International Monetary Fund

Pakistan and the IMF

Press Release:
IMF Executive Board Completes Third Review Under the Extended Fund Facility Arrangement for Pakistan and Approves US$555.9 Million Disbursement
June 27, 2014

Pakistan: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

June 19, 2014

The following item is a Letter of Intent of the government of Pakistan, which describes the policies that Pakistan intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Pakistan, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

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Letter of Intent

June 19, 2014
Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, DC, 20431

Dear Ms. Lagarde.

The Pakistani authorities reaffirm our commitment to our economic program supported by the International Monetary Fund (IMF). Performance for the third review was mostly positive. We have met all but one of the performance criteria for the third program review and have made progress on our ambitious structural reform agenda. While further effort is needed in some areas, we are committed to the additional actions described in the attached Memorandum of Understanding of Economic and Financial Policies (MEFP). There are signs of improvement in economic conditions and balance of payments pressures have begun to subside, but challenges remain. We believe that as structural reforms take hold, bottlenecks will ease, growth will accelerate, and vulnerabilities will recede. We are committed to firm policy implementation and maintenance of fiscal, monetary, and financial sector buffers to safeguard against risks.

Our performance on the quantitative targets and the structural reform agenda for the third review has been strong (MEFP Tables 1 and 2).

- Quantitative performance criteria and indicative targets. The end-March 2014 quantitative performance criteria were observed with the exception of the target on Net Domestic Assets of the SBP which was missed by a small margin. We have since taken action to address this shortcoming and are on track to meet the end-June 2014 target as outlined in the attached MEFP. The indicative target on transfers under the Benazir Income Support program (BISP) was also met.

- Structural Benchmarks. The end-March 2014 structural benchmark on tax administration notices was observed as was the end-April 2014 benchmark on the audit of NEPRA. However, the benchmark on hiring privatization advisers was only partially met, as advisers were hired for only three firms rather than six. To address this shortcoming we have agreed on a new benchmark to push forward the privatization process with completed share offers for two firms by end-June 2014.

The program will continue to be monitored through quarterly reviews, prior actions, quantitative performance criteria and indicative targets, and structural benchmarks. As detailed in the MEFP, we propose four new structural benchmarks against which to measure progress under the program (MEFP, Table 2). The TMU explains how the program targets are measured.

In the attached MEFP, we set out our plans to further advance on the objectives of our macroeconomic program. In view of our strong performance under the program supported by the IMF, the Government of Pakistan and the State Bank of Pakistan (SBP) request a waiver on the missed performance criterion and completion of the third review under the Extended Arrangement. We also propose modification of the adjusters on the end-June NIR and budget deficit performance criteria.

We believe that the policies set forth in this letter and in the letters of August 19, 2013, December 11, 2013, and March 6, 2014 are adequate to achieve the objectives of our economic program, but we stand ready to take additional measures as appropriate to ensure achievement of its objectives. As is standard under all IMF arrangements, we will consult with the IMF before modifying measures contained in this Letter or adopting new measures that would deviate from the goals of the program, and will provide the IMF with the necessary information for program monitoring. We authorize the IMF to publish this Letter of Intent and its attachments, and the related staff report.

/s/	/s/
Ishaq Dar	Ashraf Wathra
Minister of Finance	Governor of the State Bank of Pakistan
Pakistan	Pakistan

Attachment I. Memorandum of Economic and Financial Policies

Recent Economic Developments and Outlook

1. Economic activity is improving. Preliminary estimates show that the aggregate output grew above 4 percent in the first half of FY2013/14 over the same period last year. This was primarily driven by the services and manufacturing sectors, as reforms in the electricity sector seem to be bearing fruit with declining electricity shortages. Large scale manufacturing continues to show strong growth (at about 5¼ percent) in the first eight months of the fiscal year. Agricultural growth, on the other hand, remains roughly at the same rate as last year. We now expect that GDP will expand by about 3.3 percent in FY 2013/14, while in the next fiscal year, the expansion should accelerate to around 4 percent. Risks to growth remain tilted downside, but have begun to ease as the recovery in reserves provides an improving cushion against external vulnerabilities (such as oil price volatility, capital flows, or declines in economic activity elsewhere). Annual headline inflation is now forecast at 9½ percent by end-June, 2014. For next fiscal year, inflation is expected to fall to around 7½ percent by end-June 2015, helped by prudent monetary policy and a favorable commodity price outlook.

2. The overall balance of payments situation for the third quarter of FY2013/14 was broadly in line with expectation. The current account deficit was as expected, with lower-than-forecast imports and continued strong growth in remittances. In contrast, the capital and financial account was stronger than expected, helped by two tranches of grant aid from a friendly Gulf country totaling US$1.5 billion. All told, gross reserves increased from US$3.5 billion at end-December to US$5.4 billion by end-March, in line with expectations. After significant downward pressure on the Rupee in late 2013, the currency rebounded strongly in the third quarter, appreciating by 6.5 percent against the dollar. The sharp recovery in reserves has continued since end-March, bolstered by the oversubscribed placement of US$2 billion in Eurobonds and significant program disbursements from the World Bank and ADB. For the next fiscal year, we expect the current account to remain broadly stable, and its financing will continue to be supported by significant program disbursements.

A. Monetary and Exchange Rate Policies

Economic Policies

3. Monetary aggregates continued to grow in line with program objectives in the third quarter of FY 2013/14. The stock of Net Foreign Assets (NFA) of the SBP turned positive at end-March 2014, for the first time since September 2013. The growth rate of broad money declined by 1 percent to 12.7 percent y-o-y in the third quarter, while reserve money stayed flat during the same period. Credit to the private sector increased by some 5 percent y-o-y in March, a slight slowdown compared to 5.6 percent in the past quarter and still negative in real terms.

4. Performance under the end-March monetary targets was mixed. The PC on Net International Reserves (NIR) was met by a wide margin of US$732 million, due in part to ambitious spot market purchases in the month of March. The ceiling on the net swap/forward position was also met (by US$120 million), as was the ceiling on government borrowing from the SBP (by PRs 163 billion) (see ¶19). Although the government reduced borrowing from the SBP in line with program targets, sterilization of the grants through Pakistan Development Fund was not sufficient to contain Net Domestic Assets (NDA) growth, and the SBP missed the program ceiling by PRs 41 billion. The central bank has since taken steps to bring NDA back within the programmed path. To avoid any slippages in future, the SBP will appropriately sterilize foreign exchange inflows and spot market intervention to keep NDA in line with future program targets.

5. Monetary and exchange rate policies continue to be geared toward rebuilding SBP reserves and reducing inflation. The SBP has taken advantage of the current favorable foreign exchange market conditions to further accelerate purchases of foreign reserves in the spot market, and is on track to achieve the projected increase in gross international reserves and the NIR target for end-June 2014. However, a modification of the adjuster on the NIR target to allow use of the overperformance on the Eurobond issue to partially cover the anticipated shortfall in privatization and 3G license receipts will be needed for end-June 2014 for the SBP to meet the end-June NIR program target. The SBP has continued to unwind its net swap/forward position to US$1325 million as of end-April 2014 and is on track to meet the end-June program target.

6. The SBP is committed to sustainably reducing inflation over time. The recent spike in both headline and core inflation in March and April is a cause for concern, and the SBP will use monetary policy tools to contain inflation, consistent with bringing it sustainably below 8 percent by the end of FY2014/15. In particular, the central bank will adjust the policy interest rate in a forward-looking fashion to maintain positive real interest rates in line with its desired inflation path. Going forward, the SBP is committed to taking additional policy actions as and when needed to assure achievement of its reserve accumulation and price stability objectives.

7. Enhanced central bank independence is key for an improved monetary policy framework. We have submitted amendments to the SBP Act to the National Assembly (NA), with a view toward having them enacted by end-June 2014 (structural benchmark), although there may be some delays in the parliament. We will continue to work to ensure that the final law incorporates the recommendations of the IMF safeguards assessment mission and comments provided by Fund staff. It will strengthen the autonomy of the SBP, including full operational independence in the pursuit of price stability as the SBP's primary objective. Among other things, the amendments will establish an independent decision-making monetary policy committee to design and implement monetary policy and prohibit any form of new direct lending from the SBP to the government. Independent of the new legislation, the SBP will undertake several initiative to improve its internal operations, including by: (i) reestablishing an advisory monetary policy committee to advise the Board on its policy decisions; (ii) establishing a Board committee to centralize and oversee risk management activities across the bank; and(iii) begin publishing summaries of the monetary policy proceedings of the Board meetings and monetary policy committee deliberations (with an appropriate lag). These initiatives will be implemented by end-August 2014 (new structural benchmark). Finally, the SBP will hire a consultant to help with the transition to International Financial Reporting Standards (IFRS), and we now plan to adopt IFRS as our financial reporting framework by end-[September] 2014.

B. Fiscal Policy

8. Fiscal consolidation remains a crucial objective of the government's economic program. Fiscal consolidation of around 4–4½ percent of GDP over the three year program will lower the deficit to around 3½ percent of GDP and place the debt-to-GDP ratio on a firmly declining path. Moreover, a more efficient and equitable tax system will foster competition, while providing the needed resources to finance infrastructure and support the poor through targeted assistance. The negative impact of fiscal consolidation on economic activity will be ameliorated by structural reforms to boost growth and by increases in targeted assistance programs to protect the most vulnerable.

9. Fiscal performance was strong in the first nine months of FY 2013/14, with a smaller deficit than envisaged under the program. Revenues were broadly in line with expectations, while the pace of spending remains slower than programmed—particularly on capital spending—as a way to manage the risks related to some of the envisaged revenues. As part of our initial adjustment package, we undertook across-the-board reductions of 30 percent from budget allocations in ministries' nonwage current expenditures—amounting to about 0.15 percent of GDP. We have also scaled back the budgeted increase in capital spending, and delayed some remaining capital spending as a precaution against shortfalls in revenue. For FY 2013/14 as a whole, the government remains committed to deliver a fiscal adjustment of some 2 percent of GDP. The initial consolidation effort relied mainly on the revenue side given the chronically low tax revenue-to-GDP ratio. To strengthen revenues, in addition to the measures approved in the 2013 Finance Bill, we increased the Gas Infrastructure Development Cess (GIDC) at the start of 2014. While the current GIDC is entering the government coffers, the expected recovery of arrears has yet to materialize due to legal issues. The increase in the Cess and the envisaged higher-than-budgeted volumes will lead to additional revenues of about 0.36 percent of GDP on an annualized basis, and we will make further adjustments to bring the yield to 0.55 percent of GDP in FY2014/15. This charge also fosters a more efficient allocation of gas to its highest value economic uses. The provinces are running surpluses which are consistent with achieving the envisaged year-end fiscal outturn. Despite these efforts, recent tax collection data suggest that fourth quarter revenues may end up lower than envisaged under the program by about ¼ percent of GDP due to less-than-budgeted revenue collection at the import stage because of exchange rate appreciation and a slowdown in import growth. However, after adjusting for the base rate effect, the tax-to-GDP ratio will still increase by the envisaged 0.7 percent of GDP. In this context, we are strengthening our tax administration efforts—particularly with respect to enforcement, accelerated auctions of seized assets and recoveries from arrears. We are also redoubling efforts to recover GIDC arrears, and have further reduced our envisaged capital spending to ensure that we achieve the program target. Moreover, the government has sent to parliament a FY2014/15 budget proposal consistent with the program objectives (prior action). The deficit (excluding grants) will be lowered from 5.7 percent of GDP to 4.8 percent of GDP. The envisaged fiscal adjustment is underpinned by tax revenue measures amounting to 0.8 percent of GDP, and further rationalization of subsidies of 0.5 percent of GDP. These additional revenue efforts will ensure that the reduction in capital spending undertaken to address the tax revenue shortfall in FY2013/14 does not become permanent.

10. To ameliorate risks to the program, several contingent measures have been identified and will be implemented in case the expected fiscal adjustment falls short of objectives. On the revenue side, plans to eliminate Statutory Regulatory Orders (SROs) in FY2015/16 will be brought forward if tax revenues fall below the level envisaged in the program. On the expenditure side, we will again reduce expenditure allocations in the first nine months of the year compared to the budget to create a reserve against any shortfall. These measures could yield savings amounting to [0.5] percent of GDP. In any case, we stand ready to take compensatory measures as needed, including adjustment on the revenue side, to reach our fiscal target.

11. On the expenditure side, the government continues to implement its National Energy Policy which, among other things, will largely phase out electricity subsidies over the life of the program. The policy entails periodic increases in the average tariff, aimed at eliminating the tariff differential subsidy for all consumers except the most vulnerable over the next three years. The first adjustments to commercial, industrial, bulk, and large consumers (¶26) reduced subsidies about ¾ percent of GDP on an annualized basis. In the context of the FY 2014/15 budget, we will further rationalize subsidies by roughly 0.5 percent of GDP. We will undertake additional action in the FY 2015/16 budget to reach a maximum of 0.3 percent of GDP thereafter.

12. Tax administration reforms will gradually deliver further improvements in revenue collections. The strategy is aimed at addressing structural flaws in the taxation system, improving tax administration and inducing behavioral change. The plan comprises among others, measures for: (i) electronic volume tracking of production to improve sales tax collection; (ii) field surveys for the broadening of the sales tax base, (iii) the implementation of an IT solution (CREST) for pointing out discrepancies in sales tax invoices at different stages and putting an effective check on fake invoices; (iv) risk based e-registration in sales tax to thwart spurious registration; (v) revised valuation rulings in customs duties to arrest the tendency of misdeclaration and underinvoicing, and (vi) the electronic data interchange (EDI) connectivity to streamline trade with Afghanistan. Moreover, setting up an integrity and performance unit to encourage high achievers and prosecute the corrupt elements in the tax service, and a fiscal management cell to target non taxpayers with an ostentatious lifestyle, will further strengthen the FBR.

13. Efforts to broaden the income tax net also seek to foster a culture of compliance. The Prime Minister's incentive package provided a final opportunity for tax payers to voluntarily comply, and the way forward will focus on enforcement. The initiative to incorporate 300 thousand new taxpayers into the income tax net is moving ahead. For this purpose, we continue to strengthen our database by collecting information from multiple sources including urban property transactions, motor vehicle procurement, and international travel. More than 80 thousand initial notices (u/s 114 of the Income Tax Ordinance 2001) have been issued—based on large potential fiscal liabilities and location to ensure the initiative is nationwide—and more than 20 thousand second notices (u/s 122c of the law) which will be followed by a provisional assessment, collection procedures, and penal and prosecution proceedings. By end-September, we will issue 125,000 first notices (u/s 114) which will be followed by second notices (u/s 122c) to at least 75 percent of those who did not respond satisfactorily to their first notice within 60 days. The FBR will also issue a provisional tax assessment to 75 percent of those who did not respond satisfactorily within 60 days to the second notice. So far, over 6,300 individuals have registered and filed returns as a result of the initiative, and this number is expected to rise in the coming months. We published in mid-February a tax directory of all current parliamentarians at both the federal and provincial levels and the full directory of all taxpayers at end-April, in an effort to foster a culture of transparency and compliance. These efforts will be further assisted by increasing the number of tax audits to 5 percent of declarations (from 2.2 percent last year), which is already underway. We will also continue to seek technical assistance on tax administration from our international partners.

14. We remain committed to our plan to broaden the tax net through the elimination of most tax exemptions and loopholes granted through SROs. Since the start of the program, we have issued a few SROs to address some implementation issues of already budgeted measures and address some legal concerns. The budgetary implications of these SROs are negligible and we are covering the cost through administrative measures. We have issued no new SROs granting so-called "special exemptions," compared to some 56 in the previous fiscal year. We reaffirm our commitment to refrain from issuing any new tax concessions or exemptions (including customs tariffs) through SROs, and will approve legislation by end-December 2015 to permanently prohibit the practice. At end-December 2013, we finalized an analysis of all existing SROs granting tax exemptions or concessions. At end-May 2014, we completed a calendar to eliminate the vast majority of them and convert the remainder into regular legislation (prior action). This plan will ultimately increase revenues by 1–1½ percent of GDP, with all designated SROs eliminated in no more than three years. The FY2014/15 budget proposal includes the necessary legislation to eliminate SRO exemptions and concessions totaling 0.4 percent of GDP (structural benchmark). It also includes additional tax policy measures to broaden the tax base amounting 0.2 percent of GDP. Moreover, the FY2014/15 budget proposal includes a detailed list of the remaining tax expenditures and we will continue to include it in future budgets. These steps will facilitate gradually moving the General Sales Tax (GST) to a full-fledged integrated modern indirect tax system with few exemptions along with an integrated income tax by 2016/17.

15. Beyond the current fiscal year, further revenue and expenditure measures will be implemented to achieve a sustainable deficit of around 3½ percent of GDP by 2016/17. This will require further fiscal consolidation of 1¼–1½ percent of GDP in FY2015/16. Well over half of the adjustment should come from the revenue side, mainly through further widening of the tax base (particularly from the elimination of SROs), with some contribution from improved tax administration. With improved collections and a broader tax base, we hope to avoid the need for further increases in GST or income tax rates while achieving our overall deficit targets. On the expenditure side, further reductions in untargeted subsidies will be undertaken in 2015/16, along with steps to streamline wage and salary costs via civil service reforms.

16. Provincial governments remain crucial in the fiscal reform process. Under successive constitutional amendments (most recently the 18th), Pakistan has moved decisively to a more decentralized federal system of government. The most recent National Finance Commission (NFC) award granted 57.5 percent of most revenues to the provinces, along with a substantial devolution of spending responsibilities and taxation authority in agriculture, property and services. To assure achievement of our fiscal targets in FY2014/15, and following last year's agreement under the Council of Common Interest, the provincial finance secretaries have agreed to increase provincial budget surpluses consistent with the program. In addition, the federal government is encouraging the provinces to balance their budgets and has provided incentives for them to maintain surpluses. The new National Finance Commission will be established by end-August, and the government will seek a new agreement that will ensure that the terms of fiscal decentralization find a balance between devolution of revenue and expenditure responsibilities and is consistent with the imperatives of macroeconomic stability. In preparation for these negotiations, we will seek technical assistance from our international partners on best practices in sustainable federal-provincial fiscal relations.

17. We continue our support to the poor and most vulnerable segments of the population through the Benazir Income Support Program (BISP). We have reached around 4.4 million women paid by end- March 2014 and achieved the indicative target for transfer payments. Funds for the current quarter have already been released to allow time for BISP to begin delivering payments by mid-May. We remain on track to reach around 4.7 million women paid by end-June 2014. To protect the vulnerable segments of the society from reduction in untargeted electricity subsidies, inflation, and fiscal adjustment measures, we will increase the stipends paid to the poorest families from PRs 3600 to PRs 4500 per quarter starting from FY 2014/15. We will also expand coverage through stepped-up outreach efforts, with a target of reaching an additional 0.6 million eligible women by end-June 2015. We will shift our payment mechanism to competitively selected e-banking options by July 1, 2014. In parallel, we will roll-out new ATM cards that will include identity and security features to avoid fraud. This transition will reduce costs, improve beneficiary services—including using branchless banking options to ensure greater financial inclusion—and improve access for beneficiaries who are in rural and security affected areas with limited banking access. This transition may temporarily affect the timeliness of beneficiary payments in the first quarter of the FY 2014/15, and we will assure that all beneficiaries will receive their payments before the quarter ends. We also made significant progress in preparing the rollout of the education conditional cash transfers with an objective to move from five pilot districts to at least 27 more districts by end-September 2014.

18. In order to enable the use of anti-money laundering (AML) tools to combat tax evasion, we have started preliminary work to include tax crimes in the Schedule of Offences of the 2010 Anti-Money Laundering Act (AMLA). A list of serious tax offences is being identified. In order to ensure that serious tax crimes are predicate offences to money laundering, we will enact amendments to the relevant tax laws (as defined in the TMU) and submit amendments to the Anti-Money Laundering Act (AMLA) to Parliament by end-September 2014 (structural benchmark). We will also ensure that the AML framework is properly implemented to facilitate detection of potential cases of abuse of the investment incentive scheme to launder criminal proceeds. Proper guidance will be provided by the Financial Intelligence Unit to financial institutions and the FBR by end-June 2014. Finally, the Anti-Terrorism (Amendment) Ordinance 2013 will be enacted as a permanent law, in line with the action plan agreed with the Financial Action Task Force (FATF).

C. Fiscal Financing

19. The government continued taking measures to reduce budget financing from the SBP. The government has curtailed government borrowing to PRs 2,226 billion (some PRs 164 billion below the program target) and will continue to reduce it to achieve the end-June 2014 program target. The successful US$2 billion Eurobond issue helped the government to diversify budget financing, as it continued to shift from short-term domestic financing and borrowing from the SBP to longer-term domestic and external bond financing. In addition, we will continue to tap into international markets to attract external commercial financing and floating government T-bills in the stock exchange will enlarge the market for domestic debt. The government will also accommodate higher yields if needed to meet its borrowing targets without further reliance on the SBP.

20. We remain committed to enhancing the effectiveness of public debt management operations. We continue to diversify financing requirements from both domestic and external sources. For this purpose, we have finalized a Medium Term Debt Strategy (MTDS) in April 2014. The MTDS provides detailed guidelines to achieve desired composition of government's debt portfolio, by capturing preference of the government with regard to cost-risk tradeoff. As part of the strategy, we also intend to revamp our Debt Policy Coordination Office (DPCO) to a fully-fledged and operational debt management office. We plan to complete a detailed report on skills-gap analysis of the existing DPCO by end-September 2014 with the assistance of our development partners. Simultaneously, we will initiate the process of hiring of a professional Director General to lead DPCO and transform it into an operational Debt Management Office. As part of strengthening the debt management functions, scattered responsibilities in different wings of the MoF (dealing with the debt functions) will be consolidated in the Debt Management Office by approving an administrative order by September 2014 (new structural benchmark) and subsequently draft required rules under the Fiscal Responsibility and Debt Limitation Act 2005. These actions will lead to more effective decision-making for government borrowing.

D. Financial Sector

21. The banking system continues to show good indicators of financial soundness. As of end-March 2014, nonperforming loans (NPLs) decreased slightly (to 13.4 percent, with net NPLs to net loan ratio of 3.3 percent). Profitability indicators (ROA and ROE) improved, mainly attributable to increased net income and lower provision charges. Capital adequacy (CAR) remained well above the minimum requirement of 10 percent even after implementation of Basel-III. CAR remained around 15 percent on account of improved earnings of the banking system. To further enhance the assessment of financial health and soundness of the financial sector, the SBP has made progress in compiling the "encouraged" set of the Financial Soundness Indicators (FSIs) and will work with the IMF on dissemination of some additional FSIs to the public.

22. The SBP is following up with the few banks that fall below the minimum capital requirement. The CAR shortfall for noncomplaint banks (one state-owned and three private) is only PRs 13.2 billion (less than 0.05 percent of GDP) as of end-April 2014. Although these banks do not pose major systemic risks as they comprise 6.4 percent of banking assets, the SBP has maintained strong vigilance on the activities of these banks to ensure compliance with minimum CAR by end-December 2014. Specifically:

- ***State-owned bank***: the bank's CAR has improved to 9.3 percent as of end-March 2014 and will be able to meet the CAR requirement by end-December 2014 given the present profitability trend.

- ***Private banks***: one bank received an Expression of Interest from a strategic foreign investor for both capital injection and acquisition of shares from the existing major shareholders. The sponsors of another bank have already deposited an additional PRs 2.5 billion as an advance against subscription of a rights issue, and the bank has received offers from potential foreign investors as well as a commitment from existing sponsors for injection of remaining capital shortfall. The SBP is actively engaged with the last bank for its capitalization either through equity injection or through possible merger with domestic bank over the coming months.

23. We remain committed to safeguarding financial stability by strengthening the regulatory and supervisory frameworks. Specifically:

a. The draft Securities Bill is being finalized by the authorities and will be discussed with the IMF by end-June 2014. It will be adopted by end-December 2014 (structural benchmark).

b. The revised SECP Act to enhance the regulatory power of the SECP will be discussed with the IMF, before being submitted to Parliament by [end-September] 2014. The Futures Trading Bill is also being finalized.

c. The SBP-SECP joint task force has resumed its regular meetings over the last few months to ensure cooperation on the supervision of financial groups. The SBP shared its assessment about consolidated financial position of the conglomeration in the financial sector with SECP.

24. **Consultation with key stakeholders on a deposit insurance scheme and a bankruptcy law are ongoing**. The SBP has revised the Deposit Protection Fund (DPF) Act, which will be finalized during the second half of 2014 in consultation with the IMF in the context of a technical assistance on a contingency planning framework. Due to this change in the timeline, we request the revision of the corresponding structural benchmark to June 2015. In the meantime, the proposed amendments to the SBP Act include enabling clause to establish the DPF as a subsidiary of the SBP, which will be a cost effective option and facilitate avoiding regulatory overlaps and ensuring prompt reimbursement. Furthermore, after eliciting stakeholders' views (SBP, Pakistan Banks Association, business groups, and legal experts), the draft Corporate Rehabilitation Act (CRA) will be broken down into two components: (i) Corporate Restructuring Companies Act provided as a separate

legislative Bill for managing troubled assets; and (ii) Corporate Rehabilitation Act given more time is needed to prepare a concept note on the suitable mode of rehabilitation law.

E. Structural Reforms

Energy Sector Reforms

25. **The National Energy Policy identified priority steps to anchor the reform agenda for the next three–five years**. We are implementing our time-bound strategy to tackle price distortions, insufficient collections, costly and poorly targeted subsidies, governance and regulatory deficiencies, and low efficiency in energy supply and distribution with the support of our international partners.

26. **Price Adjustments**. We have prepared the third round identified in the three-year plan for phasing out the Tariff Differential Subsidy (TDS) to continue to bring tariffs to cost recovery level. In this round, NEPRA will finalize the determination and notification of tariffs for FY2013/14 by end-May (prior action). Lower oil prices and better company performance led to a lower tariff determination relative to the previous fiscal year. For this reason, the notification will produce only a [4] percent increase in the weighted average notified tariff (as defined in the TMU), while continuing to protect the most vulnerable consumers. The notified tariff will reduce the electricity subsidy to 0.5 percent of GDP for FY 2014/15.

27. **Arrears**. The technical and financial audit of the system which was finalized in early-May identified the stock and flow of payables at all levels of the energy sector (including Power Sector Holding Company Limited, PHCL). Building on this audit, we have designed a roadmap to limit the accumulation of payables arrears and to gradually reduce the stock:

a. The stock of arrears at the PHCL in the syndicated term credit finance (STCF) facility stood at PRs 240 billion at end-March 2014. The servicing of these payables will be made through inclusion in the tariff notification for FY 2013/14. Alternatively a suitable surcharge will be levied for this purpose.

b. The payables in the power sector reached around PRs 270 billion at end-March 2014 of which around PRs 90 billion constitute current payables. The remainder comprises: (i) a residual leftover from payables clearance of May and July 2013; (ii) A disputed amount with the Independent Power Producers (IPP); and (iii) DISCO nonrecovery and penalties levied on past nonpayment. We will pursue the recovery of receivables in the power and oil and gas sector and use the proceeds to reduce payables by end-June 2014.

c. We will continue to reduce losses and improve collections through capital expenditures and revenue based load management. We envisage reducing losses by 1 percentage point [(to 17 percent)] and increase revenues by 3 percentage points at the end of the current fiscal year. Going forward, continued efficiency improvements will reduce the pace of the payables buildup due to corporate losses.

d. We are developing a monitoring mechanism to track the stock and flow of payables.

28. **Monitoring and Enforcement**. To tackle losses, raise payment compliance, and improve energy efficiency and service delivery in the distribution companies (DISCOs), we have already signed six performance contracts; we are on track to finalize the contracts for the remaining three DISCOs by end-May 2014. We have also finalized the signing of the remaining power purchase agreement in March 2014. In cases of failure to comply with the performance contracts, we will invoke remedial measures for management and Boards as specified in the Companies' Ordinance. The amendments to Penal Code 1860 and the Code of Criminal Procedures 1898 have been promulgated through Presidential ordinance. The ordinance has been submitted to Parliament for ratification, and the President extended the promulgation by another 120 days. In parallel, we drafted the new Electricity Act to modernize governance of the sector and have circulated it for comments. We declared the session courts (district level courts) as Utility Courts as defined in the Penal Code. Utility Courts will build on investigation systems and fast track mechanisms to improve enforcement by end-2014. In order to minimize losses from low payment rates, all state-owned DISCOs are now implementing revenue-based load shedding, which has begun to help increase collections. To minimize losses in fuel delivery to generation companies (GENCOs), we signed a Memorandum of Understanding (MoU) between Muzaffargah Power Generation Company (GENCO-III) and Pakistan State Oil (PSO) to lease the fuel storage and delivery facilities to Pakistan State Oil (PSO). The implementation of the MoU has begun and the handover will begin by end-September 2014.

29. **Demand Side Management**. To encourage energy conservation, we will use pricing ¶27 and other market based instruments to improve resource allocation and energy efficiency. In this regard, we have begun the consultative process with the stakeholders on the draft Pakistan Energy Efficiency and Conservation Act. We placed the revised draft before the Council of Common Interest (CCI) for expected consultation in the upcoming meeting. The act will include equipment performance standards, and would cover key electrical and gas equipment and appliances which are not yet covered.

30. **Supply Side Management**. We will continue to prioritize the use of gas and coal rather than fuel oil in electricity generation and remain committed to a transition to market-based allocation of natural gas in the medium-term. The Economic Coordination Committee has approved the policy directive to encourage the conversion of fuel oil-based GENCOs and Independent Power Producers (IPPs) to coal-based plants. To further improve supply, we will continue to rehabilitate generation plants, while upgrading electricity transmission and distribution facilities to reduce technical losses. We finalized the efficiency testing of fuel-based GENCOs and the current round of three rehabilitations in March 2014, which are expected to: (i) generate savings by next fiscal year; (ii) recover around 700 MW of capacity; and (iii) increase efficiency by 1–1.5 percent. Moreover, to enhance clean energy supply, we will continue with the development of hydropower projects—the cheapest source of supply. We will promote policies for private investment for power generation through both the entry of new players as well as expanding existing capacity of those IPPs systematically adhering to energy mix targets and least-cost generation plans. The expansions are expected to generate additional 2000 MW by 2016.

31. **Governance, Regulatory, and Transparency Improvements**. We continue to place high priority on improving energy sector governance and transparency. We have already hired entry and middle management positions to enhance the technical capacity of the regulatory body, the National Electric Power Regulatory Authority (NEPRA). In order to begin addressing administrative and technical constraints, we conducted a diagnostic study of the regulatory framework of the power sector and prepared an interim report in April 2014 (structural benchmark). We will begin implementing the findings of the report by initially filling the vacancies on the NEPRA Board by end-July 2014 (new structural benchmark). We aim to appoint individuals with legal, financial, regulatory and technical skills, and include the key performance indicators in the employment contract. The performance indicators of NEPRA will be a part of the annual performance report of NEPRA. NEPRA is also committed to streamlining the tariff determination process to four months by the next determination cycle. In the meantime, NEPRA has begun preparations for a multi-year tariff framework. The methodology for the framework was finalized in March 2014. To facilitate the transition, we will establish three year investment plans for at least three DISCOs by end-September 2014. The first phase of the determination and notification of multi-year tariffs will begin with these DISCOs by end-September 2015. We will continue to apply fuel price adjustments (FPAs) determined by NEPRA in its normal monthly schedule. We have set-up the Central Power Purchasing Agency (CPPA) by separating it from the National Transmission and Despatch Company (NTDC) and have amended the Articles of Association. To make CPPA operational, we issued the standard operating procedures for payments and settlements and key CPPA staff will be in place by end-June 2014.

32. **Energy public sector enterprise (PSE) reform**. The institutional capacity of all energy sector PSEs needs to be strengthened to allow them to operate independently from the Government as efficient commercial entities. We have already transferred governance of DISCOs, three GENCOs, and the NTDC to new boards of directors and management. We are committed to building the institutional capacity of the Water and Power Development Authority (WAPDA) through corporatization and commercialization, and we have begun to strengthen WAPDA's financial capacity by allowing the tariff to incorporate capital investment plans. We are also committed to ensure timely payments by NTDC/CPPA for all power purchased from WAPDA. In the medium term, we are committed to beginning privatizations, and to introducing competitive pricing and direct contracting between power producers and wholesale customers in the power sector.

33. **Oil and Gas Sector**

- **Supply**. To help tackle gas shortages, we have started efforts to import Liquefied Natural Gas (LNG). We finalized the evaluation and awarded an LNG services agreement in April, 2014, with a view toward receiving the first LNG imports by early 2015. Moreover, we will accelerate the development of domestic natural gas and continue to limit further expansion of the gas distribution networks for domestic consumption. We are committed to maintaining the priority ranking of the power sector to second (after households) and continue to divert the excess supply of gas to the most efficient power plants.

- **Pricing**. We will gradually rationalize gas prices to encourage new investment, promote efficiency in gas use, and assure that there will continue to be no fiscal cost from the gas sector. We have produced a gas price rationalization plan in December 2013 to address both production and consumption of gas.

  - We have begun implementing the new Petroleum Exploration and Production Policy 2012 (2012 Policy) with amendments for enhanced production from existing and new fields, and to further improve producer incentives. With price increases ranging from 2.8–3 U.S. dollars per MMBTU to 6–10 U.S. dollars per MMBTU, we are incentivizing producers to enhance production from existing fields as well as initiate new exploratory efforts. We have awarded 43 new blocks for exploration in new fields while finalizing the concession agreements for 7 blocks. During the next financial year we will award an additional 10–15 blocks. As new production and additional gas supply from imports come on line, the cost of this gas will continue to be fully reflected in the base tariff on a semiannual basis, beginning with the next adjustment on July 1, 2014;

  - To better allocate gas consumption, we adjusted the weighted average consumer prices at end-December 2013, through the application of the GIDC, which will be further adjusted with the FY 2014/15 budget to generate 0.55 percent of GDP fiscal revenues.

  - We are evaluating the downstream gas business with the objective of bringing in efficiencies in the transmission and distribution segments for better operation of the market system. In this respect, we will hire consultants by end-December 2014 to conduct the study on the restructuring and unbundling of the two gas utility companies. This study will help formulate recommendations based on international best practices including segregating the gas network into one transmission and multiple distribution companies. These companies will further be internally segregated into independent profit and cost centers to ensure maximum efficiency. A mechanism will be developed for determining separate transmission and distribution tariffs and a new pricing mechanism for sale of natural gas to various sectors of the economy will be devised to account for the higher cost of additional gas in the system, especially the imported gas.

- **Governance**. We have been enhancing the capacity of Ministry of Petroleum and Natural Resources to fully implement the 2012 Policy, streamline approval processes, and complete the conversion to the 2012 Policy for those Petroleum Concession holders who wish to do so. We will further encourage bilateral contracting between producers and consumers and improve rules for third party access to the gas transmission system. The current level of unaccounted for gas losses (UFG) is on average 11 percent due to commercial and technical losses. We will expedite the work on National Gas Efficiency Project (NGEP) in coordination with IFIs. We are pursuing companies at the highest level to reduce losses benchmarking international standards through investment measures, managerial and administrative improvements, and through building the capacity of the gas distribution companies. In January 2014, the President has promulgated the Gas (Theft Control and Recovery) Ordinance 2014, which was sent to the

Parliament. Finally, we affirm our commitment to enhance the capacity of Oil and Gas Regulatory Authority (OGRA).

Improving the business climate, liberalizing trade, and reforming public enterprises

34. **We are working to improve the business climate, the trade regime, and PSEs to increase foreign and domestic private investment and boost economic growth**.

35. **Business Climate**. Private investment and growth are hampered by impediments in the legal framework for creditors' rights and contract enforcement, barriers to new business start-ups, complicated legal and taxation requirements, and impaired access to finance hamper the business climate and investment.

- ***Contract enforcement***. While the draft Corporate Rehabilitation Act is prepared (¶[19]), we completed in March 2014 a study to identify the needs of corporations to speed up rehabilitation of weak but viable companies. Based on the findings of the study, we will expedite the liquidation of the insolvent entities. In addition, we have begun expanding the use of Alternative Dispute Resolution (ADR) Mechanisms beyond Karachi. ADR is now open to all businesses in Lahore.

- ***Start-ups***. The FBR, in coordination with SECP, Employees Old-Age Benefits institute (EOBI), and other stakeholders (including provinces) have approved a plan to simplify procedures and costs for setting up businesses and have prepared another for paying taxes in Pakistan. We will finalize a time-bound detailed implementation plan in coordination with IFIs and after consultation with key stakeholders by end-June, 2014.

- ***Access to credit***. Access to finance for poor and marginalized segments including micro, small and rural enterprises remains very limited owing to both demand and supply-side constraints. The SBP, with the help of World Bank experts, is developing a comprehensive National Financial Inclusion Strategy under its financial inclusion program to address industry bottlenecks and barriers in access of micro, small and rural enterprises to financial services. The strategy will include regulatory reforms to encourage microfinance banks (MFBs) to upscale their credit operations, developing risk mitigation mechanism, and market interventions for strengthening credit enhancement mechanisms, improving market information and infrastructure, product innovation, improved delivery mechanisms, financial literacy, and consumer protection. In this regard, SBP and the World Bank (WB) have started a mapping exercise to take stock of existing initiatives and identify gaps for future interventions. Following the stock taking, SBP and WB will be conducting detailed consultations with all stakeholders to develop the NFIS.

36. **Trade Policy**. Trade policy reforms will increase consumer welfare and stimulate growth as a result of increased competition. Simplifying tariff rates, phasing out statutory regulatory orders (SROs) that establish special rates and/or nontariff trade barriers in some 4,000 product areas, and improving trade relations should deliver the much needed competitive environment.

- ***Tariff simplification***. We are working on simplifying the tariff structure to move over three years to a simple, transparent framework, with four slabs between 0 and 25 percent rates with few exceptions. We are on track to finalize the design of the new system by end-May 2014.The phase-in of the revised tariff rates and phase-out of trade SROs would begin with effect in July 2014 (see also ¶14). For FY2014/15, we will move from eight tariff slabs to six by moving most items currently at 30 and 35 percent to the 25 percent rate. Implementation of the new tariff structure would be completed by July 2017.

- ***Improved trade relations***. We are implementing a strategy to take full advantage of trade preferences available from the EU who have extended GSP plus benefits (i.e., 0 percent customs duty) from January 1, 2014 on a broad range of Pakistan's exports. We remain committed to promoting trade with regional countries, especially under various regional trade arrangements.

37. **Public Sector Enterprises**. We are working towards reforming or privatizing public sector enterprises (PSEs), focusing on limiting poor performance and improving public sector resource allocation. The Cabinet Committee on Privatization (CCOP) approved a list of 31 PSEs for action, and we have developed a plan to sequence the capital market and pre-privatization restructuring for these firms. The privatization program is aimed at offering and/or marketing one transaction in each quarter during the upcoming year.

- ***Capital Market Transactions Roadmap***. We have identified eleven companies, (listed in the TMU), in the oil and gas, banking and insurance, and power sectors for block sales and primary or secondary public offerings. We hired three financial advisors for United Bank Limited (UBL), Pakistan Petroleum Limited (PPL) and Oil and Gas Development Company Limited (OGDCL) in May 2014. Subject to investor interest and global market conditions, we will offer minority shares in UBL and PPL to domestic and international investors by end-June 2014 (new structural benchmark). Furthermore, we will hire financial advisors for Allied Bank Limited (ABL) and Habib Bank Limited (HBL) by end-September 2014 to market minority stakes within six months thereafter.

- ***Strategic Private Sector Participation***. Strategic partnerships will act as a catalyst in unlocking the potential of PSEs through their managerial and investment participation. They can also increase the value of Government's residual shareholding. We have identified 17 companies (listed in the TMU). For profitable PSEs, we will make efforts to balance the objectives of sale proceeds while adequately addressing labor market issues and social implications. We will hire a financial advisor for National Power Construction Co. (NPCC) by end-June 2014 to finalize the sale offer by end-December 2014. We will also appoint financial advisors for share sales of Faisalabad Electric Supply Company (FESCO) and Northern Power Generation Company Limited (NPGCL) by end-June 2014.

- ***Restructuring***. We will continue our restructuring plans and hire professional chief executives and board members for those enterprises with a corporate structure in line with the corporate governance rules. We are developing medium-term action plans to restructure Pakistan International Airlines (PIA), Pakistan Steel Mill (PSM) and Pakistan Railways (PR). Specifically,

- **Pakistan International Airlines**. We will appoint a financial advisor by end-June 2014 (structural benchmark) to seek potential options for restructuring and strategic private sector participation in the company. In the meantime, PIA will continue leasing more efficient airplanes and rationalizing routes.

- **Pakistan Steel Mills**. We have appointed a professional board and approved a comprehensive restructuring plan in April 2014 to prepare for potential strategic private sector participation in the company.

- **Pakistan Railways**. Aging and shortage of equipment, overstaffing, and large debts continue to weigh on railway operations. Nevertheless, we have improved revenue in the first nine months of the year through rationalization of tariffs and expenditures and improved occupancy rates. We finalized a plan that identifies the needs of Pakistan Railways in April 2014 and are developing a comprehensive restructuring plan, which will include improvements in business processes and institutional framework, financial stability, and service delivery. The plan will be finalized by end-September 2014. We are also in the process of reviving the Railway Board and will finalize the appointment of Board members by end-July 2014.

Table 1. Pakistan: Quantitative Performance Criteria and Indicative Targets for FY2013/14 and FY2014/15 1/

(In billions of rupees, at program exchange rates, unless otherwise specified)

	FY2012/13	FY2013/14								FY2014/15		
	end-June	end-September		end-December		end-March		end-June	end-September	end-December	end-March
	Actual	First Review	Actual	Second Review	Actual	Third Review	Actual	Program		Projection	
Performance Criteria											
Floor on net international reserves of the SBP (millions of U.S. dollars) 2/, 3/ 4/	-2,437	-2,850	-3,154	-5,107	-4,547	-2,872	-2,140	1,800	3,000	3,500	4,500
Ceiling on net domestic assets of the SBP (stock, billions of Pakistani rupees) 5/, 6/	2,402	2,877	2,595	2,968	2,821	2,609	2,650	2,324	2,306	2,420	2,324
Ceiling on overall budget deficit (cumulative, excluding grants, billions of Pakistani rupees) 7/	2,012	419	297	882	572	1,209	982	1,464	376	711	1,095
Ceiling on SBP's stock of net foreign currency swaps/forward position (millions of U.S. dollars)	2,255	2,255	1,775	2,255	2,650	2,255	2,135	2,150	1,900	1,775	1,775
Ceiling on net government borrowing from the SBP (including provincial governments, stock, billions of Pakistani rupees) 1/, 8/	2,168	2,690	2,521	2,560	2,611	2,390	2,227	2,240	2,070	2,000	1,905
Continuous Performance Criterion											
Accumulation of external public payment arrears by the general government (continuous)	0	0	0	0	0	0	0	0	0	0	0
Indicative Targets											
Cumulative floor on Targeted Cash Transfers Spending (BISP) (billions of Pakistani rupees)	54	19	14	32	16	48	49	62	14	44	69

Sources: Pakistani authorities; and Fund staff estimates.

1/ All items as defined in the TMU. Fiscal year runs from July 1 to June 30.
2/ End-September 2013 target of -2499 has been adjusted downward by 351 millions of U.S. dollars to reflect a shortfall in multilateral/bilateral disbursements to Pakistan. End-December 2013 target is modified from -2,090 millions of U.S. dollars.
3/ End-December 2013 target of -4130 has been adjusted by -977 millions of U.S. dollars to reflect a shortfall in multilateral/bilateral disbursements to Pakistan.
4/ End-March 2014 target of -2750 has been adjusted by -122 millions of U.S. dollars to reflect a shortfall in multilaterial/bilateral inflows to Pakistan.
5/ End-December 2013 NDA target of 2901 has been adjusted upward by 67 billions of PRs to reflect a shortfall in multilateral/bilateral disbursements to Pakistan
6/ End-March 2014 NDA target of 2627 has been adjusted downward by 18 billions of PRs to reflect an excess in multilateral/bilateral disbursements to Pakistan
7/ Excluding grants, FY2012/13 overall budget deficit is a stock.
8/ FY 2012/13, total stock of government debt as of June 30, 2013.

Table 2. Pakistan: Structural Benchmarks Under Extended Fund Facility

Item	Measure	Time Frame (by End of Period)	Comment
Prior Actions			
1	Finalize the determination and notification of electricity tariffs for FY2013/14.		
2	Complete a calendar to eliminate the vast majority of SROs granting tax exemptions or concessions and convert the remainder into regular legislation		
3	Send to parliament a FY2014/15 budget proposal consistent with the program objectives		
Structural Benchmarks			
Fiscal sector			
1	Develop and finish launching initiatives to enhance revenue administration for sales tax, excises, and customs similar to that prepared for income tax.	end-December 2013	Met
2	Announce a rationalization plan for gas prices which will involve a levy to generate 0.4 percent of GDP fiscal savings.	end-December 2013	Met
3	Increase the issuance of first notices (u/s 114) to 75,000 and follow up with a second notice (u/s 122c) to 75 percent of those who did not respond satisfactorily to their first notice within 60 days by end-March, 2014. Issue a provisional tax assessment to 75 percent of those who did not respond satisfactorily within 60 days to the second notice by end-March, 2014.	end-March 2014	Met
4	Eliminate exemptions and concessions granted through SROs for an amount consistent with the fiscal deficit reduction objective in the FY2014/15 budet.	end-June-2014	
5	Enact amendments to the relevant tax laws (as defined in the TMU) and submit amendments to the Anti-Money Laundering Act (AMLA) to Parliament	end-September 2014	
Monetary sector			
6	Enact the amendments to the SBP law to give SBP autonomy in its pursuit of price stability as its primary objective, while strengthening its governance and internal control framework, in line with Fund staff advice.	end-June 2014	
Financial sector			
7	Prepare detailed plans to achieve compliance of all banks that fall below minimum capital adequacy, including specific actions, end dates, and contingency arrangements. Also detail a plan for recapitalization, consolidation or liquidation of banks that fall below the minimum capital requirement but not CAR.	end-December 2013	Met at end-Feb, 2014
8	Enact the Deposit Protection Fund Act, in line with Fund staff advice.	end-June 2015	
9	Enact the Securities Bill, in line with Fund staff advice.	end-December 2014	
Structural Policies			
10	Develop and approve PSE reform strategy for thirty firms among the 65 PSEs approved for privatization by the Council of Common Interest (CCI).	end-September 2013	Met
11	Hire a professional audit firm to conduct a technical and financial audit of the system to identify the stock and flow of payables at all levels of the energy sector (including Power Sector Holding Company Limited).	end-November 2013	Met
12	Make Central Power Purchasing Agency (CPPA) operational by separating it from the National Transmission and Despatch Company (NTDC), advertise key staff positions, issue CPPA rules and guidelines, and initiate the payment and settlement system.	end-December 2013	Met at end-Feb, 2014
13	Enact the amendments to the Pakistan Penal Code 1860 and the Code of Criminal Procedures 1898.	end-December 2013	Met
14	Initiate revenue based load shedding in six remaining electricity distribution companies .	end-January 2014	Met
15	Hire three financial advisors for three PSEs in the capital market transactions list and three financial advisors for the three PSEs in the strategic private sector enterprises list for privatization in the TMU.	end-March 2014	Partially met
16	Conduct a diagnostic study of the regulatory framework of the power sector and prepare an interim report.	end-April 2014	Met
17	Privatize 26 percent of PIA's shares to strategic investors.	end-December 2014	
New Structural Benchmarks			
18	Improve the internal operations of the SBP by: i) reestablishing an advisory monetary policy committee to advise the Board on its policy decisions; ii) establishing a Board committee to centralize and oversee risk management activities across the bank; and iii) begin publishing summaries of the monetary policy proceedings of the Board meetings and monetary policy committee deliberations.	end-August 2014	
19	Fill the vacancies in the NEPRA Board.	end-July 2014	
20	Offer the minority shares in United Bank Limited and Pakistan Petroleum Limited to domestic and	end-June 2014	
21	Approve an administrative order to consolidate the responsibilities of public debt management in the debt management office.	end-September 2014	

Attachment II. Technical Memorandum of Understanding (TMU)

June 19, 2014

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

A. Quantitative Targets

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

Performance criteria

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

Continuous performance criteria

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

Indicative targets

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

B. Definitions of Monitoring Variables

2. **The net international reserves** (stock) of the (SBP) are defined as the dollar value of the difference between usable gross international reserve assets and reserve-related liabilities, evaluated at the program exchange rates. On October 31, 2013, the NIR of Pakistan amounted to US$4551 million.

3. Usable gross international reserves of the SBP are those readily available claims on nonresidents denominated in foreign convertible currencies and controlled by the monetary authorities for meeting balance of payments financing needs, for intervention in exchange markets to affect the currency exchange rate, and for other related purposes. Gross official reserves include (i) holding of foreign currencies, (ii) holdings of SDRs, (iii) the reserve position in the IMF, and (iv) holdings of fixed and variable income instruments. Excluded from usable reserves, inter alia, unless there is also a reserve-related liability associated with it, are: (i) claims on residents; (ii) assets in nonconvertible currencies; (iii) precious metals (iv) illiquid assets; (v) assets that are pledged or collateralized.

4. Reserve-related liabilities of the SBP include all foreign exchange liabilities to residents or nonresidents, including (i) foreign currency liabilities with remaining maturity of one year or less, (ii) any foreign exchange liabilities arising from derivatives (such as futures, forwards, swaps, and options) on a net outstanding basis—defined as the long position minus the short position, (iii) outstanding IMF credits to Pakistan, (iv) foreign exchange deposits with the SBP of foreign governments, foreign central banks, foreign deposit money banks, international organizations, and foreign nonbank financial institutions, as well as domestic financial institutions. General government foreign exchange liabilities at the SBP will not be included in reserve-related liabilities.

5. Aggregate net position in the foreign exchange derivatives is defined as the aggregate net positions in forward and futures in foreign currencies of the SBP vis-à-vis the domestic currency (including the forward leg of currency swaps). The SBP's aggregate position was –US$2.3 billion at end-June 2013.

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

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

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

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

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

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

- **Net external financing**, excluding valuation gains and losses.
- **Change in net domestic credit from the banking system**, excluding valuation gains and losses from deposits denominated in foreign currency.
- **Change in the net domestic nonbank financing**, excluding valuation gains and losses. These include (i) domestic privatization receipts transferred from the privatization accounts to the budget, (ii) the stock of issued government securities held outside the general government and the banking system, net of valuation changes, (iii) net deposits and reserves received by the government (public accounts deposits), (iv) any other government borrowing from domestic nonbank sources net of repayments, minus (v) government deposits with nonbank financial institutions.
- **Total external grants to the federal and provincial governments**. These are defined as the sum of project grants, cash external grants for budgetary support, capital grants reflecting the principal amounts of external debt cancellation or swaps, and other grants.

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

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

14. Structural Benchmark on hiring of six transaction advisors for end-March 2014 is defined as follows: Three transaction advisors to undertake the sale of minority shares for three PSEs from the list of capital market transactions with at least one offering in the domestic and one offering in international markets. From the list of strategic private sector participation one transaction advisor for electricity distribution company and one generation company, and finally one transaction advisor to undertake the restructuring of Pakistan International Airlines Corp (PIAC) and will seek for a strategic investor.

15. The "relevant tax laws" in the structural benchmark on "enactment of amendments to the relevant tax laws and submission of amendments to the Anti-Money Laundering Act (AMLA) for end-June 2014" is defined as follows: Income Tax Ordinance, 2001; the Federal Excise Act, 2005; the Sales Tax Act, 1990; the Customs Act, 1969; and any other relevant law.

16. Electricity Tariff Pricing Formulas and Definitions (¶26 of the MEFP)

(i) The increase in the weighted average tariffs by 4 percent on electricity consumers' electricity consumption is defined as follows

Weighted Average Notified Tariff for electricity consumers =

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

+ Change in the Residential Users Tariff Rate for each category above 200kWh x DISCOs' estimated sales to Residential Users for each category

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

+ Change in the Single Point Supply for further distribution Tariff Rate for each category x DISCOs' estimated sales to Point Supply for further distribution Users for each category)

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

+ Change in the Other users' Tariff Rate for each category x DISCOs' estimated sales to Other Users for each category)

/ DISCO's total sales to Industrial, Residential Users consuming more than 200kWh, Commercial, Single Point Supply, Other Users and AJ&K Users

= 4 percent

(ii) Current notified electricity tariffs for users at 0-50 kWh will be retained.

C. Adjustors

17. **The floor on NIR will be adjusted upward** (downward) by the cumulative excess (shortfall) of cash inflows from multilateral and bilateral creditors, Coalition Support Fund (CSF), and bond issuance relative to projected inflows (Table 2), the adjustor will be modified for the end-June 2014 to exclude the proceeds of the US$2 billion Eurobond transaction. Cumulative cash inflows are defined as external disbursements (including grants) from official multilateral creditors (including, but not limited to Asian Development Bank, Islamic Development Bank, and World Bank), official bilateral creditors (including, but not limited to DFID, UK, USAID), and external bond placements that are usable for the financing of the central government budget.

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

19. **The ceiling on the consolidated overall budget deficit** (excluding grants) for FY13/14 and FY14/15 will be adjusted upward for the cumulative excess in net external program financing in rupee terms for up to PRs 15.0 billion at end-September, PRs 25.0 billion at end-December, PRs 42.0 billion at end-March, and PRs 50 billion at end-June. The ceiling for FY13/14 and FY14/15 will be adjusted downward for any shortfall in federal PSDP spending below PRs 25 billion at-end September, PRs 80 billion at end-December, PRs 243 billion at end-March and PRs 410 at end-June. The ceiling will be adjusted downward for any shortfall in the targeted cash transfers (BISP). The ceiling will be adjusted upward for over performance in the BISP up to PRs 12 billion from their indicative targets.

D. Public Sector Enterprises

List of Companies for **Capital Market Transactions**

- Oil and Gas Development Co. Ltd (OGDCL)
- Pakistan Petroleum Ltd (PPL)
- Mari Petroleum Ltd.
- Government Holding Private Ltd (GHPL)

- Pak Arab Refinery Ltd (PARCO)
- Habib Bank Limited (HBL)
- United Bank Limited(UBL)
- Allied Bank Limited (ABL)
- National Bank Limited (NBP
- State Life Insurance Corp. (SLIC)
- Kot Addu Power Company Ltd. (KAPCO)

List of Companies for **Strategic Private Sector Participation**

- National Insurance Co. Ltd. (NICL)
- National Investment Trust Ltd. (NITL)
- Small & Medium Enterprise (SME) Bank
- Pakistan Reinsurance Co Ltd. (PRCL)
- Heavy Electrical Complex (HEC)
- Islamabad Electric Supply Co. Ltd (IESCO)
- Faisalabad Electric Supply Co. Ltd (FESCO)
- Hyderabad Electric Supply Co. Ltd (HESCO)
- Jamshoro Power Generation Co. Ltd (JPCL)
- Northern Power Generation Co. Ltd (NPGCL—Thermal Power Station—Muzaffargarh
- National Power Construction Co. (NPCC)
- Pakistan Steel Mills Corp (PSMC)
- Pakistan Engineering Co Ltd (PECO)
- Pakistan International Airlines Corp (PIAC)
- Pakistan National Shipping Corp (PNSC)
- Convention Centre, Islamabad.
- PIA Investment Ltd—Roosevelt Hotel NY & Scribe Hotel—Paris

List of Companies for **Restructuring followed by Privatization**

- Pakistan State Oil Co Ltd (PSO)
- Sui Southern Gas Co Ltd (SSGC)
- Sui Northern Gas Pipelines Ltd (SNGPL)

E. Program Reporting Requirements

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

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
State Bank of Pakistan (SBP)	SBP balance sheet	Summary	Weekly	First Thursday of the following week
	SBP balance sheet	Summary at program exchange rates; and by official exchange rates	Monthly	Within 15 days of the end of each month
	Monetary survey	Summary banking system balance sheet for the central bank at both program exchange rates and by chart of accounts at actual official exchange rates; the consolidated balance sheet of commercial banks at actual official exchange rates	Monthly	Within the first three days of the following month.
	International reserves	By (i) program exchange rates; and (ii) at actual official exchange rates.	Daily	The following working day
	Foreign exchange market	Market exchange rates (buying and selling); weighted average customer exchange rate; monthly trade volume, and high and low exchange rate of the interbank, the KERB market.	Daily/ Monthly	Within one day/ monthly within 5 working day
	Foreign exchange market	SBP foreign exchange operations, and intervention,(volume)	Daily	Within one day
	Foreign exchange market	SBP operation against the domestic currency in swap/forwards by (volumes)	Daily	Within one day
	Foreign exchange market	Breakdown of short, long, counterparts, of the swap/forward contracts	Monthly	Third working day of the following month
	Foreign exchange market	Outstanding swap/forward positions by maturity buckets, and counterparties.	Monthly	Third working day of the following month
	Net International Reserves	Net International reserves at program exchange rates as defined in TMU, including a breakdown by currency and specification of *nostro* balances with foreign branches of National Bank of Pakistan.	Quarterly	Seventh working day after quarter end
	External financing	Foreign assistance received and projections for the coming four quarters. Please categorize all grants and loans by program/project, and the amounts received/expected in cash.	Quarterly	Within 15 days of the end of each quarter
	Interbank money market	Daily interbank repo volume and interest rate of trades	Daily	Within one day
	SBP operations	Repo (reverse repo) operations, open market operations,	Weekly	First Monday of the following week
	Bank liquidity	Excess reserves, in local currency	Bi-weekly	With a lag of 15 days
	T-bill and coupon bond financing, SBP securities	Auction data: date, original and remaining maturities, issuance volume, allocation, average yield and coupon yield (if available)	Fortnightly	Last working day of the fortnight
	Banking data	Sectoral distribution of loans and deposits; loans and deposits by local and foreign currency; deposit and lending rates,;	Monthly	Within 25 days of the end of each month.
	Banking data	Loan maturities	Quarterly	Within 45 days of the

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
				following quarter
	Banking indicators	Capital adequacy; asset composition and quality; profitability; liquidity; open FX positions;	Quarterly	Within 45 days of the following quarter
	Banking sector stress tests	Results of stress tests on exchange rate, liquidity, and credit risk	Quarterly	Within 60 days
	Transfers	Workers' remittances.	Monthly	Within 25 days of the following month
	Other monetary data	The SBP survey, ODCs and DCs published in IFS.	Monthly	Within 45 days of the end of each month
	Balance of payments	Detailed export and import data Detailed balance of payments data	Monthly	Within 28 days of the end of each month
	Privatization receipts	Balance on the PC Fund account; gross inflows into and outflows from the PC Fund account during the month, specifying the nature of each transaction	Quarterly	Within seven days of the end of each quarter
Ministry of Finance (MOF)	External debt	Disbursements and stock of outstanding short-term and contracting or guaranteeing and outstanding stock of medium-and long-term external debt of the government, the SBP, and state-owned companies; any stock of arrears on external debt service and outstanding stock of government guarantees and external arrears.	Monthly	Within 25 days of the following month
	External financing	Foreign assistance received and projections for the coming four quarters. Please categorize all grants and loans by program/project, and the amounts received/expected in cash and in kind.	Quarterly	Within 15 days of the end of each quarter
	Federal government	State budget	Monthly	Within 30 days of the end of each month
	Consolidated general government	Federal and provincial governments	Quarterly	Within 45 days of the end of each quarter
	Consolidated general government	Federal and provincial governments	Annual	Within 180 days of the end of each year
Pakistan Bureau of Statistics (PBS)	SPI, CPI, WPI	Detailed monthly price indices	Monthly	Within five days of the following month
	CPI	Index of core inflation	Monthly	Within 21 days of the end of each month
	Tax arrears	By category	Quarterly	Within five days of each quarter
		By type of tax	Quarterly	Within 30 days of the end of each quarter (monthly data provided on a quarterly basis)

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
Federal Board of Revenue (FBR)	Revenue collection Tax credits	Total revenue collected separately by the tax administration and customs administration, including revenue by individual tax, and social contributions.	Monthly	Within 7 days of the end of each month
	VAT refund claims in arrears	For the 30 largest debtors	Quarterly	Within 30 days of the end of each quarter
	Automated VAT refunds	Detailed data, by type of tax, of outstanding tax credits for all types of tax revenues	Quarterly	Within 45 days of the end of each quarter
		Number of refunds that were processed automatically (share of total refunds); total value of automated and automatic refunds and offsets; average waiting time (days) to receive refund	Quarterly	Within 45 days of the end of each quarter
	Large taxpayers	Data on the number of taxpayers and amount of taxes managed by the large tax payer units (LTUs)	Quarterly	Within 45 days after the end of each quarter
	Import data	1. Total value of recorded imports 2. Total value of duty-paid recorded imports; 3. Number of total transactions involving recorded imports; 4. Number of total transactions involving nonduty free recorded imports	Quarterly	Within 30 days of the end of each quarter
	Audits	Percentage of selected companies and identified revenue from audits	Quarterly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
Ministry of Water and Power		Key Power Sector Statistics (Please see the attached template) Cumulative Monthly Subsidy Position (Rs. Billion) PEPCO Month End Payables and Receivables Positions And Aging Schedule, Rs. Billion Receivables Positions - Total and DISCO-wise Break-up CPPA/PEPCO Month-wise Consolidated Cash Flow AT&C Statistics Monthly TDS Claims by DISCOs and Total Inter Corporate Circular Debt Sheet Prepared by Ministry of Finance DISCOs Consolidated Income Statement Net Electrical Output & Power Purchase Price by Source, GWh Generation, Demand and Shortfall for FY10 to date Net Electrical Output (MkWh) Plant and Fuel-wise Detail	Quarterly	Within 30 days

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		Working Capital Loans For each loan type		
	Domestic expenditure arrears	Energy arrears	Quarterly	Within 45 days of the end of each month for government arrears
		Determined and Notified Tariff's for each User and User Group (Please see template)	Annual	Within 30 days of determination and notification
Ministry of Petroleum and Natural Resources		Gas supply Gas prices	Quarterly on monthly frequency	Within 30 days from the end of the quarter
OGRA		UFG losses	Quarterly	Within 30 days from the end of the quarter
BISP	Targeted cash transfers	Coverage (number of beneficiaries paid) and payment by conditional and unconditional transfers.	Quarterly	Within 30 days from the end of the quarter

Table 1. Exchange Rates of the SBP

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

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

Table 2. Projected Disbursements to Pakistan

(In millions of U.S. dollars)

	Sep-13	Dec-13	Mar-14	Jun-14		Sep-14	Dec-14	Mar-15	Jun-15
				Projection	Revised Projection 3/	Projection			
Multilateral and bilateral disbursement	557	830	951	3,219	3,751	1,584	1,932	3,049	2,764
of which: in cash 2/	387	641	1,861	2,830	3,247	1,297	1,582	2,498	2,264
Euro Bond issuance	0	0	0	500	2,000	0	500	500	0
Coalition Support Fund	0	322	352	350	375	350	350	350	350
Other 1/	0	0	0	2,500	916	0	900	350	500
Gross Inflows	557	1,152	1,303	6,569	7,042	1,934	3,682	4,249	3,614
of which: in cash	962	963	2,213	6,180	6,538	1,647	3,332	3,698	3,114
Debt service	747	823	1,033	1,320	1,504	1,026	1,244	1,613	992
Memorandum items									
Gross International Reserves	4,694	3,478	5,366	9,308	8,676	10,325	10,931	12,196	13,326
Program Net International Reserves	-2,499	-4,130	-2,750	1,800	1,800	3,000	3,500	4,500	5,500

1/ Includes privatization and 3G licenses.
2/ Numbers need to be confirmed with the MoF.
3/ As of May 25, 2014.

Table 3. External Inflows to the General Government
(In millions of US dollars)

	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15
Non Tax revenue	322	352	891	350	350	350	350
Coalition Support Fund	322	352	375	350	350	350	350
3G Licences	0	0	516	0	0	0	0
Grants	100	75	195	174	191	127	191
External interest payments	215	155	286	263	283	291	313
Net external debt financing	50	-115	4681	610	1302	2125	1905
Disbursements	645	760	5386	1371	2257	3445	2578
of which budgetary support	309	285	4540	1034	1812	2931	2270
Amortization	594	875	705	761	955	1320	673
Privatizations	0	0	400	0	900	350	500
Memorandum item							
Program financing	409	360	5135	1208	2903	3409	2961

Table 4. Government Sector (Budgetary Support)

(End-of-period stocks/PRs. Millions)

Item	June 30, 2013	Prov. March 31, 2014
Central Government	**5,561,994**	**6,232,568**
Scheduled Banks	**3,320,870**	**3,698,224**
Government Securities	1,117,115	1,775,122
Treasury Bills	2,611,512	2,319,986
Government Deposits	-407,757	-396,884
State Bank	**2,241,124**	**2,534,344**
Government Securities	3,127	2,786
Accrued Profit on MRTBs	44,959	51,158
Treasury Bills	2,275,183	2,776,202
of which: MTBs created for replenishment of cash balances	2,274,675	2,775,693
Treasury Currency	8,653	8,653
Debtor Balances (Excl. Zakat Fund)		
Government Deposits	-96,260	-309,918
(Excl. Zakat and Privatization Fund)		
Payment to HBL on a/c of HC&EB	-287	-287
Adjustment for use of Privatization Proceeds		
for Debt Retirement	5,749	5,749
Provincial Governments	**-315,607**	**-571,130**
Scheduled Banks	**-287,393**	**-314,702**
Advances to Punjab Gov Advances to Punjab Government for Cooperatives	1,024	1,024
Government Deposits	-288,417	-315,726
State Bank	**-28,214**	**-256,428**
Debtor Balances (Excl. Zakat Fund)	13,715	816
Government Deposits (Excl.Zakat Fund)	-41,930	-257,243
Net Govt. Budgetary Borrowings		
from the Banking system	**5,246,387**	**5,661,438**
Through SBP	2,212,910	2,277,916
Through Scheduled Banks	3,033,477	3,383,522
Memorandum Items		
Accrued Profit on SBP holding of MRTBs	**44,959**	**51,158**
Scheduled banks ' deposits of Privitization Commission	**-5,433**	**-5,987**
Outstanding amount of MTBs (Primary market; discounted value)	**2,529,412**	**2,265,393**
Net Govt. Borrowings (Cash basis)		
From Banking System	**5,124,762**	**5,561,675**
From SBP	2,167,951	2,226,758
From Scheduled Banks	2,956,811	3,334,916