached between WAPDA and Sindh on the settlement of PRs 6.7 billion of overdue receivables. The federal government will continue to ensure that federal agencies and provinces remain current on their electricity bills, including if needed through deduction at source from the provincial share in tax revenues. These measures should allow WAPDA to remain current on its remaining debt service payments and its obligations toward the IPPs and other suppliers.

**24. The restructuring program for the Karachi Electricity Supply Corporation (KESC) was launched in December 2000 as scheduled.** The financial situation of KESC remains of even greater concern. A financial and technical restructuring operation supported by the AsDB aims to turn around KESC's financial position and prepare it for privatization by end-2002. As an important step, KESC will implement an increase in the average tariff of 9.5 percent by end-March 2001. While KESC will need nonetheless exceptional financing for its projected cash shortfalls, borrowing from the banking system for FY 2001 will be limited to PRs 7.5 billion.

**25. Financial sector reforms are on track.** The planned overhaul of the National Saving Scheme (NSS) is underway. Following the linking of interest rates on Defense Certificates to market rates, beginning July 1, 2001 interest rates on all other NSS instruments will also be market-based, and the tax-exempt status for new NSS instruments will be removed. All subsidies under the existing export finance scheme (EFS) will be eliminated by mid-2001. Consistent with this objective, the SBP raised the interest rate for the EFS by 1 percentage point to 9 percent in January 2001, and will raise it further in April 2001. The authorities intend to accelerate their drive to strengthen the financial soundness of the banking system, especially the major nationalized commercial banks, and promote competition between banks. In addition to the ongoing operations, which include the closure of nonprofitable branches in the rural sector and efforts to recover nonperforming loans, the government is discussing World Bank support for plans involving major labor shedding of the nationalized commercial banks and the liquidation or merger of a number of development financial institutions. However, a substantial recapitalization of some of these nationalized banks will be needed before their envisaged privatization. To support their effort in developing a sound and effective financial system and assess remaining weaknesses, the authorities reiterated their request for participation in the Financial Sector Assessment Program (FSAP) as early as possible. The restriction on commercial banks' placement abroad of the funds associated with the mobilization of new foreign currency deposits (FE25s) will be withdrawn effective April 1, 2001 and prudential norms will be put in place to ensure their safety (MEFP, paragraph 24). To deepen the interbank market, nostro limits on banks' balances held abroad on account of trading activities would be relaxed around mid-2001.

**26. Preparations for the transition to a financial system based on Islamic principles are underway.** In December 1999, the Supreme Court of Pakistan set end-June 2001 as the deadline for transformation of the country's financial system to one which complies with

Islamic finance principles, as is necessary in order to be consistent with the Constitution. Reasonable progress has been achieved by the authorities in preparing the legal and accounting frameworks needed in the new system. Several small Islamic banks have been in existence for some time so that bank supervisors, for example, have familiarity with the underlying concepts and the implications for bank supervision. In some important areas, however, including the design of specific financial instruments, advancement has been slow. Little has been done so far on developing a plan with the conventional banks of how to implement the transformation of their activities. Fund technical assistance missions have stressed to the authorities that the transformation should only be done in a careful and orderly manner. The Government has announced that foreign public debt will continue to be raised using conventional instruments and existing foreign debt will not be affected by the transformation of the financial system.

**27. The SBP should in principle be able to continue to operate monetary policy in the new system in much the same way as at present.** Much of the work to date on the transformation has focused on the introduction of an initial government funding instrument that satisfies Islamic principles. If such an instrument could be launched successfully, it would support most of the same monetary operations that the SBP currently undertakes, with the exception that repos would almost certainly not be permissible as they incorporate a predetermined yield. Outright purchases and sales on an interbank market at market determined prices would, however, be possible and should enable the SBP to manage banking system liquidity.

**28. The government remains committed to the trade liberalization measures to be implemented with the 2001/02 budget.** The maximum tariff will be reduced to 30 percent; the number of tariff slabs will be reduced to four; the differential excises on imported and domestically produced goods will be eliminated; and all remaining regulatory duties will be allowed to lapse. Quantitative import restrictions maintained for balance of payments reasons will be phased out by end-June 2002 according to a schedule agreed to with the WTO Committee on Balance of Payments Restrictions in November 2000. In December 2000, Pakistan removed import restrictions on a number of textile products, complying with the terms of the revised phase-out schedule, as well as on a number of other products well ahead of the phase-out schedule. In December 2000, the anti-dumping duties law according to WTO guidelines and a patent law were promulgated, which will greatly contribute to strengthening the legal framework of Pakistan's trade policy.

**29. The authorities' strategy to improve governance is based on reforms in five areas:** (a) devolution of power to the local levels; (b) civil service reform; (c) improved fiscal and financial transparency; (d) the fight against corruption; and (e) legal reforms. The first three areas focus on improving the management of the public resources and are incorporated in the Fund-supported program. Progress so far in these three areas is encouraging and the authorities are committed to implementing the next steps as programmed (Appendix III). However, as discussed in detail in Appendix II, much work remains to be done in the preparation of the fiscal devolution initiative.

30. **Other structural reforms also contribute to improving governance.** Elements of the structural reform program in the tax, energy, financial sector, and trade areas have also positive implications for governance in Pakistan. These reforms will contribute to the development of a transparent and predictable economic and regulatory environment that would establish a level playing field for private economic activities, bring back confidence in the economy and further stimulate the return of private capital to Pakistan. In the tax and customs reform area, this is being achieved through measures that simplify the present system, and broaden the tax base in a fair and transparent manner. In the energy sector, the objective is to fully liberalize energy imports and prices, while privatizing or restructuring public enterprises in the energy sector, under the supervision of transparent and autonomous regulatory bodies. Several significant steps have already been taken as described above. In the financial sector, progress is being made in the area of deregulation, restructuring of the state-owned financial institutions, as well as in the area of the financial transparency and accountability of the SBP. Considerable progress has been made in implementing remedies to mitigate the vulnerabilities identified in the Stage-Two Safeguards Assessment report, including the completion of the two prior actions to be taken before the first review under the Stand-By Arrangement (Appendix IV). The deregulation includes the elimination of all subsidies under an export-financed scheme by end-June 2001 (which has been reportedly misused to finance working capital needs for many enterprises). The forthcoming FSAP mission will provide key inputs to improve the financial standards and codes and other policies to encourage financial transparency and accountability of the financial system.

#### IV. BALANCE OF PAYMENTS OUTLOOK AND EXTERNAL FINANCING ISSUES

31. **The projected external current account deficit for 2000/01 remains as programmed despite a deterioration in the terms of trade.** The structure of the underlying flows is, however, expected to change. A lower trade deficit and somewhat higher workers' remittances should offset higher-than-expected service payments on account of larger profit repatriation by foreign-owned companies. The projected growth rate of exports in value terms has been lowered, as unit values are expected to remain below originally projected values with the anticipated slowdown in the world economy. Export volumes, however, are expected to evolve as projected under the program. The growth of import values during the remainder of 2000/01 is forecast to slow down on account of lower oil prices, leading to a significant reduction in import values on an annual basis compared with earlier projections.

32. **External financing from debt rescheduling is on track but shortfalls in program financing are expected in 2000/01 (Table 7).** The Paris Club creditors agreed to reschedule Pakistan's medium- and long-term debt covering arrears current maturities through September 2001 on loans contracted before end-September 1997 (Appendix V). The debt relief provided by the Paris Club is in line with that assumed under the program. The authorities will proceed expeditiously with the bilateral negotiations with Paris Club and other bilateral creditors. As expected, representatives of institutional FCD holders agreed to rollover 75 percent of their US\$1.1 billion deposits until end 2001/02, while US\$900 million in deposits (of private and official sector depositors) either with the SBP or the National Bank of

Pakistan have also been rolled over on existing terms and conditions.<sup>12</sup> The authorities will implement in a timely manner all agreed-upon measures required for disbursements by the AsDB of several program loans and by the World Bank of the structural adjustment credit as envisaged under the program. However, disbursements from the AsDB will be about US\$125 million less than envisaged in the original program, mainly due to delays in the processing of the Agricultural Program Loan, which is now expected to be disbursed in the first half of 2001/02. On the basis of the revised current account projections and taking into account the above-described financing elements, the targeted level of reserve at end-June 2001 would fall slightly short of the program objective, as noted above.

**33. The medium-term projections of the balance of payments remain broadly unchanged.** The external current account is projected to improve to a quasi-balanced position by 2003/04. Export volumes are projected to grow at 8 percent a year, slightly more than import volumes (7 percent), while terms of trade are projected to improve by about 2 percent each year, starting next year, reflecting the expected decline in crude oil prices. Pakistan is expected to benefit from moderately increasing net inflows of public and private capital over the medium term, following the implementations of the reforms under the program and the building-up of confidence. The financing gap remains broadly the same for the projection period (US\$2 billion in 2001/02 to 1.4 billion in 2003/04), and will have to be closed by continued financial support from multilateral and bilateral sources, as well as additional debt rescheduling from official and private creditors. The external debt is projected to decline from the current level of 245 percent of exports of goods and services to 209 percent by end-2003/04 (Table 8).

**34. The staff continues to believe that under the envisaged policies Pakistan should not encounter difficulties with respect to its capacity to repay the Fund.** Assuming that all purchases under the Stand By arrangement are made, Pakistan's liabilities to the Fund would represent a maximum of 5.2 percent of total public and publicly guaranteed debt and less than 13 percent of projected exports (Tables 9 and 10). Debt service obligations would remain below 3 percent of exports during the repayment period and would only barely exceed 15 percent of gross official reserves after 2000/01.

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<sup>12</sup> Representatives of institutional foreign currency deposits holders have agreed to rollover 75 percent of their deposits for a period of two years. The institutional holders will be free to repatriate 25 percent of their deposits, and the remaining amount will be rolled over for a period of two years with initial rollover for a period of one year from the date of their respective maturities or March 31, 2001, whichever is earlier. A further 25 percent will be repatriable at the expiry of the first rollover and the balance will be rolled over on the same conditions for an additional year, after which the remaining balance will be fully repatriable. Interest on rolled over deposits (Libor plus 1 percent a year) will be paid on a quarterly basis. US\$500 million from the Bank of China deposits with the National Bank of Pakistan will be rolled over on a six-month basis at interest rates ranging between 8.1 and 8.9 percent a year; US\$150 million from U.A.E. deposit with the SBP will be rolled over on a quarterly basis until December 28, 2002 at interest rate of 7.29 percent a year; and a US\$250 million Kuwait Investment Authority deposit with the SBP will be rolled over on a 6-month basis until August 3, 2002 at an interest rate of 4 percent a year.

## V. PROGRAM MONITORING AND DESIGN

35. New elements in program monitoring and design were introduced and modifications to two quantitative performance criteria for end-March are proposed. The attached MEFP sets the quantitative performance criteria for end-June 2001. As discussed above, the authorities are also requesting the modification of the quantitative performance criteria on the NDA of the SBP and CBR revenue for end-March. Following the completion of the Stage-two Safeguards Assessment, four remedial measures agreed upon by the authorities and staff were added to the list of structural performance criteria and benchmarks. The MEFP also specifies prior actions (Table 3 of the MEFP), all of which are essential for achieving the macroeconomic objectives of the program or for ensuring adequate safeguards for the use of Fund resources. With the exception of those related to the tariff increases by WAPDA and KESC, which need to be effected prior to the Executive Board meeting, all prior actions were implemented before the issuance of this report. Regarding program design, two new adjustors were added to performance criteria. The first adjustor corrects the NFA of the SBP for assets related to counterpart funds of FE25 foreign currency deposits because they do not constitute usable reserves. The second adjustor would correct the NDA of the SBP for any changes in rates and regulations concerning the daily CRR for deposit liabilities of commercial banks to ensure that changes in the daily CRR should not be used for short-term monetary policy purposes.

## VI. STAFF APPRAISAL

36. The program approved in November 2000 aimed at stabilizing the macroeconomic situation while the authorities pressed ahead with structural reforms to enhance the economy's growth potential and reduce poverty over the longer term in the context of an overall strategy to improve governance. The achievements so far have been encouraging regarding export volumes, the external current account deficit, the fiscal deficit, and inflation, all of which fared well compared with program targets. However, the revenue targets were not achieved reflecting mainly weaknesses in tax administration, and agricultural output was adversely affected by below average rainfall. Following the insufficiently tight monetary policy, foreign exchange reserves came under pressure in January and February. Progress in the implementation of structural reforms was as envisaged under the program, except for the delay in petroleum price adjustments by two weeks in December because of Ramadan. All quantitative performance criteria except for that on CBR revenue were met at end-December.

37. Despite these favorable developments, the macroeconomic situation remains difficult and structural weaknesses persist. Achieving the program targets in the near future, especially with regard to foreign exchange reserves, will be challenging. In this regard, the build up in reserves in March is encouraging. Sustained implementation of strong demand management policies and steadfast adherence to the structural reform agenda will be essential to consolidate the achievements so far and build a solid foundation for sustainable high rates of growth over the medium-term.

38. Given the low level of reserves, careful coordination of monetary and exchange rate policies will be critical for the success of the stabilization program in the short-term. The

authorities are committed to continue to move to a genuinely flexible exchange rate policy. In this regard, the staff welcomes the intention of the authorities to discontinue the sale of foreign exchange to the interbank market to finance oil imports, reduce gradually purchases in the kerb market, and implement measures to develop the interbank market.

39. Although the demand for money during the first half of 2000/01 turned out to be higher than programmed, a risk that was acknowledged in the last staff report, the NDA target under the program was met, albeit by unorthodox measures. However, the underlying monetary policy stance was more expansionary than warranted given the fragile balance of payments situation. The revised monetary program takes into account the more permanent nature of high demand for rupee cash and allows for a more gradual deceleration of reserve money growth compared with the original program. Nevertheless, it would imply a significant tightening compared with the underlying monetary policy during the period through end-January. The revised stance of monetary policy, including the recent increases in interest rates, should help keep inflation under control and achieve the reserve targets, while preventing undue pressures on the exchange rate. Nevertheless, given the uncertainties with regard to rupee cash demand, the authorities need to monitor monetary developments closely and stand ready to adjust the policy stance, through appropriate adjustments in interest rates and open market operations, to ensure that it remains appropriately tight.

40. The overall budget deficit target remains as originally programmed, with lower tax revenues compensated by lower expenditures. The fiscal stance is appropriate, particularly in light of the high debt burden and still fragile balance of payments situation. The revised revenue targets, while ambitious, are realistic, and their achievement will require the pursuit of resolute action to broaden the tax base, and strengthen further tax enforcement and collection. The staff welcomes the action plan for the CBR revenues that has been adopted by the authorities. This needs to be steadfastly implemented. The expenditure target will be achieved primarily through cuts in low-priority development spending, improved financial control, and the package of measures to strengthen WAPDA's finances. The shortfall in poverty-reducing expenditure during the first half of 2000/01 is of concern, despite the widely shared view that these shortfalls may not have adversely affected the delivery of social and other services to the poor because of improved accountability and governance. The targeted increase in such spending for the fiscal year as a whole remains unchanged. To this end, the federal Ministry of Finance will continue to release expenditure appropriations for poverty-reducing spending fully, and to encourage the provincial governments to achieve the targeted increases and improve service delivery, especially to the poor.

41. In light of the challenges associated with the fiscal outlook, in particular the need to increase tax revenue, the staff welcomes the commitment of the authorities to move forward with tax reforms as envisaged under the original program. In this regard, the extension of GST to the retail sector and agricultural inputs, the overhaul of the income tax, and the reform of the tax administration are crucial. The staff welcomes the faster-than-expected progress in the preparation of the income tax reform. At the same time, the staff urges the authorities to intensify efforts with the objective to make the agricultural income tax fully operational as



soon as possible, and to complete the work of the task force on tax administration with a view to having a medium-term tax administration reform ready for implementation at the beginning of the next fiscal year.

42. The authorities should be commended for resolving the disputes with IPPs, the steps being undertaken towards improving the financial position of WAPDA and KESC, and more broadly for having launched the process of deregulation of the energy sector. These efforts should allow WAPDA to remain current on its debt service obligations, help turn around KESC's financial position and prepare its privatization, and increase the efficiency in the energy sector. In view of the substantial impact of WAPDA's and KESC's finances on public sector finances and the viability of the financial program, prior actions have been specified for completion of this review related to their tariff increases. The staff urges the authorities to move forward expeditiously with the restructuring program and other energy sector related reforms.

43. In the financial sector, although important progress has been made with regard to national savings and export finance schemes, much remains to be done to strengthen the financial soundness and efficiency of the banking system, especially the major nationalized banks. The staff welcomes the intention of the authorities to continue with the closure of nonprofitable bank branches and the recovery of nonperforming loans. The authorities are discussing World Bank support for the further restructuring of nationalized banks, which will involve major labor shedding and the liquidation or merger of a number of development financial institutions. The costs of the restructuring will need to be carefully assessed and fully reflected in next year's budget.

44. Improving governance is one of the pillars of the authorities' reform agenda. In this regard, important measures are being implemented to improve the management of public resources and to support the development of a transparent economic and regulatory environment conducive to efficient private sector activities. In addition to tax, energy, financial, and trade reforms, efforts in improving governance include devolution of power to local levels and enhancing fiscal and financial transparency. The devolution plan, while aiming at better accountability and delivery of services, poses a number of challenges and risks for fiscal management. In the circumstances, staff recommends rapid progress in preparatory work, in particular in specifying the pace and scope of devolving expenditure and tax assignments, devising a new revenue sharing formula, and enhancing the administrative capacity of district administrations.

45. Important progress has been made over the past year in addressing data-related issues. However, progress has been somewhat slower than anticipated in accounts reconciliation and reporting at the provincial level, which will become increasingly important with the devolution of tasks to district levels. The staff welcomes the strong commitment of the authorities to improving the quality, timeliness, and reporting of public finance data and recommends that efforts be accelerated to address data issues at provincial levels so as not to complicate the ability to monitor developments under the program.

46. As envisaged under the program, the authorities reached agreements for the rollover of FCDs of institutional investors as well as deposits at the SBP and NBP. The staff encourages the authorities to move forward expeditiously in concluding bilateral agreements with Paris Club creditors and seek comparable treatment from all other bilateral creditors. The staff also encourages the authorities to implement the structural reforms without delay to enable the AsDB and the World Bank to disburse related program financing. On the basis of the financing elements secured so far, the staff recommends the completion of the first quarterly financing review.

47. There are significant risks to achieving the program objectives. The deceleration in agricultural growth and its implications for economic activity could be more severe than projected. Exports could be more adversely affected than currently envisaged by the slowdown in the U.S. economy. The targeted increase in revenues might not be realized due to continued weaknesses in tax administration. The budget continues to remain prone to shortfalls in external financing during the remainder of the fiscal year. Furthermore, the envisaged buildup in foreign exchange reserves during the remainder of the year is substantial and will require cessation of provision of foreign exchange to the interbank market supported by a tightening of the monetary stance by the SBP. Despite these risks, the staff believes that Pakistan merits continued Fund support in view of the progress made so far in policy implementation, the tariff increases by WAPDA and KESC that will be implemented prior to the Executive Board meeting, and the authorities' continued commitment to strengthen the financial situation and broaden structural reforms. Accordingly, the staff recommends the completion of the first review under the Stand-By Arrangement and waivers for nonobservance of the end-December 2000 performance criterion related to CBR revenue and the structural performance criterion related to the December 2000 petroleum price adjustment. The staff also recommends the approval of the modifications of end-March 2001 performance criteria related to CBR revenue and the NDA of the SBP.

Table 1. Pakistan: Macroeconomic Framework, 1995/96–2003/04 (continued)

	1995/96	1996/97	1997/98	Prel. 1998/99	Est. 1999/00	2000/01		Proj.		
						Prog.	Rev. Prog.	2001/02	2002/03	2003/04
(Annual changes in percent)										
<b>Output and prices</b>										
Real GDP at factor costs	6.6	1.7	3.5	3.1	4.8	4.5	3.8	4.5	5.5	6.0
Partner country demand	3.8	3.8	2.3	2.0	3.8	3.8	4.0	3.5	3.6	3.5
Consumer prices (p.a.)	10.8	11.8	7.8	5.7	3.6	6.0	5.0	4.8	4.5	3.9
GDP deflator (factor costs)	8.2	13.5	7.7	5.9	3.2	6.0	5.7	4.8	4.5	3.9
Partner country consumer prices 1/	3.7	-3.3	-4.5	-0.7	0.1	1.4	-1.3	0.8	1.3	1.3
Import prices 1/ 2/	4.6	-2.3	-7.4	-2.5	7.6	1.7	3.0	-1.6	-0.1	0.8
Rupees per U.S. dollar (p.a.)	8.8	16.2	10.7	17.0	3.2	11.7	11.7	7.6	6.5	4.9
(In percent of GDP)										
<b>Savings and investment</b>										
Gross national savings	11.8	12.3	15.0	11.2	13.3	13.9	13.9	14.9	16.3	17.4
Public 3/	-0.5	-2.1	-2.6	-1.1	-2.1	-0.5	-1.0	0.2	1.2	2.3
Private	12.3	14.4	17.7	12.3	15.4	14.3	14.9	14.8	15.1	15.1
Gross capital formation	19.0	18.0	17.7	15.0	15.0	15.5	15.5	16.2	16.9	17.5
Public 3/	8.3	6.1	5.6	5.0	4.3	4.7	4.5	4.7	4.9	5.2
Private	10.8	11.9	12.2	9.9	10.7	10.8	11.0	11.5	12.0	12.3
Savings-investment balances	-7.2	-5.7	-2.7	-3.8	-1.6	-1.6	-1.6	-1.3	-0.6	-0.1
Public 3/	-8.8	-8.2	-8.2	-6.1	-6.5	-5.2	-5.5	-4.5	-3.7	-2.9
Private	1.6	2.5	5.5	2.4	4.9	3.5	3.8	3.3	3.1	2.8
<b>Public finances</b>										
Budgetary revenue	17.5	16.1	15.8	16.3	16.5	16.5	16.3	17.6	18.2	18.6
Budgetary expenditure	25.3	22.9	23.5	22.4	22.9	21.8	21.5	22.0	21.8	21.7
Budgetary balance	-7.8	-6.8	-7.7	-6.1	-6.4	-5.2	-5.3	-4.4	-3.6	-3.0
Primary balance	-1.7	-0.3	-0.3	1.3	1.2	1.5	1.5	2.5	2.9	3.3
Net public debt	86.3	87.5	89.4	91.9	91.6	93.8	94.3	94.0	92.0	88.7
Net domestic public debt	43.2	43.6	46.0	44.3	45.9	42.8	43.5	42.2	39.8	37.0
Implicit interest rate on public debt (percent) 4/	8.1	8.6	9.2	8.9	9.2	8.2	8.1	7.5	7.1	6.5
In real terms (growth-adjusted) 4/	-5.5	-5.9	-1.0	0.1	0.0	-3.1	-2.2	-2.1	-3.1	-3.7
<b>Monetary sector</b>										
(Annual changes in percent of initial stock of broad money)										
Net foreign assets	-4.9	-2.5	-2.7	1.6	1.5	5.6	4.0	...	...	...
Net domestic assets	18.7	14.7	17.3	4.5	7.8	5.7	6.3	...	...	...
Of which:										
credit to the private sector	7.6	7.3	8.1	8.5	1.4	5.9	6.6	...	...	...
Of which:										
net credit to government	6.0	7.5	4.5	-3.9	3.1	-1.2	-1.0	...	...	...
Broad money	13.8	12.2	14.5	6.2	9.4	11.3	10.3	...	...	...
6-month treasury bill rate (in percent, p.a.) 5/	12.8	15.6	15.1	12.5	8.8	...	...	...	...	...
Inflation-adjusted (in percent; p.a.) 6/	2.0	3.8	7.3	6.8	5.3	...	...	...	...	...

Table 1. Pakistan: Macroeconomic Framework, 1995/96–2003/04 (continued)

	1995/96	1996/97	1997/98	Prel.	Est.	2000/01		Proj.		
				1998/99	1999/00	Prog.	Rev. Prog.	2001/02	2002/03	2003/04
(In percent of GDP)										
<b>External sector</b>										
Merchandise trade balance	-5.8	-5.0	-3.0	-3.6	-2.3	-1.8	-1.7	-1.3	-0.7	-0.1
Merchandise exports	13.1	12.9	13.5	12.9	13.3	15.3	15.0	16.2	17.3	18.2
Merchandise imports	18.9	17.9	16.5	16.5	15.6	17.1	16.7	17.5	18.0	18.3
Current account excluding official transfers	-7.6	-6.1	-3.1	-4.1	-1.9	-1.8	-1.8	-1.5	-0.9	-0.4
Current account including official transfers	-7.2	-5.7	-2.7	-3.8	-1.6	-1.6	-1.6	-1.3	-0.6	-0.1
(In percent of current foreign exchange receipts 7/)										
Total public and private external debt	279.9	280.1	270.2	323.1	281.6	266.2	267.4	256.3	240.1	223.8
Actual debt service 8/	44.6	56.4	55.8	43.7	35.2	28.9	28.6	27.9	25.4	25.2
Implicit interest rate (in percent) 9/	5.3	5.3	5.2	4.2	4.8	5.1	5.0	4.9	4.6	4.6
In real terms (growth-adjusted) 9/	2.5	2.5	1.5	20.0	-8.6	-4.6	-2.4	-2.3	-3.1	-3.1
Gross reserves (millions of U.S. dollars) 10/	2,053	1,141	932	1,672	916	1,740	1,636	2,088	2,688	3,478
In weeks of next years' imports (G&S)	7.4	4.4	3.9	7.8	4.2	7.3	6.6	8.0	9.7	11.9
In percent of short-term external debt 11/	22.7	11.9	9.6	35.2	19.4	71.6	62.1	65.8	85.4	116.3
In percent of broad money	6.7	3.8	3.4	5.8	3.4	6.4	6.3	...	...	...
<b>Memorandum items:</b>										
Real effective exchange rate (percentage change)	-0.5	-0.9	3.6	-9.1	-0.5	-7.1	-5.4	-3.0	-3.0	-2.0
Terms of trade (percentage change)	-7.3	0.3	6.0	4.1	-9.5	-2.1	-3.0	1.9	2.4	1.8
Real per-capita consumption (percentage change)	2.2	1.9	-3.0	5.2	0.9	2.0	2.0	1.1	1.7	2.2
GDP at market prices (PRs billion)	2,120	2,428	2,678	2,914	3,182	3,543	3,510	3,844	4,237	4,668

Sources: Pakistan authorities; IMF, World Economic Outlook; and Fund staff calculations.

1/ In U.S. dollar terms, import-based weights.

2/ Unit value deflators for exports of goods and services of partner countries.

3/ Includes public sector enterprises throughout the projection period even though some of them may be (partially) privatized.

4/ The implicit interest rate on public debt is calculated as interest payments in percent of the end-of-period debt stock of the previous year. The growth-adjusted real interest rate is the implicit interest rate minus the nominal GDP growth rate.

5/ In July 1996, 6-month treasury bills were replaced by 6-month short-term federal bonds.

6/ Nominal rate minus average annual inflation rate as measured by the CPI.

7/ Defined as sum of receipts from exports of merchandise and services exports, and from private transfers.

8/ Scheduled debt service minus rescheduled debt service plus debt service on previously rescheduled debt.

9/ The implicit interest rate on external public debt is calculated as interest payments in percent of the end-of-period debt stock of the previous year. The growth-adjusted real interest rate is based on the growth rate of current foreign exchange receipts.

10/ Excluding gold, and foreign assets relating to foreign currency deposits contracted after May 1998 (FE25s), and short-term foreign exchange swaps and forward contracts.

11/ Short-term external debt includes public and private short-term at original maturity plus actual amortization payments on public medium- and long-term debt of the following year (including payments on debt that was rescheduled earlier). Rescheduled public short-term debt at original maturity is excluded from 1999/2000 onward, rescheduled private short-term debt at original maturity from 1998/99.

Table 2. Pakistan: Medium-term Balance of Payments, 1998/99–2003/04 (concluded)

	1998/9	1999/200	Jul-Dec	Jul-Dec	Prog.	Rev. Prog.	Rev. Proj.		
			Prog.	Est.			2000/01	2001/02	2002/03
(In millions of U.S. dollars)									
<b>Current account balance</b>	<b>-2,236</b>	<b>-1,006</b>	<b>-1,046</b>	<b>-658</b>	<b>-984</b>	<b>-978</b>	<b>-780</b>	<b>-404</b>	<b>-68</b>
Trade balance	-2,085	-1,411	-923	-763	-1,134	-1,050	-777	-435	-75
Exports f.o.b.	7,528	8,191	4,495	4,333	9,355	9,117	10,037	11,062	12,176
Imports f.o.b.	-9,613	-9,602	-5,418	-5,096	-10,489	-10,167	-10,814	-11,498	-12,251
Services (net)	-2,619	-2,795	-1,371	-1,596	-2,939	-3,112	-3,093	-3,142	-3,223
<i>Of which</i> : interest payments	-1,460	-1,676	-849	-871	-1,753	-1,731	-1,744	-1,696	-1,638
Private transfers (net) 1/	2,274	3,064	1,199	1,631	2,985	3,062	2,964	3,025	3,035
Official transfers (net)	194	135	49	70	105	122	126	149	194
<b>Capital account</b>	<b>-907</b>	<b>-2,886</b>	<b>-17</b>	<b>148</b>	<b>189</b>	<b>154</b>	<b>167</b>	<b>796</b>	<b>811</b>
Public medium- and long-term capital	970	-661	-129	-207	19	-41	222	169	67
Project and nonproject loans	620	127	-63	-176	15	-99	383	268	118
Disbursements 2/ 3/	2,658	2,095	851	798	1,779	1,672	1,951	1,787	1,605
Amortization	-2,038	-1,968	-914	-974	-1,764	-1,771	-1,568	-1,519	-1,487
Commercial banks and IDB	-370	-170	-30	-26	-26	-21	-102	-58	-15
Other	720	-618	-36	-5	30	79	-59	-41	-36
Net public sector short-term (net)	-968	-221	318	147	223	205	-145	71	30
Private medium- and long-term	466	273	-159	-43	107	125	219	501	659
Nonbank	466	275	-159	-41	107	127	219	501	659
Deposit money banks	0	-2	0	-2	0	-2	0	0	0
Private short-term (incl. errors & omissions)	-1,375	-2,278	-47	251	-160	-134	-129	55	55
Nonbank	-1,052	-953	-93	-188	-210	-309 4/	-130	50	50
Deposit money banks	-1,315	-1,829	46	215	51	-50 5/	1	5	5
Errors and omissions	992	504	0	224	0	224	0	0	0
<b>Overall balance, before debt relief</b>	<b>-3,143</b>	<b>-3,892</b>	<b>-1,063</b>	<b>-510</b>	<b>-795</b>	<b>-824</b>	<b>-613</b>	<b>392</b>	<b>743</b>
<b>Financing</b>	<b>3,143</b>	<b>3,892</b>	<b>1,063</b>	<b>510</b>	<b>795</b>	<b>824</b>	<b>613</b>	<b>-392</b>	<b>-743</b>
Reserve assets (increase -)	-1,254	208	51	-73	-1,017	-865	-600	-600	-790
State Bank of Pakistan (including FE25s)	-807	379	51	-82	-1,017	-874	-600	-600	-790
Deposit money banks	-447	-171	0	9	0	9	0	0	0
Use of Fund credit (net)	430	-280	-148	-145	-242	-239	-195	-336	-406
Exceptional Financing	3,967	3,965	1,160	728	2,054	1,928	1,408	545	453
Accumulation/repayments of arrears	0	343	-495	-495	-517	-517	0	0	0
Debt relief on public and publicly guaranteed debt	1,406	988	0	1,089	0	1,632	0	0	0
Rollover of FDCs and deposits at SBP & NBP	1,512	1,872	-65	-71	-276	-282 6/	-198	-992	-500
Debt rescheduling from commercial banks	834	152	0	-117	-298	-298	-532	0	-17
Eurobond rescheduling in 1999	0	610	0	0	0	0	0	-155	-155
Additional commercial bank borrowing	0	0	45	0	145	195	0	0	0
Actual/assumed additional financing from IFIs 3/	0	0	578	344	1,350	1,221	140	0	0
Bridge financing	218	0	-23	-23	-23	-23	0	0	-195
Financing gap	0	0	1,120	0	1,673	0	1,998	1,692	1,320

Table 2. Pakistan: Medium-term Balance of Payments, 1998/99–2003/04 (concluded)

	1998/9	1999/200	Jul-Dec	Jul-Dec	Prog.	Rev. Prog.	Rev. Proj.		
			Prog.	Est.			2000/01	2001/02	2002/03
<b>Memorandum Items:</b>									
End-period gross official reserves (excl. gold)	1,740	1,359	1,307	1,441	2,375	2,233	2,833	3,433	4,223
<b>End-period gross official reserves (usable) 7/</b>	<b>1,672</b>	<b>916</b>	<b>724</b>	<b>735</b>	<b>1,740</b>	<b>1,636</b>	<b>2,088</b>	<b>2,688</b>	<b>3,478</b>
(In weeks of imports of goods and nonfactor services)	7.8	4.2	3.1	3.2	7.3	6.6	8.0	9.7	11.9
Current account (excl. official transfers)	-2,430	-1,142	-1,095	-728	-1,088	-1,100	-906	-553	-262
Current account balance, before adjustment 1/	-2,775	-2,640	-1,046	-658	-984	-2,478	-780	-404	-68
(In percent of GDP)									
<b>Current account balance</b>	<b>-3.8</b>	<b>-1.6</b>	<b>-3.4</b>	<b>-2.2</b>	<b>-1.6</b>	<b>-1.6</b>	<b>-1.3</b>	<b>-0.6</b>	<b>-0.1</b>
Current account (excl. official transfers)	-4.2	-1.9	-3.6	-2.4	-1.8	-1.8	-1.5	-0.9	-0.4
Current account balance, before adjustment 1/	-4.8	-4.3	-4.8	-4.7	-4.1	-4.1	-1.3	-0.6	-0.1
Trade balance	-3.6	-2.3	-3.0	-2.5	-1.8	-1.7	-1.3	-0.7	-0.1
Exports f.o.b.	13.0	13.3	14.7	14.3	15.3	15.0	16.2	17.3	18.2
Imports f.o.b.	-16.5	-15.6	-17.7	-16.8	-17.1	-16.7	-17.5	-18.0	-18.3
(Annual percentage change)									
Exports f.o.b.	-10.7	8.8	18.9	14.8	14.5	11.3	10.1	10.2	10.1
Imports f.o.b.	-6.7	-0.1	13.1	6.3	9.3	5.9	6.4	6.3	6.5
Export volume	-7.3	12.6	...	...	12.2	12.0	8.1	8.4	8.1
Import volume	0.9	-6.2	...	...	5.3	3.4	6.5	7.1	6.5

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

1/ The State Bank of Pakistan includes in private transfers an adjustment for the workers' remittances through informal channels. The adjustment is based on SBP's purchases of foreign exchange on the kerb market.

2/ Includes financing from Saudi Arabia for oil imports that has been agreed through 2001/02.

3/ Starting in 2000/01, actual or envisaged IBRD, IDA and AsDB disbursements are included in exceptional financing.

4/ Includes repayment of FCDs held in NBFIs (reschedulings shown as exceptional financing).

5/ Includes repayment of FCDs held in banks (reschedulings shown as exceptional financing).

6/ Includes \$1.1 billion in FCDs, \$300 million in deposits at the SBP, and \$500 million in deposits at the NBP.

7/ Excluding new foreign currency deposits (FE25s) held with the SBP, and net of outstanding short-term foreign currency swap and forward contracts.

Table 3. Pakistan: Monetary Developments, 1995/96–2000/01

	1995/96	1996/97	1997/98	1998/99	1999/2000				2000/01						
					Sep.	Dec.	Mar.	Jun.	Sep.	Dec.		Mar.		Jun.	
										Prog.	Act.	Prog.	Rev. Prog.		Prog.
(End-of-period stocks in billions of Pakistan rupees)															
Net foreign assets	-37.5	-61.2	-90.1	-70.7	-69.9	-68.7	-54.5	-50.1	-74.4	-48.7	-45.2	-18.3	-41.4	27.8	5.5
Net domestic assets	976.2	1,114.4	1,296.4	1,351.3	1,335.6	1,385.7	1,375.6	1,450.8	1,471.6	1,480.8	1,521.8	1,500.8	1,510.6	1,531.1	1,539.4
Net claims on government	468.9	542.3	597.5	551.4	557.8	553.4	555.1	629.6	653.3	612.0	601.9	609.5	595.6	614.9	615.2
<i>Of which:</i>															
Net bank borrowing	434.1	504.6	552.4	505.9	516.8	518.8	530.0	545.8	581.8	552.2	536.5	565.7	551.8	529.1	531.4
Commodity operations	47.4	53.1	63.7	67.3	63.1	58.0	49.4	107.4	95.8	85.4	91.1	67.4	67.4	107.4	107.4
Net claims on nongovernment	531.1	602.8	697.5	816.7	791.9	837.6	841.2	842.8	834.1	891.6	924.7	914.1	938.6	939.0	947.8
<i>Of which:</i>															
Private sector	478.7	546.8	632.0	734.7	719.7	762.2	768.9	753.2	753.6	794.8	836.3	815.7	840.1	836.5	845.2
Privatization account	-8.7	-3.5	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9
Other items, net	-15.1	-27.1	4.3	-13.9	-11.2	-2.3	-17.8	-18.7	-13.0	-19.9	-1.8	-19.9	-20.7	-19.9	-20.7
Total liquidity (broad money)	938.7	1,053.2	1,206.3	1,280.5	1,265.7	1,317.0	1,321.0	1,400.6	1,397.2	1,432.1	1,476.7	1,482.5	1,469.2	1,558.9	1,544.9
(Changes in percent of stock of broad money in the beginning of the fiscal year)															
Net foreign assets	-4.9	-2.5	-2.7	1.6	0.1	0.2	1.3	1.5	-1.7	0.1	0.4	2.3	0.6	5.6	4.0
Net domestic assets	18.7	14.7	17.3	4.5	-1.2	2.7	1.9	7.8	1.5	2.1	5.1	3.6	4.3	5.7	6.3
<i>Of which:</i>															
Net bank borrowing by govt.	6.0	7.5	4.5	-3.9	0.8	1.0	1.9	3.1	1.7	-1.3	-2.0	-1.4	-2.4	-1.0	-1.0
Net claims on private sector	7.6	7.3	8.1	8.5	-1.2	2.1	2.7	1.4	0.0	3.0	5.9	4.5	6.2	5.9	6.6
(Changes over 12 months; in percent)															
Broad money	13.8	12.2	14.5	6.2	4.7	4.3	5.8	9.4	10.4	8.7	12.1	12.2	11.2	11.3	10.3
Net domestic assets	18.7	14.2	16.3	4.2	1.6	2.6	5.0	7.4	10.2	6.9	9.8	9.1	9.8	5.5	6.1
Net bank borrowing by govt.	12.9	16.2	9.5	-8.4	-10.3	-7.0	2.7	7.9	12.6	6.5	3.4	6.8	4.1	-3.1	-2.6
Net claims on private sector	15.0	14.2	13.7	16.2	17.5	9.9	8.8	2.5	4.7	4.3	9.7	6.1	9.3	11.1	12.2

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

Table 4. Pakistan: Accounts of the State Bank of Pakistan, 1995/96–2000/01

	1995/96	1996/97	1997/98	1998/99	1999/2000				2000/01 1/						
					Sept.	Dec.	Mar.	Jun.	Sept.	Dec.		March		June	
										Prog.	Act.	Prog.	Rev. Prog.	Prog.	Rev. Prog.
(End-of-period stocks in billions of Pakistan rupees)															
Net foreign assets	11.9	-11.1	-48.6	-42.5	-49.7	-55.9	-49.2	-55.1	-74.9	-63.3	-52.9	-46.4	-58.9	-4.6	-13.5
Net domestic assets	298.1	358.1	418.1	440.4	449.1	524.4	506.6	552.9	543.7	526.6	511.8	513.3	560.8	517.4	538.6
Net claims on government	187.7	231.3	223.7	257.8	276.8	338.0	350.0	391.0	391.8	381.0	338.6	371.0	418.5	371.0	389.2
Of which:															
Budgetary support	200.2	246.7	242.2	279.6	298.8	361.4	374.3	414.6	416.1	406.6	364.3	394.6	442.2	392.6	412.8
Claims on nongovernment	42.8	41.6	40.8	56.1	53.8	52.2	51.1	51.2	49.6	45.9	48.9	41.6	41.6	40.7	40.7
Claims on scheduled banks	66.0	89.9	158.5	187.2	182.3	192.9	186.7	193.4	195.0	190.4	204.0	191.4	191.4	196.4	199.4
Privatization account	-8.7	-3.5	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9
Other items, net	10.4	-1.0	-2.0	-57.7	-60.9	-55.8	-78.3	-79.8	-89.8	-87.8	-76.8	-87.8	-87.8	-87.8	-87.8
Reserve money	310.1	347.0	369.5	398.0	399.4	468.5	457.4	497.8	468.8	463.3	458.8	466.9	501.9	512.8	525.0
Of which:															
Currency	253.4	262.0	291.7	306.6	304.1	363.1	361.2	375.1	355.7	355.2	430.7	363.1	406.0	394.0	423.7
(Changes in percent of stock of reserve money in the beginning of the fiscal year)															
Net foreign assets	-7.5	-7.4	-10.8	1.7	-1.8	-3.4	-1.7	-3.2	-4.0	-1.7	0.4	1.7	-0.8	10.1	8.3
Net domestic assets	17.1	19.3	17.3	6.0	2.2	21.1	16.6	28.2	-1.8	-5.3	-8.3	-7.9	1.6	-7.1	-2.9
Of which:															
Budgetary support	14.2	15.0	-1.3	10.1	4.8	20.6	23.8	33.5	0.2	-78.5	-10.5	-4.0	5.5	-4.0	-0.4
(Changes over 12 months; in percent)															
Reserve money	9.6	11.9	6.5	7.7	9.7	13.0	10.9	25.1	17.4	-1.1	-2.1	2.1	9.7	3.0	5.5
Currency	9.3	3.4	11.3	5.1	6.4	13.7	9.0	22.4	16.9	-2.2	18.6	0.5	12.4	5.0	13.0

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

1/ At program exchange rates



Table 5. Pakistan: Summary of Consolidated Federal and Provincial Budgetary Operations, 1999/2000–2000/01

	1999/00 Prel. Act.	2000/01 Prog.	First half 2000/01		2000/01 Rev. Proj.
			Prog.	Prel. Act.	
(In billions of Pakistan rupees)					
Total revenue	524.4	585.2	256.3	251.9	570.4
Tax revenue	406.8	487.7	218.9	204.8	471.4
<i>Of which:</i>					
CBR revenue	348.1	430.2	189.9	182.0	417.3
Surcharges	38.9	33.0	16.3	13.0	31.6
Nontax revenue	117.6	97.5	37.4	47.1	99.0
<i>Of which:</i>					
SBP profit transfer	30.0	16.4	6.0	8.0	20.4
Total expenditure	728.7	770.9	360.2	329.8	756.1
Current expenditure	640.2	663.7	310.2	303.1	659.5
<i>Of which:</i>					
Interest	243.3	239.0	113.9	105.2	237.0
Defense	150.8	157.5	66.4	70.7	157.5
Development and net lending	88.5	107.2	50.0	26.7	96.6
Budget balance	-204.3	-185.7	-103.8	-77.9	-185.7
Financing	204.3	185.7	103.8	77.9	185.7
External	74.2	130.9	71.5	43.6	122.0
Domestic	130.1	54.7	32.4	34.3	63.7
Bank	40.0	-16.9	6.5	-9.4	-14.4
Nonbank	90.2	71.6	26.0	43.7	78.1
(In percent of GDP)					
Total revenue	16.5	16.5	7.2	7.2	16.3
Tax revenue	12.8	13.8	6.2	5.8	13.4
<i>Of which:</i>					
CBR revenue	10.9	12.1	5.4	5.2	11.9
Surcharges	1.2	0.9	0.5	0.4	0.9
Nontax revenue	3.7	2.8	1.1	1.3	2.8
Total expenditure	22.9	21.8	10.2	9.4	21.5
Current expenditure	20.1	18.7	8.8	8.6	18.8
<i>Of which:</i>					
Interest	7.6	6.7	3.2	3.0	6.8
Defense	4.7	4.4	1.9	2.0	4.5
Development and net lending	2.8	3.0	1.4	0.8	2.8
Budget balance	-6.4	-5.2	-2.9	-2.2	-5.3
(excluding net lending)	-6.8	-5.5	-3.0	-2.6	-5.7
<b>Memorandum items:</b>					
Primary balance (in percent of GDP)	1.2	1.5	0.3	0.8	1.5
Social and poverty-related expenditures (in PRs billions)	76.3	97.5	48.8	35.2	97.5
Social and poverty-related expenditures (in percent of GDP)	2.4	2.8	1.4	1.0	2.8
Annual GDP (in PRs billions)	3,182	3,543	3,543	3,510	3,510

Sources: Ministry of Finance; and Fund staff estimates and projections.

Table 6. Pakistan: Summary Accounts of Seven Key Public Sector Enterprises, 1995/96–2000/01

(In millions of Pakistan Rupees)

	1995/96	1996/97	1997/98	Prel.	Prov.	2000/01	
				1998/99	1999/2000	Prog.	Rev. Prog.
<b>Net operating surplus (incl. interest charges) 1/</b>	<b>28,313</b>	<b>-738</b>	<b>-2,263</b>	<b>26,587</b>	<b>21,017</b>	<b>33,604</b>	<b>7,228</b>
WAPDA	16,037	-8,282	-7,993	17,678	4,985	4,878	-14,949
KESC	-470	-6,781	-6,970	-7,483	-12,897	-7,964	-17,246
OGDC	3,316	5,034	3,875	3,849	10,422	9,850	15,103
SSGCL	-69	-302	-1,156	-1,030	-773	1,014	-549
SNGPL	166	241	-250	-222	56	645	789
PTCL	12,584	10,943	12,407	17,567	21,421	23,266	23,267
Railways	-3,251	-1,592	-2,177	-3,772	-2,197	1,915	813
<b>Gross savings 2/</b>	<b>45,571</b>	<b>20,602</b>	<b>28,536</b>	<b>56,473</b>	<b>49,216</b>	<b>61,195</b>	<b>42,023</b>
WAPDA	24,890	5,546	9,625	33,704	19,080	19,973	6,279
KESC	2,374	-5,062	-4,822	-4,757	-9,916	-4,510	-14,105
OGDC	3,790	5,234	6,690	6,000	13,857	11,286	17,473
SSGCL	1,710	2,042	2,406	2,802	2,772	4,859	3,596
SNGPL	1,821	2,249	2,466	2,695	2,895	3,541	3,835
PTCL	14,238	12,184	14,348	19,802	22,725	24,131	24,132
Railways	-3,251	-1,592	-2,177	-3,772	-2,197	1,915	813
<b>Gross capital expenditure</b>	<b>72,852</b>	<b>67,439</b>	<b>56,654</b>	<b>43,184</b>	<b>46,920</b>	<b>74,272</b>	<b>62,184</b>
WAPDA	31,064	21,652	22,959	19,185	22,414	33,899	23,822
KESC	10,261	9,031	6,278	2,386	2,674	4,442	4,442
OGDC	3,710	13,342	5,187	2,707	2,871	9,985	8,825
SSGCL	4,299	1,968	2,697	1,215	979	3,150	2,552
SNGPL	4,945	6,722	4,487	2,466	2,280	4,096	3,843
PTCL	14,950	12,009	12,828	11,776	14,633	15,500	15,700
Railways	3,623	2,715	2,219	3,450	1,069	3,200	3,000
<b>Overall balance 3/</b>	<b>-40,637</b>	<b>-60,801</b>	<b>-47,443</b>	<b>-5,663</b>	<b>-19,386</b>	<b>-36,112</b>	<b>-36,112</b>
WAPDA	-14,109	-25,235	-24,473	3,967	-15,046	-26,399	-30,113
KESC	-10,731	-15,812	-13,248	-9,869	-15,571	-12,406	-21,688
OGDC	80	-8,108	-700	1,746	8,445	190	6,914
SSGCL	-3,760	-1,292	-2,045	-262	-185	-789	-913
SNGPL	-4,531	-6,222	-4,102	-2,049	-1,855	-3,189	-2,368
PTCL	-712	175	1,520	8,026	8,092	7,766	8,432
Railways	-6,874	-4,307	-4,395	-7,222	-3,266	-1,285	-2,187
				(In percent of GDP)			
Net operating surplus	1.3	0.0	-0.1	0.9	0.7	0.9	0.2
Of which: WAPDA	0.8	-0.3	-0.3	0.6	0.2	0.1	-0.4
Gross savings	2.1	0.8	1.1	1.9	1.5	1.7	1.2
Of which: WAPDA	1.2	0.2	0.4	1.2	0.6	0.6	0.2
Capital expenditure	3.4	2.8	2.1	1.5	1.5	2.1	1.8
Of which: WAPDA	1.5	0.9	0.9	0.7	0.7	1.0	0.7
Overall balance	-1.9	-2.5	-1.8	-0.2	-0.6	-1.0	-1.2
Of which: WAPDA	-0.7	-1.0	-0.9	0.1	-0.5	-0.7	-0.9

Source: Pakistan authorities; and Fund staff estimates.

1/ Gross operating revenue minus operating expenditure (accrual basis).

2/ Gross operating surplus plus other revenue minus other expenditure plus noncash expenditure (depreciation).

3/ Revenue minus expenditure.

Table 7. Pakistan: External Financing Requirements, 1998/99–2003/04 1/

(In millions of U.S. dollars)

	1998/99	1999/00	Prog. 2000/01	Rev. Prog. 2000/01	Rev. Proj.		
					2001/02	2002/03	2003/04
<b>Gross external financing requirements</b>	<b>-10,612</b>	<b>-7,627</b>	<b>-5,489</b>	<b>-5,362</b>	<b>-4,716</b>	<b>-4,018</b>	<b>-3,906</b>
Current account	-2,236	-1,006	-984	-978	-780	-404	-68
Reserve assets (increase -)	-1,254	208	-1,017	-865	-600	-600	-790
State Bank of Pakistan	-807	379	-1,017	-874	-600	-600	-790
Deposit money banks	-447	-171	0	9	0	0	0
Amortization before rescheduling	-6,975	-6,541	-3,246	-3,280	-3,142	-2,677	-2,643
Public and publicly guaranteed debt	-4,016	-3,290	-2,226	-2,268	-2,524	-2,167	-2,158
Private debt	-2,959	-3,251	-1,020	-1,012	-618	-510	-485
Repayments to the Fund	-147	-287	-242	-239	-195	-336	-406
<b>Identified capital inflows</b>	<b>6,645</b>	<b>3,675</b>	<b>3,435</b>	<b>3,434</b>	<b>3,308</b>	<b>3,473</b>	<b>3,453</b>
Public medium- and long-term capital	3,813	2,150	1,909	1,823	1,951	1,787	1,605
Project and nonproject loans	2,658	2,095	1,779	1,672	1,951	1,787	1,605
Commercial bank loans	14	27	50	50	0	0	0
Other official capital	1,141	28	80	101	0	0	0
Public sector short-term borrowing	205	271	559	609	650	620	650
Private medium- and long-term	902	866	689	803	708	966	1,098
Private short-term (including errors & omissions)	1,148	380	278	199	0	100	100
Of which: Errors and omissions	992	504	0	224	0	0	0
Disbursements from the Fund	577	7	0	0	0	0	0
<b>Exceptional Financing (net)</b>	<b>3,967</b>	<b>3,965</b>	<b>2,054</b>	<b>1,928</b>	<b>1,408</b>	<b>545</b>	<b>453</b>
<b>1. Official Sector</b>	<b>1,556</b>	<b>1,687</b>	<b>833</b>	<b>2,336</b>	<b>140</b>	<b>-400</b>	<b>0</b>
Accumulation of Arrears to Paris Club and non-Paris Club Bilateral	0	463	-462	-462	0	0	0
Debt Relief Public Debt and Publicly Guaranteed	1,406	988	0	1,632	0	0	0
Repayment of arrears	0	-64	-55	-55	0	0	0
Net Roll-over of UAE and Kuwait Central Banks' Deposits at SBP	150	300	0	0	0	-400	0
Net Roll-over of Deposits at SBP from Kuwait Central Bank	0	0	0	0	0	-250	0
Rollover of Kuwait Central Bank's Deposits at SBP	0	0	250	250	250	0	0
Repayment of rescheduled Kuwait Central Bank's deposits at SB	0	0	-250	-250	-250	-250	0
Net Roll-over of Deposits at SBP from UAE Central Bank	150	300	0	0	0	-150	0
Rollover of UAE Central Bank's Deposits at SBP	150	300	150	150	300	0	0
Repayment of rescheduled UAE Central Bank's deposits at SBP	0	0	-150	-150	-300	-150	0
Additional IFI Disbursements	0	0	1,350	1,221	140	0	0
World Bank	0	0	350	350	0	0	0
AsDB	0	0	525	403	0	0	0
Other (including IMF)	0	0	475	468	140	0	0
<b>2. Private Sector</b>	<b>2,413</b>	<b>2,278</b>	<b>-452</b>	<b>-408</b>	<b>-730</b>	<b>-747</b>	<b>-867</b>
Roll-over of Institutional Non-Residents FCDs (FE-45)	1,212	1,072	-1,072	-1,072	-790	-592	0
Additional rollover of FE45s	0	0	796	790	592	0	0
Net Roll-over of Deposits at NBP from Bank of China	150	500	0	0	0	0	-500
Rollover of Bank of China's Deposits at NBP	150	500	500	500	500	500	0
Repayment of Resch. Bank of China's Deposits at NBP	0	0	-500	-500	-500	-500	-500
Debt rescheduling from commercial banks	834	152	-298	-298	-532	0	-17
Principal and Interest Arrears Paid	0	-56	0	0	0	0	0
Rescheduling of Bonds	0	610	0	0	0	-155	-155
Additional Borrowing	0	0	145	195	0	0	0
Bridge Financing	218	0	-23	-23	0	0	-195
<b>3. Financing Gap</b>	<b>0</b>	<b>0</b>	<b>1,673</b>	<b>0</b>	<b>1,998</b>	<b>1,692</b>	<b>1,320</b>

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

1/ See Table 2 for explanatory notes.

Table 8. Pakistan: Summary of Public External Debt and Debt Service, 1995/96–2003/04

	1995/96	1996/97	1997/98	1998/99	1999/00	Rev. Prog.	Proj.		
						2000/01	2001/02	2002/03	2003/04
<b>Total public and publicly guaranteed external debt</b>	<b>28,121</b>	<b>28,709</b>	<b>29,000</b>	<b>30,480</b>	<b>31,010</b>	<b>33,297</b>	<b>34,719</b>	<b>35,169</b>	<b>35,167</b>
Medium- and long-term debt	24,967	25,726	25,776	26,607	27,262	29,114	30,737	31,451	31,825
Project & nonproject aid	22,275	23,145	23,042	23,101	23,834	23,829	24,299	24,719	24,837
Commercial banks and IDB	647	701	1,100	730	560	539	437	379	364
Other <sup>1/</sup>	2,045	1,880	1,634	2,776	2,868	4,747	6,001	6,354	6,624
Short-term Debt (by initial maturity)	1,619	1,667	1,809	2,049	2,253	2,458	2,313	2,384	2,414
Commercial banks and IDB	873	418	298	583	671	938	822	922	952
FEBCs and DBCs	496	414	328	196	147	118	89	60	60
Deposits of non-residents with the SBP	250	835	1,183	1,270	1,435	1,402	1,402	1,402	1,402
Fund credit and loans <sup>2/</sup>	1,535	1,316	1,415	1,825	1,496	1,725	1,670	1,334	928
Service of medium- and long-term public and publicly guaranteed debt	3,174	3,644	3,286	3,546	3,586	3,286	3,143	3,231	3,284
Of which: to the Fund <sup>2/</sup>	289	369	237	191	347	305	281	414	467
Amortization	2,201	2,679	2,282	2,569	2,452	2,081	1,865	1,913	1,908
Of which: to the Fund <sup>2/</sup>	241	319	195	147	287	239	195	336	406
Interest	973	965	1,004	977	1,133	1,206	1,278	1,318	1,377
Of which: to the Fund <sup>2/</sup>	48	50	42	44	60	67	86	78	62
Interest on public and publicly guaranteed short-term debt	80	89	70	96	94	96	82	45	43
<b>Total public and publicly guaranteed external debt</b>	<b>44.2</b>	<b>45.8</b>	<b>46.4</b>	<b>52.4</b>	<b>50.4</b>	<b>54.8</b>	<b>56.2</b>	<b>55.0</b>	<b>52.6</b>
Long-term	39.2	41.0	41.3	45.8	44.3	47.9	49.7	49.2	47.6
Short-term	2.5	2.7	2.9	3.5	3.7	4.0	3.7	3.7	3.6
Fund credit and loans <sup>2/</sup>	2.4	2.1	2.3	3.1	2.4	2.8	2.7	2.1	1.4
Service of medium- and long-term public and publicly guaranteed debt	5.0	5.8	5.3	6.1	5.8	5.4	5.1	5.1	4.9
Amortization	3.5	4.3	3.7	4.4	4.0	3.4	3.0	3.0	2.9
Interest	1.5	1.5	1.6	1.7	1.8	2.0	2.1	2.1	2.1
Interest on public and publicly guaranteed short-term debt	0.1	0.1	0.1	0.2	0.2	0.2	0.1	0.1	0.1
<b>Total public and publicly guaranteed external debt</b>	<b>227.0</b>	<b>224.8</b>	<b>219.0</b>	<b>273.4</b>	<b>244.7</b>	<b>244.6</b>	<b>238.8</b>	<b>224.6</b>	<b>208.7</b>
Of which: Fund credits and loans <sup>2/</sup>	12.4	10.3	10.7	16.4	11.8	12.7	11.5	8.5	5.5
Service of medium- and long-term public and publicly guaranteed debt	25.6	28.5	24.8	31.8	28.3	24.1	21.6	20.6	19.5
Of which: to the Fund <sup>2/</sup>	2.3	2.9	1.8	1.7	2.7	2.2	1.9	2.6	2.8
Amortization	17.8	21.0	17.2	23.0	19.4	15.3	12.8	12.2	11.3
Of which: to the Fund <sup>2/</sup>	1.9	2.5	1.5	1.3	2.3	1.8	1.3	2.1	2.4
Interest	7.9	7.6	7.6	8.8	8.9	8.9	8.8	8.4	8.2
Of which: to the Fund	0.4	0.4	0.3	0.4	0.5	0.5	0.6	0.5	0.4

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

<sup>1/</sup> Includes FCBCs, Eurobonds, Military debt and Special U.S. dollar bonds, and part of the financing gap, which is assumed to be covered by exceptional financing to the government of Pakistan.

<sup>2/</sup> Includes the possible use of Fund resources in 2000/01 and 2001/02.

Table 9. Pakistan: Indicators of Fund Credit, 1999/2000–2007/08 1/

	1999/00	Prog.	Rev. Proj.						
		2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
<b>Outstanding Fund Credit</b>									
In millions of SDRs	1,132	1,308	1,266	1,014	712	410	156	71	13
In millions of US Dollars	1,496	1,728	1,684	1,357	958	554	211	96	18
In percent of:									
Quota	109.5	126.5	122.5	98.1	68.9	39.6	15.1	6.8	1.3
GDP	2.4	2.8	2.7	2.1	1.4	0.7	0.3	0.1	0.0
Exports 2/	12.3	13.1	12.0	9.0	5.9	3.7	1.4	0.6	0.1
Public and publicly guaranteed debt	4.8	5.2	4.9	3.9	2.7	1.6	0.6	0.3	0.1
<b>Debt service to the Fund</b>									
In millions of SDRs	233	237	212	310	348	336	274	96	66
In millions of US Dollars	347	312	281	414	467	453	370	130	90
In percent of:									
Exports 2/	2.7	2.3	1.9	2.6	2.8	3.0	2.5	0.9	0.6
Gross official reserves	37.9	19.1	13.5	15.4	13.4	10.9	8.9	3.1	2.2

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

1/ Under the assumptions of the program.

2/ Exports of goods and nonfactor services and workers' remittances.

Table 10. Pakistan: Fund Position, 1999/00–2003/04

(In millions of SDRs)

	1999/00	Prog. 2000/01	Proj.			Total 1999/00 2003/04
			2001/02	2002/03	2003/04	
Total transactions (net)	-233	123	-107	-310	-348	-874
Disbursements under the Stand-by arrangement	0	360	105	0	0	465
Repayments	233	237	212	310	348	1,340
Principal	197	184	147	252	302	1,082
Charges and interest	36	53	65	58	46	258
Total Fund credit outstanding at the end of period	1,132	1,308	1,266	1,014	712	...
Memorandum item:						
Total Fund credit outstanding at the end of period (In millions of U.S. dollars)	1,496	1,728	1,684	1,357	958	...

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

**Pakistan: Fund Relations**  
As of February 28, 2001

I. <u>Membership Status:</u> Joined: 07/11/1950; Article VIII						
II. <u>General Resources Account:</u>						
			<u>SDR Million</u>		<u>%Quota</u>	
Quota			1,033.70		100.0	
Fund Holdings of Currency			1,782.59		172.4	
Reserve position in Fund			0.10		0.0	
III. <u>SDR Department:</u>						
			<u>SDR Million</u>		<u>%Allocation</u>	
Net cumulative allocation			169.99		100.0	
Holdings			2.05		1.2	
IV. <u>Outstanding Purchases and Loans:</u>						
			<u>SDR Million</u>		<u>%Quota</u>	
Stand-By arrangements			210.28		20.3	
Extended arrangements			186.00		18.0	
Contingency and Compensatory			352.70		34.1	
SAF arrangements			21.85		2.1	
PRGF arrangements			393.02		38.0	
V. <u>Latest Financial Arrangements:</u>						
	<u>Approval</u>	<u>Expiration</u>	<u>Amount Approved</u>		<u>Amount Drawn</u>	
<u>Type</u>	<u>Date</u>	<u>Date</u>	<u>(SDR Million)</u>		<u>(SDR Million)</u>	
Stand-By	11/29/2000	09/30/2001	465.00		150.00	
EFF	10/20/1997	10/19/2000	454.92		113.74	
ESAF/PRGF	10/20/1997	10/19/2000	682.38		265.37	
VI. <u>Projected Obligations to Fund:</u> (SDR Million; based on existing use of resources and present holdings of SDRs):						
	<u>Overdue</u>		<u>Forthcoming</u>			
	<u>02/28/2001</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Principal	...	127.2	201.8	354.7	225.5	72.0
Charges/Interest	...	35.0	41.2	29.5	16.4	11.6
Total	...	162.2	243.0	384.2	241.9	83.6

## **A. Nonfinancial Relations**

### **VII. Exchange System**

Over the last few years, Pakistan implemented a fixed exchange rate system with periodic step devaluation to compensate for the inflation differential with major trading partners. On July 21, 1998, a dual exchange system was introduced consisting of a fixed official exchange rate at PRs 46 per US\$1 and a floating interbank market exchange rate (FIBR). Under this system, all authorized transactions were effectively conducted at the so-called "composite rate" which was the weighted average of the FIBR and the official exchange rate. In addition, since May 28, 1998, withdrawals from foreign currency accounts have only been allowed in rupees (at the official exchange rate). Also, an advance import deposit of 30 percent was introduced on July 12, 1998; it was subsequently reduced to 20 percent on January 9, 1999 and 10 percent on January 24, 1999, and was eliminated on February 24, 1999. On May 19, 1999, the official exchange rate of PRs 46 per U.S. dollar was eliminated and the exchange rate system unified, with all international transactions conducted at the FIBR. As of February 28, 2000 the FIBR was PRs 60.23 per U.S. dollar.

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

The last Article IV consultation discussions were held in Islamabad during September 2000. The staff report (EBS/00/230 and Supplements 1 and 2), together with Pakistan's request for a Stand-By Arrangement was discussed by the Executive Board on November 29, 2000. In concluding the 2000 Article IV consultation, the Executive Board adopted Decision No. 12335-(00/117), adopted on November 29, 2000.

### **IX. Recent Technical Assistance**

There have been a number of technical assistance (TA) missions during the past several years.

**a. FAD:** In May/June 1997, a mission conducted a review of the public expenditure management system. In May 1997, May 1998 and again in February 1999, missions reviewed the operation of the GST, and recommended measures to improve tax administration and increase tax compliance. In April 1999, a mission reviewed the income tax system and developed a strategy to improve its efficiency, potential for long-term development and ease of administration. A mission in January–February 2000 assisted with the revision of fiscal data and advised on measures to strengthen the fiscal reporting and accounting systems. In May, a mission assisted with the preparation of the fiscal module of the Report on the Observance of Standards and Codes. In August, a joint FAD–STA follow-up mission reviewed progress in the strengthening of the fiscal reporting and accounting systems and assisted authorities in the preparation of revised fiscal data for 1993/1994–1998/99. In September, a mission provided technical assistance on overhauling the income tax law. In January 2001, a mission provided advice on priorities and strategies for improving the tax collection operations of the Central Board of Revenue (CBR).



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

**c. STA:** In May/June 2000, a mission reviewed the compilation of data considered most important for program design and monitoring. A follow-up mission in July helped develop a series of time-bound measures to improve the national accounts statistics.

#### **X. Resident Representative**

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

## **Pakistan: Provincial Public Finances and the Devolution Initiative— Fiscal Management Issues and Risks**

### **Introduction and background**

Pakistan's fiscal architecture is bound to change profoundly through the fiscal devolution initiative, which intends to establish about 100 district administrations as the new cornerstone of local government from August 14, 2001 onward.<sup>1</sup> The authorities expect that this initiative will improve accountability and efficiency in the delivery of public services, primarily on account of the greater proximity between the providers and beneficiaries. At the same time, however, there are fears that the initiative will complicate fiscal management. The government is currently in the process of designing the fiscal framework required to make the initiative work. This preparatory work will need to address the weaknesses in the current provincial and local government system, and resolve many new intricate issues, as discussed below. The discussion generally focuses on macro-relevant fiscal topics, and touch only briefly upon public service delivery issues.<sup>2</sup>

### **Provincial public finances**

The four provinces Balochistan, North Western Frontier Province (NWFP), Punjab, and Sindh are currently the cornerstone of public finances below the federal level.<sup>3</sup> Below the provinces, divisions, districts, and municipalities have little administrative and financial independence. Over the past several years, the provinces have accounted for about one-third of total government spending (on average, some 6 percent of GDP). They are responsible for a number of important functions, including the delivery of many education and health services and the implementation of poverty alleviation and other development programs. Provincial public finances are characterized by a large degree of vertical imbalance, as only about 20 percent of their spending is financed by own revenue, collected from a dispersed tax base with little revenue buoyancy.<sup>4</sup> The provinces thus are highly dependent on federal grants and loans to balance their budgets. Since provinces are indebted to the

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<sup>1</sup> Elections for district, *tehsil*, and union councils and posts started in December 2000 and are expected to be completed over the next few months. See Government of Pakistan, *Local Government—Proposed Plan*, May 2000.

<sup>2</sup> The latter are discussed in detail in a number of World Bank documents. See *Pakistan—Reforming Provincial Finances in the Context of Devolution: An Eight Point Agenda*, draft report, June 2000; and *Pakistan—Punjab Expenditure Review*, draft report, September 2000.

<sup>3</sup> The provinces are highly unequal in terms of population size and economic importance. With a population of around 73 million (in 1998), Punjab is larger than many countries; it clearly dominates the other provinces. Sindh is also large (with about 30 million people, of whom at least 12 million live in Karachi). Together these two provinces account for about 80 percent of Pakistan's population (131 million in 1998).

<sup>4</sup> Major provincial taxes include the immovable property tax, agricultural and land revenue taxes, the motor vehicle tax, and stamp duties. With the 2000/01 budget, provinces reduced the number of their taxes from about 30 to around 10.

federal government, they are not allowed to borrow domestically without federal approval. External assistance to provinces must also be approved by the federal government.

There are serious concerns about the lack of accountability of public spending and poor public service delivery at the provincial and local government levels. For example, the World Bank's public expenditure review for Punjab concluded that the problem of the provincial public finances is not so much one of open budget deficits but one of "development deficits" in the sense of inadequate service delivery, poor social indicators, and a high, possibly rising poverty. These findings may apply for the other provinces as well.

In the first half of this fiscal year, provincial budget performance was better than expected, as a budget surplus of about PRs 17 billion (0.5 percent of annual GDP) was achieved, primarily on account of expenditure restraint (see the example of the Sindh Province in Box 1). As a backdrop, the provinces seem to have spent less on social sectors and poverty reduction than expected.

**Box 1: Budget Performance in Sindh Province in 2000/01**

According to provisional and largely unreconciled data, in the first half of 2000/01 Sindh province's overall spending was limited to PRs 30 billion, compared with a budgetary target of PRs 39 billion. Only 80 percent of the authorized amounts on non-wage outlays were spent, and except for poverty alleviation programs, no "major expenditures" were authorized. On the Annual Development Program, only PRs 1.4 billion were disbursed compared with a half-year target of PRs 4.5 billion, reflecting in part the fact that the provincial finance administration has begun to review the "graveyard of development projects" with the objective to stop spending on low-priority, half-finished projects. On the recurrent side, savings were achieved through a ban on new recruitment (with the exception of health and education staff) and the elimination of approximately 12,500 civil service positions (out of a total of about 450,000). Although the provincial authorities expect overall spending to pick up during the second half of the fiscal year, they project an outcome for the fiscal year as a whole somewhat better than budgeted—instead of a budget deficit of PRs 3.4 billion as originally targeted, it is now estimated that the budget will be balanced, despite lower-than-budgeted revenue transfers from the federal level.

Source: Sindh Provincial Finance Secretariat

Despite some recent efforts (e.g., the establishment of provincial Fiscal Monitoring Committees), fiscal management continues to be hampered by weak financial management and poor fiscal data quality and transparency at the provincial and local government levels. For example, the federal government and provinces provide inconsistent data on grants and loans received from the federal level. There are significant errors and omissions items in provincial accounts, which are also deficient in timeliness, frequency, and Government Finance Statistics (GFS) consistency. Local governments are outside the mainstream of the public sector accounting and auditing system, and at the provincial level, accounting is lax while data reconciliation between the accounts of departments and the provincial Accountant Generals (AGs) is insufficient. This is compounded by the present

absence of separation between functions in accounting and auditing. As a result, misuse and mistakes have gone by unreviewed and uncorrected.<sup>5</sup>

### **The devolution initiative: challenges and risks for fiscal management**

Cognizant of the shortcomings in the current system of provincial and local government finances, the authorities are currently preparing the fiscal framework for the devolution initiative. A local government law is under preparation, and the authorities have established an institution framework for the preparatory work, including the Fiscal Decentralization Committee (the FS Committee), the Provincial Finance Commissions (PFCs), and District Implementation Committees (DICs)

**Administrative structure and recurrent costs.** The new local government structure (districts, *tehsils*, and unions) will require substantial institutional strengthening through hiring of new and training of existing staff, and offering incentives for those willing to be redeployed from the provinces to local administrations. The authorities intend to limit the increase in staff and the number of functional departments at the district level.<sup>6</sup> However, devolution will give rise to perhaps significantly higher recurrent government spending. There will also be start-up and transition costs, which should be estimated.

**Budget preparation and expenditure assignments.** Under the new system, important expenditure assignments will likely be devolved to the districts, including primary and secondary education, primary health care, public works, irrigation services, and some police and judiciary functions. Ultimately, the districts will have to prepare and manage a large share of what is currently part of the provincial budgets, considering also that spending on social sectors and poverty alleviation is expected to increase significantly in the coming years. As it will take time to build up the necessary capacity to do this, the authorities have decided that, during a transition phase (which could last up to three years), provinces will remain responsible for personnel payments and ongoing development projects, while the districts will be responsible for non-wage recurrent budgets and new development projects. However, starting with the 2001/02 budget, provinces will prepare budgets on a district-by-district basis.

**Tax assignments and revenue sharing.** The PFCs have been asked to identify taxes that could be devolved from the provinces to the districts, and rationalize the plethora of local taxes. According to some proposals, the immovable property tax and a number of minor taxes (e.g., entertainment tax, professional tax) could be given to the districts. For the provinces, there are proposals to reduce the number of their taxes further, and develop the new agricultural income tax into one of the major provincial revenue sources. Some have also suggested that the revenue from a number of taxes (e.g.,

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<sup>5</sup> The World Bank's Punjab public expenditure review, for example, found that one-third of the provincial agencies and departments have failed to reconcile their accounts with those of the AG.

<sup>6</sup> For example, Sindh Province intends to allow districts to establish no more than 12 functional departments.

stamp duties, motor vehicles tax) could be shared by provinces and districts. However, little consideration appears to have so far been given to how the federal-provincial revenue sharing formula should be adjusted under the new system.<sup>7</sup> Also, it is unclear how the provincial and local government tax administrations will have to change as a result of devolving taxation assignments. Finally, the authorities will need to devolve taxes gradually in line with expenditure tasks, and put adequate safeguards in place to limit and control the access of districts to bank borrowing.

**Fiscal transfer system.** The PFCs have been asked to determine the modalities of fiscal transfers from the provinces to the districts. The authorities intend to establish an equalization framework, which will take account of needs and capacities of each district, and provide incentives to mobilize more own revenue. Although the specifics of this framework are still under discussion, the government wants to devise a system by which grants to each district would be determined on the basis of a set of indicators, focusing on need, quality of service delivery, and own revenue mobilization effort.

**Accounting, auditing, and data reconciliation.** Although the authorities want to ensure that minimum standards are being met by each district, there is a risk that devolution will result in a further deterioration in fiscal data quality and accounting, especially if expenditure assignments are given to the districts without a commensurate rise in administrative capacity.

## Conclusions

At the moment, Pakistan's fiscal architecture has a number of weaknesses, including inadequate public service delivery and severe weaknesses in fiscal data quality and accounting. The devolution initiative is expected to improve public service delivery, but poses several challenges and risks for fiscal management, which will need to be addressed. In recent months, the government has intensified the preparations for a new fiscal framework and seems to have found a workable solution for the next budget and a transitory arrangement for the next couple of years. However, much more preparatory work remains to be done to fully specify the fiscal framework for the devolution initiative so as to make sure that the new fiscal architecture will work better than the present one. Among other things, such work should focus on calculating the costs of the devolution initiative and how these will be financed; the pace and scope of devolving expenditure and tax assignments from the provinces to the districts; limiting the districts' access to domestic and external financing; increasing the administrative capacity of the district administrations; improving the fiscal accounting, auditing, and data reconciliation at all levels below the federal government; and devising a new revenue sharing formula as well as a workable grant equalization framework.

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<sup>7</sup> Under the 1997 National Finance Commission (NFC) award, valid through 2002, the divisible revenue pool includes all federally collected taxes. From this pool, the provinces get 37½ percent of all revenue, which is then assigned to the provinces on the basis of population shares (i.e., Punjab receives about 58 percent, Sindh 23¼ percent, NWFP 13½ percent, and Balochistan 5¼ percent).

## **Pakistan: The Authorities' Strategy to Improve Governance**

The authorities consider good governance as a key pillar of their Economic Revival Program. Chief Executive General Pervez Musharraf recently listed economic revival, good governance, poverty alleviation and political restructuring as priorities of his government. In the last draft of Pakistan's Interim Poverty Reduction Strategy Paper that was presented to the community of donors in March at the Pakistan Development Forum, rising poverty is viewed not as the outcome of exogenous economic adverse shocks but as a result of bad governance over past years. Therefore, poverty reduction is only considered possible when the economic, political and social dimensions of governance are addressed. In the authorities' views, the five key priorities for improved governance are: (a) devolution of power to local councils; (b) civil service reform; (c) fiscal and financial transparency and accountability; (d) fight against corruption; and (e) improvement of the legal system.

### **Devolution**

The current structure of local governments (districts, subdistricts, unions and villages), which are managed by a bureaucratic system headed by "Deputy Commissioners", and the absence of horizontal coordination at the district level are viewed as the main factors behind mismanagement of public resources and corruption, as well as the persistence of poverty, especially in the rural sector. Consequently, a phased-in plan has been launched for the devolution of power to elected district level authorities and local councils. The plan is viewed as key instruments to improve the management of public resources, including the quality of the delivery of social services, (see Appendix II on fiscal aspects of the plan). Elections for local governments have started in December 2000, and are to be completed by June 2001. A minimum of 33 percent of the seats in local councils will be reserved for women. The new local governments would be formally installed on August 14, 2001.

### **Civil service reform**

The low quality of public services in Pakistan also reflects, in the authorities' view, the low capacity of the civil service, because of skills shortage, lack of incentive structure for better performance, quota-based employment, politicization, and vested interests. To address these problems, the government has launched a civil service reform that relies on educational programs, the review of the salary structure, the introduction of a promotion system that is based on merit and for revamped personnel evaluation procedures, and on across-the-board downsizing through early retirement measures. Several steps have already been implemented, including the enactment of an ordinance that increased the autonomy of the Federal Public Services Commission in appointing and promoting civil servants in November 2000; the review of civil service pay and benefits should be completed by June 2001, and related measures will be included in the next budget. The restructuring of all federal ministries should be completed by July 2002.

### **Improved fiscal and financial transparency and accountability**

The authorities consider that improving the quality of and access to information is key to eliminating corruption, improving economic governance, and enabling greater participation of all the stakeholders. Based on these principles, the government has prepared a draft legislation for a Freedom of Information Act. With the assistance of the Bank and the Fund, it has designed a program to improve transparency with respect to economic and financial developments and policy intentions.<sup>1</sup> This program has been already initiated with the publication in March of a government report on its debt strategy and the large discussion of its poverty reduction strategy. Specific steps to improve public sector financial accountability have already been initiated, including the set-up of Fiscal Monitoring Committees to ensure the regular and timely publication of fully reconciled quarterly budget reports at the federal and provincial levels. The government intends to take a set of additional steps (see MEFP, paragraphs 26-27), which includes the separation of the government accounting and audit functions in two entities, and the release of audit reports for FY1997/98 and FY1998/99 by June 2001. In addition, the government has broadly endorsed the recommendations arising out of the Fund's recent assessment of the SBP's financial safeguards and has incorporated a specific implementation plan into its reform program.

### **Fight against corruption**

The authorities have recognized that corruption undermines economic growth and poverty reduction, by reducing integrity in the formulation and conduct of economic policy and by hindering the execution of government functions and provision of public services. To tackle specific corruption cases, the government has established the National Accountability Bureau (NAB), with powers to investigate and prosecute corruption cases in the civil service and in public enterprises. The scope of the NAB investigations appears also to include abusive loan defaulters, land misappropriations, officials responsible for illegal appointments, as well as tax evaders. As of January 15, 58 persons were under arrest by the NAB. In addition, the government suspended 1000 CBR staff on corruption charges in mid-2000.

### **Reform of the legal and judiciary systems**

The authorities are aware that a transparent legal system and an independent judiciary system are necessary conditions to promote sustainable and higher growth, by securing property rights and guaranteeing the enforcements of private contracts. With assistance of the AsDB, they are preparing an action plan that would improve the functioning of courts, starting at the lower level.

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<sup>1</sup> The Fund's recommendations to improve fiscal transparency have been provided to the authorities in the Report on Observance of Standards and Codes (ROSC), Fiscal Transparency Module (SM/00/264), and included in the present Fund-supported program.

## **Pakistan: Safeguards Assessment—Summary of Conclusions**

### **Introduction**

An on-site safeguards assessment of the State Bank of Pakistan (SBP) was conducted in December 2000. The assessment noted that the SBP's management has embarked on a strategic restructuring aimed at bringing the operations of the central bank in line with recognized best practices, but also observed the existence of several vulnerabilities. **Specific remedies to address the vulnerabilities were agreed on with the authorities, and these are being implemented as part of conditionality under the Stand-By Arrangement.** A follow-up mission in March confirmed that the prior actions in the areas of accounting, auditing, and reserves management to be taken by end-March had been completed.<sup>1</sup>

### **Findings and Remedies**

**External audit mechanism: The SBP will bring the external audit process in line with international best practices.** The external audit of the SBP is currently performed by qualified auditors associated with international accounting firms, but the value of these audits is compromised by statutory restrictions. The following actions have been taken by the SBP to address these issues:

- the external audit will be conducted in accordance with International Standards on Auditing; and
- an Audit Committee has been appointed to oversee the bank's external audit process.

**Legal structure and independence: The SBP will be granted more autonomy in the reserves management area.** There is currently a lack of clarity in the statutory provisions governing the ownership and management of reserves. The SBP Act also does not provide sufficient statutory independence of the SBP's management from the government.

To address these issues, longer-term remedies in the form of amendments to the SBP Act were recommended. Changes to the SBP Act will be coordinated in the context of the work of the Banking Law Commission, which is currently reviewing all banking laws in Pakistan. As a short-term remedy, resolutions will be passed as follows:

- the Monetary and Fiscal Policies Coordination Board will grant the SBP autonomy in the management of reserves; and

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<sup>1</sup> Table 1 summarizes the agreed-upon remedies and the status of implementation.



- the Government will issue a resolution stating that the Governor and Central Board members can only be removed for legal cause and after being afforded due process of law.

**Financial reporting practices: The SBP has adopted International Accounting Standards (IAS) as the financial reporting framework.** The central bank's current accounting and financial reporting practices fall short of international best practices. Recommendations from the external auditors on accounting issues and internal controls indicated a number of concerns regarding the bank's financial disclosures (including a lack of consistency and transparency with respect to the disclosures of obligations to the Fund).

To mitigate these concerns, the SBP will implement IAS as the new financial reporting framework as follows:

- audited financial statements for the year ending June 30, 2001 in accordance with IAS will be published by end-September; and
- the June 30, 2000 financial statements will be restated under IAS by the external auditors and approved by the Audit Committee by end-March.

**Internal audit mechanism: The SBP is in the process of restructuring its internal audit function is in line with best practices.** The work of the Internal Audit Department is now limited to routine or procedural audits. No financial audits are conducted and the department does not have the capacity to perform risk-based audits.

To address these issues, the SBP has:

- appointed a new head of Internal Audit (after a search among qualified outside candidates), who will report directly to the Governor; and
- engaged a reputable outside firm to evaluate the internal audit function and formulate a plan for enhancing its effectiveness.

**Internal controls: Measures have been adopted to enhance the quality of data reported to the IMF and to safeguard the liquidity of foreign exchange reserves.** The on-site assessment identified vulnerabilities in the controls for verifying and reconciling data reported to the IMF. The assessment also noted that a large proportion of reserves are held with Pakistani banks abroad, which could compromise the availability of reserves in the event of a crisis.

Longer-term remedies will include the review and restructuring of the central bank's risk management and control systems in line with international best practices. Short-term measures to be implemented include:

- quarterly reconciliations between the data reported to the IMF and the accounting records;
- the appointment of the external audit firm to review these reconciliations, with separate audit reports issued on net foreign assets; and
- the adoption of guidelines to limit the liquidity risk of reserves, including quantitative limits on the amounts that can be deposited with Pakistani banks abroad.

### **Status of Implementation of Remedies**

A follow-up mission in March confirmed that the SBP has completed the two prior actions to be taken before the first review under the Stand-By Arrangement and noted considerable progress in the implementation of remedies to be completed later in the program. Specific actions taken by the SBP include:

- the adoption of a resolution to require compliance with internationally recognized standards in the areas of accounting and auditing;
- the establishment of a formal process for reconciling data reported to the IMF; and
- the adoption of formal guidelines on reserves management that prohibit operations that encumber foreign reserves beyond an authorized framework.

<b>Table 1. Pakistan: Summary of Agreed-upon Remedies</b>		
<b>1. Prior Actions</b>	<b>Date</b>	<b>Status</b>
A. Central Board of SBP to adopt resolutions in the areas of accounting and auditing to require compliance with internationally recognized standards.	Prior to 1 <sup>st</sup> program review (mid-March)	Completed
B. SBP to establish a formal process for reconciling data reported to the IMF and to adopt formal guidelines that prohibit operations that pledge or encumber reserves, place restrictions on, or otherwise impair the availability of foreign exchange reserves outside an authorized framework.	Prior to 1 <sup>st</sup> program review (mid-March)	Completed
C. SBP to publish audited financial statements in accordance with International Accounting Standards for the year ending June 30, 2001, and external auditors to prepare a separate report on net foreign assets (NFA), as reported to the IMF as part of the annual audit.	Prior to 3 <sup>rd</sup> program review (mid-September)	In progress
<b>2. Structural Performance Criteria</b>		
A. Prepare an IAS-compliant reporting format and comparative IAS financial statements for the previous year ended June 30, 2000.	End-June	In progress
B. Reduce SBP deposits with Pakistani banks abroad to a maximum of US\$200 million and formulate plan to further reduce placements with Pakistani banks abroad.	End-June	In progress
<b>3. Stated Intentions in the Letter of Intent</b>		
A. Commission and complete an independent review of SBP's internal audit function.	End-June	In progress
B. Prepare draft revisions to the SBP Act and issue resolutions (i) to ensure that the Governor and other Central Board members can only be removed by legal cause; and (ii) to guarantee autonomy of the SBP in respect of the management of reserves.	End-August	In progress

### **Pakistan: Paris Club Rescheduling**

1. Representatives from Pakistan and eighteen countries met in Paris on January 22–23, 2001, to consider Pakistan's request for debt rescheduling.<sup>1</sup> Observers of the Government of Australia, as well as from the IMF, the IBRD, the AsDB, the UNCTAD, and the OECD also attended the meeting, which was chaired by Ms. Stéphane Pallez, Assistant Secretary for International Affairs at the French Treasury at the Ministry of Economy, Finance and Industry and Chairman of the Paris Club.<sup>2</sup>
2. The representatives of the creditor countries welcomed Pakistan's program of macroeconomic policies and structural reforms supported by the Fund's Stand-By arrangement, and considered it important to make a positive contribution to the government's efforts. In this spirit, and taking note of Pakistan being a highly indebted lower middle income country, the creditor countries agreed to a major reorganization of Pakistan's external debt under Houston lower middle income terms.
3. The agreement covers medium- and long-term government and publicly guaranteed debt of Pakistan resulting from loans and guaranteed credits extended by creditor countries contracted before September 30, 1997 that were not previously rescheduled. It includes all the amounts of principal and interest (excluding late interest) due as of November 30, 2000 and not paid, and all the amounts of principal and interest (excluding late interest) due from December 1, 2000 up to September 30, 2001. All the above amounts will be rescheduled or refinanced.<sup>3</sup> Official development aid loans are to be rescheduled over 20 years with 10 years grace; repayments by Pakistan will be made in 20 equal semi-annual payments, the first payment to be made on November 1, 2011 and the last payment to be made on May 1, 2021. Other loans are to be rescheduled over 18 years with 3 years grace; repayments by Pakistan will be made on a graduated payments schedule, with the first payment on November 1, 2004, and the final payment on May 1, 2019. The detailed arrangements for rescheduling or refinancing will be determined in bilateral agreements to be concluded between the Government of Pakistan and each of the creditor country governments or their appropriate institutions before August 31, 2001.

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<sup>1</sup>The participating countries were Austria, Belgium, Canada, Denmark, Finland, France, Germany, Italy, Japan, the Netherlands, Norway, the Republic of Korea, the Russian Federation, Spain, Sweden, Switzerland, the United Kingdom and the United States of America. The Russian Federation, however, did not sign the agreed minute.

<sup>2</sup> The Fund staff representatives were Ms. Eken (MED), Ms. Ross (PDR) and Mr. Ronci (PDR).

<sup>3</sup> The provisions of the agreement do not apply to creditor countries with principal and interest falling due during the consolidation period on debt specified above, including arrears, of less than SDR 1 million.

4. The agreement provides for, on a voluntary and bilateral basis, debt for nature, debt for aid, debt for equity swaps or other debt swaps of eligible outstanding official development aid loans as well as up to 20 percent of other eligible loans outstanding as of December 31, 1998 or up to an amount of SDR 30 million, whichever is higher.

5. The Government of Pakistan committed itself to seek from all its external public or private creditors debt reorganization arrangements on terms comparable to those described above while avoiding any discrimination among various categories of creditors. In particular, the Government of Pakistan committed itself to seek from bond holders the reorganization of bonds on comparable terms. It also agreed to inform the chairman of the Paris Club in writing not later than August 31, 2001 of the progress made in negotiations with other creditors.

6. The Government of Pakistan undertook to pay all debt service due and not paid as at the date of the agreement on consolidations, on loans, on credits or pursuant to contracts or other financial arrangements payable in cash terms, extended or guaranteed by the government of the participating creditor countries or their appropriate institutions, and not covered by the present agreement as soon as possible, and in any case no later than June 30, 2001. Late interest will be charged on those amounts.

7. The provisions of this agreement will continue to apply until September 30, 2001, provided that Pakistan continues to have an appropriate arrangement with the IMF, provided that the government of Pakistan has made on due date the payments referred to in the agreement and implemented the provisions of the agreement regarding non-participating creditors.

8. The participating creditor countries will review the implementation of the conditions under the agreement for the comparability of treatment between all external creditors; if they determine that these conditions are not substantially fulfilled, they will declare the provisions for debt reorganization under the agreement null and void.

9. The debt relief provided by Paris Club creditors is estimated at US\$1.8 billion for the period through end-September 2001.

March 18, 2001

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

Dear Mr. Köhler:

The Pakistan authorities held discussions with Fund staff for the first review under the Stand-By Arrangement approved by the Fund's Executive Board on November 29, 2000. Based on these discussions, the attached Memorandum on Economic and Financial Policies (MEFP), which supplements that dated November 4, 2000, updates the macroeconomic framework, reviews economic developments and policy implementation during the first half of 2000/01, and discusses the stabilization policies and structural reform program which have been specified in the context of the present review. Moreover, for reasons detailed in the MEFP, we request a waiver of the quantitative performance criterion on revenue of the Central Board of Revenue (CBR) at end-December 2000, a waiver of the structural performance criterion related to petroleum price adjustment on December 15, 2000, and modifications of the performance criteria on the CBR revenue and the net domestic assets (NDA) of the State Bank of Pakistan (SBP) for end-March 2001. On the basis of the performance up to end-December 2000 and policies set out in the attached memorandum, the government requests that the completion of the first review be considered by the Executive Board of the Fund.

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

Sincerely yours,

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S  
Shaukat Aziz  
Minister of Finance and Economic Affairs

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S  
Ishrat Husain  
Governor  
State Bank of Pakistan

**Attachments:**

**Memorandum of Economic and Financial Policies**

**Technical Memorandum of Understanding**

## PAKISTAN

### Memorandum of Economic and Financial Policies

1. This Memorandum of Economic and Financial Policies (MEFP) reviews economic developments and policy implementation in the first half of fiscal year 2000/01 (July–December 2000), updates the macroeconomic framework, and discusses the stabilization policies and structural reform program for the remainder of the fiscal year. It updates and supplements the MEFP dated November 4, 2000.

#### I. DEVELOPMENTS DURING JULY 2000–JANUARY 2001

2. The macroeconomic performance in the first half of 2000/01 was adversely affected by exogenous factors. Lower-than-expected rainfalls have led to a small contraction in the production of cotton following the bumper crop of 1999/2000, and have weakened prospects for the forthcoming spring wheat crop. At the same time, available data appear to confirm the expected recovery in the industrial sector. In the circumstances, we now expect real GDP growth at 3.8 percent for the year, compared to an original target of 4.5 percent. Inflation as measured by the average CPI during July 2000–January 2001 picked up to only 4.9 percent instead of the projected 5.4 percent. The less-than-anticipated increase reflected primarily lower food prices, although delays in the adjustment of administered petroleum prices, and a lesser-than-expected pass through of the recent exchange rate depreciation also played a role.

3. During the first half of 2000/01, the underlying external current account position was broadly in line with program projections, with shortfalls in exports and larger profit transfers compensated by lower imports and higher worker remittances. Taking into account State Bank of Pakistan (SBP) purchases in the kerb market, the current account registered a significantly lower deficit than programmed. The export shortfalls were due to lower unit values; volumes increased as programmed with strong growth in non-traditional exports, such as, pharmaceuticals, chemicals, and leather goods. Despite lower-than-projected foreign direct investment inflows and shortfalls in Asian Development Bank (AsDB) and IDB disbursements, gross official reserves (excluding FE25 foreign currency deposits and short-term swaps and forwards) at end-December 2000 amounted to US\$735 million, somewhat higher than the program target. Taking into account the program adjusters, including for external-financing shortfalls, the performance criterion on net foreign assets of the SBP was met (Table 1). Reflecting largely debt service and oil import payments, gross reserves declined to US\$566 million at end-February 2001. The interbank market exchange rate, which had depreciated by 12 percent during July–November 2000, depreciated further by 2 percent during December 2000–February 2001, despite a sizable dollar-liquidity injection by the SBP to finance lumpy oil payments and avoid upsetting a thin market. During this period, the premium on the kerb market remained in the daily range of 4–5 percent.

4. The consolidated government deficit (including grants) for the first half of 2000/01 amounted to 2.2 percent of programmed annual GDP, 0.7 percentage points lower-than-programmed, with shortfalls in tax revenues more than compensated by higher-than-



projected federal nontax revenue and stronger-than-envisaged expenditure restraint. On the revenue side, shortfalls in tax revenues, in the order of 0.4 percent of annual GDP, were the result of shortfalls in Central Board Revenue (CBR) revenues (mainly in sales and income tax collections) and, to a lesser extent, in receipts from energy surcharges. Nonetheless, CBR revenue recorded an increase of 14 percent during July 2000–January 2001 over the corresponding period last year. Total expenditure and net lending was nearly 1 percent of GDP lower than programmed. The underspending mostly reflected lower current and capital spending at the provincial levels, owing to deliberate expenditure restraint and better enforcement of accountability and governance standards. The latter also partly explains why, despite full release of budgeted appropriations at the beginning of the year, social and poverty-related expenditures fell short of program objectives by PRs 13.6 billion (as per provisional accounts); weak financial management and delivery systems at district levels were also factors. Federal current spending was higher than anticipated due to higher subsidies on account of larger-than-programmed payments to Water and Power Development Authority (WAPDA) and wage spending (including military), reflecting mostly the advance payment of January 2001 wages in December 2000 because of the Eid holidays. In the circumstances, the performance criteria on the fiscal deficit and net bank borrowing were met with large margins while that on the CBR revenue was breached.

5. The higher-than-expected demand for cash and the rebound in private credit complicated the conduct of monetary policy. With a continued increase in the cash-to-deposit ratio (see below), the targeted growth in reserve money in the program proved excessively tight. Furthermore, while discount and treasury bill rates were raised in the fall of 2000 by about 360 basis points, banks generally did not raise deposit rates and with booming credit demand, were faced with a liquidity crunch at year-end. To ease the crunch while observing the performance criteria on central bank net domestic assets (NDA) at year-end, the SBP took several steps in December 2000. It gave banks the option to convert into T-bills part of the reserves freed up with the reversal in early December 2000 of the weekly cash reserve requirements (CRR) from 7 percent to 5 percent; allowed banks to convert temporarily the rupee counterpart of the foreign currency deposits of nonresident institutional investors held with the SBP into T-bills; reduced the daily CRR from 4 percent to 3 percent and waived it on December 31, 2000; and closed the discount window on December 30, 2000. While the NDA target was thereby met with a comfortable margin, we recognize that the underlying monetary stance was more expansionary than indicated by the artificially depressed reserve money stock at end-year, and that correcting for the above-described operations at end-year would indicate a reserve money expansion in the order of 15 percent for the year, primarily driven by increased demand for cash.

6. Broad money expanded to 12.1 percent in the year through December 2000, above the programmed level of 8.7 percent. On the liability side, the expansion was largely driven by the unexpected growth in currency holdings (a 20 percent increase year-on-year compared to a reduction of 1.8 percent envisaged under the program). The currency-to-deposit ratio rose to 38.5 percent, compared to a decline to 30.5 percent projected under the program. While difficult to quantify, we believe that the continued strong preference for cash reflects, inter alia, the lingering effects of the bumper crops on incomes in the rural sector with

limited access to financial intermediation services; the ongoing tax survey/documentation drive; increased transaction demand for the rupee in Afghanistan as confidence in the Afghani declined further with a severe drought and the tightening of UN sanctions; and exceptional factors relating to the coincidence of year-end and the end of Ramadan. On the asset side, monetary expansion reflected: (a) a stronger-than-envisaged growth in private sector credit owing to higher cotton prices and the related rising working capital needs of the textile industry; (b) a lower credit expansion last year during the same period, which resulted in lower retirement in current year and; (c) a large increase in other items net, owing mainly to a sharp temporary increase in suspense accounts during the long holidays at end-December 2000. Both claims on government and net foreign assets of the banking system contracted by more than programmed. Preliminary figures for January 2001 indicate that some of the exceptional factors explaining the surge in demand for cash may be unwinding as reflected in some decline in currency and broad money growth.

7. Structural reforms gained momentum in a number of areas and structural performance benchmarks and criteria were met, except that related to the adjustment in petroleum prices (Table 2). Domestic petroleum prices were adjusted on December 31, 2000 instead of December 15, 2000 to avoid socio-political stress during the Ramadan period. The price increases in the range of 7 percent to 23 percent exceeded the requirements implied by the agreed formula, except for kerosene for which the price was increased less than implied by the formula to protect poor households (which consume the bulk of this product). In view of the short delay in adjusting petroleum prices, the government would request a waiver for nonobservance of the structural performance criterion related to the petroleum price adjustment in December 2000.

8. The 3½-year long tariff dispute between Hub Power Corporation (HUBCO) and Water and Power Development Authority (WAPDA) was settled. The settlement resulted in overall savings to WAPDA of US\$63 million per annum and US\$3 billion over the life of the contract. Following the interim tariff increases (of 4 percent in September 2000) granted to WAPDA and Karachi Electricity Supply Corporation (KESC), WAPDA was granted another 0.9 percent increase in December 2000. The agreement between WAPDA and the government on the settlement of past arrears was implemented as planned, resulting in a decline in the stock of arrears of the government vis-à-vis WAPDA. At the same time, WAPDA made debt service payments to the budget as programmed. The special audit of the Central Directorate of National Savings (CDNS) was completed in late 2000; follow-up actions on unresolved issues and accounting problems as well as the audit of the 1999/2000 accounts have been initiated. A new market-based medium- and long-term instrument, the Pakistan Investment Bonds (PIBs), was launched in December 2000 and interest rates on new Defense Savings Certificates were formally linked to PIB yields. Restructuring of the nationalized commercial banks continued with the closure of large numbers of unprofitable branches. In the trade area, the anti-dumping law was enacted in December 2000 thereby paving the way to abolish regulatory duties discriminating against imports. On civil service reform, the autonomy of the Federal Public Services Commission (FPSC) has been strengthened through the enactment of a new law, and greater autonomy has been given to agencies and ministries for appointments and promotions.

9. In the fiscal area, the Accountant General Pakistan Revenue verified the fiscal accounts for the first quarter of the fiscal year, and more generally the drive to improve accounting, reconciliation, and reporting of public finances continued. The fiscal reform unit has been established, and the Ministry of Finance (MOF) has made progress in public expenditure analysis, fiscal projections in the context of a medium-term budget framework, compilation of data on contingent liabilities, and strengthening of external debt statistics. Also, the Committee on Income Tax Reform undertook a tax expenditure analysis. The technical preparations for a new income tax law that will streamline withholding taxes, rationalize corporate rates, and reduce exemptions have advanced; the income tax committee submitted its preliminary recommendations to the MOF at end-December 2000 as envisaged. The tax survey/documentation drive was pursued despite strong resistance from many of the undocumented and unregistered taxpayers, bringing some 25,000 new taxpayers into the sales tax net and over 100,000 direct taxpayers. In parallel, new national tax numbers (NTN) were issued to 90 percent of taxpayers, although the target of issuing NTN to all taxpayers by year-end was not achieved. The preparation of the report of the Task Force on Tax Administration was delayed primarily due to technical reasons. The tax survey is expected to have a favorable impact on revenue collection over the medium term, but has distracted considerable CBR resources from traditional tax administration tasks, as reflected in a deterioration of compliance indicators (e.g., number of audits, outstanding tax arrears, number of non-filers). This partly explains the shortfalls in CBR revenue from program targets.

## **II. MACROECONOMIC OBJECTIVES AND POLICIES FOR THE REMAINDER OF FISCAL YEAR 2000/01**

10. The government's medium-term macroeconomic objectives of achieving high levels of growth with low inflation and building up of official foreign exchange reserves remain broadly in line with those under the original program. However, in light of the outcome in the first half of 2000/01, we have somewhat revised the macroeconomic targets for the year. Expected real GDP growth has been revised downward to 3.8 percent, and the target for the annual average inflation rate to 5 percent. The external current account deficit target remains unchanged at 1.6 percent of GDP. However, we now aim at a somewhat less ambitious build-up of reserves to about US\$1.6 billion (equivalent to 6.6 weeks of imports) by end-June 2001, mainly because of expected shortfalls in external financing. The macroeconomic policy mix remains broadly unchanged. Fiscal policy will aim to reduce the budget deficit to 5.3 percent of GDP, reflecting a somewhat lower nominal GDP than envisaged. The SBP will continue to move towards a market-based exchange rate system, and monetary policy will remain appropriately tight to ensure that inflation and reserves targets are met.

11. The overall fiscal deficit target for 2000/01 remains at PRs 186 billion as originally programmed. However, reflecting developments so far, revisions have been made to revenue and expenditure levels and composition. In light of the shortfalls in most tax revenue categories in the first half, the whole-year target for tax revenue has been reduced by PRs 16 billion, most of it in CBR revenues. Nevertheless, the revised target remains ambitious and implies an improvement in tax revenue by 16 percent over the last year. The

government will forcefully implement a short-term action plan for improving tax administration prepared with FAD technical assistance (attached). The plan includes detailed timetables and specific monitoring indicators and focuses on strengthening the CBR resources devoted to the audit and arrears collection process, along with a tighter penalty regime for nonfilers and late payments which went into effect in March 2001. The 14.4 percent average increase in gas prices, which became effective mid-March 2001, will also help revenue mobilization; the PRs 1.5 billion estimated revenue impact of this measure has not been reflected in the revised fiscal projections and would provide a small cushion for possible shortfalls in other areas. In view of the remedial measures that have been put in place to prevent further slippages in CBR revenue performance and the other measures that are being implemented to ensure the achievement of the overall budget target under the original program, the government requests a waiver of the end-December 2000 performance criterion and the modification of the end-March 2001 performance criterion on CBR revenue.

12. The target for total expenditures has been revised downward by PRs 15 billion, mostly on account of lower development spending through cuts in low priority projects in the PSDP, net lending due to the higher-than-expected repayments of government loans by the Oil and Gas Development Corporation (OGDC), and the impact of improved financial control. Cuts in the public sector development program (PSDP) will reduce investment expenditures by the National Highway Authority, Pakistan Railways, and WAPDA. The containment of expenditures will also be facilitated by the package of measures to strengthen WAPDA's finances (discussed below). The objective to increase social/poverty-related spending by at least 0.4 percent of GDP remains unchanged. Expenditure authorizations for social sectors and poverty alleviations have been fully released and the provincial government has been encouraged to achieve targeted levels in this area. It is however conceivable that some savings could be realized also in this category because of efficiency gains induced by better accountability, without affecting the delivery of social services. The financial performance of the seven large public enterprises remains broadly on target, although it will be affected by higher payments to independent power producers (IPPs) following the settlements with HUBCO and Kot Addu Power Corporation (KAPCO).

13. To ensure achievement of the fiscal deficit target in case of further revenue shortfalls or other unexpected factors, the MOF will continue to monitor expenditure closely. For the three-quarters ending in March 2001, the MOF has released 60 percent of annual appropriations for spending other than for social sectors or poverty alleviation. The remaining budgetary provisions will be released keeping in view the fiscal deficit target and overall revised revenue projections.

14. Monetary policy is geared towards achievement of the reserve targets and prevention of any resurgence in inflation. Taking into account the slower-than-expected unwinding of increases in cash demand above trend for the reasons explained above, we have revised our reserve money target. For the year through June 2001, we will aim to reduce reserve money growth to 5.5 percent. The resulting stance of monetary policy recognizes, on the one hand, that the above-trend demand for rupee cash appears to be of a more permanent nature and that the original targets for March 2001 would therefore be excessively tight. On the other

hand, it also recognizes that the underlying monetary stance through end-December 2000 was insufficiently tight (veiled by an artificially depressed reserve money stock at end-year), as indicated by the difficulties in achieving reserve targets and the rapid loss of reserves in January 2001. Accordingly, the NDA target was also eased somewhat and the government would request a modification of the performance criterion on the NDA of the SBP. Given the uncertainty surrounding the evolution of the cash-to-deposit ratio, the SBP will exercise vigilance to ensure that monetary policy is tightened through indirect instruments, as needed, to achieve the reserves target and to keep inflation under control in case the demand for cash declines faster than assumed. In particular, despite the decline in interest rates abroad, nominal interest rates on rupee assets will be maintained or even raised if needed. Indeed, the three-month treasury bill rate was increased by 50 basis points on February 21, 2001. Broad money growth for the year through end-June 2001 is projected at 10.3 percent, broadly in line with expected nominal GDP growth. Given the envisaged buildup of net foreign assets and repayment of government credit, this would allow for a 12.2 percent growth in private sector credit.

15. The government remains committed to move towards a market-based exchange rate system to achieve the external sector objectives. To this end, the SBP will stop providing foreign exchange to the interbank market to finance petroleum imports, limit its interventions to smoothing out the temporary effects of bulky transactions in the thin interbank market, and for the year as a whole, the SBP will not be a net provider of foreign exchange to the interbank market after taking into account government debt service payments effected through commercial banks. A market-based exchange rate system will also require the deepening of the interbank foreign exchange market and cessation of SBP purchases in the kerb market; however, given the low level of reserves, these measures would need to be implemented gradually and cautiously. As an initial step, the SBP's practice of dealing for same day value in foreign exchange has been changed to two-day value for spot dealing, in line with best international practice. Nostro limits on banks' balances held abroad on account of trading activities will be relaxed around mid-2001. The government reiterates its firm commitment to not hinder the flow of funds for current account transactions. Combined with the gradual withdrawal of the SBP from the kerb market, this policy should help prevent the emergence of any multiple currency practice and ensure compliance with Pakistan's obligations under Article VIII of the Fund's Articles of Agreement.

### **III. STRUCTURAL REFORMS**

16. The government remains committed to implementing the structural reform agenda laid out in the original MEFP of November 4, 2000, which is a crucial part of its strategy to revive the economy and to address the many distortions and governance problems that have impeded higher sustainable growth and contributed to a trend of growing poverty.

### **A. Tax and Trade Reforms**

17. The tax registration drive has been successful in terms of bringing additional taxpayers into the GST/income tax net. However, so far the payoff in terms of revenue has fallen short of expectations. In the circumstances, the government has adopted the aforementioned short-term action plan to improve tax administration. To address lingering uncertainties among taxpayers, the government has confirmed in several public pronouncements that no further tax amnesties will be granted. Beyond these short-term actions, the task force on tax administration will submit its report to the government in early-March 2001, and on this basis, the government will derive a strategy for fundamental reform of the CBR to be launched with the next budget.

18. The planned reforms of the GST and the income tax are on track. The GST will be extended to pesticides and urea fertilizers on March 31, 2001 and to all remaining agricultural inputs by September 1, 2001. The government has reconfirmed in various public pronouncements its intention to extend GST to the retail level (for turnovers exceeding PRs 5 million) as planned on July 1, 2001; a vigorous campaign to prepare retailers for the associated filing and documentation requirements is underway. Agricultural income is for the first time being taxed in 2000/01. Relevant provincial legislation is in place and implementing regulations will be issued shortly to allow filing to commence in the coming weeks, although expected revenue gains for the current fiscal year will be limited. Preparations for the overhaul of the income tax are underway. The report of the relevant committee and a draft law will be submitted to the cabinet by end-March 2001, to be promulgated with the next budget.

19. The government is firmly committed to trade liberalization envisaged in the program. By July 1, 2001, the maximum tariff will be reduced to 30 percent; the number of tariff slabs will be reduced to four; the differential excises on imported and domestically produced goods will be eliminated; and all remaining regulatory duties will be allowed to lapse. The government will phase out quantitative import restrictions maintained for balance of payments reasons by end-June 2002 according to a schedule agreed with the World Trade Organization Committee on Balance of Payments Restrictions in November 2000.

### **B. Public Enterprise Reform and Privatization**

20. The government remains committed to an ambitious program to streamline, restructure, corporatize, and in some cases privatize public enterprises. For the coming year, the focus will be on steps towards improving the financial situation of major enterprises through further moves towards market-based pricing policies, greater efficiency through labor shedding and reduction in subsidization and cross-subsidization, and settlement of arrears. For the major nationalized commercial banks, a large number of unprofitable branches will be closed in the first half of 2001. For a few selected enterprises (nationalized commercial banks, telecommunications, OGDC, and Pakistan Petroleum Limited (PPL)), preparatory work towards privatization will continue, although we now expect delays in the privatization of the Pakistan Telecommunications Company Ltd. (PTCL) due to the financial

difficulties of the major international players. By contrast, the scheduled steps towards market-based pricing in the gas sector should pave the way for successful privatization of the PPL. More generally, the process of deregulation of the energy sector continues. To this end, the government has decided to deregulate the import of High Speed Diesel from April 2001, dismantle the residual freight pool for petroleum products (a mechanism is being worked out) and make biannual adjustments in consumer gas prices in order to maintain parity with oil prices. The first adjustment (of 14.4 percent) has been announced for mid-March 2001.

21. The government recognizes the particular urgency to address the financial difficulties of WAPDA and KESC. Agreement has now been reached between WAPDA and the Sindh Province on the settlement of PRs 6.7 billion of overdue receivables. Sindh has already paid PRs 1.7 billion during July 2000–January 2001 and will pay an agreed amount monthly to settle remaining arrears. The federal government will continue to ensure that federal agencies and provinces remain current on their electricity bills, including if needed through deduction at source from the provincial share in tax revenues. In addition, the independent national power regulatory authority (NEPRA) is expected to authorize WAPDA to increase its tariffs by at least an additional 4.5 percent in March 2001, in conjunction with a rationalization of its tariff structure in consultation with the World Bank, and to grant WAPDA's request for an automatic fuel price adjustment clause. Together with a streamlining of its expenditure and a deferment of scheduled debt service payments to the government of PRs 2 billion in FY 2001, this should allow WAPDA to remain current in its debt service payments and obligations towards the IPPs and other suppliers. However, the government will keep WAPDA's situation under close review, as its financial position will remain fragile. It remains particularly vulnerable to furnace fuel price increases on international markets and shortfalls in rain that would force WAPDA to increase relatively expensive thermal power production to substitute for hydro-power. The financial situation of KESC remains of even greater concern. A financial and technical restructuring operation supported by the AsDB aims to turn around KESC's financial position and prepare it for privatization by end-2002. As an important step, KESC will implement an increase in the average tariff of 9.5 percent in March 2001. Although KESC will need exceptional financing for its projected cash shortfalls, borrowing from the banking system for FY 2001 will be limited to PRs 7.5 billion.

### **C. Financial Sector Reforms**

22. The government remains committed to establishing a market-based financial system. To this end, the planned overhaul of the National Saving Scheme (NSS) is under way. Following the recent linking of the interest rate for new issues of Defense Savings Certificates (DSCs) to PIB yields, beginning January 1, 2001 interest on all other NSS instruments will also become market-based beginning July 1, 2001, when their returns will be linked to benchmark bonds or treasury bills of similar maturities. Concomitantly, the tax-exempt status for new NSS instruments will be removed and income from NSS instruments would be taxed in the same manner as other financial instruments. In a similar vein, all subsidies under the existing export finance scheme (EFS) will be eliminated by mid-2001, while a new fully market based export finance window is being developed with support from the AsDB to enhance export credit access for small- and medium-sized enterprises.

Consistent with this strategy, the SBP has raised the interest rate for the EFS by 1 percentage point to 9 percent in January 2001. The remaining interest subsidy will be phased out in two steps to be taken by end-March 2001 and end-June 2001. Subsequently, the EFS interest rate would fully cover the cost of funds (based on the 6-month treasury bill rate) and cost of intermediation. The government is also reviewing various options of moving to an Islamic financial system and will prepare a roadmap for the transition that will not endanger financial stability and efficiency.

23. The government is accelerating its drive to strengthen the financial soundness of the banking system, and especially the major nationalized banks. Ongoing operations include the closure of nonprofitable branches in the rural sector and strong efforts to recover nonperforming loans. In addition, the government is discussing World Bank support for additional action involving major labor shedding of the nationalized commercial banks and liquidation or merger of a number of development financial institutions. More generally, the government has strengthened enforcement of prudential regulations and have requested an early FSAP mission to assist in assessing the weaknesses in the banking sector and in formulating a comprehensive strategy to develop a financial sector that is viable and contributes to higher investment and growth.

24. The restriction on commercial banks' placement abroad of the funds associated with the mobilization of new foreign currency deposits (FE25s) will be withdrawn effective April 1 2001, and prudential norms will be put in place to ensure their safety. Accordingly, the banks should be required to maintain CRR in U.S. dollars for all foreign currency deposits under FE25s. We, therefore, intend that 25 percent of foreign currency deposits under FE25s will be placed as CRR with the SBP, of which at least 20 percent will be remunerated at market-related rates.

#### **D. Transparency, Governance, and Public Sector Financial Management and Accountability**

25. The government remains committed to the original agenda of a wide range of reforms aimed at enhancing governance, and in particular, measures to curb rent seeking and improve the efficiency of public expenditure and delivery of social services to the intended beneficiaries. To allow greater and better informed public debate and public participation in formulating economic policies, the government would continue its drive towards greater transparency with respect to economic and financial developments and policy intentions. In this context, the government intends to publish in a few weeks a report on its debt strategy and will prepare the next budget in the context of medium-term budgetary framework. The government is preparing with broad participation of civil society, a poverty reduction strategy with a first blueprint to be discussed with donors, NGOs, and others in March 2001.

26. Specific steps to improve public sector financial accountability over the coming months will include the promulgation before end-June 2001 of legislation separating the government audit and accounting functions into two separate departments, with effective application starting with the next budget. Both the accounting and the audit functions will be



strengthened under a World Bank project (PIFRA), including through computerization and better human resource management. A new accounting model (NAM) broadly consistent with the revised GFS methodology was recently promulgated and will be gradually implemented over the next two years, in the context of a major computerization drive and with technical and financial assistance from the World Bank. To increase transparency and accountability, the government will provide public access to the deliberations of the ad-hoc Federal Public Accounts Committee and release outstanding audit reports for FY 1997/98 through FY 1998/99 before end-June 2001. Also, the government would release before end-March 2001 the second quarterly report prepared by the fiscal monitoring committee covering the second quarter of FY 2000/01 after reconciliation of federal expenditure. Reconciled provincial data for the first three-quarters of fiscal year 2000/01 would be available to the Ministry of Finance for the preparation of consolidated budget data by end-May 2001.

27. The government is preparing additional steps to improve fiscal reporting and transparency, notably the publication of public contingent liabilities, greater disclosure of quasi-fiscal activities, and publication of the schedule of tax expenditure. To drive this work forward, the government set up a fiscal reform unit in February 2001. The government will also speed up the process of reconciliation of provincial fiscal data, especially against the background of the forthcoming devolution of many fiscal tasks to the newly created district administrations. At the provincial level, at least quarterly detailed expenditure accounts (e.g., economic classification of current spending, social and poverty-reducing spending) will be prepared with a lag of at most two months.

28. Progress is also made with the devolution of the delivery of relevant government services to local government. These will be operational by August 2001, but to ensure fiscal control and accountability, the fiscal transfer systems and financial accountability mechanisms will be devolved gradually over 2001–03. Particular emphasis will be given to ensuring that transfers for health and education reflect needs at the district levels, are well coordinated with donor programs, and that strong incentives for good performance on agreed outcome indicators are in place from July 1, 2001. Responsibility for accounting and auditing will remain for the time being with the established structures reporting to provincial/federal rather than local government. With regard to civil service reform, the review of civil service pay and benefits will be completed over the next few months, and its results will be reflected in the 2001/02 budget. We will complete the action plan for the restructuring of the Ministry of Finance and Planning and implement it by June 2001, and remain committed to restructure the other federal ministries by July 2002.

29. The government broadly endorses the recommendations arising out of the Fund's recent assessment of the SBP's financial safeguards and has incorporated a specific implementation plan into their reform program. The SBP adopted resolutions in the areas of accounting and audit to require compliance with internationally recognized standards; and prior to Board presentation of the forthcoming review, will establish a formal process for reconciling data reported to the IMF, as well as guidelines to prohibit operations that pledge or encumber reserves, or place restrictions on or otherwise impair the availability of foreign

exchange reserves outside an authorized framework. By mid-2001 the SBP will prepare an IAS-compliant reporting format and comparable IAS financial statements for the previous years ended June 30, 2000, and will also commission and complete an independent review of SBP's internal audit function. By mid-September 2001, the SBP will publish audited IAS financial statements for the year ended June 30, 2001 and commission external auditors to prepare a separate report on net foreign assets as reported to the IMF as part of the annual audit. To strengthen the safeguarding of reserves, the SBP will reduce its deposits with Pakistani banks abroad to a maximum of US\$200 million by end-June 2001 and formulate a plan to further reduce placements with Pakistani banks abroad. Finally, the government will prepare draft revisions to the SBP Act and issue resolutions to the Monetary and Fiscal Policy Coordination Board to: (a) ensure that the Governor and other SBP board members can only be removed by legal cause; and (b) guarantee autonomy of the SBP in respect of reserves management.

#### IV. EXTERNAL FINANCING ISSUES

30. Following the approval of the Stand-By Arrangement, the Paris Club creditors agreed on January 23, 2001 to reschedule Pakistan's public sector medium- and long-term debt covering arrears and current maturities through September 2001 on loans contracted before end-September 1997. The debt relief provided by the Paris Club is broadly in line with that assumed under the program. The government will proceed expeditiously with bilateral negotiations with all Paris Club and other bilateral creditors. The AsDB approved the disbursement of US\$50 million under the micro-credit program in February 2001. The government will implement in March 2001 all the agreed measures required for disbursements by the AsDB under Trade Export Promotion and Industry Loan (TEPIL) and Small- and Medium- Enterprises Trade Enhancement Facility and will implement expeditiously all the measures required for the envisaged disbursements from the World Bank (Structural Adjustment Credit) and the AsDB (Energy Sector Loan and an additional Tranche of TEPIL) in the fourth quarter of 2000/01. However, disbursements from the AsDB will be less than envisaged in the original program by US\$125 million mainly due to delays in the processing of the Agricultural Program Loan, which is expected to be disbursed in the first half of 2001/02. Representatives of institutional foreign currency deposit holders agreed to rollover 75 percent of their deposits until end 2001/02. Deposits of foreign financial institutions with the SBP or the National Bank of Pakistan have also been rolled over on existing terms and conditions.

31. On the basis of the revised current account projections and taking into account the above-described financing elements, the targeted level of reserves at end-June 2001 would fall slightly short of the program objective, as noted above.

## V. PROGRAM MONITORING

32. The government is aware that purchases under the Stand-By Arrangement remain contingent on the observance of quantitative and structural performance criteria and the completion of reviews. The monitoring of the program by the Fund staff will also take into account indicative targets and structural benchmarks.

33. For purposes of monitoring the remainder of the program for 2000/01, quantitative performance criteria and quantitative indicative targets have been agreed for end-June 2001 as presented in Table 1, and structural performance criteria and benchmarks were set as detailed in Table 2. The government has implemented or will implement a number of measures as prior actions for the Board completion of the first review under the arrangement; these are listed in Table 3. Remaining purchases under the Stand-By Arrangement shall be subject to reviews to be completed in June 2001 and September 2001. Definitions of each of the monitoring variables and, where necessary, of the structural performance criteria and benchmarks, together with reporting requirements and monitoring mechanisms are detailed in the attached revised and updated Technical Memorandum of Understanding.

Table 1. Pakistan: Quantitative Performance Criteria, and Indicative Targets Under the Stand-By Arrangement, December 2000–June 2001

(Cumulative flows from July 1, 2000 unless otherwise specified)

Performance Criteria	Outstanding Stock End-June 2000	Performance Criteria					
		End-December 2000			2001		
		Prog.	Adj.	Act.	End-Mar.		End-Jun.
				Prog.	Mod. Prog.	Prog.	
(In billions of Pakistan rupees)							
Net foreign assets of the SBP 1/	-55.1	-8.2	-12.2	2.1	8.7		41.5
Net domestic assets of the SBP 2/	552.9	-26.3	-22.1	-41.1	-39.6	8.0	-14.3
Overall budget deficit	206.4	103.8	103.8	77.9	152.8		185.7
<i>Of which</i> : net bank borrowing 3/	40.0	6.4	21.1	-9.4	19.9		-14.5
CBR revenue	346.6	189.9	189.9	182.0	291.6	279.3	417.3
Credit to the seven major public enterprises 4/	44.5	6.5	0.0	-9.4	9.5		11.5
Accumulation of budgetary arrears to WAPDA		0.0	0.0	0.0	0.0		0.0
(In millions of U.S. dollars)							
Contracting of short-term public and publicly guaranteed external debt 5/	657	800	...	264	800		800
Contracting of nonconcessional medium- and long-term public and publicly guaranteed external debt 5/		2,000	...	533	2,500		3,000
<i>Of which</i> : External debt with an initial maturity of over one year and up to five years 5/		1,000	...	33	1,500		1,500
Accumulation of external payments arrears (continuous performance criterion during the program period)		0	...	0	0		0
(In billions of Pakistan rupees)							
Net domestic assets of the banking system 6/	1,451.5	29.3	44.0	71.7	49.3	59.8	88.6
Federal tax revenue 7/	386.8	207.5	207.5	195.5	317.2	302.1	451.3
Social and poverty-related spending 8/	76.3	48.5	48.5	35.2	77.9	...	97.5
(In millions of U.S. dollars)							
<b>Memorandum items:</b>							
Net external budget financing 9/	73.6	71.5	...	43.6	87.0	...	122.0
(In millions of U.S. dollars)							
Stock of non-resident institutional foreign currency deposits with SBP forward exchange cover	1,072	1,007	...	1,001	804	798.0	790
Program financing		1,690	...	1,281	1,997		2,550
BOP support loans 10/		570	...	192	567		918
Debt rescheduling		1,120	...	1,089	1,430		1,632
Stock of foreign exchange swaps of the SBP	756	717	...	798	717		717
<i>Of which</i> : short-term	104	65	...	256	0		0
Forward exchange contracts of the SBP	0	23	...	27	23		23
External financing counted as SBP liability		117	...	75	220		207
Net foreign assets of the SBP (level; PRs bln)	-55.1	-63.3	...	-52.9	-46.4		-13.5
Net domestic assets of the SBP (level; PRs bln)	552.9	526.6	...	511.8	513.3	560.8	538.6

Sources: Quarterly macroeconomic projections for 2000/01 agreed between the Pakistan authorities and the Fund staff.

1/ These floors will be adjusted: (a) upward by the rupee equivalent of the excess in program financing; (b) downward by the rupee equivalent of the shortfall in program financing provided that the SBP net foreign assets remain above PRs –78 billion at end-December 2000, above PRs –61.3 billion at end-March 2001, and above PRs –20 billion at end-June 2001; (c) upward by the rupee equivalent of the full amount of any privatization proceeds from abroad; and (d) upward by the rupee equivalent of the excess in nonresident institutional foreign currency deposits with SBP forward exchange cover above the end-August 2000 level (US\$1,068 million), in foreign exchange swaps of the SBP above the end-August 2000 level (US\$717 million), in outright forward sales of foreign exchange by the SBP above the end-August 2000 level (US\$23 million), and in SBP foreign exchange reserves held with foreign branches of domestic banks above the end-June 2000 level (US\$545 million). The floor for end-June 2001 will also be adjusted upward/downward for the excess/shortfall in FE25s held with the SBP above their projected end-June 2001 level of US\$530 million.

2/ These ceilings will be adjusted (a) downward by the rupee equivalent of the excess in program financing; (b) upward by the rupee equivalent of the shortfall in program financing provided that the net domestic assets of the SBP remain below PRs 541.3 billion at end-2000, below PRs 563.1 billion at end-March 2001, and below PRs 545 billion at end-June 2001; (c) downward by the rupee equivalent of the full amount of any privatization proceeds from abroad used by the budget; and (d) downward by the rupee equivalent of the excess in foreign currency deposits with SBP forward exchange cover above the end-August 2000 level and in foreign exchange swaps of the SBP above the end-August 2000 level, in outright forward sales of foreign exchange by the SBP above the end-August 2000 level, and in SBP foreign exchange reserves held with foreign branches of domestic banks above the end-June 2000 level. The ceiling for end-June will be adjusted downward/upward for the excess/shortfall in FE25s held with the SBP above their projected end-June 2001 level of US\$530 million (PRs 31.62 billion). These ceilings will also be adjusted downward/upward by the amount of banks' reserves freed/seized by any reduction/increase of daily CRR of 4 percent and by the amount of any reduction/increase in the deposit base with respect to the programmed levels of PRs 1,084 billion at end-March 2001 and PRs 1,143 billion at end-June 2001 that is related to changes in definition of deposits subject to CRR.

3/ These ceilings will be adjusted: (a) downward by the rupee equivalent of the excess in net external budget financing; (b) upward by the equivalent of any shortfall in net external budget financing provided that net bank borrowing by the government remains below PRs 21.1 billion at end-December 2000, below PRs 34.8 billion at end-March 2001, and below PRs –8 billion at end-June 2001; and (c) downward by the rupee equivalent of the amount of new privatization proceeds used by the budget.

4/ The seven major enterprises are Pakistan Railways, the Water and Power Development Authority, the Karachi Electricity Supply Corporation, Ltd., Sui Northern Gas Pipelines Ltd., Sui Southern Gas Company Ltd., the Pakistan Telecommunications Corporation Ltd., and the Oil and Gas Development Corporation. This ceiling will be adjusted downward if the difference between program and actual amounts of restructuring credits to KESC related to the financing of its cash shortfall is positive; the program amount is PRs 7.5 billion.

5/ This performance criteria applies not only to debt as defined in point No. 9 of the Guidelines on Performance criteria with respect to Foreign Debt (adopted on August 24, 2000), but also to commitments contracted or guaranteed for which value has not been received. See paragraph 12 of the Annex to the attached Technical Memorandum of Understanding.

6/ These ceilings include the rupee counterpart of external debt service due on rescheduled government and government guaranteed debt. These indicative ceilings will be adjusted: (a) downward by the rupee equivalent of the excess in program financing; (b) upward by the rupee equivalent of the shortfall in program financing provided that the net domestic assets of the banking system remain below PRs 1,495.5 billion at end-2000, below PRs 1,515.7 billion at end-March 2001, and below PRs 1,545.8 billion at end-June 2001; (c) downward by the rupee equivalent of the full amount of any privatization proceeds from abroad; and (d) downward by the rupee equivalent of the excess in foreign currency deposits with SBP forward exchange cover above the end-August 2000 level.

7/ Consists of the taxes collected by the Central Board of Revenue, gas and petroleum surcharges, and the foreign travel tax.

8/ Consists of central and provincial government spending under the Public Sector Development Program and the Social Action Program (SAP), including outlays on agricultural income generating programs, education and training, health and nutrition, rural development (farm to market roads), manpower and employment, women development, population welfare, social welfare, environment, integrated rural and urban development, and the special areas social action program. SAP spending also includes basic education and health sector current outlays. Expenditures under the Zakat program outside the budget are excluded.

9/ Includes all receipts from foreign currency government debt (including net amount of special dollar bonds issued), except for Non-Plan resources; receipts (cash or in kind) from the refund from the purchase of war planes from the United States; the accumulation of arrears on foreign currency government debt (including arrears on military debt); and the rescheduling of foreign currency government debt (including military debt); less the repayment of principal on foreign currency government debt (excluding military debt).

10/ Include adjustment loans from the World Bank and the AsDB net of principal payments due to the World Bank, AsDB, IDB, and IFAD; bilateral grants and loans for balance of payments support; additional loans from commercial banks; and debt relief from commercial banks.

Table 2. Pakistan: Structural Performance Criteria and Benchmarks  
Under the Stand-By Arrangement

Measures	Timing	Status
<b>I. Structural Performance Criteria</b>		
Implementation of the quarterly petroleum price adjustment mechanism for all major petroleum products as described in Section VI of the Technical Memorandum of Understanding.	December 15, 2000, March 15, 2001, and June 15, 2001.	Implemented on December 31, 2000, and March 15, 2001.
Ban on introduction of new GST exemptions and fixed-tax schemes under the GST.	Continuous during the program period.	
Publication of quarterly fiscal reports that have been verified by the Accountant General Pakistan Revenue (starting with the first quarter of 2000/01; reports are to be published no later than two months after the end of the quarter).	End-February 2001, end-May 2001, and end-August 2001.	Report for Q1 published in November 2000, and for Q2 in February 2001.
GST extension to urea fertilizer and pesticides.	By end-March 2001.	
GST extension to all other agricultural inputs.	By September 1, 2001.	
Promulgation of a new income tax law, that puts into place a global income tax with: (a) a simpler rate structure for individuals; (b) uniform tax of all companies; (c) less emphasis on withholding and presumptive taxes; (d) fewer exemptions; and (e) replacement of investment incentives by a simple system of accelerated depreciation.	With the passage of the 2001/02 budget before end-July 2001.	
Extension of income tax to all new issuance of NSS instruments on the same basis as the income tax currently applies to other financial instruments.	With the passage of the 2001/02 budget before end-July 2001.	
The extension of GST to all retailers/traders above the PRs 5 million threshold.	With the passage of the 2001/02 budget before end-July 2001.	
The reduction of the maximum customs tariff to 30 percent and the number of tariff slabs to four.	July 1, 2001.	
The elimination of interest subsidy element of the export finance scheme.	July 1, 2001.	
Prepare an IAS-compliant reporting format and comparable IAS financial statements for the SBP for the previous year ended June 30, 2000.	End-June 2001.	
Reduce SBP deposits with Pakistani banks abroad to a maximum of US\$200 million and formulate plan to further reduce placements with Pakistani banks abroad.	End-June 2001.	

Table 2. Pakistan: Structural Performance Criteria and Benchmarks  
Under the Stand-By Arrangement

Measures	Timing	Status
<b>II. Structural Benchmarks</b>		
Completion and publication of a special audit in line with international standards of the Central Directorate of National Savings.	End-October 2000.	Met.
Establishment and implementation of a formula linking interest rates on new Defense Savings Certificates to the market-determined yield of the new government bond.	January 1, 2001.	Met.
Enactment of the anti-dumping law that would lead to the withdrawal of the different excises applied to domestically produced and imported goods as an anti-dumping measure.	End-December 2000.	Met.
Preparatory steps relating to the promulgation of a new income tax law with the 2001/02 budget:		
The income tax committee will submit its preliminary recommendations to the Ministry of Finance.	End-December 2000.	Met.
The final report and draft law will be submitted to cabinet.	End-March 2001.	
Establish basic reconciliation processes in all provinces. All provinces will produce quarterly reports for internal use and reporting to the MoF that are fully reconciled in terms of AG/Departmental accounts, clearance of suspense accounts, SBP and scheduled bank accounts, and provincial/federal records of intergovernmental flows.	Quarterly, starting end-March 2001 (covering data through December 2000).	
Publication of public sector contingent liabilities as an annex to the Economic Survey.	By end-June 2001, with the economic survey presented prior to the 2001/02 budget.	
Publications of a schedule of tax expenditures as an annex to the Economic Survey.	By end-June 2001, with the economic survey presented prior to the 2001/02 budget.	
Initiate a review of Part A of the budget (covering costs of government services such as wages and salaries).	By end-December 2000.	Met.
Establish a fiscal reform unit to build up technical capacity and more effective ownership of fiscal reform programs, which would cover tax reform as well as public expenditure management reform.	January 2001.	Established in February 2001.
Commission and complete an independent review of SBP's internal audit function.	End-June 2001.	



Table 2. Pakistan: Structural Performance Criteria and Benchmarks  
Under the Stand-By Arrangement

Measures	Timing	Status
Prepare draft revisions to the SBP Act and issue resolutions by the MFP Coordination Board: (i) to ensure that the Governor and other Central Board members can only be removed by legal cause; and (ii) to guarantee autonomy of the SBP in respect of the management of reserves.	End-August 2001.	
Send report on research studies in the framework of National Accounts Project to the Fund's Statistics Department according to the following schedule:		
Those related to fishing, shipping, and services.	End-March 2001.	
Those related to livestock, mining and quarrying, and public administration and defense.	End-June 2001.	

**Table 3. Pakistan: Prior Actions**

1. In order to improve tax administration:
  - (i) Prepare and adopt a short-term tax administration action plan, with monitorable actions and targets;
  - (ii) Restore the one-time penalty on sales tax nonfilers to at least the old rate of PRs 5,000 (from the current PRs 2,500);
  - (iii) Raise the penalty interest rate for late payment of taxes to at least 2 percent per month; and
  - (iv) Make a public announcement of the above three elements as well as the government's decision that no further tax amnesties will be granted and that the sales tax will be extended to all retailers and traders above the PRs 5 million threshold by end-June 2001. (The latter measure is a structural performance criterion under the program).
2. Collect cumulative CBR revenue of PRs 243 billion by end-February 2001.
3. Increase in retail gas prices by an average of 14.4 percent.
4. Increase in electricity tariffs charged by WAPDA by at least 4.5 percent and introduction of a formula-based automatic fuel adjustment clause.
5. Increase in electricity tariffs charged by KESC by at least 9.5 percent (including the interim raise) and introduction of a formula-based automatic fuel adjustment clause.
6. Increase in net reserves of the SBP (gross reserves minus FE25 foreign currency deposits with the SBP, short-term foreign currency swaps and forwards) to at least US\$650 million.
7. Remedies under stage two safeguards assessment:
  - (i) Central Board of SBP to adopt resolutions in the areas of accounting and audit to require compliance with internationally recognized standards.
  - (ii) SBP to establish a formal process for reconciling data reported to the IMF and to adopt formal guidelines that prohibit operations that pledge or encumber reserves, place restrictions on, or otherwise impair the availability of foreign exchange reserves outside an authorized framework.

Pakistan—Central Board of Revenue (CBR) Short-term Action Plan

Area	Action	Completion Date	Status
A. General	1. Hold sales tax Collectors' conference to discuss actions to be taken with regard to sales tax audit, arrears, and non-filers.	February 11	Done
B. Community Awareness	1. Minister of Finance and CBR and other officials will publicize the authorities' commitment to extend sales tax to retail traders with turnover over PR 5 million effective July 1, 2001, and to grant no further tax amnesties.	March	
C. Sales Tax Audits	1. Set up full-time "Management Cell within the CBR comprising one chief, one cost accountant and one secretary to work in consultation with DFID consultant.	February 1	Done
	2. Set up similar "Audit Management Cell" in each Collectorate in accordance with decisions taken in February 11 Collectors' conference.		
	3. Prepare reassignment of sales tax auditors from tax survey project to auditing, with the objective to have at least 400 auditors assigned to audit work.	March 1	
	4. Reassign other auditors gradually from tax survey work to auditing.		
	5. Finalize recruitment process for new auditors.	End-May	
	6. Issue guidelines to set new audit completion standards and requirements for streamlining audit procedures.	February 5	Done
	7. Achieve an average of 2.5 audits per auditor in March, an average of 3 in April, an average of 3.5 in May, 4 in July, and 4.5 in September.	March–September	
	8. Prepare a new audit plan for March and communicate it to Collectorates.	11-Feb	Done
	9. Achieve the following targets for completion of audits: 1,000 in March; 1,200 in April; 1,400 in May; 1,600 in July; and 1,800 each in August and September.	March–September	
	10. Ask Collectorates to strengthen supervision of auditors by strictly following management checks as per Audit Handbook; follow up with written instructions.	February 11 and 15	Done
	11. Request supervisors in Collectorates to accompany auditors in specific cases and to randomly check their performance in a certain percentage of cases.	Ongoing	
	12. Strengthen follow up by supervisors on the findings of audit visits through "Audit Management Cells" in Collectorates.	Ongoing	
	13. Prepare revised TOR for private auditors, send for comments and views on expected fees to selected private auditors, and convey funding request to MoF.	Feb. 1–20	Partly done
	14. Use private auditors for specified durations and specific tasks until end-June 2001 to enhance coverage.	March 1	
	15. Compile details on additional funding requirements to improve work of auditors, and convey to Ministry of Finance.	February 20	Done

Pakistan—Central Board of Revenue (CBR) Short-term Action Plan

Area	Action	Completion Date	Status	
D. Sales Tax Arrears	1. Increase the penalty for late payment of tax to 2 percent per month.	March		
	2. Raise the penalty for non-filing of sales tax returns to PR 5,000.	March		
	3. Member Sales Tax will oversee an arrears collection/non-filer enforcement drive by tabulating a list of authentic arrears as on December 31, 2000 for monitoring as per following schedule: (i) top 10 arrears cases in each Collectorate (total of 100 cases); (ii) case-wise details of arrears above PRs 1 million principal liability; (iii) similar details for all cases above PRs 100,000 principal liability.	Ongoing		
		(i) top 10 arrears cases in each Collectorate (total of 100 cases);	(i) Feb. 15	Done
		(ii) case-wise details of arrears above PRs 1 million principal liability;	(ii) Feb 15;	Done
	(iii) similar details for all cases above PRs 100,000 principal liability.	(iii) Feb. 20	Done	
	4. Compile a list of top 100 sales tax “defaulters.”	February 11	Done	
	5. Establish and implement a monthly monitoring system for top 100 sales tax “defaulters,” compiling an updated position at the end of each month.	Ongoing		
	6. Set monthly targets for arrears recovery for Collectorates.	March 1		
7. Set monthly targets for Collectorates on the number of cases closed/settled and revenue recovered.	March 1			
8. Prescribe format for Collectorates to report arrears regularly on a monthly basis, showing arrears accrual from January 1, 2000 onwards per month and providing details on cases involving principal amounts in excess of PR 1 million.	Start March 1			
	9. Ensure that sales tax Appellate Tribunals are operational and prioritize large-revenue cases by; (i) informing the Chairman Appellate Tribunals on importance of early settlement of large-revenue cases; (ii) sending monthly letters to the Chairman Appellate Tribunals with list of cases for early hearing of large-revenue cases; (iii) clearing officers for promotion to staff Appellate Tribunals; and (iv) get 6 benches operational.	(i) Feb.	Done	
		(ii) Ongoing		
		(iii) Feb.		
(iv) as soon as possible		Done		
E. Sales Tax Non-filers	1. Identify those registered taxpayers who have not filed any monthly return for the period July-December 2000.	February 20	Done	
	2. Treat these habitual offenders as a separate enforcement category.	Start March 1		
	3. Pursue these habitual offenders for de-registration on settlement of any outstanding liability or compel them to comply when still in business.	Complete by end-May		
		February 25	Done	
	4. Put embargo on transaction of these habitual offenders’ registration numbers in customs and other tax departments.	Ongoing		
		February 25	Done	
	5. For other non-filers, Collectors will identify multiplicities/duplicities and categorize them as follows: (i) identify the top 10 percent non-filers in terms of revenue potential and have enforcement staff visit them in addition to issuing notices; and (ii) issue notices to all others.	Ongoing		
6. Reintroduce computer identification of non-filers.	February 15	Done		
7. Set quantitative targets for Collectorates for accelerated decline in number of non-filers.	March 15			
F. Income Tax Arrears	1. Increase the penalty for late payment of tax to 2 percent per month.	March		
	2. Member Income Tax to oversee arrears collection/non-filer enforcement drive.	Ongoing		
	3. Commissioners prepare lists of cases with arrears over PR 1 million.	February 28	Done	

Pakistan—Central Board of Revenue (CBR) Short-term Action Plan

Area	Action	Completion Date	Status
	4. Compile a list of the top 100 arrears cases (defaulters).	February 25	Done
	5. Create and implement monthly monitoring system for the top 100 defaulters; monitoring is done by Member Direct Tax, Regional Commissioners, and designated regional officials.	Started Feb. 28	Done
	6. Set monthly targets on arrears collection for Regional Commissioners.	March 1	
	7. Monitoring of arrears collection is a distinct component of overall review process.	Start March 1	
	8. Identify defaulters for assessment year 2000/01 and initiate enforcement.	February 14	Done
	9. Issue instructions to Regional Commissioners to identify cases involving revenue of more than PR 1 million that are stuck in appeals process.	March 15	
	10. Chairman CBR/Member Income Tax to meet Chairman Appellate Tribunals to request early hearing and disposal of cases with revenue of more than PR 1 million.	March	
	11. Chairman CBR/Member Income Tax write monthly letters to Chairman Appellate Tribunals with list of cases for early hearing due to revenue importance.	Ongoing	
	12. Get all Appellate Tribunal benches activated, in consultation with Law Ministry.	March 15	
	13. Undertake study to identify factors contributing to incidence of disputed assessments (to be done by Committee on Revision of I March	March	
G. Customs Refunds	1. Conduct investigation of current practices by Collector Exports in Karachi, Faisalabad and Sialkot.	February 28	
	2. Finalize draft refund rules and update input/output tables.	As soon as possible	

## **PAKISTAN**

### **Technical Memorandum of Understanding on the Program Supported by Stand-By Arrangement**

(March 2001)

1. This memorandum sets out the understandings between the Pakistan authorities and the Fund staff relating to the monitoring of the program for 2000/01 supported by the Stand-By Arrangement. Section I specifies the quantitative performance criteria; Section II specifies the indicative targets; Section III specifies structural performance criteria; Section IV specifies structural benchmarks; Section V specifies the content and frequency of the data to be provided for monitoring the financial program; and Section VI describes the mechanism for monitoring of the petroleum price adjustments and national accounts project. Definitions of the relevant financial variables are provided in the Annex.

#### **I. QUANTITATIVE PERFORMANCE CRITERIA**

2. The quarterly performance criteria will consist of ceilings or floors on the following variables:

- Cumulative change from July 1, 2000 in the net foreign assets of the SBP;
- Cumulative change from July 1, 2000 in the net domestic assets of the SBP;
- Cumulative overall budget deficit from July 1, 2000;
- Net borrowing from the banking system by the government from July 1, 2000;
- Cumulative CBR revenue from July 1, 2000;
- Banking system credit from July 1, 2000, to the seven major public enterprises listed in Table 1 of the Memorandum on Economic and Financial Policies (MEFP);
- Accumulation of budgetary arrears to the Water and Power Development Authority (WAPDA) from July 1, 2000;
- Contraction of short-term public and publicly guaranteed external debt;
- Contraction of new nonconcessional medium- and long-term public and publicly guaranteed external debt from July 1, 2000, with a subceiling on debt with an initial maturity of over one year and up to and including five years; and

- Non accumulation of external payments arrears.

3. The floors and the ceilings applicable to the preceding variables will be monitored on the basis of the magnitudes specified in Table 1 of the MEFP.

**A. Adjustments to the Net Foreign Assets of the SBP**

4. The floors on the net foreign assets of the SBP will be adjusted:

- Upward by the rupee equivalent of the excess in program financing;
- Downward by the rupee equivalent of the shortfall in program financing provided that the SBP net foreign assets remain above PRs -78.0 billion at end-December 2000, above PRs -61.3 at end-March 2001, and above PRs -20 billion at end-June 2001. These amounts will be calculated at program exchange rates.
- Upward by the rupee equivalent of the full amount of any privatization proceeds from abroad; and
- Upward by the rupee equivalent of the excess in nonresident institutional foreign currency deposits with SBP forward cover above the end-August 2000 level (US\$1,068 million), in foreign currency exchange swaps of the SBP above the end-August 2000 level (US\$717 million), in outright forward sales of foreign exchange by the SBP above the end-August 2000 level (US\$23 million), and in SBP foreign exchange reserves held with foreign branches of domestic banks above the end-June 2000 level (US\$545million).
- The floor for end-June 2001 will also be adjusted upward/downward for the excess/shortfall in FE25s held with the SBP above their projected end-June 2001 level of US\$530 million (PRs 31.62 billion).

**B. Adjustments to the Net Domestic Assets of the SBP**

5. The ceilings on the net domestic assets of the SBP will be adjusted:

- Downward by the rupee equivalent of the excess in program financing;
- Downward by the rupee equivalent of the full amount of any privatization proceeds from abroad used by the budget;
- Upward by the rupee equivalent of the shortfall in program financing provided that the net domestic assets of the SBP remain below PRs 541.3 billion at end-December 2000, below PRs 563.1 billion at end-March 2001, and below PRs 545 billion at end-June 2001; and

- Downward by the rupee equivalent of the excess in foreign-currency deposits with SBP forward exchange cover above the end-August 2000 level, in foreign exchange swaps of the SBP above the end-August 2000 level, in outright forward sales of foreign exchange by the SBP above the end-August 2000 level, and in SBP foreign exchange reserves held with foreign branches of domestic banks above the end-June 2000 level.
- Downward/upward by the amount of banks' reserves freed/seized by any reduction/increase of daily CRR of 4 percent and by the amount of any reduction/increase in the deposit base with respect to the programmed level of PRs 1,084 billion at end-March 2001 and PRs 1,143 billion at end-June 2001 that is related to changes in deposits subject to CRR. Changes in required reserve regulations will modify the NDA ceiling of the SBP according to the formula:  $\Delta NDA = \Delta rB_0 + r_0\Delta B + \Delta r\Delta B$ , where  $r_0$  denotes the daily reserve requirement ratio prior to any change;  $B_0$  denotes the programmed level of the reservable money supply in the period prior to any change;  $\Delta r$  is the change in the reserve requirement ratio; and  $\Delta B$  denotes the change in the reservable deposits with respect to the programmed level as a result of changes in definition of reservable money supply (deposits).
- The ceiling for end-June 2001 will be adjusted downward/upward for the excess/shortfall in FE25s held with the SBP above their projected end-June 2001 level of US\$530 million (PRs 31.62 billion).

### **C. Adjustments to Net Banking Borrowing**

6. The ceiling on net bank borrowing by the government will be adjusted:
- Downward by the rupee equivalent of the excess in net external budget financing (defined below);
  - Upward by the rupee equivalent of the shortfall in net external budget financing provided that net bank borrowing by the government remains below PRs 21.1 billion at end-December 2000, below PRs 34.8 billion at end-March 2001, and below PRs -8 billion at end-June 2001; and
  - Downward by the rupee equivalent of the amount of any privatization proceeds used by the budget.

### **D. Adjustments to Credit to the Seven Major Public Enterprises**

7. The ceilings for end-December 2000, end-March 2001, and end-June 2001 will be adjusted downward by the difference between program and actual amounts of restructuring credits to KESC related to the financing of its cash shortfall agreed with AsDB is positive; the program amount is PRs 7.5 billion.



## II. INDICATIVE TARGETS

8. The following variables constitute quarterly indicative targets: (a) cumulative change from July 1, 2000, in the net domestic assets of the banking system; and (b) federal tax revenue in 2000/01 (comprising taxes collected by the Central Board of Revenue, gas and petroleum surcharges, and the foreign travel tax); and (c) social and poverty-related spending in 2000/01. Social and poverty-related budgetary expenditures are defined as central and provincial government spending under the Public Sector Development Program (PSDP) and the Social Action Program (SAP), including outlays on agricultural income generating programs, education and training, health and nutrition, rural development (farm to market roads), manpower and employment, women and development, population and welfare, social welfare, environment, integrated rural and urban development, and the special areas social action program. SAP spending also includes basic education and health sector current outlays. Expenditures under the Zakat program outside the budget are excluded. Observance of these quarterly indicative targets will be monitored on the basis of the magnitudes specified in Table 1 of the MEFP.

### **Adjustments to the net domestic assets of the banking system**

9. The ceilings on the net domestic assets of the banking system will be adjusted:
- Downward by the rupee equivalent of the excess in program financing;
  - Upward by the rupee equivalent of the shortfall in program financing provided that the net domestic assets of the banking system remain below PRs 1,495.5 billion at end-December 2000, below PRs 1,515.7 billion at end-March 2001, and below PRs 1,545.8 billion at end-June 2001;
  - Downward by the rupee equivalent of the full amount of any privatization proceeds from abroad; and
  - Downward by the rupee equivalent of the excess in foreign currency deposits with SBP with forward exchange cover above the end-August 2000 level.

## III. STRUCTURAL PERFORMANCE CRITERIA

10. The following measures constitute structural performance criteria:
- Implementation of the quarterly petroleum price adjustment (program period) for all major petroleum products as described in Section VI below;
  - Ban on introduction of new GST exemptions and fixed-tax schemes under the GST (continuous during the program period);

- Publication of quarterly fiscal reports that have been verified by the Accountant General Pakistan Revenue (program period, starting with the first quarter of 2000/01; reports are to be published no later than two months after the end of the quarter);
- GST extension to urea fertilizer and pesticides by end-March 2001 and to all other agricultural inputs by September 1, 2001;
- The promulgation of a new income tax law with the passage of the 2001/02 budget that puts into place a global income tax with: (a) a simpler rate structure for individuals; (b) uniform tax of all companies; (c) less emphasis on withholding and presumptive taxes; (d) fewer exemptions; and (e) replacement of investment incentives by a simple system of accelerated depreciation;
- The extension of income tax to all new issuance of NSS instruments on the same basis as the income tax currently applies to other financial instruments with the passage of the 2001/02 budget;
- The extension of the GST to all retailers/traders above the PRs 5 million threshold with the passage of the 2001/02 budget;
- The reduction of the maximum custom tariff to 30 percent and the number of tariff slabs to 4 on July 1, 2001; and
- The elimination of the interest rate subsidy in the export finance scheme on July 1, 2001. The subsidy will be measured as the difference between the export finance scheme interest rate less 1.5 percentage points and the average 6-month Treasury bill yield prevailing in auctions during the previous quarter.
- Preparations of an IAS-compliant reporting format and comparable IAS financial statements for the SBP for the previous year ended June 30, 2000 by end-June 2001.
- Reduction of SBP deposits with Pakistani banks abroad to a maximum of US\$200 million and formulation of a plan to further reduce placements with Pakistani banks abroad by end-June 2001.

#### **IV. STRUCTURAL BENCHMARKS**

11. The following measures constitute structural benchmarks:

- Completion and publication of a special audit in line with international standards of the CDNS (end-October 2000);

- Establishment and implementation of a formula linking interest rates on new Defense Savings Certificates (DSCs) to the market-determined yield of the new government bond (January 1, 2001);
- Enactment of the anti-dumping law (end-December 2000); that would lead to the withdrawal of the differential excises applied to domestically-produced and imported goods as an anti-dumping measure.
- Preparatory steps relating to the promulgation of a new income tax law with the 2001/02 budget: (i) the income tax committee will submit its preliminary recommendations to the Ministry of Finance by end-2000; and (ii) the final report, with a draft law, will be submitted to the cabinet by end-March 2001; and
- Measures to improve national accounts statistics, as detailed in Section VI.
- Commissioning and completion of an independent review of SBP's internal audit function by end-June 2001.
- Preparations of draft revisions to the SBP Act and issuance of resolutions by the MFP Coordination Board: (i) to ensure that the Governor and other Central Board members can only be removed by legal cause; and (ii) to guarantee autonomy of the SBP in respect of the management of reserves.

12. In addition, the following measures constitute structural benchmarks related to improving fiscal transparency:

- Establish basic reconciliation processes in all provinces. All provinces will produce quarterly reports for internal use and reporting to the Ministry of Finance that are fully reconciled in terms of between Accountant General and departmental accounts, clearance of suspense accounts, SBP and scheduled bank accounts, and provincial/federal records of intergovernmental flows, starting end-March 2001 (covering data through December 2000).
- A statement of contingent liabilities should be published as an annex to the Economic Survey presented prior to the 2001/02 budget.
- A schedule of tax expenditures should be published as an annex to the Economic Survey presented prior to the 2001/02 budget.
- Initiate a review of Part A (covering cost of government services such as wages and salaries) of the budget by end-December 2000.
- Establish a fiscal reform unit in the Ministry of Finance by January 2001 to build up technical capacity and more effective ownership of fiscal reform programs, which would cover tax reform as well as public expenditure management reform.

## V. FINANCIAL PROGRAM REPORTING REQUIREMENTS

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

- Monthly statements on federal tax revenue.
- Deposits into and withdrawals from the privatization accounts for each quarter of 2000/01. Withdrawals are to be reported with the following breakdown: (i) those which constitute budgetary use of privatization proceeds; (ii) those which constitute costs of privatization; and (iii) other (please explain the purpose of other withdrawals).
- Quarterly statements on nontax revenue.
- Quarterly statements on capital receipts and disbursements, including repayments of bonds, recovery of loans from provinces and "others".
- Quarterly statement on consolidated budgetary expenditure.
- Quarterly data on social sector and poverty-related budgetary expenditures.
- Quarterly data on the stock of domestic government debt, broken down by instrument.
- Quarterly data on budgetary arrears to and from WAPDA.
- Quarterly data on external financing (as defined in paragraph 9 of the Annex), including project aid, commodity aid, food aid, and other nonproject financing (including suppliers' credit used by NHA).
- Quarterly data on the revenues and expenditures of the seven public enterprises as per the formats adopted in Tables 28 through 34 of the Recent Economic Developments paper (SM/97/253).
- The following monthly monetary data on a last-Saturday basis, both at current and program exchange rates:
  - (a) monetary survey;
  - (b) accounts of the State Bank of Pakistan (SBP);
  - (c) consolidated accounts of the scheduled banks;
  - (d) lending to the government; and
  - (e) deposits of the government and of public sector enterprises on account of external debt service payments subject to rescheduling (in arrears).

- The same tables as in the preceding item, but on an end-quarter basis, both at current and program exchange rates.
- Weekly data on SBP's sales and purchases in the kerb and interbank foreign exchange markets, swaps and forward outright sales.
- Monthly data on the outstanding stock of the SBP's forward foreign currency operations, including swaps and outright forward sales and purchases. The terms of any new transactions will also be provided.
- Monthly data on the SBP's foreign exchange reserves, with details on the currencies, instruments, and institutions in which the reserves are held.
- Quarterly data on bank credit to the seven major public enterprises listed in Table 1 of the MEFP.
- The following quarterly data on external debt:
  - (a) Stock of public and publicly guaranteed external debt (including deferred payments arrangements), with initial maturities of up to and including one year;
  - (b) Loan-by-loan detail of the contracted new medium and long-term non-concessional public and publicly-guaranteed external debt with separate identification of the contraction of debt with an initial maturity of over one year and up to and including five years; grace periods and scheduled repayments; currency denominations; and interest rates;
  - (c) Monthly data on external payments arrears on public and publicly guaranteed debt;
  - (d) Monthly statements on rescheduling agreements on public and publicly guaranteed debt reached with creditors; and
  - (e) Monthly data on deposits in special accounts by public sector enterprises on account of rescheduled (or in arrears) publicly guaranteed debt service payments.
- Copies of new ordinances regarding changes in tax policy and administration no later than 3 days after official issuance, or notification that ordinances have been posted on the CBR website.
- Monthly data on the import parity prices of the seven major oil products listed in Table 1.

## **VI. MONITORING MECHANISMS**

### **A. Monitoring of Petroleum Products Price Adjustments**

14. The quarterly adjustment of prices for petroleum products will be undertaken using an automatic formula based on absolute prices that would determine pump prices as the sum of average import parity prices (IPP) during the preceding three months plus applicable margins and taxes as specified in Table 1. Prices of the following products will be adjusted automatically on the basis of this formula each quarter during the program period (on September 15, 2000; December 15, 2000; March 15, 2001; and June 15, 2001): Motor Spirit (MS), High-Octane Blend Component (HOBC), Methyl Tertiary Butyl Ether (MTBE), Kerosene (SKO), High-Speed Diesel (HSD), Light-Diesel Oil (LDO), and Jet Fuel (JP-4). The automatic price adjustment for each product will be corrected to the extent necessary to eliminate negative surcharges, and with constant or higher total surcharges for each product over the program period as shown in Table 1 for September 2000.

### **B. Monitoring of National Accounts Project**

15. Detailed planning of the full improvement of the National Accounts Project including a draft allocation of the available budget will be completed before October 15, 2000. A report outlining the plan will be provided to the Statistics Department of the Fund by end-October 2000.

16. Reports on research studies, including tabulation of statistical results and a description of the methodology followed, in the framework of this project will be sent to the Fund's Statistics Department according to the following schedule:

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<b>Date</b>	<b>Economic Activity</b>	<b>Main Issues for Improvement</b>
March 31, 2001	Fishing	Coverage Increased specification types of fish Capital formation
March 31, 2001	Shipping	Coverage, forward/clearing agents
March 31, 2001	Services	Estimates for newly emerged Business and personal services
June 30, 2001	Livestock	Yields of milk. Meat, by-products, Inputs structure
June 30, 2001	Mining & Quarrying	Coverage surface mining Services of mining Input structure; transport incidental to oil and gas
June 30, 2001	Public Admin. & Defense	Budget classification Capital formation Deflation methodology

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## Definitions of the Monitoring Variables

### Reserve money

1. Reserve money (RM) is defined as the sum of currency outside scheduled banks, scheduled banks' domestic cash in vaults, scheduled banks' (deposit money banks) required and excess deposits with the State Bank of Pakistan (SBP), and deposits of the rest of the economy with the SBP excluding those held by the federal government, the provincial governments, CEC, RECP, and counterpart funds. For end-June 2001, reserve money will be defined as above minus the change in the reserve money due to changes in the cash reserve requirements (CRR) on FE25s according to the following formula:

$$RM - (CRR_{FE25s} - 0.05) * FE25s.$$

### Net foreign assets of the SBP

2. The net foreign assets of the SBP are defined as the difference between its foreign assets and foreign liabilities. Foreign assets of the SBP consist of gold, foreign exchange, balances held outside Pakistan, foreign securities, foreign bills purchased and discounted, net IMF position and SDR holdings. The definition of foreign assets of the SBP will need to be fully consistent with the Data Template on International Reserves and Foreign Currency Liquidity. Gold will be valued at SDR 35 per fine troy ounce. Foreign liabilities of the SBP include deposits with the SBP of foreign governments, foreign central banks, foreign deposit money banks, and international organizations. For monitoring purposes, assets and liabilities denominated in SDRs, including the SDR value of the gold holdings and assets and liabilities resulting from transactions with the Fund (purchases, disbursements, repurchases, and repayments) will be converted into U.S. dollars at the rate of US\$1.3648 per SDR.<sup>1</sup> Those denominated in currencies other than the U.S. dollar will be converted into U.S. dollars at the market rates of the respective currencies prevailing on June 30, 2000, as published in the IFS. The U.S. dollar value of foreign assets and liabilities will be converted into Pakistan rupees at end-September 2000, at the rate of PRs 54.60 per U.S. dollar, at end-December 2000 at PRs 58.66 per U.S. dollar, at end-March 2001 at PRs 59.52 per U.S. dollar, and end-June 2001 at PRs 59.66 per U.S. dollar.

### Net domestic assets of the SBP

3. The net domestic assets of the SBP are defined as the difference between reserve money and the net foreign assets of the SBP.

### Domestic liquidity

4. Domestic liquidity is defined as currency outside scheduled banks plus demand, time, and savings deposits of private residents held with the banking system in both domestic

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



currency and foreign currency. Foreign currency deposits denominated in currencies other than the U.S. dollar will be converted into U.S. dollars at the market rates of the respective currencies prevailing on June 30, 2000 as published in IFS. The U.S. dollar value of foreign currency deposits will be converted into Pakistan rupees at end-September 2000 at the rate of PRs 54.60 per U.S. dollar, at end-December 2000 at PRs 58.66 per U.S. dollar, at end-March 2001 at PRs 59.52 per U.S. dollar, and at end-June 2001 at PRs 59.66 per U.S. dollar.

#### **Net foreign assets of the banking system**

5. The net foreign assets of the banking system are defined as the difference between foreign assets and foreign liabilities of the banking system. Foreign assets of the banking system are defined as the sum of the foreign assets of the SBP (as defined above), balances held abroad by the scheduled banks, and foreign bills purchased and discounted by the scheduled banks. Foreign liabilities of the banking system are defined as the sum of the foreign liabilities of the SBP (as defined above), deposits of nonresidents held with the scheduled banks and borrowing from banks abroad by the scheduled banks. For monitoring purposes, the assets and liabilities denominated in currencies other than the U.S. dollar will be converted into U.S. dollars at the market rates of the respective currencies prevailing on June 30, 2000 as published in IFS. The U.S. dollar value of foreign assets and liabilities will be converted into Pakistan rupees at end-September 2000, at the rate of PRs 54.60 per U.S. dollar, at end-December 2000 at PRs 58.66 per U.S. dollar, at end-March 2001 at PRs 59.52 per U.S. dollar, and at end-June 2001 at PRs 59.66 per U.S. dollar.

#### **Net domestic assets of the banking system**

6. The net domestic assets of the banking system are defined as the difference between domestic liquidity and net foreign assets of the banking system.

#### **Net borrowing from the banking system by the government**

7. Net borrowing from the banking system by the government is defined as the difference between the banking systems claims on the central and provincial governments and the deposits of the central and provincial governments with the banking system (including domestic currency counterpart deposits for relief from debt rescheduling on government and military debt). For purposes of this memorandum, claims on Government exclude: (i) revaluation of securities in the IMF accounts; and (ii) credit for commodity operations. In turn, government deposits exclude: (i) Zakat deposits; and (ii) balances in the privatization fund.<sup>2</sup>

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<sup>2</sup>Government deposits do not include deposits in extra-budgetary government accounts with the banking system, including those related to privatization.

### **Overall budget deficit**

8. The consolidated overall budget deficit—the excess of total budgetary expenditure over total budgetary revenue of the consolidated fund of the federal government and provincial governments—will be measured by the sum of: (a) budgetary use of privatization proceeds; and (b) total net financing to the federal and provincial governments. The latter is defined as the sum of net external financing (defined below), net borrowing from the banking system (as defined above), and net domestic nonbank financing (defined below).

### **Net external financing of the budget**

9. Net external financing is defined as follows:

- All plan resources (grants and loans) enumerated in the 2000/01 Budget document “Estimates of Foreign Assistance”, including Project Aid; Non-Food Commodity Aid; Food Aid; and Other Aid (Short-term Borrowings), including financing from the Islamic Development Bank.
- Net receipts from the issuance of foreign currency denominated debt including FEBC, DBC, and FCBC and special government dollar bonds. Net receipts from these bonds will be adjusted downward (upward) by the increase (decrease) in the stock of those bonds held by the banking system.
- The accumulation of arrears on public foreign currency debt (including military debt), since July 1, 2000.
- Debt relief associated with rescheduling of public debt (including military debt) owed to bilateral and commercial creditors.
- Receipts from the contracting other foreign currency government debt, not specified above.

Less:

- The repayment due of foreign loans enumerated in schedule II of the 2000/01 Budget document “Demands for Grants and Appropriations” (medium- and long-term debt); and
- The repayment due of short-term foreign credits enumerated in section II (Capital Receipts) of the 2000/01 Budget document “Explanatory Memorandum on Federal Receipts.”

Amounts assumed in the program for components of net external financing of the budget are provided in the table below:

## Pakistan: Net External Financing of the Budget Deficit from July 1, 2000 1/

(In billions of Pakistani rupees)

	2000/01			
	Q1	Q2	Projection	
			Cum. From July 1, 2000	Q3
<b>External Financing (net)</b>	22.3	71.5	87.0	122.0
External receipts	44.2	115.6	154.4	211.0
Project aid 2/	9.3	19.9	32.5	51.4
Commodity aid (non-food) 3/	0.0	22.2	23.6	43.5
Food aid	0.0	0.0	0.0	0.0
Other	19.1	42.5	65.6	84.4
Islamic Development Bank (loans)	8.0	18.5	26.2	32.0
Gulf countries (grant) 4/	11.0	23.7	36.6	44.7
F16	0.0	0.0	2.4	4.8
FCD conversion bonds	0.1	0.3	0.4	2.9
FEBCs/DBC/FCBCs (net)	-0.7	-1.4	-2.1	-1.0
Amortization (due)	21.9	44.1	67.4	89.0
Arrears	-20.5	-20.5	-20.5	-29.0
Debt rescheduling	36.9	53.0	55.2	61.7
<b>Memorandum items:</b>				
Exchange rate (PRs/US\$, quarterly average)	53.8	58.3	59.4	59.6

Sources: Ministry of Finance; and Fund staff projections.

1/ External financing data in Pakistani rupees is derived from quarterly data in U.S. dollars using quarterly average exchange rates, except in the cases of external financing related to issuance of foreign currency denominated debt and the Saudi oil facility. In those cases, financing is derived from the change in the rupee-denominated debt stock as reported by the SPB (which converts the debt stock into rupees at the exchange rate prevailing at issuance) and rupee deposits of refineries in the dedicated SBP account, respectively.

2/ Includes grants.

3/ Includes all AsDB and World Bank lending; assumes SAL disbursements in 2000/01 Q4.

4/ Assumes 80,000 barrels a day and US\$29.5 per barrel.

### **Net domestic nonbank financing of the budget**

10. Net domestic nonbank financing is defined as the change, during each fiscal year, in the stock of: (a) permanent debt, which consists of non-bank holdings of prize bonds, SLIC bonds, BNFBs, FIBs, the new long-term bond and other receipts; plus (b) floating debt held by nonbanks; plus (c) public account (or unfunded debt), which consists of NSS debt, Postal Life Insurance, and the Provident Fund; plus (d) stock of deposits and reserves received by the Government; plus (e) suspense account; plus (f) any other government borrowing from domestic sources net of repayments; minus (g) government deposits with NBFIs.

11. Nonbank holdings of permanent and floating debt is defined as total debt outstanding, as reported by the SBP, minus holdings of banks as per the monetary survey. Total treasury bill debt is valued at discount value.

### **Public and publicly guaranteed external debt**

12. The performance criteria on contracting of nonconcessional medium- and long-term public and publicly guaranteed external debt and on contracting of short-term public and publicly-guaranteed external debt apply not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (adopted on August 24, 2000), but also to commitments contracted or guaranteed for which value has not been received. Public and publicly-guaranteed external debt includes the following (a) guarantees provided by the SBP; (b) partial credit guarantees from external creditors, if covered by a Government counter guarantee; and (c) external debt contracted by state-owned enterprises or banks when they are clearly only motivated by balance of payments considerations. It excludes: (a) the foreign currency deposit liabilities of the banking system; and (b) the outstanding stocks of FEBCs, DBCs, and FCBCs. Short-term external debt is defined as loans with original maturity of up to and including one year. Medium- and long-term external debt consists of debt with initial maturity of over one year. The external debt will be expressed in U.S. dollar terms, with debts in currencies other than the U.S. dollar converted into U.S. dollars at the market rates of the respective currencies prevailing on June 30, 2000 as published in IFS.

### **Nonconcessional borrowing**

13. Nonconcessional borrowing is defined following the methodology set out in the staff report SM/96/86 and approved by the IMF Executive Board on April 5, 1996. The discounting rate will be the average Commercial Interest Reference Rates (CIRRs) prevailing during the previous six-month period (February 15 to August 14 or August 15 to February 14) for maturities of less than 15 years; and the average CIRRs for the period 1986–95 for maturities of at least 15 years, as prepared by the Policy Development and Review Department of the Fund.

### Program financings

14. Program financing is defined to include balance of payments support loans, including adjustment loans from multilateral creditors other than the Fund, balance of payments support from bilateral creditors, and rescheduling and arrears on medium- and long-term public and publicly guaranteed debt. Specifically, balance of payments support loans are defined to include:

- adjustment loans from the World Bank and the Asian Development Bank
- bilateral grants and loans for balance of payments support
- loans from commercial banks (net)
- rollover of FE-45 deposits (net)
- Saudi oil facility
- less principal payments due to the World Bank, AsDB, IDB, and IFAD.

#### Pakistan: Balance of Payments Support Loans (Cumulative from July 1, 2000)

(In millions of U.S. dollars)

	Sept. 2000	Dec. 2000	Mar. 2001	Jun. 2001
Program financing	86	570	567	918
World Bank loans	0	0	0	350
AsDB loans	0	380	405	403
Bilateral grants and loans	220	452	689	858
Saudi oil facility	205	422	640	773
Project grants	15	30	49	85
Additional commercial bank borrowing	0	45	95	195
Debt relief from commercial bank	0	0	-207	-298
Amortization to multilateral Creditors, excluding the IMF	-140	-320	-434	-590

15. Rescheduling and arrears on medium- and long-term public and publicly guaranteed debt is defined as the difference between the debt service due on the debt to bilateral, supplier, and commercial creditors, and payments made on this debt (see paragraph 14). External financing counted as reserve liability of the SBP is defined to include all net deposits of foreign banks and agencies with the SBP, and net purchases and disbursements from the IMF, as well as bridge financing.

**Pakistan: External Financing Counted as Reserve Liabilities of SBP  
(Cumulative from July 1, 2000)**

(In millions of U.S. dollars)

	Sept. 2000	Dec. 2000	Mar. 2001	Jun. 2001
Total	-12.1	117.7	205.8	218.2
Deposit of NBP	66.0	66.0	66.0	-22.0
Fund disbursements	0.0	204.7	348.0	491.3
Repayments to the Fund	-78.1	-153.0	-208.2	-251.1

**Budgetary arrears to WAPDA**

16. Payments of electricity bills of federal and provincial governments overdue by more than 30 days, as reported by WAPDA in the following format:

**POSITION OF BILLING/RECEIVABLES AND RECONCILIATION IN RESPECT OF FEDERAL AND PROVINCIAL GOVERNMENT DEPARTMENTS VIS-À-VIS WAPDA FOR THE QUARTER OF \_\_\_ TO \_\_\_**

SR. NO.	CATEGORY	RECEIVABLES AT THE QUARTER END OF PREVIOUS	AMOUNT WITHDRAWN AGAINST PREVIOUS QUARTER	BILLING DURING QUARTER	AMOUNT RECONCILED AGAINST COLUMN 5	TOTAL	PAYMENT DURING QUARTER	RECEIVABLES AT THE END OF THE QUARTER
1	2	3	4	5	6	7=3-4+5	8	9=7-8
A	Federal Govt.							
I.	Federal Govt. Agencies							
II.	AJK							
	Subtotal							
B	Provincial Govt. Depts							
I.	Punjab							
II.	NWFP							
III.	Sindh							
IV.	Baluchistan							
	Subtotal							
C	Total Govt (A+B)							
	WAPDA Debt Service Liability to government							
	Net position							

**Table 1. Pakistan: Automatic Petroleum Price Adjustment Formula**

Product	IPP				CED/CD	Distribution margin	Freight margin	Dealer commission	Total surcharges 1/	GST	Fixed sales price (in PRs)	Increase in Fixed Sales Price (in percent)
	Jun-00	Jul-00	Aug-00	Average								
(1)	(2)	(3)	(4)	(5)	Sep-00	Sep-00	Sep-00	Sep-00	Sep-00	(11)=0.15*((5)+(6)+(7)+(8)+(9)+(10))	(12)=(5)+(6)+(7)+(8)+(9)+(10)+(11)	Sep-00
(In PRs per liter)												
MS	9.33	9.22	10.21	9.59	0.88	0.61	0.75	0.57	12.19	3.69	28.29	2.86
HOBC	10.52	10.41	11.48	10.80	0.88	0.77	0.79	0.68	15.02	4.34	33.29	2.42
SKO	9.87	10.84	12.77	11.16	0.00	0.19	0.83	0.00	0.00	1.83	14.01	24.51
HSD	9.65	10.33	12.55	10.84	0.25	0.30	0.98	0.35	0.73	2.02	15.47	14.59
LDO	9.68	9.93	11.77	10.46	0.04	0.18	0.97	0.00	0.00	1.75	13.40	21.82
JP-4	9.62	10.17	11.64	10.48	0.06	0.00	0.00	0.00	2.39	1.94	14.86	10.90

Sources: Ministry of Finance; and Fund staff estimates.

1/ As of July 2000 for MS, HSD, and JP-4.

**Statement by the IMF Staff Representative**  
**March 30, 2001**

1. This statement reports on the implementation of prior actions that have been specified in the Memorandum on Financial and Economic Policies (MEFP) and provides an update on the main recent economic developments and financing issues. The information contained in the statement does not alter the analysis and appraisal contained in the staff report (EBS/01/39).

2. **The two remaining prior actions at the time of the circulation of the staff report to the Board have been implemented.** Increases in the average electricity tariff rates of the Water and Power Development Authorities (WAPDA) and of the Karachi Electricity Supply Corporation (KESC) of 4.5 percent and 13.2 percent, respectively, were approved by the National Electric Power Regulatory Authority (NEPRA) in decisions dated March 18, March 22, and March 24, and became effective on March 27, 2000. In addition, formula-based automatic fuel price adjustment clauses for electricity tariffs were introduced.

3. **Official reserves are improving without undue pressure on the rupee.** As of March 28, the level of usable gross official reserves amounted to US\$735 million. The build-up of reserves over the last month (from US\$566 million at end-February) was mainly achieved through purchases of foreign exchange in both interbank and kerb markets, without any recourse to short-term swap and forward contracts. The rupee has depreciated by 0.7 percent since the beginning of the month and the spread between the interbank and kerb rates remains at about 5 percent.

4. **Monetary policy stance has been tightened.** To mitigate the pressure on the exchange rate from the foreign exchange purchases and to meet the NDA target of the State Bank of Pakistan for end-March, the central bank has started to mop up rupee liquidity and raised interest rates on March 21. Treasury bill rates have risen by 32–65 basis points. With the parallel loosening of the U.S. Federal Reserve's monetary policy stance, the spread in favor of the rupee has increased even more. At 11.3 percent, the rate on three-month treasury bills is now above the comparable U.S. rate by more than 700 basis points, against 430 points in November 2000.

5. **The Central Board of Revenue (CBR) has continued to implement the short-term action plan to improve tax administration broadly as scheduled.** Over the past few weeks the authorities have focused especially on sales tax audits, arrears, and nonfilers. In particular, the CBR has increased the number of sales tax audits to 620 in February (from a monthly average of 240 during July–December 2000, and 510 in January 2001); reassigned 400 auditors from tax survey work to sales tax audits; and stepped up supervision of auditing and follow-up on nonfilers in collectorates. In addition, effective March 15, the establishment of Appellate Tribunal benches has been simplified to allow more and faster hearings of sales tax arrears cases. The final report of the Committee to Revise the Income Tax Ordinance has been submitted to the government by end-March as scheduled and the authorities have



requested further technical assistance from LEG and FAD with the objective to have the new income tax ordinance ready for promulgation with the 2001/02 budget in July. The submission of the final report of the Task Force on Tax Administration has been delayed until mid-April.

6. **The SBP has approved a further cut in subsidies under the Export Finance Scheme (EFS) and withdrawn the restriction on commercial banks' placement of foreign currency deposits abroad, effective April 1.** EFS rates will increase from 9 percent per annum to 10.5 percent; the authorities intend to eliminate the remaining EFS subsidies by end-June 2001. The SBP has put in place a reserve requirement of 25 percent on foreign currency deposits, as well as other measures to protect the interest of depositors, as envisaged in the MEFP.

7. **The mobilization of exceptional financing is proceeding as envisaged in the MEFP.** All the prior actions required by the Asian Development Bank related to two loans have been implemented, and US\$80 million are expected to be disbursed shortly. Preparation for the World Bank's Structural Adjustment Credit (SAC) is under way. Drafts of the President's Report and of the Country Assistance Strategy Update are under review by the World Bank's Operation Committee. The US\$350 million credit is expected to be considered by the Executive Board of the World Bank by end-May 2001.

**NEWS**  **BRIEF**

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News Brief No. 01/32  
FOR IMMEDIATE RELEASE  
March 30, 2001

International Monetary Fund  
700 19th Street, NW  
Washington, D. C. 20431 USA

**IMF Approves Release of US\$133 Million Credit to Pakistan**

The Executive Board of the International Monetary Fund (IMF) completed today its first review of Pakistan's performance under a Stand-by Arrangement (see Press Release No. 00/64), which enables the release of SDR 105 million (about US\$133 million).

As part of the Executive Board's review, revisions to initial performance criteria under the Stand-by Arrangement were also reviewed and approved. A revised Memorandum on Economic and Financial Policies (MEFP), which updates and supplements an MEFP dated November 4, 2000, is being published on the IMF's website ([www.imf.org](http://www.imf.org)). The memoranda provide details on Pakistan's IMF-supported economic and structural reform program.

The Executive Board's decision will bring total disbursements to Pakistan under the Stand-by Arrangement to SDR 255 million (about US\$324 million).

Following the Board's discussion of Pakistan's program, Eduardo Aninat, Deputy Managing Director and Acting Chairman, issued the following statement:

"Pakistan's achievements to date under the program supported by the Stand-By Arrangement have been encouraging. Inflation, the balance of payments, and the budget balance have been better than expected, and the build-up of official reserves has been brought in line with program assumptions. Economic activity was lower than expected, however, because of adverse weather conditions. The implementation of important

structural reforms has been on track, including those on fiscal transparency and the rationalization of energy prices.

“To consolidate these achievements and build a solid foundation for sustained high growth over the medium-term, the authorities will need to pursue further macroeconomic adjustment and implement the structural reform program. A key challenge will be to achieve the targets for foreign exchange reserves, which will require a tightening of monetary policy and coordination of monetary and exchange rate policies. The authorities’ commitment to make further progress toward a genuinely market-based exchange rate policy will also help.

“Another challenge will be to boost revenue collections, a key precondition for containing the fiscal deficit while increasing social and pro-poor spending. This will require resolute action to broaden the tax base and strengthen tax administration. The extension of the sales tax coverage, and steadfast implementation by the Central Board of Revenue of the recently adopted short-term action plan to improve tax administration, will be critical.

“Other reform priorities are to further improve governance in the management of public resources, develop a transparent and business-friendly economic and regulatory environment, continue the restructuring of public enterprises, accelerate privatization, and strengthen financial soundness and efficiency,” Mr. Aninat said.

**Statement by Abbas Mirakhor, Executive Director, and  
Meekal Ahmed, Advisor, for Pakistan  
March 30, 2001**

Our authorities wish to thank staff for a clear and well-written report and concur with the broad thrust of their appraisal and policy recommendations. Despite the intensification of drought conditions and an external environment that is becoming more difficult as export unit values fall amid a generalized slowing of external demand, economic performance in Pakistan during the first six months (July–December 2000) offers grounds for cautious optimism. While the setback to the agricultural sector stemming from the drought hurt overall GDP growth, the industrial upswing gathered strength, inflation performance was better than expected, the underlying current account position was broadly in line with program projections, and gross official reserves rose to more comfortable levels—a shortfall in capital inflows and official assistance notwithstanding. More importantly, fiscal adjustment, which is seen by the authorities as the anchor of the program and crucial to the task of achieving macroeconomic stability and external adjustment, was better than programmed with an overperformance equivalent to 0.7 percent of GDP.

Good progress was also achieved on the structural side. The IPP issue was settled: the long drawn-out tariff dispute between the Water and Power Development Authority (WAPDA) and the Hub Power Company (HUBCO) was finally resolved in a manner satisfactory to both parties; new medium- and long-term bonds (the Pakistan Investment Bonds) were issued on schedule; the restructuring of the financial sector continued; and the authorities made further headway on their governance agenda, especially with regard to the drive to improve the reporting of public finances.

There were, however, some less propitious developments. The authorities' wide-ranging and unprecedented tax registration and documentation drive did not produce the quick results they had expected. Tax revenues fell short of the very ambitious target, but this shortfall was more than offset by expenditure cuts so as to protect the target for the fiscal deficit. The task of monetary policy was complicated by an unanticipated surge in the demand for currency and credit to the private sector. As a consequence, meeting the very tight end-December performance criteria required some drastic and unconventional steps.

Looking at the overall economic performance in the first six months under the SBA, the authorities believe that Pakistan is off to a good start in implementing its adjustment and reform agenda despite the challenges posed by adverse exogenous developments. To be sure, as staff note, lower growth and shortfalls in external financing have weakened macroeconomic prospects. Nevertheless, there are still a number of positive developments which, taken together, suggest that Pakistan will succeed in meeting program objectives. A

momentum has been built up in the structural reform area and it will gather strength in the period ahead, setting the foundation for higher growth and poverty alleviation over the medium term.

Fiscal policy will remain on track with an unchanged deficit target for the year. The revenue target for the year has been lowered in recognition of earlier shortfalls, but, the target—while still ambitious—is realistic. To preclude further shortfalls, the authorities are implementing a short-term action plan—the elements of which are well described in the staff report and the attachment to the MEFP—for improving tax administration that is based on recommendations of FAD. Total expenditure has also been reduced, mainly through cuts in low-priority development spending. The authorities are concerned with the shortfall in social and poverty-related spending in the first half of the year although much of this shortfall may actually reflect a more cautious attitude to spending in line ministries/departments in the context of the emphasis on improved accountability and governance.

Monetary policy has been tightened with two recent increases in interest rates to protect the external sector and to keep inflationary pressures at bay. The authorities recognize that the external reserves, while improving, are still at a low level, which calls for vigilance and prompt action, should the situation warrant. The exchange rate has been, and will continue to be, managed flexibly as the authorities discontinue sales of foreign exchange in the interbank market to finance oil imports and gradually phase-out purchases from the kerb market. The revised monetary program takes into account the more permanent nature of high demand for rupee cash and, accordingly, envisages a gentler deceleration in reserve money growth. It will, however, still entail a considerable tightening in monetary policy compared to the end-January period.

The structural reform agenda is comprehensive and demanding. It envisages further tax, energy, financial sector, and governance reforms. In the tax area, the authorities remain committed to extending the GST to the retail sector and agricultural inputs, a major reworking of the income tax, a meaningful agricultural income tax, and a plan to reform tax administration. These reforms will durably strengthen the fiscal position and make room for urgently needed spending on physical infrastructure and social and poverty-related programs. Steps are being taken to improve the financial position of WAPDA and the Karachi Electric Supply Corporation (KESC), including, as a prior action, an adjustment in their tariffs. KESC is to be restructured with the assistance of the Asian Development Bank (ADB). The World Bank is preparing a Structural Adjustment Credit (SAC), which will focus on governance, growth, and human resource development issues. The Bank is considering a further operation in support of the planned reforms in the financial sector, which, inter alia, will entail major labor shedding and liquidation and/or mergers of a number of development financial institutions.

As the staff report clearly brings out, improving governance is a theme that runs through virtually all the government's reform agenda. This is a multi-faceted task, and the staff report describes well the scope and breadth of this effort. The government's devolution plan, which is anchored on greater accountability and delivery of services, is proceeding well and with

due recognition of the challenges it may pose for fiscal management. Good progress also continues to be made on data-related issues, although the authorities recognize that the accounts reconciliation and reporting process in the provinces need to be strengthened further.

The staff report suggests that there remain “significant risks” to achieving program objectives. Clearly, if domestic and external shocks intensify, the risk of not meeting key program objectives will rise—as it would in any program that is buffeted by unanticipated adverse events. Barring that gloomy scenario, however, the authorities are confident that they are up to the challenges confronting them and that the known risks are manageable. At the same time, they recognize that this review constitutes only one small step on the long and arduous road of adjustment and reform and that the benefits of their reform actions in terms of improvements in the life of the people of Pakistan will be felt only slowly. Nevertheless, their commitment to continue along the path of reform remains undiminished, and they look forward to the Executive Board’s discussion and advice, as well as its support for an early negotiation on a program that can be supported by the PRGF.

As before, the Pakistan authorities have agreed to the full release and publication of the LOI/MEFP as well as of the staff report.