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Pakistan: Sixth and Seventh Reviews Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criteria—Staff Report; Staff Statement; Press Release; and Statement by the Executive Director for Pakistan

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

- the staff report for the sixth and seventh reviews under the three-year arrangement under the Poverty Reduction and Growth Facility and request for waiver of performance criteria, prepared by a staff team of the IMF, following discussions that ended on **September 10, 2003,** with the officials of Pakistan on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on October 14, 2003**. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of **October 27, 2003** updating information on recent developments.

- a Press Release summarizing the **views of the Executive Board as expressed during its October 27, 2003 discussion** of the staff report that completed the review.

- a statement by the Executive Director for Pakistan.

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

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

*May also be included in Staff Report

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

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PAKISTAN

Sixth and Seventh Reviews Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criteria

Prepared by the Middle Eastern and Policy Development and Review Departments

(In consultation with other departments)

Approved by Mohammad Shadman-Valavi and Michael T. Hadjimichael

October 14, 2003

- Discussions for the combined sixth and seventh reviews under the Poverty Reduction and Growth Facility (PRGF) arrangement were held in Islamabad from August 29–September 10, 2003. The staff team consisted of Messrs. Zavadjil (head), Al-Atrash, and Martin (all MED); Mr. Schimmelpfennig (FAD); Mr. Sobolev (PDR); and Ms. Dakanay (assistant, MED). The mission was assisted by Mr. Ghesquiere (Senior Resident Representative). Mr. Mirakhor, Executive Director for Pakistan, participated in the policy meetings. Ms. Ferro (World Bank) also participated in the discussions.

- The mission held meetings with the Finance Minister, the Governor of the State Bank of Pakistan (SBP), the Finance Secretary, other senior officials, and representatives of the donor community. Messrs. Mirakhor, Ghesquiere, and Zavadjil also met with Prime Minister Jamali.

- In the last Executive Board discussion (June 18, 2003), Executive Directors commended the authorities for Pakistan's strong macroeconomic performance and satisfactory program implementation in a context of global economic weakness and a difficult regional security situation. Directors noted the need to make further progress in stabilizing the economy and accelerating structural reforms to achieve sustained growth and poverty reduction in the medium term. In this respect, Directors underscored the importance of increasing tax collection, improving the quality of social spending, reducing the cost of public debt (notably through reforming the National Saving Schemes (NSS)), and tackling more forcefully the reform of the power sector.

- The principal authors of this report are Milan Zavadjil, Hassan Al-Atrash, and Edouard Martin, with inputs from Axel Schimmelpfennig, Yuri Sobolev, and Alina Milasiute.

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Appendices

Attachment

List of Acronyms

ABL	Allied Bank Limited
AsDB	Asian Development Bank
CBR	Central Board of Revenue
CPI	Consumer Price Index
CWIQ	Core Welfare Indicators Questionnaire
DFID	U.K. Department for International Development
FATA	Federally Administered Tribal Areas
FATF	Financial Action Task Force on Money Laundering
FIBR	Floating Interbank Market Exchange Rate
FIP	Financial Improvement Plan
FSAP	Financial Sector Assessment Program
GDDS	General Data Dissemination System
GPF	General Provident Fund
GST	General Sales Tax
HBL	Habib Bank Limited
I-PRSP	Interim Poverty Reduction Strategy Paper
KESC	Karachi Electric Supply Corporation
MEFP	Memorandum of Economic and Financial Policies
MTBF	Medium-term budget framework
NAM	New Accounting Model
NBP	National Bank of Pakistan
NDA	Net Domestic Assets
NEPRA	National Electric Power Regulatory Authority
NFA	Net Foreign Assets
NHA	National Highway Authority
NPL	Nonperforming loans
NSS	National Saving Schemes
NWFP	North West Frontier Province
OGDC	Oil and Gas Development Corporation
PBS	Pakistan Bureau of Statistics
PIA	Pakistan International Airlines
PIB	Pakistan Investment Bonds
PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Paper
PSDP	Public Sector Development Program
PTCL	Pakistan Telecommunication Company Limited
ROSC	Report on the Observance of Standards and Codes
SBP	State Bank of Pakistan
SDDS	Special Data Dissemination Standard
TMU	Technical Memorandum of Understanding
UBL	United Bank Limited
WAPDA	Water and Power Development Authority

Executive Summary

Pakistan's macroeconomic performance continues to strengthen. Growth picked up in 2002/03 (July–June) and inflation remained subdued. External balances continued to overperform relative to program targets, while the Pakistani rupee remained broadly unchanged against the U.S. dollar. Driven by net foreign asset accumulation and private sector credit expansion, growth of monetary aggregates remained strong. Fiscal targets, including Central Board of Revenue (CBR) collection and the overall deficit, were met, as were all other quantitative performance criteria for end-March and end-June.

Progress was made in implementing structural reforms. Electricity tariff increases determined by the sector regulatory authority were notified, if only partly for the Karachi Electric Supply Company (KESC), and adequate adjustments were made to gas and petroleum prices. Substantial progress was made in fiscal reform, including the removal of 20 tax exemptions in the budget and the submission to Parliament of the fiscal responsibility law.

However, there were also some minor setbacks in the fiscal area. The authorities have requested waivers for the nonobservance of three structural performance criteria: (a) the submission to Parliament of the fiscal responsibility law (it was submitted on October 11 instead of by end-June); (b) the elimination by end-June of all exemptions from withholding tax on interest income (it was maintained for NSS instruments under PRs 150,000); and (c) the commitment not to introduce new tax exemptions (three exemptions, aimed at ensuring uniform treatment of taxpayers and of marginal revenue impact, were introduced).

The authorities plan to maintain the current mix of macroeconomic policies, while continuing the reform process. Monetary policy is geared to maintaining low inflation within a flexible exchange rate system. The budget aims at further reducing the public debt while increasing poverty-related expenditures. The deepening of the tax administration reform and the broadening of the tax base, the reform of the energy sector, and the modernization of NSS aim at stimulating private investment and creating additional fiscal space for social expenditures. Program conditionality regarding tax administration and policy, and financial sector and energy sector reforms has been strengthened. The privatization process is expected to accelerate. The authorities intend to float a new Eurobond, so as to diversify government funding sources.

The risks to the program arise mainly in the fiscal area. The attainment of the budget target will crucially depend on the full implementation of the power utilities' Financial Improvement Plans (FIPs) and on a strict control of budgetary expenditures.

I. Introduction and Background

1. On December 6, 2001, the Executive Board approved Pakistan's request for a three-year arrangement under the PRGF with access of 100 percent of quota (SDR 1.03 billion) and endorsed the country's Interim Poverty Reduction Strategy Paper (I-PRSP).[1] The Executive Board completed the fifth review of the program on June 18, 2003 (IMF Country Report No. 03/180), thus enabling Pakistan to draw SDR 86 million. As of August 31, 2003, total Fund credit and loans outstanding to Pakistan amounted to SDR 1.42 billion (137.0 percent of quota).

2. In the attached letter dated October 11, 2003 and the Memorandum of Economic and Financial Policies (MEFP; Attachment I), the government of Pakistan requests completion of the combined sixth and seventh reviews under the PRGF arrangement and waivers for the nonobservance of three structural performance criteria (see paragraph 8). The seventh and eight disbursements (each SDR 86 million) are conditional on the completion of the two combined reviews.[2]

II. Performance Under the Program From January–August 2003 [3]

3. **The domestic political situation is stable.** The opposition continues to refuse to participate in parliamentary work, conditioning its participation on the cancellation of some constitutional amendments made under the previous government. However, this did not prevent the adoption of the budget for 2003/04 (July–June). The authorities believe that overall support for the economic reforms is strengthening, though some measures continue to face stiff resistance in and outside Parliament. Tensions with India have eased with the recent resumption of diplomatic relations and progress in restoring transport links.

4. **Macroeconomic performance continues to strengthen.** Program targets were exceeded and all quantitative performance criteria for end-March (the third quarter) and end-June 2003 were met. GDP growth (at factor costs), at 5.1 percent in 2002/03, was higher than projected, on account of stronger-than-expected activity in all sectors. Inflation slowed further to 1.8 percent year-on-year for August because of the deceleration of food and energy prices; core inflation increased slightly to 2.6 percent year-on-year in August. Both the current and overall external accounts overperformed relative to program targets, reflecting high remittances, strong exports, and sizeable external support, although net foreign exchange inflows have recently decelerated. Since January, the SBP has sharply reduced its purchases on the foreign exchange market. This has slowed the accumulation of gross official reserves, which nevertheless reached $9.5 billion (equivalent to seven months of imports) at

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[1] Pakistan's relations with the Fund and the World Bank are described in Appendices I and II, respectively.

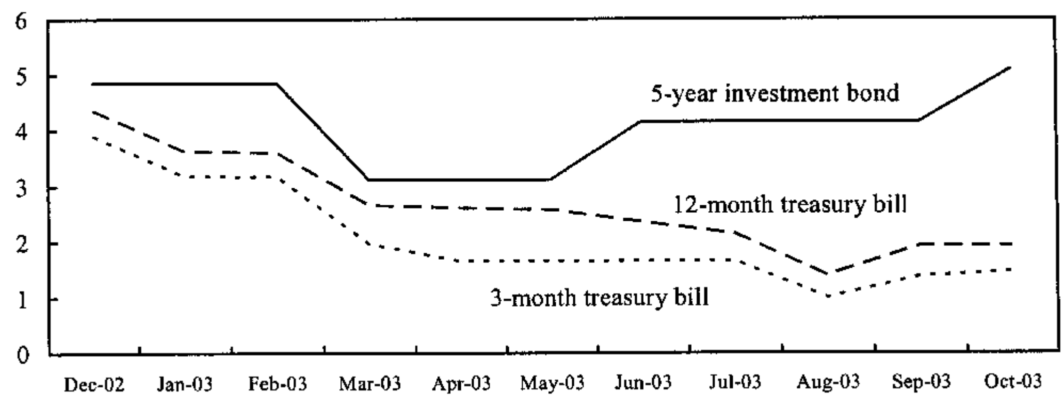
[2] The authorities requested combining the two reviews because of the delay in completing the fifth review.

[3] Refer to Tables 1–6 and Figures 1–6.

end-June. The Pakistani rupee remained broadly unchanged against the U.S. dollar during the fourth quarter of 2002/03. In real effective terms, the rupee depreciated by 5.2 percent during the 12 months ending June 2003.

5. **Monetary developments in the first half of 2003 were largely in line with expectations, except for credit to the private sector, which has accelerated significantly in recent months.** Broad money, which continued to be driven by the accumulation of net foreign assets (NFA) and growth of private sector credit, grew by 19 percent year-on-year in June. The SBP significantly reduced sterilization in the first half of 2003, reflecting reduced net foreign exchange inflows, but has increased sales of medium- and short-term paper substantially since June to absorb excess bank liquidity. The yield on three-month treasury bills, which had been on a strong declining trend as banks remained highly liquid, has recently increased to 1.5 percent (from a minimum of 1.0 percent).

Pakistan: Treasury Bill and Investment Bond Yields, 2003 1/
(in percent)



Source: Pakistani authorities.
1/ Last observation: October 2003.

6. **Fiscal targets for end-March and end-June were met.** The overall deficit of the consolidated government was 4.5 percent of GDP in 2002/03, lower than the program ceiling, and the CBR collection exceeded the target by a small margin. Bank financing was substantially lower than programmed as high nonbank domestic financing (largely from the NSS) more than offset shortfalls in external financing. Social- and poverty-related expenditure through June grew by 18 percent over the same period a year earlier, but still fell short of the indicative program target by 2 percent.

7. **Progress was made in implementing structural reforms.** As discussed in the MEFP (paragraphs 9 and 10), financial and tax administration reforms proceeded largely according to schedule. Even in the troubled **energy sector**, both the Water and Power Development Authority (WAPDA) and the KESC met their revised FIP accrual deficit targets for 2002/03 (Tables 7 and 8). Appropriate adjustments were made to gas and petroleum prices, but the increase in the KESC tariff was lower than recommended by the National

Electric Power Regulatory Authority (NEPRA) and was delayed. The authorities have begun to implement the anti-corruption strategy approved by the previous government. They considered that reconfirmation of the strategy (a structural benchmark) by the current (new) government was not necessary, since there was full policy continuity in the economic area.[4] Finally, the SBP issued a circular requiring the reporting of all interest income exceeding PRs 10,000.[5]

8. **However, there have been some minor setbacks in fiscal reform.** Three structural performance criteria have not been observed: (a) the submission by end-June 2003 to Parliament of the fiscal responsibility law (it was submitted on October 11); (b) the elimination by end-June of all exemptions from withholding tax on interest incomes (it was partially implemented as it was maintained for NSS instruments under PRs 150,000 because of strong opposition in Parliament); and (c) the commitment not to introduce new tax exemptions (three were introduced, see Box 1). Moreover, the publication of the FY 2003/04 federal and North West Frontier Province (NWFP) budgets according to the New Accounting Model (NAM) was not carried out (the budgets were prepared according to the model but technical problems with the new system prevented their publication).

III. Report on the Discussions

9. **Pakistan's macroeconomic performance has strengthened substantially over the past few years, with the 2002/03 outcome largely exceeding the PRGF targets** (see table below). The authorities' policies, combined with strong international financial support, have been successful in restoring and consolidating macroeconomic stability. Although Pakistan's debt burden remains high, prospects for the achievement of debt sustainability have been enhanced over the past two years and substantial improvements in debt indicators are projected for the next five years (Box 2).[6] Nevertheless, significant challenges remain, in particular in putting the economy on a sustainable growth path and ensuring that growth translates into palpable improvements in living standards for the population at large and the poor in particular.

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[4] The previous government approved the anti-corruption strategy in November 2002.

[5] This was consistent with the technical assistance recommendation, but represented a breach in the structural benchmark which specified that all interest income to be reported.

[6] A more detailed assessment of sustainability indicators will be conducted at the time of the Article IV consultation.

Pakistan: Comparison Between Original PRGF Projections
and Actual Developments for 2002/03

	Original PRGF 1/ Projections	Actual
GDP growth (in percent)	5.0	5.1
Consumer prices (annual change in percent)	5.0	3.1
Overall budgetary balance (ex-grants)		
(in percent of GDP)	-4.1	-4.5
Net public debt (in percent of GDP)	87.9	86.7
Net domestic public debt		
(in percent of GDP)	32.7	41.4
Current account (excluding official transfers)	-3.1	4.4
External public and publicly guaranteed debt		
(in percent of exports of goods and services)	317.2	231.9
Gross reserves (in billions of U.S. dollars)	3.0	9.5
(in months of imports)	2.7	7.0
(in percent of short-term external debt)	96.2	191.3

Source: Fund staff estimates.

1/ See EBS/01/197, November 26, 2001.

Box 1. Tax Exemptions Introduced in the 2003/04 Budget

1. In recent years, Pakistan has cut the number of tax exemptions significantly, and only granted a very few new tax exemptions. The new exemptions were typically related to broad-based policies rather than individuals and special interests. The authorities withdrew 55 exemptions with the 2002/03 and 20 exemptions with the 2003/04 budgets. Moreover, with the 2001 Income Tax Ordinance, income tax exemptions are required to be part of the ordinance and cannot be included in special legislation. This contrasts starkly with the past, when exemptions used to be granted in response to individual requests, in violation of good governance guidelines. The authorities consider most of the remaining tax exemptions—with the revenue forgone estimated at ½ percent of GDP—to be related to core policy objectives or international agreements; the existing exemptions relate mainly to the sale of pharmaceuticals, domestically produced edible oils, import of tractors and other agricultural machinery, and pensions.

2. In the context of the 2003/04 budget, three new tax exemptions were introduced. The authorities noted that these were not intended to be exemptions but modifications to ensure uniform treatment of taxpayers and to end discriminatory treatment of some taxpayers. The associated revenue loss is estimated to be zero as no taxes had ever been paid under any of these categories. The three exemptions are on: (a) foreign-sourced income of Pakistani nationals on temporary employment in Pakistan (the measure removed discrimination against Pakistani nationals relative to other nationals whose foreign sourced income is tax exempt); (b) salary income of a Pakistani resident citizen earned outside of Pakistan, if the citizen left Pakistan during the tax year and took up employment abroad (while such income was taxable in the past, no return was ever filed); and (c) income tax paid by nongovernment sports boards (to ensure uniform treatment between government and nongovernment sports boards).

Box 2. Fiscal and External Debt Sustainability

1. **Public debt and external debt are projected to decline significantly over the medium term.**[1/] Under the baseline scenario, gross public debt would decline from 91 percent of GDP at end-2002/03 to 63 percent in 2008/09, or close to the target envisaged under the fiscal responsibility law (Table 9). Similarly, external debt would decline from 46 percent at end-2002/03 to 30 percent in 2008/09 (Table 10).[2/] This baseline scenario assumes that recent reform gains are sustained so that growth would increase gradually from 5 to 6 percent, while the current account deficit (excluding official transfers) would reach 1 percent of GDP. Under a number of shocks to the baseline scenario, public debt would still decline over the forecast period. However, external debt would only stabilize or even remain above the 2002/03 level at the end of the forecasting period in some more extreme scenarios. The baseline scenario does not include future debt reduction through bilateral agreements—as these agreements have not been finalized—and therefore could underestimate the projected improvement in debt indicators.

2. **Public debt appears to be on a solid downward trend, declining from its peak of 110 percent of GDP in 2000/01.** Pakistan's public debt hovered around 93–100 percent of GDP during the late 1990s, and jumped to 110 percent of GDP in 2000/01, reflecting mostly the impact of the sharp depreciation of the Pakistani rupee in late 2000 on the face value of the external debt. About half of Pakistan's public debt is external, mostly on concessional terms. The fall in the public debt-to-GDP ratio over the last two years resulted from substantial primary surpluses, high real growth, falling interest costs, and a modest appreciation of the Pakistani rupee against the U.S. dollar. In the projections, continued primary surpluses of over 1 percent of GDP and a positive growth-interest differential would contribute almost equally to further debt reduction. At the same time, modest increases in tax revenue, savings on interest expenditure, and some pruning of budget support to state-owned enterprises would allow an increase in development spending from 3.2 percent of GDP in 2002/03 to 6 percent of GDP in 2008/09, as well as an associated increase in social- and poverty-related spending.

3. **The stress tests indicate that the public debt path is not likely to deteriorate significantly under a variety of shocks to the baseline scenario.** Even if a number of key parameters in the baseline scenario are replaced by less favorable outcomes (lower primary balance, lower growth, and higher interest rates), the public debt-to-GDP ratio would still decline over the forecast horizon, though at a slower pace. Similarly, a 30 percent real depreciation against the U.S. dollar in 2004/05 or an off-budget increase in public debt by 10 percentage points in 2004/005 (for example, on account of contingent liabilities being called) would only slow the fall in public debt relative to GDP.

4. **External debt appears somewhat more vulnerable to adverse shocks, though none of the sensitivity tests lead to a significant deterioration in the debt path.** Assuming less favorable outcomes for key parameters, external debt would increase temporarily relative to GDP, but decline again at the end of the forecast period. In a scenario where exports of textiles and clothing would drop by 10 percent in 2005/06 as a possible result of the expiration of the multi-fiber agreement, external debt relative to GDP would still decline to 30 percent of GDP in 2008/09.

1/ This box updates the public and external debt sustainability analysis carried out during the last Article IV consultation. See IMF Country Report No. 02/246, Annex II.

2/ In net present value terms, the external debt ratio is currently about 20 percentage points lower because a large share of the debt is on concessional terms.

10. **Against this background, the discussions focused on the 2003/04 federal budget and reform priorities in the remaining period of the PRGF to stimulate private investment and reduce poverty.** The talks covered financial sector reform, in particular the NSS, as well as reform of tax policy and administration and the key elements of a transparent regulatory framework for the setting of electricity tariffs. Program conditionality in these areas was further strengthened.

A. Macroeconomic Framework and Budget for FY 2003/04

11. **The economic growth projection was revised upward slightly because of more favorable agricultural prospects while the inflation target was kept unchanged for 2003/04.** Economic growth is expected to remain broad-based, supported by the economic recovery in Pakistan's trading partners. After a large surplus in 2002/03, the current account, excluding official transfers, is projected to return closer to balance. This would mainly reflect a tapering-off of remittances and lower export growth from the very high rate of the previous fiscal year, as well as continued strong import growth.[7]

12. **Inflation developments need to be monitored carefully even though there is no evidence of immediate pressures.** The risk of higher inflation is currently low given weak import prices and favorable prospects for agriculture. Nevertheless, the large excess liquidity in the banking system and the continued strong growth in private sector credit are of concern. The mission welcomed recent measures to absorb excess bank liquidity and supported the SBP's intention to issue, if necessary, certificates of deposits to moderate the growth of monetary aggregates (see MEFP, paragraph 13). The authorities agree that greater exchange rate flexibility could help to control inflationary pressures in case of a strong resurgence in private transfers/capital inflows. As regards the steep increase in the stock and real estate market indices, the authorities indicated that the financial system was not vulnerable to a reversal since banks have limited exposure in these markets.

13. **The federal budget for FY 2003/04 is consistent with the program and aims to further reduce the public debt ratio while increasing social expenditure** (see MEFP, paragraphs 14 and 15). The consolidated deficit will be contained to 4.0 percent of GDP (with additional outlay of up to 0.5 percent of GDP for the recapitalization of two public banks).[8] CBR revenue is projected to increase by about 11 percent, reflecting a buoyant economy, some broadening of the tax base (see below), and further improvements in administrative efficiency. Total expenditures are budgeted to increase by only 5 percent despite a 15 percent increase in base salary and pensions, but with social spending rising from 4.0 percent to 4.2 percent of GDP. Defense spending is projected to decline from 4.0 percent

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[7] It is assumed that the one-off portfolio adjustment that was reflected in the repatriation of savings by expatriate Pakistanis in 2002/03 will gradually taper off.

[8] These amounts are to cover costs incurred in the privatization or liquidation of the Allied Bank Limited and the Industrial Bank of Pakistan.

to 3.6 percent of GDP. Budgetary support to public enterprises is expected to be reduced, as support for KESC and WAPDA (including debt service arrears) will decline from 1.6 percent of GDP in 2002/03 to 1.1 percent in 2003/04. To improve transparency, this support was explicitly budgeted as subsidies, or net lending, rather than being netted against debt repayments due. Interest payments as a percent of GDP are expected to decline, owing to lower interest rates.

14. **The mission welcomed the reduction in the overall deficit, the modest increase in CBR collection relative to GDP, and the rise in social- and poverty-related spending in the 2003/04 budget.** Nevertheless, it noted that bolder steps—in the form of more aggressive revenue collection targets and higher pro-poor spending—would have been preferable, and that slippages with respect to the budget should therefore be avoided. The mission also mentioned several risks to achieving the budget targets. Containing the financial support to the two power utilities will require steadfast implementation of their respective FIPs and prompt notification of the NEPRA tariff determinations by the government. Also, the allocation for the civil government appeared tight, given the overspending in 2002/03 and the 15 percent basic wage increase. The authorities acknowledged these risks but were confident that they could achieve the budget targets, if necessary through cuts in nonpriority expenditures, and pointed to their strong recent track record in this regard. They stressed that, despite pressures for more populist measures, the government had held the line on expenditures.

15. **In view of the weak social indicators, the mission inquired about the scope for an increase in I-PRSP spending** (Box 3). The authorities noted their commitment to fully execute the budgetary allocation for I-PRSP expenditure in the current fiscal year. They were willing to consider further raising social spending, both in 2003/04 and beyond, if additional resources became available and the capacity to spend effectively at the local level was enhanced.

B. Structural Issues

Energy sector

16. **While WAPDA and KESC met their revised financial targets for 2002/03, their operational performance continues to be weak, as illustrated by higher-than-targeted line losses** (see MEFP, paragraph 8). The mission welcomed the authorities' intention to notify electricity tariff prices within 30 days of the determination by NEPRA as a way to improve transparency and predictability—the authorities believed that a shorter time period was not feasible because of possible administrative delays (see MEFP, paragraph 26). This undertaking will be an important element of an action plan to establish a transparent regulatory framework for the setting of electricity tariffs that will be completed by end-October 2003 (see MEFP, paragraph 27). However, more fundamental reforms are required to reduce technical and distribution losses. The unbundling of WAPDA, which is expected to be finalized at the end of 2003, and the consequent introduction of stronger incentives for

Box 3. Recent Social and Poverty Trends

1. **The social and poverty situation in Pakistan remains largely unchanged, though there are reasonable prospects for improvements over the medium term.** Most direct indicators of Pakistan's poverty situation are available only up to 2000/01 and show stagnation or some worsening in the poverty situation that is likely driven in part by a prolonged drought, as a large proportion of the vulnerable live in rural areas. For example, the population share living below the official poverty line increased to 32 percent in 2000/01 from a low of 26 percent in 1990/91.

2. **Social- and poverty-related expenditure has been raised as part of Pakistan's poverty reduction strategy.** Budgeted expenditures were increased from 3.8 percent of GDP in 2001/02 to 4.0 percent of GDP in 2002/03 and are budgeted to rise to 4.2 percent of GDP in 2003/04. Expenditure management capacity is low at the local government level where most of the social- and poverty-related spending takes place. In addition, funds have in many cases been released to local governments only late in the fiscal year, further complicating expenditure execution, but there have been improvements in this regard during 2002/03.

3. **Intermediate outcome indicators do not yet show significant improvements** (see Table 11). The authorities have recently begun reporting several intermediate outcome indicators for the health and the education sectors on a quarterly basis. Since 2000/01, only a few of these indicators have shown improvements, while some others have deteriorated. It should be noted that these indicators are still being developed and are probably subject to various measurement biases.

better management of enterprises, is crucial in this regard. The mission encouraged the authorities to work closely with the World Bank in finalizing the plan.

Tax policy and tax administration

17. **Despite a series of tax policy and administration measures over the past few years, Pakistan's tax-to-GDP ratio remained at 13.8 percent in 2002/03.** Some measures to raise revenues were introduced in the 2003/04 budget, including the assessment of nonfilers of sales tax on a presumptive basis and mandatory reporting of interest income by commercial banks (see MEFP, paragraph 9). This, in combination with the use of background information on utility bills, phone use, and motor vehicle ownership, will be used to cross-check declarations and to identify nonfilers. Looking ahead, the authorities were confident that their planned reforms would further expand the tax net and improve tax administration (see MEFP, paragraphs 18 and 19). The establishment of medium and large taxpayer units and a pilot customs facility is planned. The mission recommended the removal of additional tax exemptions with the 2004/05 budget. The mission also suggested that the authorities begin work on the extension of the General Sales Tax (GST) to services currently not covered (see MEFP, paragraph 18).

18. **The authorities stressed that they had resisted pressures from special interests to introduce new tax exemptions and that the continuous performance criterion was useful in this regard.** They added that the tax measures contained in the 2003/04 budget represented a tidying up of the tax code and the removal of discriminatory treatment, rather

than exemptions. The mission agreed that the new exemptions were very minor, but was concerned about the precedent that this provided, especially in light of continuous pressures for the granting of new exemptions. The authorities will submit to Parliament for the 2004/05 budget a proposal for the removal of exemptions (and/or other base-broadening revenue measures) equivalent to 0.1 percent of GDP. However, there is limited room for further removal of exemptions because the remaining ones are largely related to core government priorities (see Box 1). The authorities noted that the exemption from withholding tax on interest income for NSS instruments below PRs 150,000 was not withdrawn because both the Senate and the lower house had explicitly rejected the government's proposal to eliminate this exemption (with an impact of 0.05 percent of GDP).

Public expenditure management and fiscal transparency

19. **On the expenditure management side, the key issues are the strengthening of budget planning and execution capacity, as well as further improving fiscal accounting and reporting** (see MEFP, paragraph 22). The 2003/04 budget contains several features that should increase transparency and improve the structure of the budget. In particular, it contains realistic assumptions about the performance of public sector enterprises, consistent with the indicative quarterly targets on the deficits of WAPDA and KESC. Under a U.K. Department for International Development (DFID)-financed program, the authorities are trying to move to a medium-term budget framework (MTBF) that should help to better link policy objectives and budget allocations. Initially, MTBF principles will be implemented in the ministries of health and population welfare with a view to having costed programs as input for the 2004/05 budget. The mission regretted that while the budget submissions for the federal and NWFP governments were received on the old accounting model as well as the NAM, technical difficulties had prevented the publication of the 2003/04 budget based on the NAM. The authorities were concerned that potential reporting problems with the NAM could lead to inaccurate data which would not be suitable for publication. Technical problems as well as insufficient capacity in all provinces are also likely to delay the adoption of the NAM for the entire government with the 2004/05 budget. As an intermediate step, the authorities indicated that they would run the NAM in parallel for the federal and provincial governments in 2004/05.

Poverty Reduction Strategy Paper

20. **The full PRSP is being finalized.** A summary of the draft PRSP was circulated during the Pakistan Development Forum meetings in May 2003, and since then has been disseminated to a wide range of stakeholders to elicit feedback.[9] It was also submitted to Parliament as part of the 2003/04 budget documentation. While retaining the broad I-PRSP framework, the PRSP articulates a more comprehensive strategy covering also rural

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[9] The draft was also posted on the Ministry of Finance's web (www.finance.gov.pk).

development, gender issues, employment, and the environment. The authorities intend to incorporate the results of the pilot Core Welfare Indicators Questionnaire (CWIQ) on district-based health and education data in the final PRSP, which is now expected in late October or early November. The mission welcomed efforts to pursue a very broad-based consultative approach in preparing the PRSP (including provincial PRSPs), but also encouraged its quick finalization.

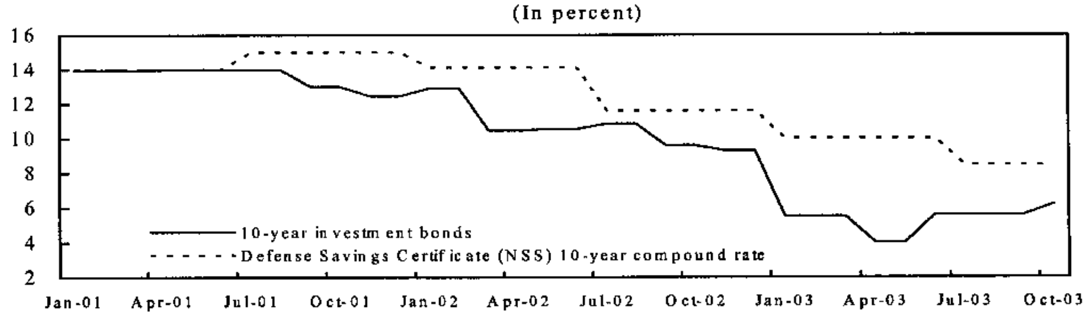
Public enterprises and privatization

21. **The privatization process is expected to accelerate in the coming months.** In 2002/03, several enterprises and financial institutions were privatized (see MEFP, paragraph 23). Looking forward, privatization of the Habib Bank Limited (HBL) is moving ahead. Significant interest has been expressed by investors and bidding will take place in early December so that a short delay could be experienced in meeting the end-December performance criterion (which refers to the transfer of ownership). In addition, progress is being made in privatizing the Allied Bank Limited (ABL) which could take place by end-year. Moreover, the authorities have sought once more expressions of interest in KESC in view of recent inquiries by several potential investors. The mission welcomed the commitment to privatization and emphasized the need to proceed quickly in privatizing HBL which has already been delayed.

Financial sector reforms

22. **Reforming the NSS has taken on greater urgency.** The NSS, which partly finances the budget deficit, provides to individuals depositing/investing a poorly targeted implicit subsidy (estimated at 0.7 percent of GDP in 2001/02) by offering higher-than-market interest rates on its instruments (see Box 3 of IMF Country Report No. 03/180). This distortion has constrained the development of the capital market. In 2002/03, the sale of NSS instruments increased sharply as interest rates on these instruments adjusted with a considerable lag to the fall in market rates and some commercial banks entered into arbitrage operations. The authorities have partially addressed this problem by temporarily banning the involvement of commercial banks in the marketing of NSS instruments. As a result, purchases of NSS instruments dropped sharply in the first two months of 2003/04.

Pakistan: Investment Bonds' and Comparable National Saving Schemes' Interest Rates, 2001–03 1/
(In percent)



Source: Pakistani authorities.
1/ Last observation: October 2003.

23. **The medium-term objective of the government is to convert the NSS into a modern savings institution, probably a mutual fund** (see MEFP, paragraph 29). As an intermediate step to control borrowing costs, the authorities agreed to strictly apply the existing formulas for adjusting NSS rates to reflect the Pakistan Investment Bonds (PIB) yields in January 2004 while working with Fund staff on a new formula that will better align NSS rates to government bonds. The new formula would apply as of the June 2004 yield adjustment.

24. **Progress is being made in other financial sector reforms** (see MEFP, paragraph 28). The mission welcomed the intention to submit to Parliament legislation on anti-money laundering and corporate bankruptcy. Together with efforts to privatize remaining publicly-owned commercial banks, these initiatives should further strengthen the financial sector. The authorities were pleased that the FSAP mission, that is expected in early 2004, will assess the strength of the financial system and identify possible vulnerabilities, including those in the securities market, and suggest remedial measures.

C. Public Debt Management Strategy

25. **There are four key elements in the authorities debt management strategy: (a) an early repayment of some expensive debts; (b) the flotation of a new Eurobond; (c) the continued recourse to borrowing from multilateral development banks; and (d) the passage of the fiscal responsibility law that prescribes a debt reduction strategy.** Plans are being finalized to retire about $4.5 billion of expensive debt in the next five years, of which $1.0 billion would be pre-paid in the current fiscal year—to the World Bank, the Asian Development Bank (AsDB), and the Fund (see MEFP, paragraph 30). The mission strongly encouraged the authorities to implement these plans quickly.

26. **The authorities intend to float a new Eurobond in late 2003 or early 2004** (see MEFP, paragraph 31). The objective of the issue is to diversify funding sources and ensure that Pakistan is present on key markets after the existing Eurobonds are repaid. The authorities recognize that there is currently no balance of payments need for the placement and that a more favorable interest rate could be obtained in the domestic market for a bond with a five-year maturity (the likely maturity of the new Eurobond). However, they believe that the intangible benefits from a bond placement in the form of positive publicity for Pakistan and possible lower cost of import financing are important considerations for returning to capital markets. The authorities also stressed that the bond placement would be fully consistent with their debt reduction strategy outlined in the fiscal responsibility law, and that borrowing in international markets would further reinforce the discipline imposed by this law. The mission agreed that Pakistan will gradually need to move toward commercial market borrowing, but underscored the need to proceed cautiously and to keep overall nonconcessional borrowing within the program ceiling. This would help avoid a significant increase in the government's interest costs. A limited amount of foreign borrowing would not carry significant foreign exchange risk, especially as some expensive foreign debts will be repaid at about the same time.

27. **The authorities stated that they would not request a successor arrangement to the current PRGF.** Nevertheless, they were keen for Fund staff to stay closely involved with Pakistan after the current PRGF arrangement is completed in December 2004 and engage in dialogue on how economic growth could be strengthened over the medium term. They agreed that the key issues where the Fund could give support were the strengthening of institutions in the financial, public sector, and statistical areas, as well as macroeconomic policy advice.

IV. Other Issues

Statistical issues

28. **The mission welcomed the authorities' intention to participate this year in the General Data Dissemination System (GDDS), following World Bank assistance with preparing the missing socio-demographic metadata** (see MEFP, paragraph 33). The authorities plan further improvement in the statistical infrastructure before subscribing to the Special Data Dissemination Standard (SDDS). An STA mission is scheduled for December to undertake a data ROSC.

Program financing and monitoring

29. **The program remains fully financed.** Proposed quantitative and structural performance criteria and indicative targets, as well as structural benchmarks are specified in the MEFP (see Box 4). Given the strong improvement in Pakistan's external and fiscal prospects, the authorities requested, and staff supports, moving to semiannual reviews. The discussions with staff for the eighth review and assessment of the end-December 2003 quantitative performance criteria are expected to take place in February 2004. Accordingly, the ninth disbursement (eighth review; SDR 172.28 million) will be scheduled for March 20, 2004 (with end-December 2003 test dates) and the tenth and final disbursement (ninth review; SDR 172.28 million) will be scheduled for September 20, 2004 (with end-June 2004 test dates). The timing of reviews and phasing of remaining disbursements under the PRGF is provided in Table 17.

V. Staff Appraisal

30. **Pakistan continues to make strides in consolidating macroeconomic stability.** Growth picked up in 2002/03, inflation remained subdued, and the external position improved substantially, despite the weak global economic environment. Fiscal adjustment, together with external support, has improved public debt dynamics and Pakistan's economy today is far less vulnerable to shocks than a few years ago. A broad structural reform agenda is being implemented, focusing on improved governance and transparency. Despite some delays and setbacks, tangible progress has been made in tax policy and tax administration, fiscal accountability and transparency, as well as financial sector reform. Nevertheless, further progress in structural reform is needed to increase private sector investment sufficiently to ensure sustainable economic growth and poverty reduction.

Box 4. Structural Conditionality [1/]

1. **Coverage of structural conditionality in the PRGF program for FY 2002/03 and 2003/04**

While there were a few minor setbacks in fiscal reform, most of the structural conditionality was met in 2002/03. Structural conditionality for 2003/04 is detailed in Tables 2(a) and 2(b) of the MEFP. The focus remains on tax policy and tax administration reform and fiscal transparency, but emphasis is also given to the reform of the two power utilities and to the modernization of the NSS. The extension of Fund conditionality to these two areas, which is usually covered by the World Bank, reflects their critical relevance for the macroeconomic framework, and notably for fiscal consolidation. The privatization of a public bank is a structural performance criterion, since privatization is critical to creating a sound and efficient financial sector, that is less vulnerable to government interference.

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

In FY 2001/02, World Bank program lending was delivered under a one-tranche ($500 million) Structural Adjustment Credit (SAC). Conditionality aimed at (a) accelerating power sector reforms with a view to restoring the sector's financial viability; (b) revamping the tax administration system to improve governance and increase revenues; (c) improving the policy framework in the oil and gas sectors to attract domestic and foreign investment; (d) improving the effectiveness in the delivery of social services through civil service reforms, and enhanced transparency and accountability in the use of public resources; (e) accelerating the implementation of the Education Sector Reforms Action Plan and the National Health Policy; and (f) establishing monitoring and evaluation systems to assess progress in the implementation of the poverty reduction strategy. In 2002/03, as setbacks in the implementation of the energy sector reform precluded the finalization of a new SAC, World Bank structural conditionality was included for the most part in the two provincial SACs (for the provinces of Sindh and the NWFP) approved in July 2002. These two loans, totaling $190 million, are supporting provincial reform strategies to improve fiscal transparency, resource management, and strengthen provision of public services by local governments and communities. Conditionality related to the restructuring of three public banks is part of a banking sector project loan approved in October 2001. Successful implementation of reforms have facilitated the privatization of United Bank Limited (UBL) and should help in privatizing of HBL.

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

1/ Updated from IMF Country Report No. 03/180.

31. **Staff concurs with the authorities' proposed macroeconomic policy mix for 2003/04.** Monetary policy should remain geared toward keeping inflation low, within a flexible exchange rate regime, and continued fiscal adjustment is needed to further reduce public debt. Inflationary pressures appear under control and the SBP has appropriately begun to tighten monetary policy modestly to mop-up excess liquidity. In case of a strong

resurgence in private transfers/capital inflows, greater exchange rate flexibility would help to dampen inflationary pressures. The planned repayment of relatively expensive external debts should be implemented promptly. The expected placement of the Eurobond should contribute to diversifying funding sources, although staff suggests proceeding cautiously in moving toward private financing in order to avoid an increase in interest costs to the budget and excessive exchange rate risk.

32. **The 2003/04 budget appropriately allows for an increase in social sector spending while further lowering the debt-to-GDP ratio.** However, the budget outlook is tight as regards wages and pensions and the authorities need to be on guard against any shortfall in CBR revenues from the already modest target. They should make every effort to resist future pressure to introduce tax exemptions, even minor ones, as they could have an unfavorable demonstration effect. On the expenditure side, the budget is more realistic than in the past, in particular with the explicit recognition of the two power utilities' demands on the budget. However, it is important to strictly control expenditure and implement the financial plans of the power companies. The increased allocation for social- and poverty-related expenditures, as well as the Public Sector Development Program (PSDP) is consistent with the policy objectives laid out in the draft PRSP. In the course of the fiscal year, the emphasis must now be on effective execution of these spending plans to achieve tangible improvements in Pakistan's poverty situation. This would contribute to greater public awareness and acceptance of the government's economic program. The across-the-board nature of the basic salary increase was not consistent with the need for decompressing the salary structure in the civil service and should have been a part of the overall civil service reform strategy.

33. **In the period ahead, the authorities are appropriately focusing on improving tax administration.** This is a means of both mobilizing revenues and improving the environment for private sector activity. In addition, extending the GST to a wider range of services should be given priority. On the expenditure management side, the authorities are encouraged to resolve outstanding issues related to the introduction of the NAM so that it can be successfully introduced for the consolidated government in 2004/05, even if only on a pilot basis.

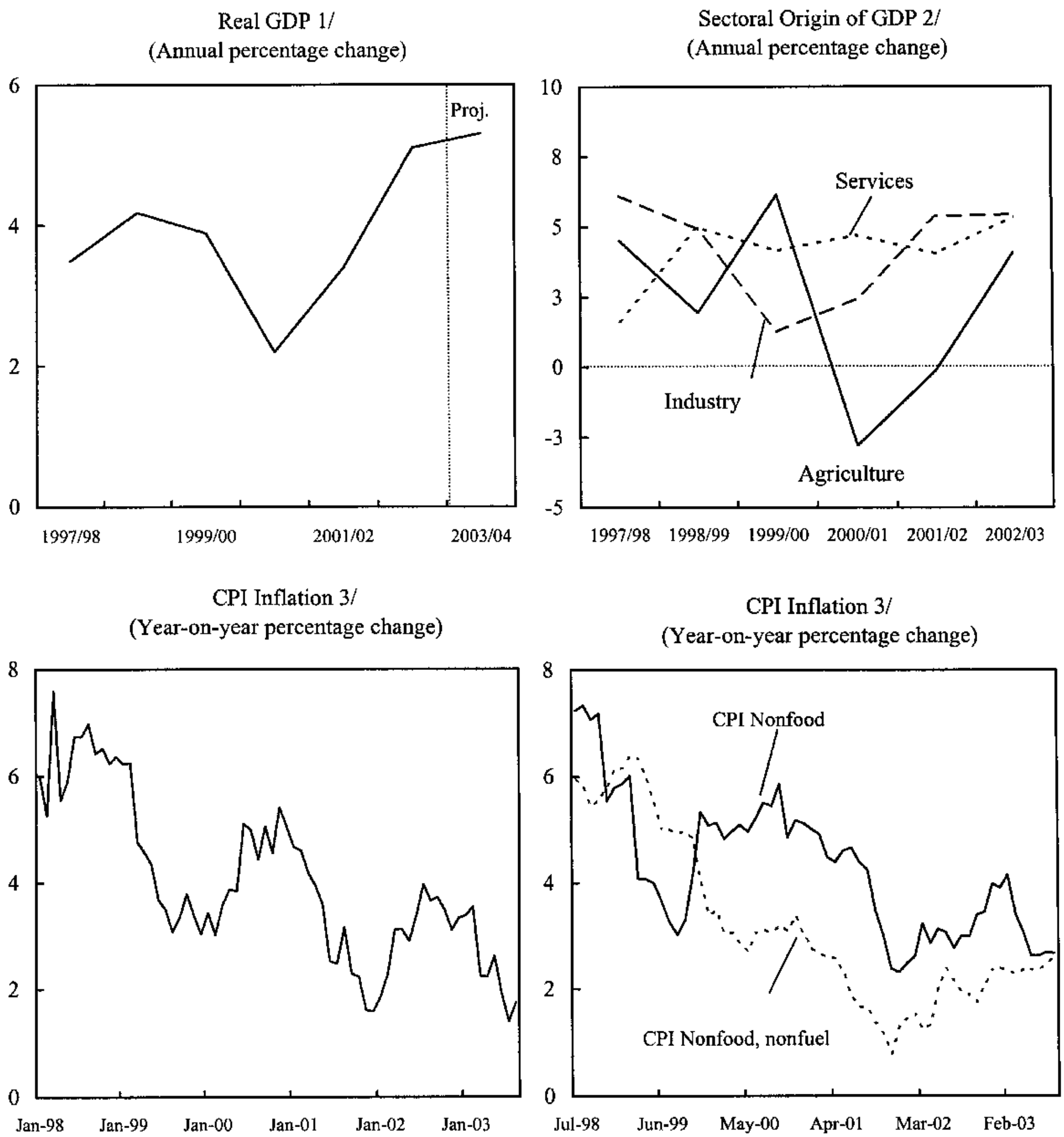
34. **In the energy sector, deep-rooted reforms are needed to ensure the attainment of the medium-term fiscal objectives and for laying the foundations for higher growth.** The authorities are encouraged to work closely with the World Bank toward making the unbundling of WAPDA effective and in finalizing the action plan to establish a transparent regulatory framework for the setting of electricity tariffs.

35. **In the financial sector, staff welcomes the intention to convert the NSS into a modern savings institution.** In the interim, the staff agrees with the steps proposed to align NSS rates with market rates. The staff also welcomes the authorities' intention to submit anti-money laundering and corporate bankruptcy laws to Parliament during the first half of 2004, and urges their quick adoption and implementation.

36. **The authorities are encouraged to quickly finalize the PRSP and to put in place a long-term strategy for improving Pakistan's still difficult poverty situation.** Information available suggests that the social and poverty situations in Pakistan remain largely unchanged. The staff would encourage the authorities to consider increasing social expenditure beyond the levels envisaged in the 2003/04 budget and the draft PRSP, if adequate financing sources can be found and the larger amounts can be spent effectively in the new decentralized framework.

37. **Pakistan's track record under the PRGF arrangement is noteworthy.** The authorities have successfully achieved and sustained macroeconomic stabilization and have begun to set the stage for a high growth path necessary to reduce poverty. However, progress on the structural reform agenda has been subject to some delays. Indeed, the success on the macroeconomic front has probably increased popular pressures for an easing of fiscal policy and a slowing of structural reforms. It will be important for the government to further strengthen the consensus for fiscal consolidation and structural reforms. The MEFP lays out a strong reform program, including a strengthening of reforms in the areas of tax administration and policy, the power sector, and the NSS. Given the strength of the authorities program and the minor nature of the tax exemptions, the staff recommends approval of the requested waivers of performance criteria, and completion of the sixth and seventh reviews.

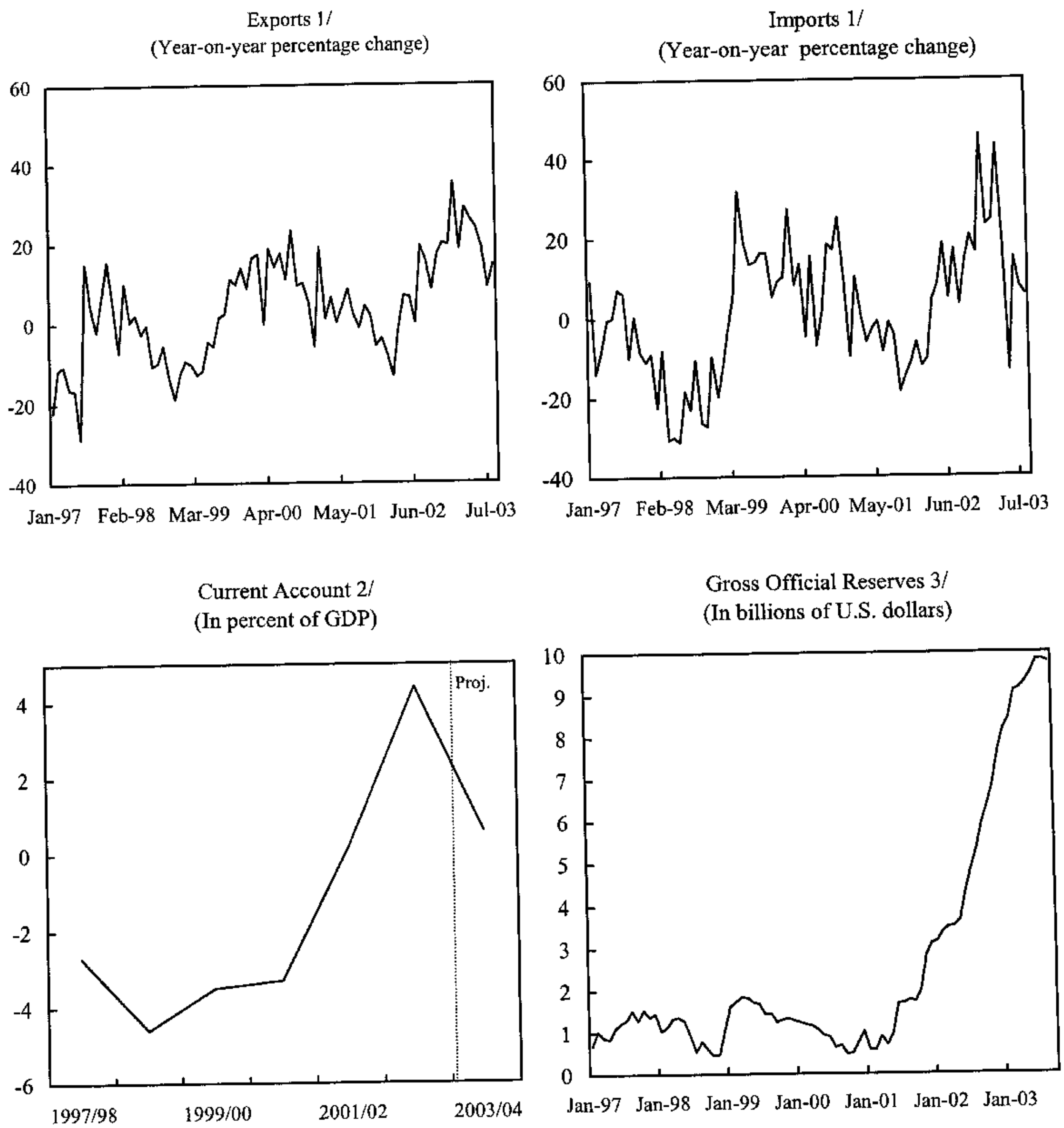
Figure 1. Pakistan: Output and Inflation, 1997/98–2003/04



Source: Data provided by the Pakistani authorities.

1/ Last data point: projection for 2003/04.
2/ Last observation: 2002/03.
3/ Last observation: August 2003.

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



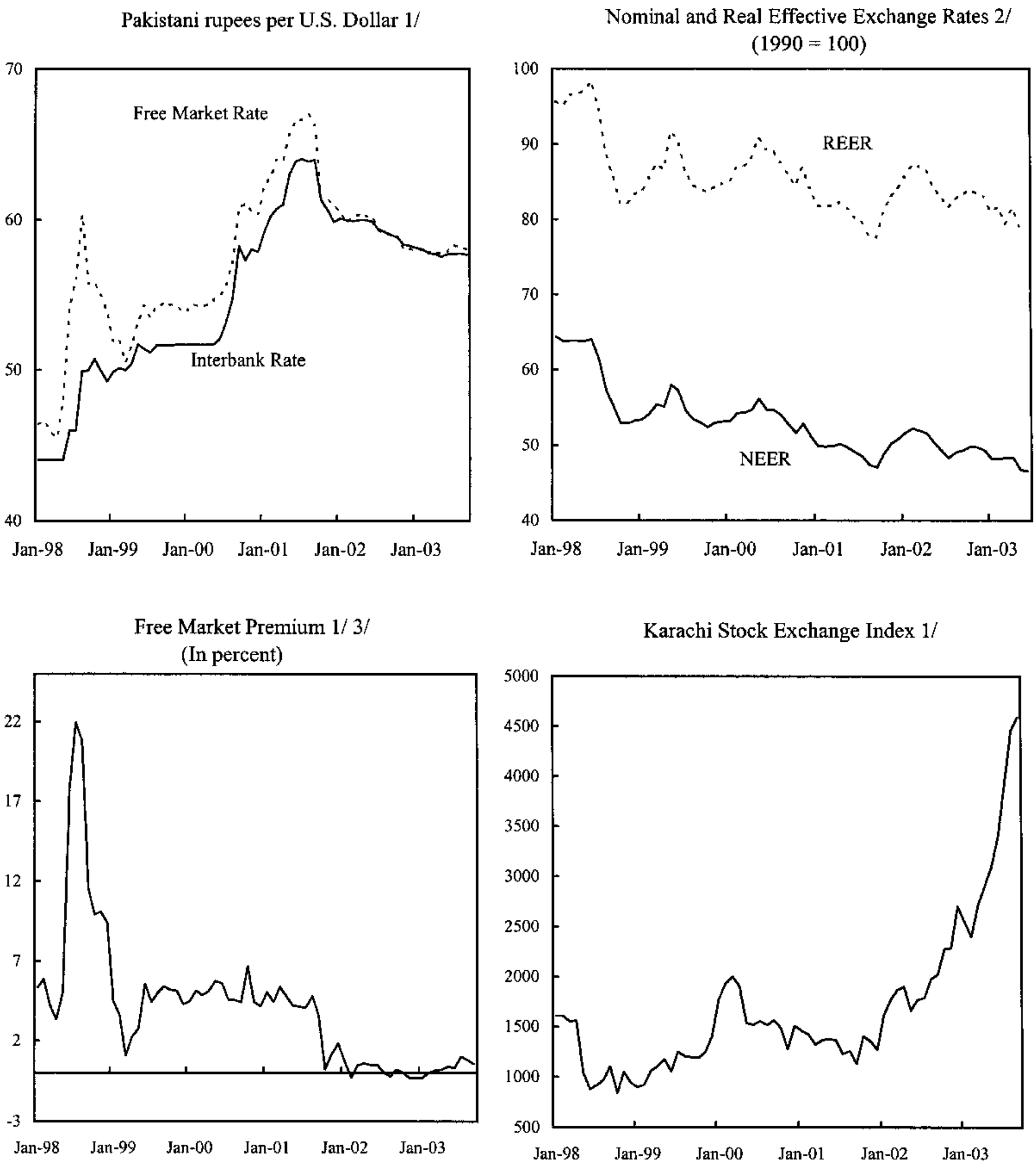
Source: Data provided by the Pakistani authorities.

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

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

3/ Excluding gold, foreign deposits held with SBP, short-term swap and forward commitments. Last observation: September 15, 2003.

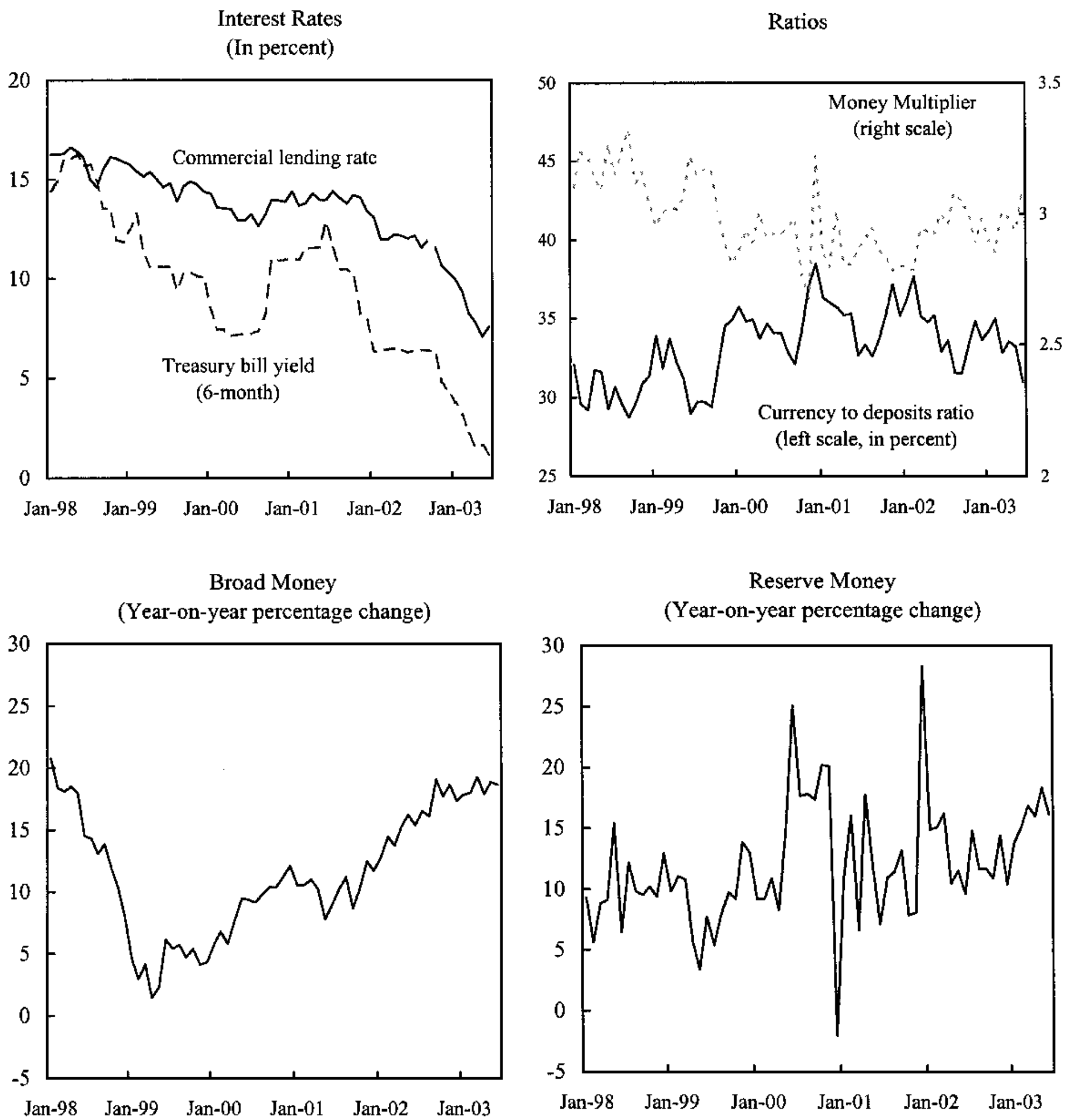
Figure 3. Pakistan: Exchange Rate and Stock Market Developments, 1998–2003



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

1/ Last observation: September 15, 2003.
2/ Last observation: June 2003.
3/ The free market premium is defined as the percent difference between the interbank rate and the kerb rate.

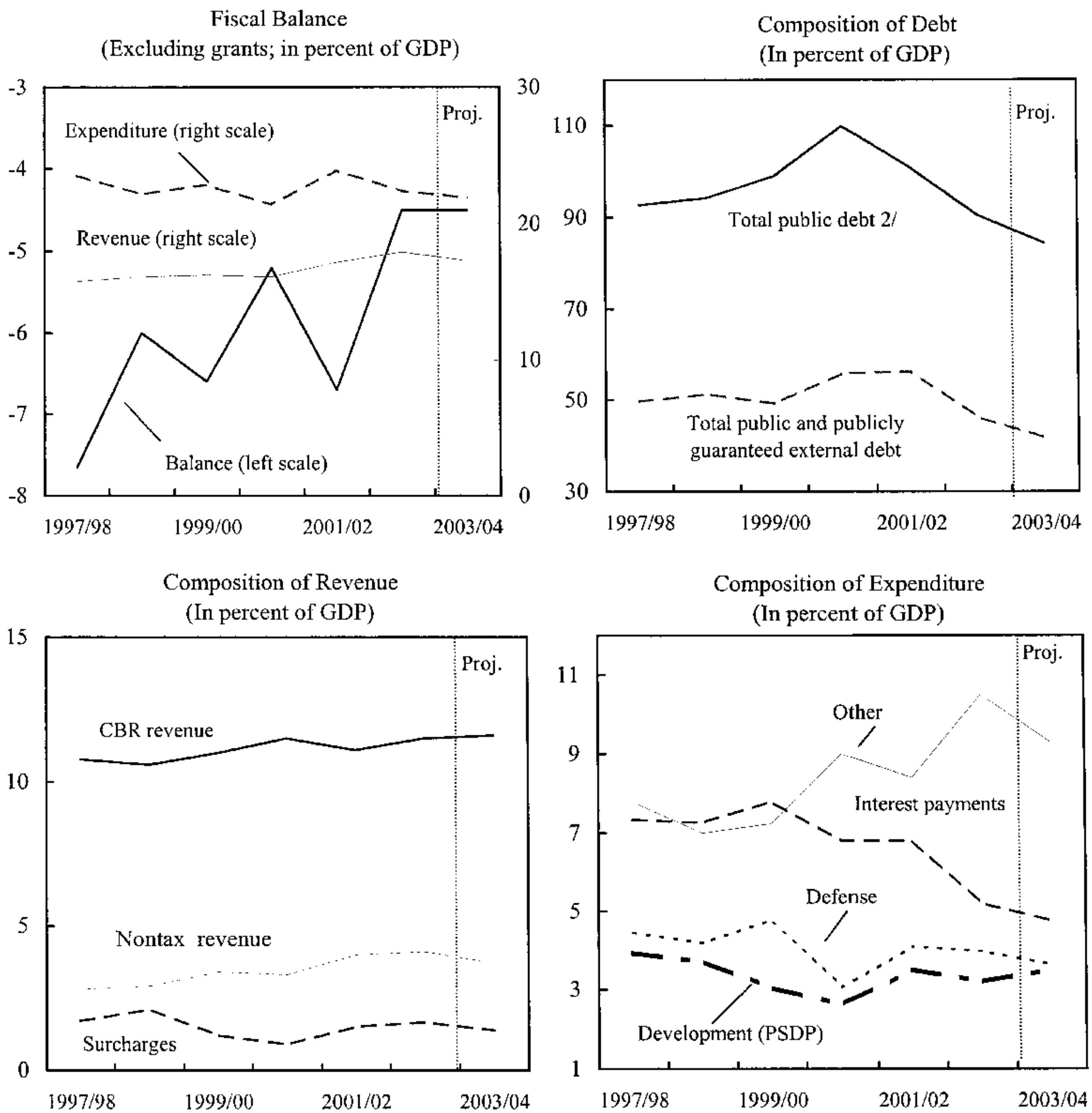
Figure 4. Pakistan: Monetary Developments, 1998–2003 1/



Source: Data provided by the Pakistani authorities.

1/ Last observation: June 2003.

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



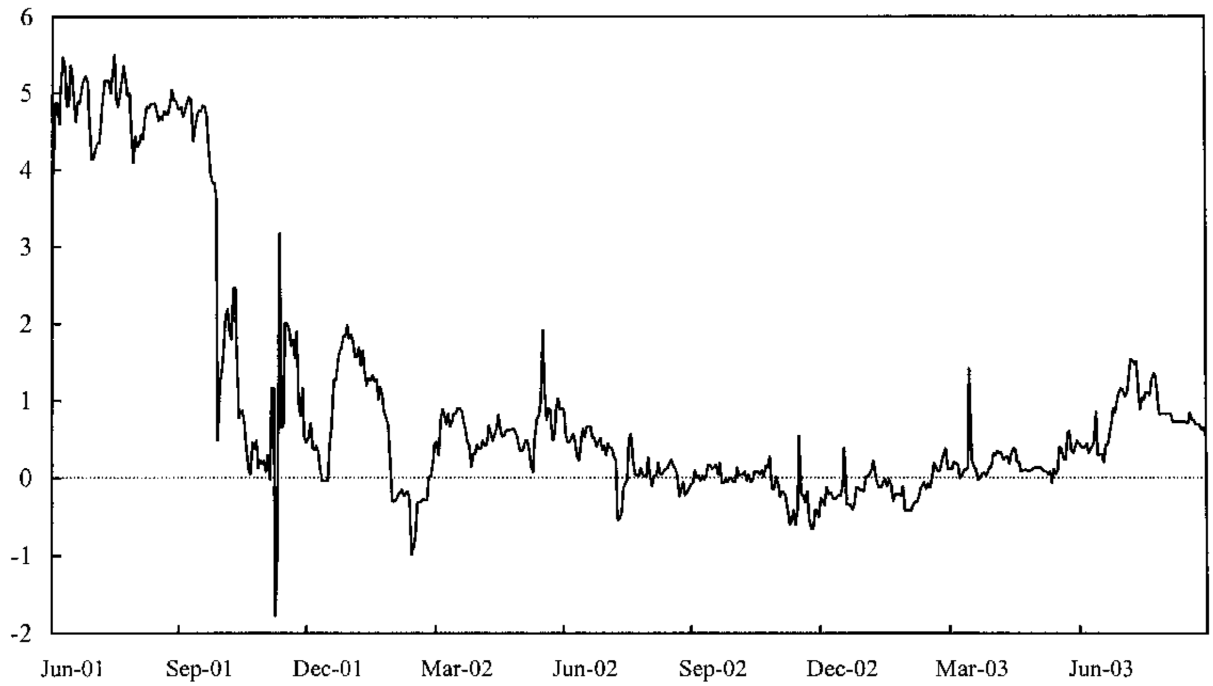
Source: Data provided by the Pakistani authorities.

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

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

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

Exchange Rate Premium in Free Market Over Interbank Market
(Pakistani rupee per U.S. Dollar, in percent)



Spread Over Generic U.S. Treasury Bond 2/
(In basis points)

Sources: Data provided by Pakistani authorities; and Datastream.

1/ First observation: June 1, 2001. Last observation: September 15, 2003.
2/ Calculated for Pakistan Islamic Republic 10 percent bond maturing on December 13, 2005.

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

	2000/01	2001/02	2002/03		2003/04	
			Prog. 1/	Est.	Prog. 1/	Rev. Proj.
			(Annual changes in percent)			
Output and prices						
Real GDP at factor costs	2.2	3.4	4.5	5.1	5.0	5.3
Real GDP at market prices	2.6	2.8	4.9	5.8	5.1	5.3
Partner country demand (WEO definition)	3.3	1.9	2.5	2.4	3.1	2.9
Consumer prices (period average)	4.4	2.7	3.7	3.1	4.0	4.0
Pakistani rupees per U.S. dollar (period average)	12.8	5.8	...	-4.9	...	...
			(In percent of GDP)			
Savings and investment						
Gross national savings	13.6	17.4	20.3	21.3	17.5	16.9
Government	-1.5	0.2	0.6	1.0	0.3	0.6
Nongovernment 2/	15.2	17.2	19.7	20.3	17.2	16.3
Gross capital formation	15.5	14.7	15.0	15.5	16.0	15.3
Government 3/	2.6	3.5	3.3	3.2	3.4	3.5
Nongovernment 2/	12.9	11.2	11.7	12.2	12.6	11.8
			(In percent of GDP)			
Public finances						
Revenue (including grants)	17.3	19.5	20.2	20.8	17.6	18.3
Expenditure 4/ 5/	21.4	23.9	21.9	22.4	21.1	21.9
Budget balance (excluding grants)	-5.2	-6.7	-4.6	-4.5	-4.5	-4.5
Budget balance (including grants)	-4.1	-4.4	-1.8	-1.7	-3.5	-3.6
Primary balance (including grants)	2.8	2.4	3.5	3.6	1.2	1.2
Total government debt	109.8	100.8	88.3	90.5	83.7	84.4
Domestic government debt	52.6	48.4	45.3	46.7	44.5	44.4
Implicit interest rate on government debt (in percent) 6/	7.5	6.5	5.9	5.7	5.9	5.8
			(Annual changes in percent of initial stock of broad money)			
Monetary sector 7/						
Net foreign assets	5.1	13.4	18.3	18.9	6.2	5.5
Net domestic assets	3.9	2.0	1.2	0.2	4.8	6.0
Of which: credit to the private sector	3.5	2.5	2.8	9.1	4.0	5.0
Of which: net claims on the government 5/	-3.3	1.5	-2.2	-4.4	0.4	0.7
Broad money	9.0	15.4	19.5	19.0	11.0	11.5
Six-month treasury bill rate (period average, in percent)	10.4	8.1	...	4.1	...	...
			(In percent of GDP)			
External sector						
Merchandise trade balance	-2.2	-0.5	-1.4	-0.8	-1.8	-1.4
Merchandise exports	15.2	15.5	14.7	15.9	13.8	15.2
Merchandise imports	17.4	16.0	16.2	16.7	15.7	16.7
Current account excluding official transfers	-3.3	0.2	3.9	4.4	0.5	0.6
Current account including official transfers	-1.9	2.7	5.3	5.9	1.5	1.6

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

	2000/01	2001/02	2002/03		2003/04	
			Prog. 1/	Est.	Prog. 1/	Rev. Proj.
	(In percent of exports of goods and nonfactor services)					
External public and publicly guaranteed debt	318.4	300.0	246.1	231.9	242.8	230.7
Debt service 8/	28.2	34.0	28.8	26.4	22.3	20.6
Implicit interest rate (in percent) 9/	4.4	3.9	3.5	3.3	2.8	2.7
Gross reserves (in millions of U.S. dollars) 10/	1,679	4,330	9,073	9,521	10,605	10,695
In months of next year imports of goods and services	1.7	3.7	7.3	7.0	8.2	7.4
In percent of short-term external debt 11/	23.7	72.1	181.5	191.3	309.3	249.5
Memorandum items:						
Real effective exchange rate (period average, percentage change)	-2.6	-1.1	...	-1.8	...	...
Terms of trade (percentage change)	-1.6	-0.7	-3.9	-1.4	-0.8	3.4
Real per-capita GDP (percentage change)	0.3	0.7	2.6	3.6	2.9	3.2
GDP at market prices (in billions of Pakistani rupees)	3,423	3,629	4,063	4,018	4,440	4,399

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

1/ Program as agreed during the fifth review (IMF Country Report No. 03/180).

2/ Includes public sector enterprises. The projected decline in gross capital formation in 2003/04 reflects an expected decline in stock accumulation. Nongovernment fixed investment would increase by 0.5 percent of GDP to 10.4 percent of GDP.

3/ Expenditures included in the Public Sector Development Program.

4/ Including the statistical discrepancy.

5/ Including KESC recapitalization and CBR bonds in 2001/02, and IDBP and ABL restructuring in 2003/04.

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

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

8/ Including interest on short-term debt.

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

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

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

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

(In millions of U.S. dollars)

	Prog. 2001/02	Prog. 1/ 2002/03	Est. 2002/03	Q1 Rev. Proj. 2003/04	Q2 Rev. Proj. 2003/04	Q3 Rev. Proj. 2003/04	Q4 Rev. Proj. 2003/04	Prog. 1/ 2003/04	Rev. Proj. 2003/04
Current account (excluding official transfers)	96	2,685	3,029	383	-4	-19	89	398	448
Current account balance (including official transfers)	1,591	3,683	4,029	599	180	227	231	1,189	1,237
Trade balance	-292	-1,002	-536	-278	-351	-279	-185	-1,453	-1,093
Exports f.o.b.	9,140	10,250	10,889	2,876	2,813	2,842	3,229	10,865	11,760
Imports f.o.b.	-9,432	-11,252	-11,425	-3,154	-3,164	-3,121	-3,414	-12,318	-12,853
Services (net)	-2,617	-1,844	-2,172	-585	-923	-916	-805	-2,259	-3,230
Of which: interest payments	-1,579	-1,311	-1,272	-242	-285	-226	-286	-1,050	-1,040
Private transfers (net)	3,005	5,532	5,737	1,246	1,270	1,176	1,079	4,110	4,771
Official transfers (net)	1,495	997	1,000	216	184	246	142	791	788
Of which: Saudi Oil Facility	579	667	637	149	149	119	121	538	538
Of which: additional grant pledges	742	225	209	44	0	104	0	111	148
Capital account	-2,322	-1,547	-1,529	-644	-392	-318	-293	-1,297	-1,647
Public medium- and long-term capital	-1,613	-1,511	-1,497	-379	-241	-48	-82	-785	-750
Project and nonproject loans	-983	-1,693	-1,696	-62	-45	-21	-44	-207	-172
Disbursements	531	721	723	182	182	182	182	697	728
Amortization 2/	-1,514	-2,414	-2,419	-244	-227	-203	-226	-904	-900
Commercial banks and IDB (net)	-224	-158	-158	-17	-16	0	0	-33	-33
Other 3/	-407	340	357	-300	-180	-27	-38	-545	-545
Public sector short-term (net)	-1,064	-135	-233	-303	-254	-3	-4	-464	-564
Private medium- and long-term	-80	143	221	53	91	45	29	378	218
Of which: FDI	368	576	611	125	150	125	100	500	500
Private short-term (including errors & omissions) 4/	435	-44	-19	-15	12	-312	-236	-426	-551
Nonbank	359	499	695	3	11	5	-5	125	14
Deposit money banks	-1,243	-709	-694	-19	1	-319	-229	-551	-566
Errors and omissions	1,319	166	-20	1	0	2	-2	0	1
Overall balance (before debt relief)	-731	2,136	2,501	-45	-212	-91	-62	-108	-410
Financing	731	-2,136	-2,501	45	212	91	62	108	410
Reserve assets (increase -)	-3,082	-5,030	-5,267	-503	-351	-339	-651	-1,407	-1,844
State Bank of Pakistan (including FE-25s)	-2,717	-5,671	-5,916	-468	-326	-169	-481	-907	-1,444
Deposit money banks	-365	641	649	-35	-25	-170	-170	-500	-400
Fund repurchases	-194	-416	-418	-147	-132	-115	-132	-526	-526
Net exceptional financing	4,007	3,310	3,185	695	695	545	845	2,042	2,780
Arrears (increase +)	0	0	0	0	0	0	0	0	0
Rescheduling 5/	1,210	991	1,009	0	100	0	0	100	100
Of which: Private Sector Involvement	0	100	100	0	100	0	0	100	100
Rollover of foreign deposits with banking system 6/	1,314	900	900	550	150	300	200	500	1,200
Program financing from IFIs	1,367	1,235	1,090	120	420	220	620	1,342	1,380
World Bank	698	252	213	0	100	0	400	500	500
AsDB	185	525	408	0	200	100	100	400	400
IMF	484	458	469	120	120	120	120	442	480
Privatization receipts	117	184	186	25	25	25	25	100	100
Financing gap	0	0	0	0	0	0	0	0	0
Memorandum items:					(In percent of GDP)				
Current account (excluding official transfers)	0.2	3.9	4.4	0.5	0.0	0.0	0.1	0.5	0.6
Current account balance (including official transfers)	2.7	5.3	5.9	0.8	0.2	0.3	0.3	1.5	1.6
Exports f.o.b. (growth rate, percent)	2.3	12.1	19.1	9.6	10.3	9.1	3.8	6.0	8.0
Imports f.o.b. (growth rate, percent)	-7.5	19.3	21.1	13.9	10.9	14.5	10.9	9.5	12.5
End-period gross official reserves 7/	4,330	9,073	9,521	9,926	10,183	10,283	10,695	10,605	10,695
(In months of next year imports of goods and nonfactor services)	3.7	7.3	7.0	6.9	7.1	7.1	7.4	8.2	7.4

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

1/ Program as agreed during the fifth review (IMF Country Report No. 03/180).

2/ In 2002/03, includes accelerated repayment of $1 billion USDA loan.

3/ In 2002/03, includes $1 billion capital grant to finance the accelerated repayment of the USDA loan.

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

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

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

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

Table 3. Pakistan: Consolidated Government Budget, 2000/01–2003/04

(In billions of Pakistani rupees)

	2000/01	2001/02	2002/03					2003/04	
	FY	FY	Sep.	Dec.	Mar.	Jun.		FY	
	Prov. Act.	Prov. Act.	Prov. Act.	Prov. Act.	Prov. Act.	Prog. 1/	Prov. Act.	Prog. 1/	Rev. Proj.
Revenue and grants	593.5	707.2	162.2	361.6	550.3	819.0	835.0	782.4	804.2
Revenue	553.0	624.1	147.9	332.9	502.7	704.5	720.8	739.7	762.4
Tax revenue	441.5	478.1	112.7	253.2	378.4	555.9	555.8	599.6	599.8
Federal	422.5	459.3	106.8	242.5	363.0	532.8	534.0	573.7	573.6
CBR revenue	392.1	403.9	90.4	203.1	310.3	458.9	461.6	510.0	510.0
Direct tax	124.6	142.6	23.6	63.3	94.7	148.4	152.9	154.8	161.1
Federal excise duty	49.0	46.9	9.6	19.8	31.3	47.5	44.9	48.8	47.7
Sales tax	153.5	166.3	43.8	92.6	139.1	204.0	195.1	232.2	223.1
Customs duties	65.0	48.1	13.4	27.3	45.2	59.0	68.8	74.2	78.1
Petroleum surcharge	17.9	36.6	10.8	21.9	32.8	46.4	46.9	46.2	46.1
Gas surcharge	12.3	17.7	5.2	11.6	15.9	21.0	21.3	15.0	15.0
Other	0.2	1.1	0.4	5.9	4.0	6.5	4.1	2.5	2.5
Provincial	19.0	18.8	6.0	10.7	15.4	23.1	21.8	25.9	26.2
Nontax revenue	111.4	146.0	35.2	79.7	124.3	148.6	165.0	140.1	162.6
Federal	91.5	124.7	31.4	71.2	110.7	125.9	139.6	114.9	134.4
Provincial	19.9	21.3	3.8	8.4	13.6	22.7	25.4	25.2	28.2
Grants	40.5	83.1	14.3	28.8	47.6	114.4	114.2	42.6	41.8
Expenditure	717.9	826.2	193.8	404.1	626.9	890.9	898.1	918.9	941.4
Current expenditure	645.7	700.2	164.2	349.9	544.8	735.2	791.7	770.2	779.3
Federal	479.0	524.6	118.7	244.8	380.6	550.1	599.8	568.2	573.9
Interest payments	234.5	245.3	50.7	103.2	161.5	214.3	209.7	211.2	210.0
Domestic	183.5	184.6	41.0	79.8	121.9	172.0	160.5	170.5	170.5
Foreign 2/	51.0	60.6	9.7	23.4	39.6	42.3	49.2	40.7	39.5
Defense	104.7	149.0	32.6	76.7	115.8	160.0	159.7	160.0	160.3
Running of the civil government	70.7	56.3	11.3	24.8	38.5	54.2	60.9	64.0	70.5
Pensions for defense and civil government	30.9	27.2	5.9	15.1	26.5	34.8	37.2	38.0	39.6
Subsidies 3/	19.9	23.7	13.7	16.6	23.5	60.3	50.0	64.6	62.5
Grants	18.1	22.8	4.3	8.5	14.5	26.0	24.4	29.2	29.2
Other 4/	0.3	0.3	0.1	-0.1	0.3	0.5	57.9	1.2	1.9
Provincial	166.7	175.6	45.4	105.2	164.2	185.1	191.9	202.0	205.4
Development expenditure and net lending	72.2	125.9	29.6	54.2	82.1	155.7	106.4	148.7	162.1
Public Sector Development Program	89.8	126.2	24.5	51.5	77.8	134.0	129.2	152.0	152.0
Federal	66.9	98.4	14.6	31.5	49.0	90.0	90.0	105.0	107.5
Provincial	22.9	27.8	9.9	20.0	28.8	44.0	39.2	47.0	44.5
Net lending	-17.6	-0.2	5.1	2.7	4.3	21.7	-22.7	-3.3	10.1
Statistical discrepancy ("+" = additional expenditure)	14.8	-11.7	-1.4	-9.0	-35.3	...	3.2	...	...
Federal government	29.8	15.3	2.3	9.3	7.6	...	-2.5	...	...
Provinces	-15.0	-26.9	-3.7	-18.3	-42.9	...	5.6	...	...
Underlying budget balance (excluding grants) 3/	-179.7	-190.5	-44.4	-62.3	-88.8	-186.4	-180.5	-179.2	-179.0
Underlying budget balance (including grants)	-139.2	-107.3	-30.1	-33.5	-41.2	-72.0	-66.3	-136.5	-137.2
One-off expenditure items 5/	...	52.0	...	...	...	...	...	20.0	20.0
Budget balance (excluding grants)	-179.7	-242.5	-44.4	-62.3	-88.8	-186.4	-180.5	-199.2	-199.0
Budget balance (including grants)	-139.2	-159.3	-30.1	-33.5	-41.2	-72.0	-66.3	-156.5	-157.2
Financing	139.2	159.3	30.1	33.5	41.2	72.0	66.3	156.5	157.2
External	80.2	51.7	24.6	32.0	41.6	20.2	-1.3	14.2	53.0
Of which: privatization receipts	...	...	...	7.3	7.3	10.0	7.6	...	7.0
Domestic	59.0	99.3	4.7	1.5	-1.6	51.8	63.9	142.3	104.2
Bank	-33.0	14.3	-12.7	-34.0	-52.5	-29.2	-55.6	34.2	40.2
Of which: not related to bank restructuring 5/	...	...	...	...	...	...	...	14.2	20.2
Nonbank	92.0	85.0	17.4	34.3	50.9	79.0	119.5	98.1	61.0
Privatization receipts	0.0	8.4	0.8	1.2	1.2	2.0	3.7	10.0	3.0
Memorandum items:									
Expenditure incl. statistical discrepancy and one-off	732.7	866.5	192.3	395.1	591.5	890.9	901.3	938.9	961.4
Primary balance (including grants and one-offs)	95.3	86.0	20.6	69.7	120.2	142.4	143.4	54.7	52.8
Social- and poverty-related expenditure	122.3	133.6	29.3	66.5	102.1	161.0	158.0	185.1	185.1
Total government debt	3,759.4	3,657.5	3,638.3	3,650.5	...	3,588.1	3,636.4	3,716.6	3,710.6
Domestic debt	1,799.2	1,757.5	1,763.5	1,799.8	...	1,842.5	1,877.6	1,974.9	1,954.3
External debt	1,960.2	1,900.0	1,874.8	1,850.7	...	1,745.6	1,758.8	1,741.8	1,756.2
Nominal GDP at market prices	3,423.1	3,628.7	1,004.5	2,009.1	3,013.6	4,063.0	4,018.1	4,440.3	4,398.9

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

1/ Program as agreed during the fifth review (IMF Country Report No. 03/180).

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

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

4/ In 2002/03, other spending corresponds essentially to the write-off of government equity in KESC (PRs 57 billion). As an equivalent amount is registered as a net-lending receipt, this write-off has no impact on total expenditure.

5/ 2001/02: KESC recapitalization (PRs 32 billion) and CBR bonds (PRs 20 billion). 2003/04: IDBP restructuring (PRs 12 billion) and ABL restructuring (PRs 8 billion).

Table 4. Pakistan: Consolidated Government Budget, 2000/01–2003/04

(In percent of GDP; unless otherwise indicated)

	2000/01	2001/02	2002/03					2003/04	
	FY	FY	Sep.	Dec.	Mar.	Jun.		FY	
	Prov. Act.	Prov. Act.	Prov. Act.	Prov. Act.	Prov. Act.	Prog. 1/	Prov. Act.	Prog. 1/	Rev. Proj.
Revenue and grants	17.3	19.5	16.1	18.0	18.3	20.2	20.8	17.6	18.3
Revenue	16.2	17.2	14.7	16.6	16.7	17.3	17.9	16.7	17.3
Tax revenue	12.9	13.2	11.2	12.6	12.6	13.7	13.8	13.5	13.6
Federal	12.3	12.7	10.6	12.1	12.0	13.1	13.3	12.9	13.0
CBR revenue	11.5	11.1	9.0	10.1	10.3	11.3	11.5	11.5	11.6
Direct tax	3.6	3.9	2.3	3.2	3.1	3.7	3.8	3.5	3.7
Federal excise duty	1.4	1.3	1.0	1.0	1.0	1.2	1.1	1.1	1.1
Sales tax	4.5	4.6	4.4	4.6	4.6	5.0	4.9	5.2	5.1
Customs duties	1.9	1.3	1.3	1.4	1.5	1.5	1.7	1.7	1.8
Petroleum surcharge	0.5	1.0	1.1	1.1	1.1	1.1	1.2	1.0	1.0
Gas surcharge	0.4	0.5	0.5	0.6	0.5	0.5	0.5	0.3	0.3
Other	0.0	0.0	0.0	0.3	0.1	0.2	0.1	0.1	0.1
Provincial	0.6	0.5	0.6	0.5	0.5	0.6	0.5	0.6	0.6
Nontax revenue	3.3	4.0	3.5	4.0	4.1	3.7	4.1	3.2	3.7
Federal	2.7	3.4	3.1	3.5	3.7	3.1	3.5	2.6	3.1
Provincial	0.6	0.6	0.4	0.4	0.5	0.6	0.6	0.6	0.6
Grants	1.2	2.3	1.4	1.4	1.6	2.8	2.8	1.0	1.0
Expenditure	21.0	22.8	19.3	20.1	20.8	21.9	22.4	20.7	21.4
Current expenditure	18.9	19.3	16.3	17.4	18.1	18.1	19.7	17.3	17.7
Federal	14.0	14.5	11.8	12.2	12.6	13.5	14.9	12.8	13.0
Interest payments	6.8	6.8	5.1	5.1	5.4	5.3	5.2	4.8	4.8
Domestic	5.4	5.1	4.1	4.0	4.0	4.2	4.0	3.8	3.9
Foreign 2/	1.5	1.7	1.0	1.2	1.3	1.0	1.2	0.9	0.9
Defense	3.1	4.1	3.2	3.8	3.8	3.9	4.0	3.6	3.6
Running of the civil government	2.1	1.6	1.1	1.2	1.3	1.3	1.5	1.4	1.6
Pensions for defense and civil government	0.9	0.7	0.6	0.8	0.9	0.9	0.9	0.9	0.9
Subsidies 3/	0.6	0.7	1.4	0.8	0.8	1.5	1.2	1.5	1.4
Grants	0.5	0.6	0.4	0.4	0.5	0.6	0.6	0.7	0.7
Other 4/	0.0	0.0	0.0	0.0	0.0	0.0	1.4	0.0	0.0
Provincial	4.9	4.8	4.5	5.2	5.4	4.6	4.8	4.5	4.7
Development expenditure and net lending	2.1	3.5	2.9	2.7	2.7	3.8	2.6	3.3	3.7
Public Sector Development Program	2.6	3.5	2.4	2.6	2.6	3.3	3.2	3.4	3.5
Federal	2.0	2.7	1.5	1.6	1.6	2.2	2.2	2.4	2.4
Provincial	0.7	0.8	1.0	1.0	1.0	1.1	1.0	1.1	1.0
Net lending	-0.5	0.0	0.5	0.1	0.1	0.5	-0.6	-0.1	0.2
Statistical discrepancy ("+" = additional expenditure)	0.4	-0.3	-0.1	-0.4	-1.2	...	0.1	...	...
Federal government	0.9	0.4	0.2	0.5	0.3	...	-0.1	...	...
Provinces	-0.4	-0.7	-0.4	-0.9	-1.4	...	0.1	...	...
Underlying budget balance (excluding grants) 3/	-5.2	-5.2	-4.4	-3.1	-2.9	-4.6	-4.5	-4.0	-4.1
Underlying budget balance (including grants)	-4.1	-3.0	-3.0	-1.7	-1.4	-1.8	-1.7	-3.0	-3.1
One-off expenditure items 5/	...	1.4	...	...	...	...	...	0.5	0.5
Budget balance (excluding grants)	-5.2	-6.7	-4.4	-3.1	-2.9	-4.6	-4.5	-4.5	-4.5
Budget balance (including grants)	-4.1	-4.4	-3.0	-1.7	-1.4	-1.8	-1.7	-3.5	-3.6
Financing	4.1	4.4	3.0	1.7	1.4	1.8	1.6	3.5	3.6
External	2.3	1.4	2.5	1.6	1.4	0.5	0.0	0.3	1.2
Of which: privatization receipts	...	...	...	0.4	0.2	0.2	0.2	...	0.2
Domestic	1.7	2.7	0.5	0.1	-0.1	1.3	1.6	3.2	2.4
Bank	-1.0	0.4	-1.3	-1.7	-1.7	-0.7	-1.4	0.8	0.9
Of which: not related to bank restructuring 5/	...	...	...	...	...	...	...	0.3	0.4
Nonbank	2.7	2.3	1.7	1.7	1.7	1.9	3.0	2.2	1.4
Privatization receipts	0.0	0.2	0.1	0.1	0.0	0.0	0.1	0.2	0.1
Memorandum items:									
Expenditure incl. statistical discrepancy and one-off	21.4	23.9	19.1	19.7	19.6	21.9	22.4	21.1	21.9
Primary balance (including grants and one-offs)	2.8	2.4	2.1	3.5	4.0	3.5	3.6	1.2	1.2
Social- and poverty-related expenditure	3.6	3.7	2.9	3.3	3.4	4.0	3.9	4.2	4.2
Total government debt	109.8	100.8	90.5	90.9	...	88.3	90.5	83.7	84.4
Domestic debt	52.6	48.4	43.9	44.8	...	45.3	46.7	44.5	44.4
External debt	57.3	52.4	46.7	46.1	...	43.0	43.8	39.2	39.9
Nominal GDP (market prices, billions of Pakistani rupees)	3,423	3,629	1,005	2,009	3,014	4,063	4,018	4,440	4,399

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

1/ Program as agreed during the fifth review (IMF Country Report No. 03/180).

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

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

4/ In 2002/03, other spending corresponds essentially to the write-off of government equity in KESC (PRs 57 billion). As an equivalent amount is registered as a net-lending receipt, this write-off has no impact on total expenditure.

5/ 2001/02: KESC recapitalization (PRs 32 billion) and CBR bonds (PRs 20 billion). 2003/04: IDBP restructuring (PRs 12 billion) and ABL restructuring (PRs 8 billion).

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

	Act.		Monetary Program 2002/03 1/						Monetary Program 2003/04 1/			
			Sep.	Dec.	Mar.		Jun.		Sep.	Dec.	Mar.	Jun.
			Act.	Act.	Prog.	Act. 2/	Prog.	Act. 2/	Rev. Prog. 3/	Rev. Prog. 3/	Prog.	Prog.
	2000/01	2001/02	2002	2002	2003	2003	2003	2003	2003	2003	2004	2004
	(End-of-period stocks; in billions of Pakistani rupees)											
Net foreign assets	26.3	230.8	348.2	414.8	519.8	512.7	559.1	569.1	582.3	603.3	623.8	664.0
Net domestic assets	1,499.7	1,530.6	1,462.6	1,526.3	1,507.6	1,482.7	1,544.1	1,526.3	1,557.1	1,683.8	1,646.1	1,657.1
Net claims on government	569.7	591.9	575.9	536.7	528.7	502.6	553.0	513.9	555.4	560.0	544.8	529.1
Of which:												
Net bank borrowing	499.9	514.2	501.5	480.2	475.6	461.7	485.0	458.6	502.1	511.7	499.5	478.8
Commodity operations	95.3	100.6	95.9	79.6	75.6	61.2	89.6	74.0	72.0	67.0	64.0	69.0
Net claims on nongovernment	902.4	921.6	885.6	990.0	979.4	1,017.0	991.6	1,070.6	1,055.0	1,177.1	1,154.6	1,181.2
Private sector	802.1	839.6	809.0	915.1	891.1	941.4	889.6	998.9	982.2	1,102.6	1,078.6	1,103.5
Public sector	100.2	82.0	76.6	75.0	88.3	75.6	102.0	71.8	72.8	74.5	76.1	77.8
Privatization account	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9
Other items, net	30.6	20.0	4.1	2.5	2.5	-34.0	2.5	-55.3	-50.4	-50.4	-50.4	-50.4
Total liquidity (broad money)	1,526.0	1,761.4	1,810.8	1,941.2	2,027.3	1,995.4	2,103.2	2,095.4	2,139.4	2,287.1	2,269.9	2,321.1
Of which:												
Pakistani rupee liquidity	1,371.9	1,603.9	1,645.8	1,806.7	1,886.7	1,866.9	1,956.2	1,964.3	2,007.6	2,150.2	2,127.9	2,174.0
	(Changes in percent of stock of broad money at the beginning of the fiscal year)											
Net foreign assets	5.1	13.4	6.3	10.1	16.1	15.7	18.3	18.9	1.5	2.5	3.5	5.5
Net domestic assets	3.9	2.0	-3.4	0.2	-0.8	-2.3	1.2	0.2	1.2	7.3	5.5	6.0
Of which:												
Net claims on the government	-3.3	1.5	-0.9	-3.1	-3.6	-5.1	-2.2	-4.4	2.0	2.2	1.5	0.7
Net claims on private sector	3.5	2.5	-1.7	4.3	2.9	5.8	2.8	9.1	-0.8	5.0	3.8	5.0
	(Changes over 12 months; in percent)											
Broad money	9.0	15.4	19.3	17.6	21.5	19.6	19.5	19.0	18.1	17.8	13.8	11.5
Net claims on private sector	6.5	4.7	3.7	7.4	6.3	12.3	6.0	19.0	21.4	20.5	14.6	10.5

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

1/ At indicative program exchange rate.

2/ Program column is the revised projection published in IMF Country Report No. 03/180. Actual numbers reflect the fact that part of the foreign assets accumulated by the SBP and pledged for the repayment of foreign banks' deposits were placed with commercial banks and thus are treated as domestic assets of the SBP.

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

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

	Act.		Monetary Program 2002/03 1/						Monetary Program 2003/04 1/			
			Sep.	Dec.	Mar.		Jun.		Sep.	Dec.	Mar.	Jun.
			Act.	Act.	Prog.	Act. 2/	Prog.	Act. 2/	Rev. Prog. 3/	Rev. Prog. 3/	Prog.	Prog.
	2000/01	2001/02	2002	2002	2003	2003		2003	2003	2003	2004	2004
(End-of-period stocks; in billions of Pakistani rupees)												
Net foreign assets	-19.1	133.5	271.7	357.4	455.0	451.6	493.0	491.9	504.5	524.2	533.6	562.3
Net domestic assets	552.3	451.1	321.0	293.1	223.0	208.2	198.0	187.2	179.4	205.7	191.0	181.7
Net claims on government	335.6	226.2	99.6	64.3	-2.7	4.5	-21.7	-18.9	-35.5	-12.9	-31.3	-44.3
Of which:												
Budgetary support	361.1	249.2	121.1	87.3	19.8	24.9	-0.1	-0.1	-16.7	5.8	-12.6	-25.6
Claims on nongovernment	40.1	22.7	17.4	14.7	17.5	14.2	17.5	12.0	12.0	12.0	12.0	12.0
Claims on scheduled banks	198.0	195.8	175.8	192.1	186.1	155.4	180.1	169.6	173.4	177.1	180.9	184.6
Privatization account	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9
Other items, net	-18.4	9.4	31.1	24.9	24.9	37.1	24.9	27.4	32.4	32.4	32.4	32.4
Reserve money 4/	533.2	584.6	592.7	650.6	677.8	659.8	690.8	679.1	683.9	729.8	724.6	744.0
Of which:												
Banks' reserves	127.3	110.5	127.3	125.8	131.6	128.6	138.5	141.8	145.1	155.2	155.6	159.7
Currency	394.6	460.2	454.3	513.3	534.8	518.3	540.8	525.0	535.9	571.8	566.2	581.4
(Changes in percent of stock of reserve money at the beginning of the fiscal year)												
Net foreign assets	7.3	28.6	22.6	37.3	54.0	53.4	60.5	60.3	4.3	7.2	8.7	13.0
Net domestic assets	-0.2	-19.0	-21.3	-26.0	-38.0	-40.6	-42.3	-44.2	-1.9	2.0	-0.2	-1.6
Of which:												
Budgetary support	-6.3	-21.0	-21.6	-27.7	-39.1	-37.9	-42.4	-41.9	-2.5	0.9	-1.9	-3.8
(Changes over 12 months; in percent)												
Reserve money 5/	-3.7	9.6	11.5	10.3	19.3	16.1	18.1	16.1	17.2	13.8	11.4	11.4
Currency	5.2	16.6	13.8	13.6	17.4	13.8	17.0	13.5	18.0	11.4	9.2	10.7

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

1/ At indicative program exchange rates.

2/ Program column is the revised projection published in IMF Country Report No. 03/180. Actual numbers reflect the fact that part of the foreign assets accumulated by the SBP and pledged for the repayment of foreign banks' deposits were placed with commercial banks and thus are treated as domestic assets of the SBP.

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

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

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

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

(In millions of Pakistani rupees, unless otherwise indicated)

	Act. 2001/02	Q1 Prel. Est. 2002/03	Q2 Prel. Est. 2002/03	Q3 Prel. Est. 2002/03	Q4 Prel. Est. 2002/03	Rev. FIP 1/ 2002/03	Prel. Est. 2002/03	Rev. FIP 2003/04
Main assumptions								
Furnace oil prices (PRs per metric ton)	11,440.0	13,221	13,159	14,292	12,243	13,688	13,297	13,806
Average exchange rate (Pakistani rupees per U.S. dollar)	61.0	59.4	58.8	58.0	57.7	...	58.4	...
Average revenue (PRs/kWh) 2/	3.93	4.18	4.59	4.20	4.64	4.40	4.40	4.34
Units generated (in GWh)	60,849	18,204	14,343	13,606	17,885	63,318	64,038	65,574
Of which: thermal units (in percent of units generated)	68.7	49.9	67.2	84.0	64.0	68.1	65.1	67.3
purchased units (in GWh)	23,242	4,750	5,124	6,370	5,862	24,378	22,106	24,685
Main operational and financial targets								
Technical and nontechnical losses 3/ 4/	25.8	25.6	22.5	27.4	28.0	25.0	25.9	24.0
Total receivables	50,969	51,862	54,027	58,098	58,842	57,040	58,842	68,591
Of which: public sector and FATA receivables	29,182	28,006	32,449	36,492	33,986	...	33,986	...
Stock of payables to fuel suppliers and IPPs 3/	25,565	16,967	14,077	16,622	6,406	6,406	6,406	4,618
Summary cash flow statement								
Total cash receipts (excluding GST, ED, & W/Tax)	177,409	55,681	48,905	37,387	59,043	202,943	201,016	204,884
Total cash outflows	178,649	51,877	44,677	39,544	71,781	210,099	207,879	213,918
Purchase of power from IPPs	109,101	28,535	25,131	24,713	37,754	121,054	116,133	106,049
Cost of fuel	37,365	12,741	10,074	8,556	16,607	45,318	47,978	40,692
Debt service to GOP (interest and amortization)	3,423	3	0	0	43	0	46	22,902
Debt service other than to GOP (interest and amortization)	11,684	6,064	3,313	928	5,639	16,017	15,944	12,269
Hydel profit payment	6,000	0	1,000	0	5,000	6,000	6,000	6,000
Operations and maintenance	17,261	4,150	4,607	4,766	5,888	19,309	19,411	21,366
Other cash outflows 5/	-6,185	384	552	581	850	2,401	2,367	4,640
Net cash available before investment program	-1,240	3,804	4,228	-2,157	-12,738	-7,156	-6,863	-9,034
Investment expenditure	20,618	2,651	1,980	2,744	4,255	23,511	11,630	30,928
Foreign-financed component	13,034	0	0	0	0	11,511	0	18,928
Locally-financed component	7,584	2,651	1,980	2,744	4,255	12,000	11,630	12,000
Cash surplus (+)/deficit(-)	-21,858	1,153	2,248	-4,901	-16,993	-30,667	-18,493	-39,962
Financing	21,858	-1,153	-2,248	4,901	16,993	30,667	18,493	39,962
Banking financing	...	-1,153	-2,248	-364	3,658	0	-107	0
Nonbanking financing	...	0	0	5,265	1,735	7,000	7,000	0
Budgetary support (subsidies and grants)	...	0	0	0	11,600	12,156	11,600	21,034
External financing	...	0	0	0	0	11,511	0	18,928
Memorandum items:								
Net change in payment arrears 6/	...	-1,919	2,792	9,227	-8,577	1,569	1,523	-1,788
Of which: arrears to the government	...	6,679	5,682	6,682	1,639	20,728	20,682	0
Of which: arrears to IPPs and suppliers	...	-8,598	-2,890	2,545	-10,216	-19,159	-19,159	-1,788
Accrual balance 7/	...	3,072	-544	-14,128	-8,416	-20,725	-20,016	-19,246
Total budgetary support (including debt arrears)	...	6,679	5,682	6,682	13,239	32,884	32,282	21,034

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

1/ To facilitate comparisons with the preliminary estimate, the classification of expenditures has been slightly modified as compared to the fifth review (IMF Country Report No. 03/180): PRs 11.8 billion in arrear payments initially accounted for as "Other cash outflows" were reclassified as "Purchase of power from IPPs" (PRs 6.1 billion) and "Cost of fuel" (PRs 5.7 billion).

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

3/ Ceiling under FIP.

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

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

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

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

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

(In millions of Pakistani rupees, unless otherwise indicated)

	Act. 2001/02	Q1 Prel. Est. 2002/03	Q2 Prel. Est. 2002/03	Q3 Prel. Est. 2002/03	Q4 Prel. Est. 2002/03	Rev. FIP 2002/03	Prel. Est. 2002/03	Rev. FIP 2003/04
Main assumptions								
Furnace oil price (PRs per metric ton)	9,386	10,562	10,765	11,643	10,656	10,874	10,953	10,922
Average tariff (PRs per kWh)	4.5	4.4	4.7	4.6	4.7	4.6	4.6	4.6
Units generated (in GWh)	11,548	3,176	2,849	2,554	3,456	11,980	12,036	12,219
Of which: purchased units (in GWh)	3,406	1,125	817	682	1,185	3,919	3,809	3,262
Main operational and financial targets								
Technical and nontechnical losses 1/	41.1	40.5	37.8	41.2	43.2	40.0	40.8	38.0
Total receivables	21,130	21,519	20,933	20,334	19,842	20,334	19,842	20,334
Of which: public sector receivables	2,366	2,635	2,138	2,316	1,913	2,316	1,913	2,316
Stock of payables to fuel suppliers and IPPs 2/	11,198	3,905	4,426	1,891	928	923	928	923
Summary cash flow statement								
Receipts	34,649	9,103	10,048	8,238	11,459	38,429	38,848	40,846
Collection of dues	32,452	8,695	9,335	7,691	10,462	35,736	36,183	38,439
GST	1,436	187	500	171	798	1,689	1,656	1,927
Other receipts	761	221	212	376	199	1,004	1,008	480
Payments	49,807	17,307	15,412	12,864	14,953	59,915	60,536	50,304
Purchase of power	14,147	10,587	5,804	3,360	5,541	24,561	25,293	14,864
Cost of fuel	21,721	4,284	6,984	6,963	5,698	24,050	23,930	23,100
Debt service (interest and amortization)	9,587	1,536	1,630	1,535	2,183	6,771	6,883	7,008
Taxes	837	162	242	239	345	1,096	987	1,587
Operations and maintenance	3,515	739	752	766	1,186	3,436	3,443	3,744
Net cash available before investment program	-15,158	-8,205	-5,364	-4,626	-3,493	-21,486	-21,689	-9,458
Investment program	1,560	317	322	328	914	2,937	1,881	5,884
Regular component	1,560	317	322	328	647	1,859	1,614	2,212
Additional component 3/	0	0	0	0	267	1,078	267	3,672
Cash surplus (+)/deficit(-)	-16,718	-8,521	-5,686	-4,955	-4,408	-24,423	-23,570	-15,342
Financing	...	8,521	5,686	4,955	4,408	24,423	23,570	15,342
Banking financing	...	521	3,686	4,955	-9,973	0	-811	0
Term Finance Certificates	...	0	0	0	0	0	0	0
Other	...	521	3,686	4,955	-9,973	0	-811	0
Budget financing	...	8,000	2,000	0	14,381	24,423	24,381	15,342
Memorandum items:								
Net change in payment arrears 4/	...	-7,293	521	-2,535	-963	-10,275	-10,270	0
Accrual balance 5/	...	-1,228	-6,207	-2,420	-3,445	-14,148	-13,300	-15,342

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

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

2/ Ceiling under FIP.

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

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

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

Table 9. Pakistan: Public Sector Debt Sustainability Framework, 1998/99–2008/09

(In percent of GDP, unless otherwise indicated)

	Prel. Actual					Projections					
	1998/99	1999/2000	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
					I. Baseline medium-term projections						
Public sector debt 1/	98.5	98.9	109.8	100.8	90.5	84.4	80.5	76.1	71.6	67.6	63.3
Of which: foreign-currency denominated	50.7	49.2	51.8	52.6	47.0	40.8	38.1	35.6	33.2	31.0	28.7
Change in public sector debt	5.9	0.4	11.0	-9.0	-10.3	-6.1	-3.9	-4.4	-4.4	-4.0	-4.4
Identified debt-creating flows	2.7	-0.9	1.3	-3.3	-8.8	-4.4	-0.5	-4.4	-4.4	-4.2	-3.9
Primary deficit	-1.7	-2.3	-2.8	-2.4	-3.6	-1.2	-1.4	-1.5	-1.5	-1.3	-1.0
Revenue and grants	16.6	17.3	17.3	19.5	20.8	18.3	18.9	19.1	19.1	19.1	19.1
Primary (non-interest) expenditure	14.9	15.1	14.6	17.1	17.2	17.1	17.4	17.6	17.7	17.8	18.1
Automatic debt dynamics 2/	4.4	1.4	4.1	-1.1	-5.5	-3.5	0.7	-3.2	-3.2	-3.2	-3.2
Contribution from interest rate/growth differential 3/	-1.0	1.3	-1.1	0.5	-4.5	-3.1	0.0	-3.5	-3.6	-3.5	-3.5
Of which: contribution from real interest rate	2.1	5.2	1.2	3.5	0.7	1.3	1.0	0.8	0.7	0.6	0.4
Of which: contribution from real GDP growth	-3.1	-3.9	-2.3	-3.0	-5.3	-4.4	-4.3	-4.2	-4.0	-3.9	-3.7
Contribution from exchange rate depreciation 4/	5.4	0.2	5.3	-1.7	-0.9	-0.4	0.7	0.4	0.3	0.3	0.3
Other identified debt-creating flows	0.0	0.0	0.0	0.2	0.3	0.2	0.2	0.3	0.3	0.3	0.3
Privatization receipts (negative)	0.0	0.0	0.0	0.2	0.3	0.2	0.2	0.3	0.3	0.3	0.3
Residual, including asset changes	3.2	1.2	9.6	-5.8	-1.5	-1.7	-3.4	0.0	0.0	0.3	-0.4
Public sector debt-to-revenue ratio 1/	592.4	569.9	633.4	517.2	435.5	461.4	426.3	397.6	374.5	353.6	330.7
Key macroeconomic and fiscal assumptions											
Real GDP growth (at market prices, in percent)	3.7	4.3	2.6	2.8	5.8	5.3	5.6	5.8	5.8	5.9	6.0
Average nominal interest rate on public debt (in percent) 5/	8.6	8.5	7.5	6.5	5.7	5.8	5.5	5.4	5.2	5.1	4.9
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	2.7	5.7	1.5	3.5	1.1	1.8	1.5	1.4	1.2	1.1	0.9
Nominal appreciation (increase in U.S. dollar value of local currency, in percent)	-10.7	-0.8	-19.2	6.8	3.9	2.0	-3.8	-2.3	-2.2	-2.2	-2.2
Inflation rate (GDP deflator, in percent)	5.9	2.7	6.1	3.1	4.6	4.0	4.0	4.0	4.0	4.0	4.0
Growth of real primary spending (deflated by GDP deflator, in percent)	-4.2	5.3	-0.9	21.0	6.4	4.5	7.7	6.8	6.2	7.0	7.7
					II. Stress tests for public debt ratio						
1. Real GDP growth, real interest rate, and primary balance are at historical averages in 2004/05–2008/09						84.4	78.4	75.8	73.2	70.9	68.0
2. Real interest rate is at historical average plus two standard deviations in 2004/05 and 2005/06						84.4	82.7	83.8	79.3	75.2	70.7
3. Real GDP growth is at historical average minus two standard deviations in 2004/05 and 2005/06						84.4	81.2	80.8	76.2	72.1	67.7
4. Primary balance is at historical average minus two standard deviations in 2003 and 2004						84.4	81.6	81.9	77.5	73.4	69.0
5. Combination of 2–4 using one standard deviation shocks						84.4	84.9	88.5	82.5	76.9	71.0
6. One time 30 percent real depreciation in 2004/05 6/						84.4	85.5	81.2	76.9	73.0	68.7
7. 10 percent of GDP increase in other debt-creating flows in 2004/05						84.4	87.2	82.7	78.2	74.1	69.7

Historical statistics for key variables 1993/94–2002/03	Historical Average	Standard Deviation	Average 2003/04–2008/09
Primary deficit	-0.8	1.9	-1.3
Real GDP growth (at market prices, in percent)	3.6	1.5	5.7
Nominal interest rate (in percent) 5/	7.6	1.1	5.3
Real interest rate (in percent)	0.3	4.1	1.3
Inflation rate (GDP deflator, in percent)	7.3	4.0	4.0
Revenue to GDP ratio	17.5	1.5	18.9

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

1/ Gross debt of the consolidated government (federal government and provincial governments).

2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as $-g$.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.

5/ Derived as nominal interest expenditure divided by previous period debt stock.

6/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 10. Pakistan: External Debt Sustainability Framework, 1998/99–2008/09

(In percent of GDP, unless otherwise indicated)

	Actual					Projections					
	1998/99	1999/2000	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
						I. Baseline medium-term projections					
External debt	51.5	54.6	55.8	56.3	46.2	41.7	38.7	36.2	33.7	31.6	29.6
Change in external debt	-2.8	3.1	1.2	0.4	-10.1	-4.4	-3.0	-2.5	-2.5	-2.1	-2.0
Identified external debt-creating flows	-0.5	3.5	-2.3	-3.6	-14.7	-7.5	-4.1	-3.1	-3.0	-2.9	-2.7
Current account deficit, excluding interest payments	1.5	-0.3	-0.4	-4.9	-7.4	-2.7	-1.5	-0.9	-0.7	-0.6	-0.5
Deficit in balance of goods and services	-5.1	-4.0	-3.8	-1.0	-0.7	-3.0	-3.8	-4.2	-4.1	-4.1	-4.0
Exports	15.5	17.6	17.5	18.8	19.9	18.1	17.0	16.2	16.1	16.0	15.9
Imports	-20.6	-21.6	-21.4	-19.8	-20.6	-21.1	-20.9	-20.4	-20.2	-20.1	-19.9
Net nondebt creating capital inflows (negative)	-0.9	-1.0	-0.3	-0.6	-0.9	-0.8	-0.8	-0.8	-0.9	-1.0	-1.0
Net foreign direct investment, equity	0.8	0.9	0.5	0.6	0.9	0.6	0.7	0.6	0.7	0.7	0.6
Net portfolio investment, equity	0.0	0.1	-0.2	0.0	0.0	0.1	0.1	0.2	0.2	0.3	0.3
Automatic debt dynamics 1/	-1.1	4.8	-1.6	1.9	-6.4	-4.0	-1.8	-1.3	-1.4	-1.3	-1.3
Contribution from nominal interest rate	2.2	2.5	2.3	2.2	1.6	1.1	1.1	1.4	1.2	1.1	1.0
Contribution from real GDP growth	-1.9	-2.3	-1.4	-1.5	-2.8	-2.2	-2.2	-2.1	-2.0	-1.9	-1.8
Contribution from price and exchange rate changes 2/	-1.5	4.6	-2.5	1.2	-5.1	-3.0	-0.7	-0.6	-0.6	-0.6	-0.5
Residual, including change in gross foreign assets	-2.3	-0.4	3.5	4.0	4.6	3.1	1.1	0.6	0.5	0.8	0.7
External debt-to-exports ratio (in percent)	331.6	310.7	318.4	300.0	231.9	230.7	227.3	223.1	209.4	196.9	185.8
Gross external financing need (in billions of U.S. dollars) 3/	10.2	10.2	9.4	8.4	2.9	3.2	3.7	3.7	3.8	3.7	3.8
In percent of GDP	17.8	18.8	16.0	14.3	4.3	4.2	4.5	4.2	4.0	3.6	3.4
Key macroeconomic and external assumptions											
Real GDP growth (at market prices, in percent)	3.7	4.2	2.7	2.7	5.8	5.3	5.6	5.8	5.8	5.9	6.0
Exchange rate appreciation (U.S. dollar value of local currency, change in percent)	-2.9	-10.6	-0.8	-5.4	5.1	2.7	-2.1	-2.4	-2.2	-2.2	-2.2
GDP deflator in U.S. dollars (change in percent)	2.8	-8.2	4.8	-2.1	10.0	6.8	1.8	1.5	1.7	1.7	1.7
Nominal external interest rate (in percent)	4.4	4.7	4.6	4.0	3.2	2.7	2.7	3.7	3.5	3.6	3.6
Growth of exports (U.S. dollar terms, in percent)	-11.7	8.3	7.4	7.5	23.5	2.3	1.2	2.3	6.7	7.4	7.0
Growth of imports (U.S. dollar terms, in percent)	-8.4	0.2	6.6	-7.1	21.6	15.2	6.1	5.0	6.7	7.3	6.5
						II. Stress tests for external debt ratio					
1. Real GDP growth, nominal interest rate, U.S. dollar deflator, non-interest current account, and nondebt inflows are at historical average in 2003-						41.7	41.6	40.9	40.2	39.6	39.1
2. Nominal interest rate is at historical average plus two standard deviations in 2004/05 and 2005/06						41.7	40.3	38.9	36.2	34.0	31.9
3. Real GDP growth is at historical average minus two standard deviations in 2004/05 and 2005/06						41.7	40.6	40.0	37.3	35.1	32.9
4. Change in U.S. dollar GDP deflator is at historical average minus two standard deviations in 2003 and 2004						41.7	45.5	50.1	47.1	44.4	41.9
5. Non-interest current account is at historical average minus two standard deviations in 2004/05 and 2005/06						41.7	47.7	53.3	50.1	47.3	44.7
6. Combination of 2–5 using one standard deviation shocks						41.7	50.0	58.5	55.2	52.2	49.4
7. One time 30 percent nominal depreciation in 2004/05						41.7	54.6	51.6	48.5	45.8	43.2
8. Impact of MFA (10 percent decline in textile and clothing exports from 2005/06)						41.3	37.9	35.7	33.5	31.8	30.2

Historical statistics for key variables (past 10 years)	Historical Average	Standard Deviation	Average 2003/04–2008/09
Current account deficit, excluding interest payments	0.0	3.7	-1.2
Net nondebt creating capital inflows	1.3	0.8	0.9
Nominal external interest rate (in percent)	4.9	0.9	3.3
Real GDP growth (at market prices, in percent)	3.6	1.4	5.7
GDP deflator in U.S. dollars (change in percent)	1.0	7.0	2.6

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

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

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

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

Table 11. Pakistan: Intermediate Outcome Indicators, 2000/01–2002/03

(In percent, unless otherwise indicated)

	2000/01	2001/02	2002/03 1/
Health sector			
Utilization rate of first level care facilities (average cases/day/facility)	34	37	34
Population covered by lady health workers 2/	30	44	58
Immunization coverage of children/pregnant mothers	76	80	69
Birth attended by skilled birth attendants	13	12	11
Number of skilled female birth attendants (in thousands)	96	102	96
Percentage of first level care facilities not experiencing stock-outs of five key supplies	26	30	28
Share of first level care facilities meeting staffing norms	30	34	30
Share of first level care facilities with four contraceptives available	68	70	69
Education sector			
Number of functioning schools (in thousands)	145	150	144
Primary	133	137	132
Middle	13	13	12
Share of functional schools with basic facilities			
Water	51	56	56
Primary	50	54	54
Middle	59	76	79
Electricity	21	22	21
Primary	19	18	18
Middle	44	51	59
Sanitary	36	37	36
Primary	36	34	34
Middle	46	54	53
Boundary wall	41	42	41
Primary	41	40	40
Middle	47	53	53
Share of trained teachers	98	98	...
Primary	98	98	...
Middle	99	99	...

Sources: Pakistani authorities; and Fund staff calculations.

PRSP Secretariat, *I-PRSP–First Report on Intermediate Social Outcomes,* March 2003.

PRSP Secretariat, *PRSP–Third Quartter Progress Report FY2002/03,* June 2003.

1/ Data for end-March 2003.

2/ Lady health workers are outreach workers providing preventive health and family planning services through house-to-house visits.

Table 12. Pakistan: Social Indicators, 1970–2004

	Latest single year				I-PRSP Target	South Asia	Lower-income (world-wide)
						Latest single year	
	1970–75	1980–85	1993–99	2000–02	2003/04	(1990–2002)	
Population							
Total population, mid-year (in millions)	71.0	94.8	134.8	144.9	…	1,401.0	2,495.0
Growth rate (percent annual average)	3.2	2.7	2.4	2.4	1.8	1.7	1.7
Urban population (percent of population)	26.4	29.8	36.5	37.0	…	27.8	30.8
Total fertility rate (births per woman)	7.0	6.5	4.8	4.5	4.1	3.3	3.5
Unemployment (as percentage of total labor force)	…	3.7	5.9	5.9	…	…	…
Income							
GNI per capita (U.S. dollars) 1/	150.0	330.0	450.0	410.0	…	460.0	430.0
Consumer price index (percentage change)	20.9	5.6	4.1	3.2	5.0	4.4	2.1
Food price index (percentage change)	…	4.4	3.9	3.3	5.0	…	…
Social indicators							
Public expenditure							
Health (percent of GDP)	…	…	0.7	0.5	0.5	0.9	1.2
Education (percent of GDP)	2.2	2.9	1.6	1.8	1.8	3.1	3.3
Education 2/							
Gross primary school enrollment rate (in percent of age group)							
Total	39.5	43.7	73.1	74.4	100.0	97.6	94.6
Male	52.7	55.7	90.8	93.3	119.0	108.2	103.0
Female	25.5	30.4	54.2	54.4	76.0	90.0	87.5
Gross secondary school enrollment rate (in percent of age group)	14.7	17.2	37.2	…	68.0	48.1	42.3
Illiteracy rate (as percentage of population aged 15 and above)	75.8	68.6	57.6	55.1	41.0	43.9	37.3
Access to safe water (in percent of population)							
Total	…	38.0	63.0	…	68.0	84.0	76.0
Urban	75.0	84.0	83.0	…	87.0	94.2	90.2
Rural	5.0	28.0	53.0	…	57.0	80.1	70.1
Immunization rate (percent of children under 12 months)							
Measles	…	38.0	54.0	54.0	…	58.1	59.8
DPT	…	30.0	56.0	56.0	…	64.8	61.5
Life Expectancy at birth (years)							
Total	52.3	57.4	61.7	63.8	64.4	62.8	58.8
Male	52.1	56.9	60.8	62.2	…	61.9	57.9
Female	52.5	58.0	62.6	64.6	…	63.3	60.0
Mortality							
Children under 5 years (per thousand live births)	181.0	157.0	112.0	109.0	65.0	98.6	114.9
Adult (15–59 years)							
Male (per 1,000 population)	339.5	282.5	224.4	221.0	…	252.5	311.9
Female (per 1,000 population)	381.1	290.9	207.6	198.0	…	201.8	255.7

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

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

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

Table 13. Pakistan: Gross Financing Requirements, 2001/02–2003/04

(In millions of U.S. dollars)

	2001/02	2002/03	Prog. 2003/04
Gross financing requirements	-7,889	-5,616	-4,702
External current account deficit	1,591	4,029	1,237
Debt amortization	-6,204	-3,961	-3,568
Medium- and long-term debt	-2,657	-2,781	-2,032
Public sector	-2,261	-2,114	-1,478
Multilateral (excluding IMF)	-604	-612	-673
Bilateral	-817	-658	-581
Bonds (net)	-35	-193	-183
Other (including SBP liabilities)	-805	-651	-41
Private sector	-396	-667	-554
Short-term debt	-3,547	-1,179	-1,536
Public sector	-2,188	-972	-1,364
Private sector	-1,359	-207	-172
Repayment of arrears	0	0	0
Gross reserves accumulation	-3,082	-5,267	-1,844
Of which: official reserves	-2,717	-5,916	-1,444
IMF repurchases and repayments	-194	-418	-526
Available financing	7,889	5,616	4,702
FDI and portfolio investment (net, excluding public securities) 1/	475	792	690
Debt financing from private creditors	2,988	2,023	1,802
Medium- and long-term financing	487	397	182
To private sector	185	392	182
To public sector	302	5	0
Short-term financing	2,501	1,626	1,620
To public sector	1,378	1,139	1,500
To private sector	1,123	487	120
Official creditors	2,623	2,253	1,628
Project lending	531	723	728
Balance of payments support	2,092	1,530	900
AsDB and World Bank	883	621	900
Debt relief from bilateral creditors 2/	1,210	909	0
Private sector involvement	0	100	100
IMF	484	469	480
Other net capital flows 3/	1,319	-20	1
Financing gap	0	0	0

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

1/ Includes privatization receipts.
2/ Debt relief agreed in January 2001 and in December 2001.
3/ For 2001/02, includes SBP purchases in the kerb market.

Table 14. Pakistan: Summary of Public External Debt and Debt Service, 1999/2000–2003/04

	1999/2000	2000/01	2001/02	2002/03	Proj. 2003/04
	(In millions of U.S. dollars)				
Total public and publicly guaranteed external debt	29,757	32,743	33,167	31,667	32,219
Medium- and long-term debt	26,009	28,165	29,433	28,107	28,719
Project and nonproject aid	24,792	26,647	28,199	27,124	27,852
Commercial banks and IDB	560	634	383	325	392
Other (including securities and frozen foreign currency accounts)	657	885	851	658	475
Short-term debt (by initial maturity)	2,253	3,075	1,795	1,571	1,557
Commercial banks and IDB	671	834	212	289	293
FEBCs and DBCs	147	72	53	36	18
SBP liabilities (including swaps)	1,435	2,169	1,530	1,245	1,245
Fund credit and loans	1,496	1,503	1,939	1,990	1,944
Service of medium- and long-term public and publicly guaranteed debt	4,175	2,616	3,556	3,515	2,783
Amortization	3,113	1,540	2,455	2,532	2,004
Interest	1,062	1,076	1,101	983	779
Interest on public and publicly guaranteed short-term debt	319	284	198	88	91
	(In percent of GDP)				
Total public and publicly guaranteed external debt	54.6	55.8	56.3	46.2	41.7
Long-term	47.8	48.0	49.9	41.0	37.2
Of which: project and nonproject aid	45.5	45.4	47.8	39.5	36.1
Short-term	4.1	5.2	3.0	2.3	2.0
Fund credit and loans	2.7	2.6	3.3	2.9	2.5
Service of medium- and long-term public and publicly guaranteed debt	7.7	4.5	6.0	5.1	3.6
Amortization	5.7	2.6	4.2	3.7	2.6
Interest	1.9	1.8	1.9	1.4	1.0
Interest on public and publicly guaranteed short-term debt	0.6	0.5	0.3	0.1	0.1
	(In percent of exports of goods and nonfactor services)				
Total public and publicly guaranteed external debt	310.7	318.4	300.0	231.9	230.7
Service of medium- and long-term public and publicly guaranteed debt	43.6	25.4	32.2	25.7	19.9
Amortization	32.5	15.0	22.2	18.5	14.4
Interest	11.1	10.5	10.0	7.2	5.6
Memorandum items:					
Implicit interest on public and publicly guaranteed external debt	4.7	4.4	3.9	3.3	2.7
Public debt service in percent of government revenue (incl. grants)	44.2	25.7	31.3	27.2	19.3
Total external debt	34,047	36,140	36,007	35,217	35,470
(In percent of GDP)	62.5	61.6	61.1	51.3	46.0

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

Table 15. Pakistan: Indicators of External Vulnerability, 1999/2000–2003/04

	1999/2000	2000/01	2001/02	2002/03	Latest available observation	Rev. Proj. 2003/04
Financial indicators						
Total government debt (in percent of GDP)	98.9	109.8	100.8	90.5	...	84.4
Broad money (12-month percentage change)	9.4	9.0	15.4	19.0	...	11.5
Private sector credit (12-month percentage change)	2.5	6.5	4.7	19.0	...	10.5
180-day treasury bill yield (in percent)	8.8	10.4	8.1	4.1	1.6 2/	...
180-day treasury bill yield, real (in percent)	5.1	6.0	5.4	1.0	-0.6 2/	...
Karachi Stock Exchange index						
End-of-period	1,521	1,366	1,770	3,402	4,143 3/	...
Period average	1,514	1,436	1,514	2,443	...	...
External Indicators						
Exports (12-month percentage changes, in U.S. dollars)	8.8	9.1	2.3	19.1	...	8.0
Imports (12-month percentage changes, in U.S. dollars)	-0.1	6.2	-7.5	21.1	...	12.5
Terms of trade (12-month percentage changes)	-9.2	-1.6	-0.7	-1.4	...	3.4
Current account balance (excluding official transfers in percent of GDP)	-3.9	-3.3	0.2	4.4	...	0.6
Gross Official Reserves (in millions of U.S. dollars)	908	1,679	4,330	9,521	10,053 3/	10,695
In months of next year imports of goods and nonfactor services	0.9	1.7	3.7	7.0	...	7.4
In percent of broad money	3.3	7.0	14.8	27.3	...	26.8
In percent of total short-term debt at remaining maturity	10.9	23.7	72.1	191.3	...	249.5
Total external debt (in millions of U.S. dollars)	34,047	36,140	36,007	35,217	...	35,470
In percent of exports of goods and nonfactor services	355.5	351.4	325.7	257.9	...	254.0
Actual debt service (in percent of exports of goods and services) 1/	80.1	60.4	60.7	34.4	...	36.5
Exchange rate (Pakistani rupees per U.S. dollar, period average)	51.6	58.2	61.6	58.6	57.4 3/	...
Real exchange rate (12-month percentage changes)	-0.6	-2.6	-1.1	-1.8	...	...

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

1/ Scheduled debt service on total debt minus rescheduled debt service plus debt service on previously rescheduled debt.
2/ September 2003.
3/ October 10, 2003.

Table 16. Pakistan: Indicators of Fund Credit, 2000/01–2007/08 1/

				Proj.				
	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Outstanding Fund credit								
In millions of SDRs	1,207	1,524	1,445	1,411	1,308	1,210	1,130	1,021
In millions of U.S. dollars	1,503	1,939	1,990	1,944	1,802	1,667	1,556	1,407
In percent of:								
Quota	116.7	147.5	139.8	136.5	126.6	117.1	109.3	98.8
GDP	2.6	3.3	2.9	2.5	2.2	1.9	1.6	1.5
Exports of goods and nonfactor services	14.6	17.5	14.6	13.9	12.8	11.5	10.1	8.5
Public and publicly guaranteed debt	4.6	5.8	6.3	6.0	5.6	5.2	4.8	4.3
Debt service to the Fund								
In millions of SDRs	228	194	333	408	297	113	90	117
In millions of U.S. dollars	294	247	458	562	408	156	124	162
In percent of:								
Exports of goods and nonfactor services	2.9	2.2	3.4	4.0	2.9	1.1	0.8	1.0
Gross official reserves	17.5	5.7	4.8	5.3	3.4	1.3	1.0	1.3

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

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

Table 17. Pakistan: Reviews and Rephasing of Remaining Disbursements Under the PRGF, September 2003–December 2004

Availability Date	Conditions to be Observed	Disbursements (in millions of SDRs)
September 20, 2003	Sixth and seventh PRGF reviews; end-March and end-June 2003 performance criteria	172.28
March 20, 2004	Eight PRGF review; end-December 2003 performance criteria	172.28
September 20, 2004	Ninth PRGF review; end-June 2004 performance criteria	172.28

Pakistan: Fund Relations

As of August 31, 2003

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

II. **General Resources Account:**	SDR Million	% Quota
Quota	1,033.70	100.00
Fund Holdings of Currency	1,637.84	158.44
Reserve position in Fund	0.12	0.01

III. **SDR Department:**	SDR Million	% Allocation
Net cumulative allocation	169.99	100.00
Holdings	170.04	100.03

IV. **Outstanding Purchases and Loans:**	SDR Million	% Quota
Stand-by arrangements	395.63	38.27
Extended arrangements	120.45	11.65
Contingency and Compensatory	88.18	8.53
PRGF arrangements	812.41	78.59

V. **Latest Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PRGF	12/06/2001	12/05/2004	1,033.70	516.86
Stand-By	11/29/2000	09/30/2001	465.00	465.00
EFF	10/20/1997	10/19/2000	454.92	113.74

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

	Overdue		Forthcoming			
	08/31/03	2003	2004	2005	2006	2007
Principal	0.0	170.3	383.0	163.9	72.0	97.9
Charges/Interest	0.0	5.1	11.3	5.9	4.1	3.4
Total	0.0	175.4	394.3	169.9	76.2	101.3

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

A. Nonfinancial Relations

VII. Exchange System

Prior to mid-1998, Pakistan implemented a fixed exchange rate system with periodic step devaluation to compensate for the inflation differential with major trading partners. On July 21, 1998, a dual exchange system was introduced consisting of a fixed official exchange rate at PRs 46 per $1 and a floating interbank market exchange rate (FIBR). Under this system, all authorized transactions were effectively conducted at the so-called "composite rate" which was the weighted average of the FIBR and the official exchange rate. On May 19, 1999, the official exchange rate was eliminated and the exchange rate system unified, with all international transactions conducted at the FIBR. As of October 10, 2003, the FIBR was PRs 57.40 per $1. Pakistan's exchange regime is classified as managed floating with no predetermined path for the exchange rate.

VIII. Last Article IV Consultation

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

IX. Safeguards Assessments

In accordance with the Fund's safeguards assessment policy, the State Bank of Pakistan (SBP) was subject to a full safeguards assessment under the Stand-By Arrangement that expired on September 30, 2001. This assessment, which included a safeguards mission to the SBP, was completed on February 13, 2001. The staff's findings and recommendations were reported in IMF Country Report No. 01/58, Appendix IV. The authorities have implemented all of the recommended remedial measures that were included under SBA conditionality, and no new critical vulnerabilities have been identified under Pakistan's current PRGF Arrangement, which was approved on December 6, 2001 and is scheduled to expire on December 5, 2004.

X. ROSCs

Fiscal Transparency Module	11/28/2000	SM/00/264

XI. Recent Technical Assistance

a. **FAD**: In 1997–99, missions reviewed the public expenditure management system, the operation of the GST, and recommended measures to improve tax administration and increase tax compliance. In April 1999, a mission reviewed the income tax system and developed a strategy to improve its efficiency, potential for long-term development, and ease of administration. A mission in January–February 2000 assisted with the revision of fiscal data and advised on measures to strengthen the fiscal reporting and accounting systems. In May 2000, a mission assisted with the preparation of the fiscal module of the Report on the

Observance of Standards and Codes (ROSC). In August 2000, a joint FAD-STA mission reviewed progress in the strengthening of the fiscal reporting and accounting systems and assisted authorities in the preparation of revised fiscal data for 1993/94–1998/99. In September 2000, a mission provided technical assistance (TA) on overhauling the income tax law. In January 2001, a mission provided advice on priorities and strategies for improving the tax collection operations of the CBR. A follow-up mission on income tax policy took place in May 2001. In August 2001, a mission assisted the authorities in the preparation of tax administration reforms. In January 2002, another mission advised the authorities on fiscal data management, quality, and transparency. In January 2003, a mission assisted the authorities in reviewing and preparing tax administration reforms. In March 2003. a mission advised the authorities on customs administration reform.

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

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

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

XII. **Resident Representative**

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

Pakistan: Fund-Bank Relations

Partnership in Pakistan's development strategy

1. The government of Pakistan's development strategy is set forth in its Interim Poverty Reduction Strategy Paper (I-PRSP). The I-PRSP focuses on: (a)strengthening governance and the integrity of the civil service; (b) creating opportunities through accelerating growth of agriculture, small- and medium-scale industries, information technology, and oil and gas sectors; and (c) reducing poverty through revival of growth and re-orienting public expenditure toward human development and poverty reduction. A Joint Staff Assessment (JSA) on the I-PRSP was discussed by the Boards of the World Bank and the Fund on December 4 and 6, 2001, respectively. The full PRSP is expected to be completed this year.

2. The Fund is supporting Pakistan's poverty reduction efforts in the context of the three-year arrangement under the Poverty Reduction and Growth Facility (PRGF). The Fund's program supports the continued pursuit of sound macroeconomic policies, in particular sustained fiscal adjustment, while increasing the share of poverty reduction-related public spending; strengthening governance; tax policy and administration reform; public enterprise restructuring and privatization; and financial sector and foreign exchange market reforms. The Fund takes the lead in the policy dialogue on macroeconomic policies including overall fiscal and monetary policy. In addition to macroeconomic targets, the Fund has established structural performance criteria relating to reforms in the areas of tax policy and administration, power sector reform, foreign exchange market liberalization, and public expenditure management. As outlined more fully below, the World Bank has complemented the Fund's work through support to structural reforms in the social sectors and support of the growth agenda through deregulation of key sectors, such as power, oil and gas, and banking reforms whose performance have a strong bearing on growth and public finances.

World Bank Group strategy

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

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[1] http://www.worldbank.org/pakistancas

4. The World Bank works closely with the Fund and the government on structural reforms underpinning macroeconomic stability, particularly in areas with an impact on the balance of payments and public finances. In this context, the World Bank's lending program has featured structural adjustment lending to support the government's actions in the areas of improving public expenditure management and supporting reforms of tax administration, safe and sound banking, efficient public utilities, and structural fiscal and governance reforms. The World Bank has also approved structural adjustment credits for two provinces (Sindh and North West Frontier Province (NWFP)) totaling $190 million supporting provincial reform strategies to improve resource management and strengthen provision of public services by local governments and communities. Further structural adjustment lending is planned, including follow-on provincial adjustment credits and a possible Poverty Reduction Support Credit to be prepared once the government has completed the full PRSP.

5. The World Bank Group's support to strengthening the investment climate includes a combination of analytical work and financial assistance targeted to reforms in key sectors. The World Bank Group continues to encourage the federal and provincial governments to pursue further the ongoing liberalization and modernization of trade, industrial, business, and labor regulations. To build the knowledge base to underpin the policy dialogue on private sector development, the World Bank Group is carrying out a significant program of analytical work. In addition to a Development Policy Review (completed in FY 2002), an Investment Climate Assessment and a Petroleum Sector Review were completed in FY 2003. Further work in the area of rural factor markets is planned for FY 2004. In addition to the governance reforms which have a direct bearing on the investment climate, the World Bank Group continues to support financially and through policy advice reforms of the governance and regulatory environment for power, gas, oil, financial sector, pricing and tariffs reforms, and privatization. The World Bank is also working with the government to explore potential lending operations targeted toward addressing critical infrastructure gaps in water and power.

6. In the social sectors, the World Bank Group's assistance is geared toward support to the implementation of the Education Sector Reform (ESR) Strategy and the government's priority of strengthening public health programs and maternal and child health and family planning. Accordingly the World Bank is focusing on: (a) programmatic support to the National Education Sector Reform Strategy; (b) support to the National Education Assessment System; (c) a program of analytical work to underpin the policy dialogue during the implementation of the ESR; and (d) province-based support to implementing the ESR within the fiscal and economic reforms of Sindh, NWFP, and Punjab. In FY 2003, World Bank Group assistance to health sector reforms also included the HIV/AIDS Prevention Project and Partnership for Polio Eradication Project, as well as analytical work, technical assistance, and policy dialogue.

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

Services Project (CIP) and the Pakistan Poverty Alleviation Fund (PPAF). A follow-on PPAF II project is expected to be completed in FY 2004 while additional CIP projects are planned for FY 2004 and FY 2005.

8. IBRD and IDA have approved 84 loans and 119 credits to Pakistan since 1952, totaling $6,975.3 million and $7,160.6 million, respectively. As of August 31, 2003, the World Bank lending portfolio in Pakistan consisted of 15 lending operations with a total commitment of $1,231 million (see Table 1). Undisbursed commitments total $416 million.

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

Project Name	Approved	Amount	Disbursements	Closing Date
Ghazi Barotha Hydropower	1995	350	339	Oct-03
Improving Financial Reporting and Auditing	1996	29	11	May-04
Phase-out of Ozone Depleting Substances	1997	13	5	Jun-06
Northern Education	1997	23	13	Sep-03
National Drainage Program	1997	285	171	Dec-04
Poverty Alleviation Fund	1999	90	61	Dec-04
Trade and Transport Facilitation	2001	3	2	Oct-04
Banking Sector Restructuring & Privatization	2001	300	205	Dec-04
GEF-Protected Areas Mgmt	2001	10	0	Dec-07
NWFP On-Farm Water Mgmt	2001	21	1	Jun-06
Banking Sector Technical Assist	2002	27	4	Dec-07
Community Infrastructure & Services	2002	20	2	Dec-06
HIV/AIDS Prevention Project	2003	37	-	Dec-08
National Education Assessment System	2003	4	-	Jun-08
Partnership for Polio Eradication	2003	20	-	Jun-06

Bank-Fund collaboration in specific areas

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

a. **Financial sector reforms**. Pakistan has been engaged in far-reaching reforms of the financial sector for five years. Considerable progress has been made, particularly with respect to reform of the banking sector. Regulations have been strengthened, loan recoveries increased, and the quality of management improved. Privatization of the three nationalized commercial banks—the core of the government's reform strategy—is well advanced. The vision for the sector is for a market-oriented, predominantly private system that operates under a strong regulatory framework supported by an effective banking court system. The World Bank and the Fund have worked closely together to support needed policy reforms. The Fund's PRGF arrangement has featured a structural benchmarks related to privatization of a nationalized bank as well as other measures to liberalize the financial system and strengthen central bank autonomy. The World Bank has maintained close dialogue with the government on banking sector reform since approval of the Banking Sector Adjustment Loan in December 1997. World Bank support is also being provided through implementation of two ongoing projects: the Banking Sector Restructuring and Privatization Project and the Banking Sector Technical Assistance Project as well as ongoing dialogue on housing finance. A joint World Bank/Fund Financial Sector Assessment Program is planned for FY 2004.

b. **Power sector reforms**. Losses in the power sector have been an ongoing source of macroeconomic instability in Pakistan, threatening achievement of fiscal deficit targets and preventing reorientation of public expenditure toward poverty reduction programs. The Fund PRGF arrangement includes conditionality related to energy tariff adjustments and other power sector reforms with the aim of reducing the sector's fiscal burden. The World Bank's program supports this objective, with a focus on enhancing market structures and improving operational performance. In the context of the structural adjustment operations approved in FY 2001 and FY 2002, the World Bank has taken the lead in working with the government of Pakistan to unbundle and privatize the state-owned Water and Power Development Authority (WAPDA). During the transition toward privatization, the government of Pakistan aims to restore WAPDA's financial viability through implementation of medium-term financial improvement plans (FIPs) developed in consultation with the World Bank, which aim to sharply reduce the level of budget support to WAPDA through a combination of measures. Given the importance of this initiative to ensuring achievement of Pakistan's macroeconomic targets, progress in implementing the FIPs is being monitored closely by both the World Bank and Fund. The World Bank is also beginning to work with the government of Pakistan prepare a comprehensive medium-term adjustment program to improve the electric services to Pakistan's industry and households at lower cost and higher reliability.

c. **Public expenditure management**. The quality of Pakistan's public expenditures has long been compromised by poor financial management practices. The government has made one of its top priorities to accelerate reforms toward achieving a modern public accounting and integrated financial management system. The World Bank, the Fund, and the government have been working closely in this area for more than three years. Under a policy framework agreed with the government and the Fund, the World Bank is taking the lead in supporting implementation of the reform program while the Fund is providing related technical assistance. World Bank support is being provided in the context of the ongoing Pakistan Improvement of Financial Reporting and Accounting (PIFRA) project through which the national accounting and audit systems are being modernized. A follow-on PIFRA II project will further these efforts, to improve the accuracy, completeness, reliability, and timeliness of intra-year and year-end government financial reports in Pakistan at the national, provincial, and district levels. Analytical and diagnostic support is being provided in the form of a Country Financial Accountability Assessment (CFAA) which was completed in FY 2003 as well as provincial financial accountability assessments, as appropriate. Policy measures relating to financial management have been included as prior actions for World Bank structural adjustment lending at both the national and provincial level. The World Bank is also taking the lead in the dialogue with the government on measures to improve the efficiency and effectiveness of public spending in the form of a Public Expenditure Review which was completed in FY 2003.

d. **Tax policy and administration reforms**. Tax administration has been among the most severe weaknesses in Pakistan's economic management. The Fund has taken the lead in supporting tax policy reforms, providing technical assistance leading, inter alia, to the formulation of an income tax reform package which became effective July 1, 2002. In consultation with the Fund and the World Bank, Pakistan has also launched a program for the fundamental restructuring of the Central Board of Revenues (CBR) in order to improve the efficiency of tax administration. The CBR reform effort is being supported by both the World Bank and the Fund. The Fund has stressed the importance of improved revenue collection performance by CBR as key element in ensuring the sustainability of Pakistan's considerable achievements in fiscal consolidation. The structural performance criteria of the PRGF include adoption of tax policy changes and implementation of CBR reform. Through the Project Preparation Facility, the World Bank is supporting preparation of a Tax Administration Reform Project which is scheduled for approval in FY 2004. This support includes financing of consultants to develop a detailed reform strategy for restructuring of CBR in the areas of human resource management, information technology, business process re-engineering, and tax payer facilitation.

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

Tom Buckley, SACPA, 473-0075

October 11, 2003

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

Dear Mr. Köhler:

Pakistan's government is committed to implementing the economic strategy set out in the Interim Poverty Reduction Strategy Paper (I-PRSP), supported by the Poverty Reduction and Growth Facility (PRGF) arrangement. This strategy is being developed into a longer-term set of policies aimed to allow higher sustainable growth and job creation, while reducing poverty, which will be articulated in the full Poverty Reduction Strategy Paper (PRSP) that will be finalized in about a month.

The Pakistani authorities held discussions with Fund staff in August–September 2003 for the sixth and seventh reviews under the PRGF Arrangement. Based on these discussions, the attached Memorandum of Economic and Financial Policies (MEFP) reviews economic developments and policy implementation through June 2003 and beyond under the arrangement, updates the macroeconomic framework, and discusses the financial policies and structural reform program for FY 2003/04. It supplements the MEFP dated November 22, 2001 as well as the supplementary MEFPs dated March 12, 2002, June 18, 2002, October 16, 2002, February 8, 2003, and May 29, 2003.

All quantitative performance criteria for end-March and end-June 2003 were met. Moreover, all structural performance criteria were met, except on (a) submitting to parliament a fiscal responsibility law that reduces consolidated government debt (federal and provincial) to below 60 percent of GDP in 10 years; (b) eliminating the exemption from income tax withholding on National Saving Scheme (NSS) instruments; and (c) not introducing new tax exemptions. We have now submitted to parliament the fiscal responsibility law and agreed with Fund staff on an action plan for aligning yields on NSS instruments to market rates. Eliminating the previously prevailing culture of frequently issuing tax specific statutory regulatory orders is a key part of our strategy. In the last three budgets, 107 exemptions under the income and sales taxes were withdrawn. With the 2003/04 budget, a few minor amendments were made related to broad-based policies rather than individuals or special interests to ensure uniformity of treatment and remove discrimination, having virtually no revenue impact. We are committed to enhancing transparency and improving the structure of the budget, including by further reducing tax exemptions in the 2004/05 budget. On this basis, and in view of the policies set out in the attached memorandum, including the strengthening of measures to be undertaken in the areas of financial sector, tax reform and administration, and the power sector, the government requests waivers for the nonobservance of the structural performance criteria listed above and the completion of the sixth and seventh reviews.

For the remainder of the program period, we are requesting that reviews take place on a semiannual basis with the eighth review scheduled for March 20, 2004 and the ninth review for September 20, 2004. We are also requesting a rephasing of the remainder of the disbursements, with remaining installments being disbursed in equal amounts.

The government of Pakistan will provide the Fund with such information as the Fund may request in connection with Pakistan's progress in implementing the economic and financial policies, and achieving the objectives of the program. The government believes that the policies set out in the attached MEFP are adequate to achieve the objectives of the program, but it will take any further measures that may become appropriate for this purpose. The government of Pakistan will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation.

Sincerely yours,

/s/
Shaukat Aziz
Minister of Finance and Economic Affairs

/s/
Ishrat Husain
Governor
State Bank of Pakistan

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

PAKISTAN

Memorandum of Economic and Financial Policies for January–June 2003 and Program for FY 2003/04

I. INTRODUCTION

1. **Pakistan has made strong economic progress over the past few years, despite a weak international economic environment and regional security issues.** Reflecting the reduction of fiscal imbalances, complemented by structural reforms, inflation has been brought under control and the foreign reserve position has improved greatly. External and fiscal vulnerabilities have been reduced, the financial system has been strengthened, and the economy has become more resilient to shocks. Finally, and most importantly, economic growth has begun to recover.

2. **The government remains strongly committed to its reform agenda.** We have successfully made the transition to implementing our policies in a democratic, but inevitably more complicated, environment. Given our achievements in stabilizing the economy, we are now increasingly focusing on policies to improve living standards and reduce poverty on a sustainable basis. Key pillars of our approach are the acceleration of economic growth while maintaining macroeconomic stability, increased investment in human capital, targeted interventions to reduce poverty, expanding the social safety net, and improving governance.

3. **Our overall strategy is elaborated in the Poverty Reduction Strategy Paper (PRSP) that will be finalized in about a month.** The process of consultation is now complete. It was spread over two and a half years and involved a dialogue with communities, civil society, and business-type organizations, each at the federal, provincial (including the preparation of four provincial PRSPs), and district levels. A draft PRSP summary was submitted to Parliament along with the 2003/04 (July–June) budget. The summary was also discussed with development partners during the Pakistan Development Forum in mid-May 2003 and many of their comments have been incorporated in the PRSP. We aim to include the results of the pilot Core Welfare Indicators Questionnaire (CWIQ) survey that is being carried out in October 2003 in the full PRSP. While retaining the broad I-PRSP framework, the full PRSP will articulate a more comprehensive strategy covering rural development, gender issues, employment, and the environment.

II. RECENT DEVELOPMENTS

4. **Macroeconomic targets for 2002/03 have been exceeded and all quantitative performance criteria for end-March and end-June have been met (Table 1(a)).** Growth in 2002/03 was higher than targeted (5.1 percent compared with 4.5 percent), reflecting better-than-expected outcomes in most sectors. Of particular importance was the rebound in agricultural output, following three years of drought, which will enhance the incomes of the

poorest segments of the population. Also on the positive side, the private investment ratio rose modestly in 2002/03, but further increases in both public and private investment are needed to ensure sustainable growth over the medium term. Inflation slowed further to 1.8 percent year-on-year in August.

5. **The external position continues to strengthen.** Exports and imports grew in FY 2002/03 by 19 and 21 percent in U.S. dollar terms, respectively. This, coupled with very strong private transfers, resulted in a large current account surplus (4.4 percent of GDP, excluding grants). Despite a reduction in State Bank of Pakistan (SBP) purchases of foreign exchange in the interbank market in the last quarter of the fiscal year, gross official reserves reached $9.5 billion at end 2002/03.

6. **The 2002/03 overall fiscal deficit (excluding grants) was somewhat lower than the program target.** Central Board of Revenue (CBR) collection was slightly higher than envisaged under the program and federal nontax revenues exceeded the target because of an arrears-equity swap related to Water and Power Development Authority (WAPDA). Expenditures were higher than programmed, reflecting in part some overshooting in the running of the civil government and in pensions. According to preliminary (unreconciled) data, social sector spending ("I-PRSP expenditure") increased by 18 percent over 2001/02, and was very close to the indicative target.[1] Reflecting favorable interest rates on National Saving Scheme (NSS) instruments, domestic nonbank financing exceeded the target by a wide range. Consequently, the government was able to retire substantially more bank debt than programmed, despite a shortfall in external financing related to lower-than-expected program financing.

7. **Broad and reserve money growth accelerated to 19 percent and 16 percent, respectively, year-on-year at end-June.** Broad money growth was driven entirely by the continuing rise in net foreign assets (NFA) of the banking system. Net claims on government fell by over 4 percent during the fiscal year but this was fully offset by the sharp growth of private sector credit in the second half of the fiscal year. The yield on six-month treasury bills fell to 1.2 percent in early July, reflecting a sharp rise in bank excess reserves in the last quarter of 2002/03. However, short-term rates have risen modestly in recent weeks.

8. **The financial performance of the large public enterprises[2] in the second half of 2002/03 was broadly in line with the targets formulated under their respective Financial Improvement Plans (FIP).** WAPDA's performance was enhanced because of a return to more normal hydrological conditions after three years of drought, which permitted greater use

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[1] The eighth progress report on implementation of poverty reduction strategy was published in September 2003 (see www.finance.gov.pk/poverty/home.htm)

[2] WAPDA, Karachi Electricity Supply Corporation (KESC), Pakistan International Airlines (PIA), Pakistan Railways (PR), and Pakistan Steel Mills (PSM).

of lower cost hydro power and enabled WAPDA to reduce supplier arrears substantially. In the case of KESC, collection performance improved considerably. However, technical and distribution losses were higher than targeted in both enterprises.

9. **Notwithstanding a few delays and setbacks, substantial progress continues to be made in implementing fiscal reforms.** The fiscal responsibility law was submitted to Parliament on October 11. Twenty **tax exemptions** were removed in the 2003/04 budget. However, the elimination of all exemptions from withholding tax on interest incomes was not implemented (it was maintained for NSS instruments valued at under PRs 150,000), because of the reluctance of Parliament to support this measure. Eliminating the previously prevailing culture of frequently issuing tax specific statutory regulatory orders is a key part of our strategy. In the last three budgets, 107 exemptions under the income and sales taxes were withdrawn. With the 2003/04 budget, a few minor amendments, having virtually no revenue impact, were made related to broad-based policies rather than individuals or special interests to ensure uniformity of treatment and remove discrimination. The structural benchmark on amending **tax regulations** to enable sales tax auditors to assess nonfilers tax liabilities on the basis of indirect methods of determination was observed. A steering committee was set up to coordinate the needed steps for introduction of universal self-assessment. The SBP issued a circular requiring the reporting by financial institutions of all interest incomes exceeding PRs 10,000, in line with technical assistance recommendations. The publication of the FY 2003/04 federal and North West Frontier Province (NWFP) budgets were prepared according to the New Accounting Model (NAM), but were not published because of technical problems.

10. **Some progress has also been made in reforming the energy and financial sectors.** In the **energy sector**, we have applied consistently the fortnightly automatic adjustment of petroleum product prices. The tariff increases determined by the National Electric Power Regulatory Authority (NEPRA) for WAPDA and KESC were notified by the government with delay and in the case of KESC only partly. In line with the WAPDA revised FIP, all WAPDA's successor entities filed petitions by end-June 2003 for their tariff determination with NEPRA. In the **financial sector**, a formulaic link to create greater transparency between the rates of return on General Provident Fund (GPF) and Pakistani Investment Bonds (PIB) yields by June 30 was observed. Key NSS rates were lowered by about 1.5 percent on July 1 to reflect falling PIB yields, though for two instruments the agreed formula was not strictly followed, thus increasing the spread between the rates on NSS instruments and PIB yields. The status of performance criteria and structural benchmarks established under the fifth review are outlined in Table 2(a).

III. Economic and Financial Policies for FY 2003/04

A. Macroeconomic Framework

11. **The macroeconomic framework for 2003/04 remains broadly unchanged from the June 2003 MEFP.** Our key objectives are to accelerate economic growth and increase social and development spending, while consolidating the progress made in macroeconomic stabilization and reducing debt vulnerability. With agricultural output expected to rise by 4.3 percent, growth could reach 5.3 percent. Inflation is targeted not to exceed 4 percent in 2003/04.

12. **The current account surplus (excluding grants) is expected to narrow, but nevertheless to remain at 0.6 percent of GDP.** We expect strong performance in exports to continue. Remittances and short-term private capital inflows are likely to decelerate, as the portfolio shift underlying the exceptionally high net inflows during the previous year may be gradually winding down.

13. **Monetary policy will remain geared toward maintaining low inflation.** The risks for an upsurge in inflation are limited because of weak import prices (except petroleum products), the strong Pakistani rupee, and the positive outlook for agricultural output. Nevertheless, the recent buildup of bank liquidity and the acceleration of private sector credit are of concern and underscore the need to carefully monitor inflation developments. The SBP will, if its stock of treasury bills is further depleted, introduce a new instrument (SBP certificates) and will use it to mop-up excess liquidity, with a view to moderating the growth of the monetary aggregates. Short-term real interest rates have begun to rise and can be expected to return to positive levels in the near future. The bilateral Pakistani rupee/ U.S. dollar exchange rate has remained broadly unchanged while there was very limited SBP intervention in the foreign exchange market.

14. **The 2003/04 federal budget, approved by Parliament on June 16, 2003, is consistent with the program targets.** The budget envisages a consolidated government overall deficit (excluding grants) of PRs 179 billion. CBR revenue collection is projected at PRs 510 billion, and bank financing would be limited to PRs 20 billion (excluding the costs of restructuring two public banks). In the process of finalizing the budget, we have made two substantial and several minor changes relative to the projections underlying the program. First, to address concerns of eroding real wages and pensions of civil servants, we raised base civil service wages and government pensions by 15 percent, increasing the allocations for running of the civil government and for pensions by PRs 7.6 billion and PRs 2 billion, respectively. This was fully offset by an upward revision of nontax revenue by PRs 6.6 billion (largely on account of Pakistan Telecommunications Company Limited (PTCL) and Oil and Gas Development Corporation (OGDC) dividend payments as well as a small profit transfer from the SBP), a reduction in the subsidy for wheat export by PRs 2 billion, and shifting an equity injection for the Government Holding Private Limited (GHPL) of PRs 1 billion into 2002/03. Second, without affecting the overall deficit, we also introduced an arrears for equity swap for

WAPDA of PRs 13 billion. Also, the budgetary support to WAPDA and KESC, as projected in their respective FIPs, is fully provided for by the budget. Finally, the budget envisages an increase in I-PRSP spending to 4.2 percent of GDP.

15. **There are two significant risks to the fiscal objectives for FY 2003/04.** First, until a comprehensive restructuring of the energy sector is completed, there is risk that the utilities' deficits could be higher than expected. For example, line losses could be larger than envisaged, or it may be difficult to increase bill collection in the federally administered tribal areas (FATA), forecast at PRs 2 billion in 2003/04. However, the more normal hydrological conditions now prevailing could be a mitigating factor. Second, the allocations for wages and pensions are tight, despite the upward adjustment mentioned above, in light of the increases in salary and pension rates. In case of unforeseen adverse developments in these or other areas, we would seek to safeguard achieving the program targets by cutting nonpriority expenditures on running of the civil government while protecting social- and poverty-related expenditures.

16. **In summary, we are confident that our macroeconomic policy targets for 2003/04 are attainable, especially in light of the improved domestic and external political environments and the strengthening of the global economy.** Among the various external risks to the macroeconomic outlook, the economy has already absorbed the impact of continued high oil prices after the Iraq conflict. If a reversal of private capital inflows were to occur (because of regional security factors, for example), it would be met by allowing a market-based exchange rate flexibility and monetary tightening, with reserves used only sparingly to maintain orderly market conditions.

B. Structural Policies

17. In 2003/04 we will continue to deepen our structural reforms with the objective of: (a) improving governance and creating a more favorable environment for private sector activity; (b) mobilizing additional revenues in order to further raise social and development spending; and (c) enhancing the transparency of public sector operations. Structural benchmarks and performance criteria for October 2003–June 2004 are outlined in Table 2(b).

Tax policy and tax administration

18. **We have already made considerable progress in implementing our reform agenda in the tax policy and administration area and will continue to work to strengthen human resource management, automation, and training.** A key objective will be to increase the number of income taxpayers (by 500,000 in three years time), including through the use of background information such as utility bills and registers of car and cell phone owners. We intend to broaden the coverage of the General Sales Tax (GST) and will prepare an action plan which will be submitted to the cabinet in February identifying specific steps needed for this. Any revenue gains would be used to strengthen social sector service delivery. In addition, we will propose to Parliament to remove income and sales tax

exemptions and adopt other tax base broadening measures yielding PRs 5 billion in estimated revenues in the 2004/05 budget. Regarding revenue administration, we will set up a pilot customs house in Karachi by June 30, 2004 that will involve entry processing on a 24-hour basis, electronic filing of declarations by importers on a self-assessment basis, parameter- and risk-based audits. Based on our positive experience with the large taxpayers unit (LTU) in Karachi and the medium taxpayers unit (MTU) in Lahore, we will open a second LTU in Lahore by August 31, 2004, and two additional MTUs by June 30, 2004. In late August 2003, we opened a model sales tax office in Karachi that experiments with functional specialization in the sales tax area and covers smaller sales taxpayers not administered by the LTU. Administrative reform is expected to be supported by a World Bank loan.

19. **The strategy we have elaborated to contain the 'Benami' practice (whereby assets are held in the name of a person who is not the true beneficiary) is being implemented with a view to enhancing compliance with taxes and supporting Customer Due Diligence for banks.** A task force has completed a first round of consultations with stakeholders and provincial governments. It will submit to the cabinet by end-October 2003 the result of these consultations and lay out the legislative steps at the federal and provincial levels that would be required to limit the enforceability of Benami transactions and holdings.

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

20. **We plan to increase social and poverty-related expenditures to 4.2 percent of GDP in 2003/04.** In October 2003, we started a pilot of the CWIQ survey in collaboration with the World Bank; the full CWIQ survey will serve as input for the 2004/05 budget discussions. We hope that our efforts in raising spending and making it more effective by monitoring outcome indicators on a regular basis will lead to noticeable improvements in Pakistan's poverty situation. We intend to broaden the definition of social- and poverty-related expenditures to include law and order, justice, and rural electrification. In many studies, inter alia the recent participatory poverty assessment, these policy areas have appeared as important factors determining, in particular, the rural poverty situation.

21. **We are in the process of taking several steps to further strengthen our anti-corruption strategy.** In the fall of 2003, we are launching an awareness campaign which would explain what corruption is and how it affects people. The campaign would also inform about the rights and obligations of civil servants as well as citizens. Given the importance of the justice system in our fight against corruption, the National Accountability Bureau (NAB) will cooperate more closely with the access to justice program. Relatedly, we will strengthen control systems in government departments which will make existing rules and regulations more effective. Looking ahead, greater reliance on automation, civil service reform and training of legislators and civil servants will form integral parts of our strategy. An interministerial task force on reducing regulations and simplifying bureaucratic processes has been set up to reduce opportunities for corruption.

22. **We have made substantial progress in expenditure management and fiscal transparency in 2002/03.** Release of funds occurred on a more timely basis so that expenditures were better distributed over the full year. Even though the overall deficit target was ambitious, we were in a position to let ministries pursue their budget without curtailing them as a result of financing constraints. Consequently, we were able to largely execute our spending plans on social- and poverty-related expenditures as well as the Public Sector Development Program (PSDP). Reconciliation of fiscal data has improved. For the federal government provisional outcome data, revenues are reconciled to 100 percent and expenditures to 98 percent with a view to achieving 100 percent once the accounts are finalized. As a result, the statistical discrepancy between reported revenues and expenditures and the financing data has narrowed significantly. With support from DFID, we have started to develop a medium-term budget framework. As a first step, we are preparing three-year forward projections in the health and population welfare sectors based on a detailed costing exercise. We will use these forward projections as input for the 2004/05 budget. In addition, we intend to introduce general rules and regulations for procurement applicable to the whole public sector. Specific rules for individual public sector organizations would be introduced in the next fiscal year. The 2003/04 federal budget and NWFP budget were prepared on the existing accounting model and a new Government Finance Statistics (GFS) compatible new accounting model (NAM). Reporting of 2003/04 fiscal data for the federal government and NWFP is done in parallel in the old accounting system and the NAM. With the 2004/05 budget, we will introduce the NAM in the remaining provinces on a pilot basis.

Public enterprises and privatization

23. **We expect the privatization process to regain momentum in the coming months, as investors' concerns over regional security and the global economy subside.** Over the past six months, we have completed the privatization of the State Enterprises Mutual Fund and divested shares (including in Pakistan Oilfields Limited and in Attock Refinery Limited) for a total value of about PRs 6.5 billion (0.2 percent of GDP). Potential investors in Habib Bank Limited have been prequalified and have started due diligence. Bidding will take place in December. We expect to complete the divestment of the government's remaining shares in Allied Bank Limited and the privatization of Pakistan State Oil by end-2003, and the sale of up to 26 percent of shares of PTCL during the first quarter of 2004. In view of recent inquiries by several potential investors, we have sought once more expressions of interest for KESC. In general, we are optimistic that KESC can meet its financial targets for 2003/04 under the revised FIP. Our optimism is based on the recent improvement in bill collection and the expected reduction in technical and distribution losses following the completion of some key investments.

24. **Although WAPDA met its revised financial targets for the second half of 2002/03, its medium-term prospects (and those of its successor companies) remain difficult.** Nevertheless, with the more normal hydrological conditions now prevailing, we are confident that WAPDA will be able to achieve its financial targets in 2003/04, despite continued high technical and distribution losses. The revised plans specify and quantify

efforts to improve bill collection, including by initiating the metering of users in FATA (starting with commercial, industrial, and public consumers). A medium-term financial recovery plan quantifying the outlook for WAPDA will be prepared in the coming months, with the assistance of the World Bank. This plan will further develop measures to contain costs, increase efficiency, and spell out tariff policies. The plan will also identify sources of subsidy to the energy sector and develop a strategy for their rationalization over the medium term. We fully recognize the need for strong reform of WAPDA to improve operational efficiency and reduce large line losses. Such measures, coupled with the reduction over time in the upfront payments under the contracts with the independent power producers (IPPs) and lower costs resulting from the increasing output at Ghazi Barotha hydropower station, will improve WAPDA's financial position over the medium term.

25. **Progress continues to be made towards the unbundling of WAPDA.** The staff of WAPDA has been allocated to the successor entities. However, the legal transfer of assets and liabilities has been delayed to end-2003 essentially because it has taken additional time to obtain the consent of official lenders to transfer the debt to unbundled entities. We expect the new tariffs of WAPDA's successor companies to be determined by January 2004. The government fully accepts the principle of differentiated electricity tariffs by region.

26. **We will adjust energy prices regularly to reflect international market developments.** In the case of petroleum prices, fortnightly adjustments in line with import cost will continue, while maintaining stable average tax rates. For gas prices, we will apply the framework agreed with the World Bank, notably through the phased rationalization of Pakistan Petroleum Limited (PPL) wellhead prices, semiannual reviews of wellhead and consumer prices, and will endeavor to eliminate cross subsidies to the domestic sector (except lifeline consumers) by end-2005. For electricity, KESC and WAPDA (and its successor companies) we will adjust tariffs as provided under the NEPRA Act, with the government notifying adjustments as determined by NEPRA within 30 days; this adjustment will take effect on the day of notification. However, downward adjustments will not be notified until and unless final data are available showing that WAPDA's and KESC's respective cumulative accrual deficits during the preceding quarter have been at or below the levels targeted in Table 1(b).

27. **By end-October, we will finalize the action plan developed with World Bank assistance aimed at establishing a transparent regulatory framework for the setting of electricity tariffs.** We consider that the NEPRA Act constitutes an adequate base for such a framework, and that there is no need to amend it. The action plan will rather focus on improving the timely implementation and the transparency of the current framework. The action plan will also review the issue of budgetary subsidization of the power sector, especially in the context of the unbundling of WAPDA.

Financial sector reforms

28. **We will pursue the implementation of our financial sector reform strategy, and would welcome a contribution from the much-delayed Financial Sector Assessment Program (FSAP) mission that is now scheduled for February 2004.** In addition to efforts to privatize some of the remaining publicly owned commercial banks, as outlined above, we will take further steps to strengthen the legislative framework. A draft anti-money laundering law reflecting best practices and Financial Action Task Force on Money Laundering (FATF) recommendations will be submitted to Parliament by January 1, 2004. Moreover, a draft corporate bankruptcy law will be submitted to Parliament by June 30, 2004.

29. **A key element of our reform strategy is to strengthen the domestic capital market so that it will be capable of generating resources to support private sector investment and to reduce interest costs to the budget.** As part of this strategy, the NSS will need to become a modern savings institution, probably in the form of a mutual fund. In the context of an Asian Development Bank-supported (AsDB) reform of the nonbank financial sector, we have hired consultants to help with (a) the computerization (pilot project to be completed by end-March 2005 and complete automation by December 2005); and (b) reorganization of the administration of the NSS to be completed by October 2004. To address social concerns, we have opened special windows for retirees and widows. To limit the access to NSS instruments, we have taken steps to limit the involvement of commercial banks in the marketing of these instruments which have resulted in a sharp drop in the issuing of NSS instruments in the first two months of 2003/04. Our ultimate goal is to align NSS rates with market rates on comparable government instruments. As intermediate steps, we will strictly apply the existing formula agreed to on adjusting NSS rates to reflect PIB yields in January 2004 and agree with Fund staff in March 2004 on a new formula that will align NSS rates to government bonds of the same maturity. Financial penalties for early retirement of NSS instruments will be reviewed by March 31, 2004, with a view to discouraging early encashment.

IV. PUBLIC DEBT STRATEGY

30. **Our debt management strategy calls for the reduction of public debt to below 60 percent of GDP over the next 10 years, as stated in the draft fiscal responsibility law.** We have already made progress in reducing the debt burden, reflecting fiscal consolidation and the support of the international community. As part of the strategy, we intend to prepay some expensive debts totaling $1 billion in the current fiscal year.

31. **We recognize that over the medium term, Pakistan will need to diversify its sources of financing development and expand its international investor base by accessing global capital markets.** Indeed, we intend to return to the international capital markets in 2003/04 with a bond issue. Our objective is to establish an effective international pricing benchmark to diversify our sources of funding and to ensure that Pakistani debt is present in key markets following the repayment of the existing Eurobonds. Our return to

capital markets will create a mechanism to sell the government's securities in financial and capital markets. In negotiating the size and terms of the new issue, we will make every effort to minimize interest costs and extend its maturity structure.

V. Other Issues

Program financing

32. **The program is fully financed for 2003/04.** We will ensure that conditions attached to expected loan disbursements of the World Bank and AsDB are met. All (but one) bilateral agreements with the Paris Club creditors have been signed, with the remaining one expected to be concluded as soon as possible. Discussions are being held with creditors on debt swaps for social expenditure and outright debt cancellation. We will keep Fund staff informed about the discussions with creditors and ensure that implementation of any swaps will be consistent with the financial program.

Data issues

33. **The remaining steps to participate in the General Data Dissemination System (GDDS) are being finalized, with statistical metadata to be posted on the Fund's data dissemination board by December 2003.** The outstanding issues are preparing the metadata on the depository corporations survey and finalizing the metadata focusing on socio-economic components, which has benefited from World Bank technical assistance. To further improve data dissemination and move closer to subscribing to the Special Data Dissemination Standard (SDDS), we plan to meet by end-2003 the requirements of quarterly national accounts and of a regular survey on wage earnings. By end-2003, we intend to finalize work on establishing the Pakistan Bureau of Statistics (PBS) consolidating various existing agencies. PBS will be granted greater autonomy to enhance the quality of our statistics.

Program monitoring

34. **Given the improved external and fiscal prospects, we are requesting moving to six-monthly reviews for the remainder of the PRGF arrangement.** We propose the ninth disbursement (subject to the eighth review which will focus on the 2004/05 budget) in an amount of SDR 172.28 million for March 20, 2004 based on end-December 2003 data, and the tenth disbursement in an amount of SDR 172.28 for September 20, 2004 based on end-June 2004 data (ninth review). The proposed additional structural performance criteria/benchmarks for September 2003–June 2004 and the proposed end-December 2003 and end-June 2004 quantitative performance criteria and the indicative targets for end-March 2004 are listed in Tables 2(b) and 1(b), respectively.

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

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

	Act. End-Dec. 2002	Prog. End-Mar. 2003	Adj. Prog. End-Mar. 2003	Act. End Mar. 2003	Prog. End-Jun. 2003	Adj. Prog. End-Jun. 2003	Act. End-Jun. 2003
Net foreign assets of the SBP (floor in millions of U.S. dollars)*	3,629.0	809.0	409.0	5,197.0	4,327.0	4,240.5	5,868.0
	(In billions of Pakistani rupees)						
Net domestic assets of the SBP*	-152.8	-13.2	10.8	-237.2	-181.2	-176.0	-258.3
Overall budget balance (floor)*	-62.3	-142.3	-150.3	-99.1	-178.4	-186.4	-179.9
Net government bank borrowing*	-34.0	-38.6	-6.6	-52.5	-29.2	-16.0	-55.6
CBR revenue (floor)*	203.1	309.0	...	310.3	458.9	...	461.6
Net banking sector claims on public sector enterprises*	-7.0	16.3	...	-6.4	20.0	...	-10.3
Social- and poverty-related spending ("I-PRSP budgetary expenditure")	66.5	114.3	...	102.1	161.0	...	158.0
WAPDA accrual balance	...	...	...	...	-20.7	...	-20.0
KESC accrual balance	...	...	...	...	-14.1	...	-13.3
	(In millions of U.S. dollars)						
Outstanding stock of short-term external debt owed or guaranteed by the government and the SBP*	418.5	500.0	...	377.1	500.0	...	286.6
Contracting or guaranteeing of noncessional medium-term and long-term debt by the government* 2/	88.8	600.0	...	578.8	650.0	...	578.8
Accumulation of external payments arrears (continuous performance criterion during the program period)*	0.0	0.0	...	0.0	0.0	...	0.0
SBP's forex reserves held with foreign branches of domestic banks (outstanding stock)	56.3	100.0	...	45.8	100.0	...	65.6
Of which: other than current account*	0.0	0.0	...	0.0	0.0	...	0.0
Stock of outstanding foreign currency swap and forward sales between SBP and residents*	45.0	400.0	...	242.0	400.0	...	140.0
Memorandum items:							
Net external program financing 3/	367.2	689.1	...	-732.6	365.5	...	-691.4
Of which: privatization proceeds	186.0	150.0	...	186.0	284.0	...	186.0
External cash budget and capital grants 3/	117.5	193.0	...	1,208.9	238.5	...	1,208.9
Daily cash reserve requirements ratio (in percentage points)	4.0	4.0	...	4.0	4.0	...	4.0
Special cash reserve requirements ratio on foreign currency deposits (in percentage points)	15.0	15.0	...	15.0	15.0	...	15.0
Outstanding KESC borrowing 4/	4.0	...	...	9.0	0.0	...	0.0

Source: Pakistani authorities.

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

2/ Excluding PRGF loans.

3/ The difference between the program projections and the outcomes reflects essentially $1.0 billion in debt cancellation, which was reported as a capital grant in "External cast budget and capital grants," and, negatively, as debt amortization in "Net external program financing."

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

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

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

	Outstanding Stock End-Jun. 2003	Prog. End-Sep. 2003	Prog. End-Dec. 2003	Prog. End-Mar. 2004	Prog. End-Jun. 2004
Net foreign assets of the SBP					
(floor in millions of U.S. dollars)*	8,189.0	495.0	833.0	996.0	1,489.0
		(In billions of Pakistani rupees)			
Net domestic assets of the SBP*	187.2	-12.6	13.4	-1.3	-10.5
Overall budget balance (floor)*	...	-77.0	-126.3	-163.7	-179.2
Net government bank borrowing*	458.6	43.5	53.1	40.9	20.2
CBR revenue (floor)*	...	92.2	218.1	347.5	510.0
Net banking sector claims on public sector enterprises*	71.8	1.0	2.7	4.3	6.0
Social- and poverty-related spending					
("I-PRSP budgetary expenditure")	...	40.7	81.4	131.4	185.1
WAPDA accrual balance	...	5.3	-3.9	-19.6	-19.2
KESC accrual balance	...	-4.4	-8.2	-12.4	-15.3
		(In millions of U.S. dollars)			
Outstanding stock of short-term external debt owed					
or guaranteed by the government and the SBP*	...	500.0	500.0	500.0	500.0
Contracting or guaranteeing of noncessional medium-term					
and long-term debt by the government* 2/	...	600.0	600.0	750.0	750.0
Accumulation of external payments arrears (continuous					
performance criterion during the program period)*	...	0.0	0.0	0.0	0.0
SBP's forex reserves held with foreign branches of					
domestic banks (outstanding stock)	...	70.0	70.0	70.0	70.0
Of which: other than current account*	0.0	0.0	0.0	0.0	0.0
Stock of outstanding foreign currency swap					
and forward sales between SBP and residents*	...	400.0	400.0	400.0	400.0
Memorandum items:					
Net external program financing	...	105.9	59.3	-239.1	132.7
Of which: privatization proceeds	...	25.0	50.0	75.0	100.0
External cash budget grants	...	22.5	55.6	148.3	148.3
Daily cash reserve requirements ratio					
(in percentage points)	4.0	4.0	4.0	4.0	4.0
Special cash reserve requirements ratio on foreign					
currency deposits (in percentage points)	15.0	15.0	15.0	15.0	15.0

Source: Pakistani authorities.

1/ The relevant variables are defined in the Technical Memorandum of Understanding (TMU) dated May 29, 2003 and are subject to adjustors specified in the TMU. For variables marked "*" end-December 2003 and end-June 2004 program flows represent ceilings (or floors, if indicated) that constitute performance criteria. All other targets are indicative.

2/ Excluding PRGF loans.

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

Measures	Timing	Status as of August 31, 2003	Related to
I. Structural Performance Criteria			
Publish quarterly progress reports on implementation of financial improvement plan of WAPDA/successors.	May 31, 2003 for the quarter January–March 2003 and August 31, 2003 for the quarter April–June 2003.	Observed so far. Fourth report on WAPDA (and other major public enterprises) published on the Ministry of Finance website in August 2003.	
No new exemptions (as per status of March 1, 2003) or special privileges regarding income tax, custom duties, or GST to be granted, no new regulatory import duties to be imposed (except for anti-dumping measures), and all time-bound exemptions and regulatory import duties to lapse without extension, except for existing contracts and exemptions based on international commitment.	Continuous	Not observed. A few minor changes were introduced with the 2003/04 budget to ensure uniform tax treatment and removing discriminatory treatment, having virtually no revenue impact.	
Submit to parliament a fiscal responsibility law, including (a) fiscal rules aimed at reducing consolidated government debt (federal and provincial) to below 60 percent of GDP within 10 years from the date of promulgation; and (b) the transparency and reporting requirements proposed in the draft published in July 2002.	June 1, 2003	Not observed on time. However, the law was submitted to Parliament on October 11, 2003.	7^{th} disbursement
Eliminate all exemptions from withholding tax on interest income, including for NSS instruments.	June 30, 2003	Partially observed. All exemptions from withholding tax on income were eliminated except for NSS instruments under PRs 150,000.	8^{th} disbursement
Establish formulaic link between rates of return on General Provident Fund and PIB yields.	June 30, 2003	Observed	8^{th} disbursement
KESC or WAPDA downward electricity tariff adjustments determined by NEPRA not to be implemented unless cumulative quarterly deficit targets of KESC, respectively WAPDA, for the preceding quarter were observed.	Continuous from June 30, 2003	Observed	
Elimination, with the approval of parliament, of at least 20 income tax exemptions.	July 1, 2003	Observed	8^{th} disbursement

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

Measures	Timing	Status as of August 31, 2003	Related to
Promulgation of federal budget for FY 2003/04 consistent with a consolidated overall budget deficit (excluding grants) not exceeding PRs 179.2 billion.	July 1, 2003	Observed	8^{th} disbursement
II. Structural Benchmarks			
Quarterly published progress reports on implementation of Poverty Reduction Strategy, including "I-PRSP expenditure," as well as on progress in (a) establishing institutional framework for I-PRSP monitoring; (b) preparation of full PRSP; and (c) developing baseline data and monitoring framework for intermediate indicators.	To start end-December 2001 for 2001/02 Q1 data, and continued on the basis of the same quarterly schedule throughout FY 2001/02 and FY 2002/03.	Observed so far. Eighth report published in September 2003.	
Effectiveness of amendments to the tax regulations to enable sales tax auditors to assess for nonfilers tax liabilities on the basis of indirect methods of determination, such as reconstructed income statements and presumptive criteria, and to authorize the CBR to make and order for assessment of tax, penalty, and additional tax on the basis of these criteria.	July 1, 2003	Observed.	
Issuance of CBR circular to require reporting by financial institutions of all interest income to the tax authority, effective from July 1, 2003.	July 1, 2003	Partially observed. The circular required reporting of interest income exceeding PRs 10,000.	
Publication for the federal government and NWFP of the 2003/04 budget according to the old accounting model and the new accounting model (NAM).	July 1, 2003	Partially observed. The documents were prepared and printed but, due to technical problems, it was not possible to publish the budgets based on NAM.	
Decision by Cabinet on future of the National Anti-Corruption Strategy (see MEFP, para. 5).	August 1, 2003	Partially observed. The previous Cabinet approved the strategy in November 2002.	
Submission to cabinet by the "Benami" taskforce of a report setting out the results of consultation with stakeholders and provincial governments and proposing specific legislation to limit enforceability of "Benami" transactions and holdings.	October 31, 2003		

1/ Conditionality as of the Executive Board's conclusion of the fifth review under the PRGF arrangement (IMF Country Report No. 03/180).

Table 2(b). Pakistan: Structural Performance Criteria and Benchmarks Under the PRGF Arrangement as Proposed for the Sixth and Seventh Reviews

Measures	Timing	Related to
I. Structural Performance Criteria		
No new exemptions (as per status of March 1, 2003) or special privileges regarding income tax, custom duties, or GST to be granted, no new regulatory import duties to be imposed (except for anti-dumping measures), and all time bound exemptions and regulatory import duties to lapse without extension, except for existing contracts and exemptions based on international commitment.	Continuous	
KESC or WAPDA downward electricity tariff adjustments determined by NEPRA not to be implemented unless cumulative quarterly deficit targets of KESC, respectively WAPDA, for the preceding quarter were observed.	Continuous	
Publish quarterly progress reports on implementation of financial improvement plan of WAPDA/successors.	November 30, 2003 for the quarter July–September 2003, February 29, 2004 for the quarter October–December 2003, May 31, 2004 for the quarter January–March 2004, and August 31, 2004 for the quarter April–June 2004.	
Preparation of an action plan to establish by end-2003 a transparent regulatory framework for the setting of electricity tariffs, that in particular (a) clarifies the respective roles of the government, NEPRA, and the power companies (including the new distribution companies) in the setting of tariffs; and (b) limits departures in actual tariff adjustments by distributors from NEPRA's determination based on the current procedures to well-specified cases of exceptional temporary spikes in oil prices.	October 31, 2003	9th disbursement
Privatize Habib Bank Limited through effective transfer of majority ownership to private investors.	December 31, 2003	9th disbursement
Adjust NSS rates to reflect PIB yields according to formula set in the amendment to the Technical Memorandum of Understanding (TMU).	January 1, 2004	9th disbursement
Government to notify electricity tariff adjustments determined by NEPRA within 30 days of their determination (effective on day of notification).	Continuous from January 1, 2004	
Propose to Parliament removing income and sales tax exemptions and adopt other tax-base broadening measures yielding a total of PRs 5 billion in estimated revenues in the context of the 2004/05 budget.	June 30, 2004	10th disbursement
Set up a pilot customs house in Karachi that will involve entry processing on a 24-hour basis, electronic filing of declarations by importers on a self-assessment basis, and parameter- and risk-based audits.	June 30, 2004	10th disbursement

Table 2(b). Pakistan: Structural Performance Criteria and Benchmarks Under the PRGF Arrangement as Proposed for the Sixth and Seventh Reviews (concluded)

Measures	Timing	Related to
II. Structural Benchmarks		
Establish a new formula in consultation with Fund staff that will align NSS rates to government bonds of the same maturity.	March 31, 2004	
Set up two additional Medium Taxpayers Units.	June 30, 2004	
Open second Large Taxpayers Unit in Lahore.	August 31, 2004	
Submit to Cabinet an action plan on extending the coverage of the GST to additional services.	February 29, 2004	

Amendments to the Technical Memorandum of Understanding (TMU)

The TMU dated May 29, 2003 will remain valid for the remainder of FY 2003/04, with the revised baseline assumptions for net external program financing and external grants as indicated in Tables 1(a) and 1(b), and the following amendments to apply from October 1, 2003.

1. The second sentence in paragraph 11 of the TMU will be amended as follows: "Excluded from this performance criterion are (a) foreign currency deposit liabilities of the SBP; (b) the outstanding stock of debt of Foreign Exchange Bearer Certificates (FEBCs), Deposit Bearer Certificates (DBCs), and Foreign Currency Bearer Certificates (FCBCs); and (c) debt contracted from the Asian Development Bank."

2. A new paragraph will be added after paragraph 14 of the TMU, as follows: "For purposes of the performance criterion on applying existing formula on adjusting NSS rates to reflect PIB yields, the existing formula is defined as follows:

$$1.028*0.918\ YPIB - 0.5 \leq NRNSS \leq 1.028*0.918\ YPIB + 0.5$$

Where:

- YPIB is the average yield, in percent, over the last six months on Pakistan Investment Bonds for three-, five-, and ten-year bonds.

- NRNSS is the net compound rate, in percent, on three-, five-, and ten-year NSS instruments, which is the gross compound rate on three-, five-, and ten-year NSS instruments, as announced by the authorities, net of withholding tax and zakat."

Statement by the IMF Staff Representative
October 27, 2003

1. This statement summarizes the information that has become available since the staff report was circulated to the Board on October 14, 2003. It does not change the thrust of the staff appraisal.

2. Inflation remained subdued in September, at 2.2 percent year-on-year (or an average of 1.8 percent in July–September 2003 over the same period a year ago). Core inflation increased slightly to 2.9 percent year-on-year.

3. According to preliminary customs data, exports and imports continued to grow strongly in the first quarter of 2003/04, with rises of 15 percent and 12 percent, respectively, in U.S. dollar terms over the corresponding quarter of 2002/03. Inflows of remittances were 14 percent lower than in the same period of the preceding year. Nevertheless, gross official international reserves continued to increase, exceeding $10.0 billion at mid-October. The State Bank of Pakistan reduced further its intervention on the interbank foreign exchange market, and the Pakistani rupee appreciated by about 1 percent in early October to PRs/$57.4 on October 14.

4. Broad money growth decelerated slightly to 18 percent, while reserve money growth fell to 14 percent (reserve money fell in absolute terms during July–August). Increased sales of treasury bills by the State Bank of Pakistan, as well as a slower rate of increase in its net foreign assets, resulted in a sharp reduction in excess bank reserves in July–August. Private sector credit growth remained strong, increasing by 24 percent in the year through August.

5. The Central Board of Revenue exceeded its end-September collection target by about 2 percent. Preliminary data for the federal government through August indicates that achieving the overall deficit target for end-September is well within reach.

6. On October 20, Moody's Investor Service raised its rating on Pakistan's foreign and domestic currency debt and bank deposits from B3 to B2.

7. The Pakistani authorities have announced that they intend to make about $1.1 billion in early repayments of external debts in 2003/04 of which about $0.5 billion to the World Bank (current interest rates 4.6–6.6 percent) and about $0.6 billion to the Asian Development Bank (current interest rates 6–11 percent). There will be no early repayments to the Fund, as interest rates on Fund loans are substantially lower than those on the above World Bank and AsDB loans. Specific loans for early repayments have been identified.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

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FOR IMMEDIATE RELEASE
October 27, 2003

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Sixth and Seventh Reviews of Pakistan's PRGF-Supported Program, Grants Waivers and Approves Disbursements Amounting to US$247.54 Million

The Executive Board of the International Monetary Fund (IMF) completed today the sixth and seventh reviews of Pakistan's economic performance under a three-year, SDR 1.034 billion (about US$1.5 billion) Poverty Reduction and Growth Facility (PRGF) arrangement, and approved disbursements amounting to SDR 172.28 million (about US$247.54 million). In this regard, Pakistan's request for waivers for the non-observance of three structural performance criteria was approved by the Executive Board.

The waivers related to a short delay in the submission of the fiscal responsibility law to Parliament, the approval of some minor new tax exemptions, and the nonremoval of the exemption from withholding tax for National Savings Scheme (NSS) instruments of less than Pakistani rupees 150,000. Given the strong improvement in Pakistan's external and fiscal prospects, the Board supported a move to semiannual reviews of the PRGF arrangement.

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

Pakistan's PRGF arrangement (see Press Release No. 01/51) was approved on December 7, 2001 and is due to expire in December 2004. The Pakistani authorities have stated that they do not intend to request a successor arrangement when the current PRGF expires in December 2004. The authorities, however, have stated that they intend to stay closely involved with the IMF after the arrangement expires, and to engage actively with the Fund in dialogue on how economic growth can be strengthened in the medium term.

Following the Executive Board's discussion of Pakistan's current PRGF-supported economic program, Agustin Carstens, Deputy Managing Director and Acting Chairman, made the following statement:

"The continued strengthening of Pakistan's macroeconomic performance is commendable. GDP growth picked up in 2002/03, inflation remained subdued, and large external current account and overall balance of payments surpluses were recorded. The fiscal deficit was lower than expected, tax collection exceeded its target by a small margin, and social- and poverty-related expenditure grew only slightly less than targeted.

"Structural reforms also advanced. Financial and tax administration reforms proceeded largely according to schedule. In the energy sector, there were adjustments of most controlled prices and tariffs. However, there were some minor delays and setbacks in fiscal reform, and three structural performance criteria were breached.

"The macroeconomic policy mix for 2003/04 is appropriate. Key elements include a fiscal policy that envisages further fiscal consolidation that will continue to reduce the public debt burden. Measures will broaden the tax base and improve tax administrative efficiency, as well as maintain wage restraint, reduce public subsidies, increase poverty-related expenditures, and improve management of public expenditures at the central and local level. Strong fiscal policies are combined with a monetary policy aimed at maintaining low inflation and a flexible exchange rate.

"To further accelerate growth and reduce poverty, the authorities need to pursue forcefully the planned structural reforms intended to create an environment more supportive of private sector investment. This will require further reforms to improve governance and reduce corruption, including through the enactment of effective anti-money laundering and bankruptcy legislation. In the fiscal area, this will include efforts to broaden the tax base through an expansion of the general sales tax to services, a reduction of tax exemptions, and an improvement in the capacity of local governments, which administer most poverty-related expenditures. The early repayment of some relatively expensive external debts is welcome. The placement of a Eurobond merits consideration as a means to diversify financing sources, especially after a major rating agency recently raised the rating on Pakistan's foreign and domestic currency debt.

"In addition, it is essential to advance reform of public institutions, including the public energy sector, which should be undertaken with World Bank assistance. Finally, the National Savings Scheme should be transformed into a modern savings institution to improve the financial sector's ability to support investment and growth," Mr. Carstens stated.

Statement by Abbas Mirakhor, Executive Director for Pakistan
October 27, 2003

Introduction

My authorities thank staff for the fruitful dialogue which culminated in a clear and balanced report on Pakistan's achievements under the program since the last review and the challenges that lie ahead. Further strong progress was made under the PRGF arrangement—despite a weak global economy and regional security problems—due to the authorities' strong commitment to sound macroeconomic policies and reforms aided by robust private capital inflows and external support. All quantitative performance criteria for March and June and most of structural performance criteria were met. The authorities are seeking waivers for the non-observance of structural performance criteria relating to: a) submitting to Parliament a fiscal responsibility law, b) eliminating the exemption from income tax withholding on National Saving Scheme (NSS) instruments, and c) not introducing new tax exemptions. While the fiscal responsibility law has now been submitted to Parliament, the elimination of the exemption from income tax withholding on NSS instruments was met with strong opposition in Parliament. However, the authorities have agreed to steps to align yields on NSS instruments to market rates. More tax exemptions were eliminated in the 2003/04 budget (bringing to 107 the total number of exemption withdrawals in the last three budgets) and those few new exemptions mentioned in the staff report are in fact meant to eliminate distortions and discriminations within the system to create a level playing field.

Recent economic developments

The macro-economy continued to strengthen in 2002/03. A higher-than-targeted—and, significantly, broad-based—growth was achieved, and a rebound in agricultural output, in particular, following three successive years of drought, will be of immense benefit to a large section of the poor. Inflation slowed further through August, thanks to lower food and energy costs and the strong macroeconomic policies. The external situation also continued to strengthen—manifested in a large current account surplus, strong reserve position, and a stable Pakistani rupee—reflecting strong exports, private transfers, and external budgetary assistance. The overall fiscal deficit was lower than targeted, driven by higher revenue performance. While expenditures were also higher than projected, owing to higher outlays on civil administration and pensions, social sector spending ("I-PRSP expenditure") grew strongly, reaching 3.93 percent of GDP (as against a programmed 3.96 percent) despite implementation capacity limitations at the provincial level. High non-bank domestic financing, largely from the National Savings Scheme (NSS) instruments, resulting from favorable interest rates, enabled more bank debt to be retired than programmed, despite lower external program financing. The continued strong NFA accumulation and private sector credit growth was countered by reinforced open market operations to moderate the impact on monetary growth.

The structural reform agenda remained on course, with most of the performance criteria and benchmarks under the program being met. In 2002/03, privatization moved forward, including of the State Enterprises Mutual Fund and divestment of shares in Pakistan Oilfields Limited and Attock Refinery Limited, among others, yielding receipts of 0.2 percent of GDP. Progress was made in fiscal reforms, including the submission of the fiscal responsibility law to Parliament, removal of 20 tax exemptions in the 2003/04 budget, and steps toward introduction of universal self-assessment. In the financial sector, a formulaic link was established between rates of return on General Provident Fund (GPF) and Pakistani Investment Bond (PIB) yields to enhance transparency. In the energy sector, the fortnightly automatic adjustment of petroleum product prices was consistently applied, while tariff increases determined by the National Electric Power Regulatory Authority (NEPRA) for the Water and Power Development Authority (WAPDA) and Karachi Electricity Supply Corporation (KESC) were notified, although slightly behind schedule. The financial performance of WAPDA and KESC, among other large public enterprises, was broadly in line with targets under the Financial Improvement Plans (FIPs). Technical distribution losses in both enterprises were, however, higher than targeted and will continue to receive high attention. Further progress was made on the PRSP preparation following the completion of the widespread consultation process that has strengthened consensus building and ownership. The final PRSP—due soon—will incorporate the results of the pilot Core Welfare Indicators Questionnaire (CWIQ) survey and will pay strong attention to rural development, gender issues, employment, and the environment.

The program for FY 2003/04

The authorities intend to maintain the current mix of macroeconomic policies that has proved successful in achieving strong growth in a low inflation environment. The 2003/04 program is geared to further raising growth, consolidating macroeconomic stabilization, and reducing debt vulnerability. A strong fiscal effort will be the key driver of the program, and the 2003/04 budget is consistent with the program targets. The increase in wages and pensions, necessary to mitigate their erosion in real terms, is to be offset by upward revision of non-tax revenue and reduction in the wheat export subsidy, among other measures. As staff rightly note, the tight budget allocation for the civil government in the 2003/04 budget calls for strict expenditure control to avoid overruns and redoubled efforts to achieve the CBR revenue target. Accordingly, expenditure management is being strengthened, including through the development of a medium-term budget framework with DFID support, and by improving public procurement and budget accounting. Moreover, the authorities are committed to execute fully the budgetary allocation for I-PRSP expenditure and have agreed with staff to consider raising social spending further in 2003/04 and beyond if additional resources became available and the capacity to spend effectively at the local level was enhanced. They would also closely monitor its impact on poverty.

The authorities recognize the importance of achieving the projected revenue in order to realize the overall fiscal targets. In this connection, Central Board of Revenue (CBR) receipts will be safeguarded by strengthening tax administration, and bringing into the tax net more taxpayers through improved information gathering. Furthermore, the scope of income and sales tax exemption is to be reduced, while other measures will be taken to broaden the tax base. At a minimum, the authorities are committed to protecting the fiscal targets by cutting non-priority spending in case of unforeseen shocks.

While the risk to inflation is considered to be low in light of weak import prices, a strong Pakistani rupee, and positive outlook for agricultural output, the authorities recognize the need to remain vigilant, especially given the recent buildup in bank liquidity and strong private sector credit growth. Accordingly, the SBP will act promptly to mop up excess liquidity, including by introducing new certificates, should the need arise. Positive real interest rates are expected to be restored following rising short-term rates in conjunction with declining inflation. Despite limited SBP intervention in the foreign exchange market, the Pakistani rupee has remained remarkably stable against the US dollar—thanks to the strong macroeconomic and financial policies.

The authorities are fully aware of the importance of maintaining the momentum of structural reforms in order to strengthen the economy's long-term growth potential and its resilience to shocks, while reducing fiscal risks. The privatization of designated public enterprises is expected to regain momentum with the anticipated renewed investor interest as concerns about regional security and the global economy subside. Reform of the energy sector, in particular, is considered vital to mitigating risks to the fiscal program. In this regard, while full budgetary provision has been made to support WAPDA and KESC, as projected in their FIPs over the medium term, their financial performance is expected to improve due to the reduction of upfront payments to independent power producers (IPPs) and the increasing output from the lower-cost Ghazi Barotha hydropower station. At the same time, plans are being developed to further contain costs and increase efficiency of their operations. The prospects for KESC divestment have improved following expression of interest from several potential investors, while progress continues to be made towards the unbundling of WAPDA. The authorities are committed to regular adjustment of energy prices, including differentiated electricity tariffs by region, in order to safeguard the financial position of WAPDA and KESC. This will be buttressed with the finalization by end-October of the action plan developed with the World Bank assistance to establish a transparent regulatory framework for setting electricity tariffs.

In the financial sector, the authorities will reinforce their reform strategy, and look forward to the FSAP long-delayed mission. Further to efforts to privatize some of the remaining state-owned banks, the legislative framework will continue to be strengthened, including in the areas of anti-money laundering and corporate bankruptcy. Capital market development remains a key plank of the authorities' strategy to support private sector investment and to reduce interest costs to the budget. The strategy also entails transformation of the NSS into a modern savings institution and development of the non-bank financial sector. The objective of creating a favorable business climate is being buttressed by strengthening governance, particularly regarding financial transparency and accountability, and reducing abuse of official discretionary power and bureaucratic regulations.

As Box 2 of the staff report shows, the paths of public and external debts are not expected to deteriorate significantly under a variety of shocks. Reducing Pakistan's debt burden over the medium- to long-term so as to maintain macroeconomic stability as well as achieve sustained growth and poverty reduction remains at the top of the authorities' agenda, and significant headway has been made through fiscal consolidation and the support of the international community. To this end, the authorities intend to repay some expensive debts this fiscal year.

Furthermore, in order to diversify Pakistan's sources of financing its development program as well as to expand its international investor base, the authorities intend to access international capital markets. They believe that Pakistan can benefit from a eurobond placement as it will provide a strong incentive for maintaining policy discipline when the current program runs its course. Additionally, the placement would provide an important instrument of debt management as well as a benchmark for Pakistan corporates.

Conclusion

Strong implementation of the PRGF-supported program, buttressed by adequate support of the international community, has turned the economy around and positioned Pakistan on a path of sustained growth, with the potential for durable reduction of poverty. The authorities greatly value their continued engagement with the Fund, which is vital to maintaining international support. While they are grateful to the Fund for the financial assistance they have received thus far, they believe that the time has come, and the circumstances are propitious, to exit Fund-supported programs. Accordingly, they have expressed their intention not to enter into a successor arrangement following the completion of the present PRGF. They will, however, maintain close contact with the Fund to seek advice, particularly in the areas of macroeconomic policy, further second-generation reforms, and strengthening of the institutional capacity in the financial, public sector and statistical areas. For now, the authorities look forward to Board support for their request for waiver of non-observance of structural performance criteria and completion of the sixth and seventh reviews under the PRGF arrangement. In view of the strong improvement in Pakistan's external and fiscal prospects, the authorities also request moving to semi-annual reviews.