January 2001
IMF Country Report No. 01/24

Pakistan: 2000 Article IV Consultation and Request for Stand-By Arrangement--Staff Report; Staff Supplement; Public Information Notice and Press Release on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2000 Article IV consultation with Pakistan and request for Stand-By Arrangement, the following documents have been released and are included in this package:

- the staff report for the combined 2000 Article IV consultation and request for Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended in September 2000, 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 November 15, 2000.** 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 **November 28, 2000** updating information on recent economic developments.
- a Public Information Notice (PIN) and a Press Release, summarizing the **views of the Executive Board as expressed during its November 29, 2000, discussion** of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.

The documents listed below have been separately released.

Letter of Intent by the authorities of Pakistan, together with Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding*
Selected Issues and Statistical Appendix
Report on Observance of Standards and Codes

*Also included in staff report

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to Publicationpolicy@imf.org.

Copies of this report are available to the public from
International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623 7430 • Telefax: (202) 623 7201
E-mail: publications@imf.org • Internet: http://www.imf.org

Price: $15.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

PAKISTAN

Staff Report for the 2000 Article IV Consultation and Request for Stand-By Arrangement

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

(In consultation with other departments)

Approved by P. Chabrier and G. Russell Kincaid

November 15, 2000

Contents | Page

Tables

Charts

Text Boxes

Appendices

Attachment

List of Acronyms

AGPR	Accountant General Pakistan Revenue
AJK	Azad Jammu and Kashmir
AsDB	Asian Development Bank
CBR	Central Board of Revenue
CDNS	Central Directorate of National Savings
CEC	Cotton Export Corporation
CIRC	Corporate and Industrial Restructuring Corporation
CIRR	Commercial Interest Reference Rates
DBC	Dollar Bearer Certificate
DFIs	Development Finance Institutions
DSC	Defense Savings Certificate
EFS	Export Finance Scheme
FATA	Federally Administered Tribal Areas
FCA	Foreign Currency Account
FCBC	Foreign Currency Bearer Certificate
FCD	Foreign currency deposit
FCEF	Foreign Currency Export Facility
FEBC	Foreign Exchange Bearer Certificate
FIBR	Floating interbank market exchange rate
FIBs	Federal Investment Bond
FMC	Fiscal Monitoring Committee
FSAP	Financial Sector Assessment Program
HUBCO	Hub Power Corporation
IDB	Islamic Development Bank
IDF	Institutional Development Fund
IFIs	International Financial Institutions
ILO	International Labor Organization
IPEC	National Program for the Elimination of Child Labor
IPPs	Independent Power Producers
IPRSP	Interim Poverty Reduction Strategy Paper
IRUDP	Integrated Rural and Urban Development Program
KAPCO	Kot Addu Power Corporation
KESC	Karachi Electricity Supply Corporation
LPG	Liquefied Petroleum Gas
MEFP	Memorandum on Economic and Financial Policies
MOF	Ministry of Finance
NBFIs	Nonbank Financial Institutions
NBP	National Bank of Pakistan
NCBs	Nationalized Commercial Banks
NDA	Net domestic assets
NFA	Net foreign assets

NFC	National Finance Commission
NGOs	Nongovernmental organizations
NHA	National Highway Authority
NPL	Nonperforming loans
NSS	National Savings Schemes
NTN	National Taxpayer Number
NWFP	North West Frontier Province
PIFRA	Pakistan Improvement of Financial Reporting and Accounting
PPAs	Power Purchase Agreements
PRSP	Poverty Reduction Strategy Paper
PSDP	Public Sector Development Program
PSO	Pakistan State Oil
RECP	Rice Export Corporation of Pakistan
ROSC	Report on the Observance of Standards and Codes
SAL	Structural Adjustment Loan
SAP	Social Action Program
SBP	State Bank of Pakistan
SLIC	State Life Insurance Company
SME	Small and Medium-sized enterprises
SPI	Sensitive price indicator
SRO	Statutory Regulatory Order
SSGCL	Sui Southern Gas Corporation Limited
WAPDA	Water and Power Development Authority

I. Introduction and Background

1. Discussions for the 2000 Article IV consultation and an economic adjustment and reform program were held in Islamabad during May 17–June 3 and September 5–20, 2000.[1] Mr. Aninat met with the Chief Executive of Pakistan in New York in September, and the Managing Director and Mr. Aninat met with the Finance Minister during the Annual Meetings in Prague. Initial program discussions were oriented toward an arrangement under the Poverty Reduction and Growth Facility (PRGF), but immediate stabilization requirements shifted the focus to a Stand-By Arrangement.

2. Arrangements under the Extended Fund Facility (EFF) and the Poverty Reduction and Growth Facility (PRGF), amounting to SDR 454.92 million (44 percent of quota) and SDR 682.38 million (66 percent of quota), respectively, that were approved on October 20, 1997, expired on October 19, 2000. The second annual PRGF arrangement and a purchase for the equivalent of SDR 352.7 million under the Compensatory and Contingency Financing Facility (CCFF) were approved by the Executive Board on January 14, 1999, at which time the last Article IV consultation was also concluded,[2] while the third review under the extended arrangement was concluded on May 24, 1999. Subsequently, the program went off track and no further purchases under the arrangements were made. The Board discussed fiscal data revisions and misreporting issues on April 28, 2000, following which Pakistan repurchased the equivalent of SDR 40.95 million.[3] As of September 30, 2000, total Fund credit and loans outstanding to Pakistan amounted to SDR 1,071.9 million (103.7 percent of quota).

3. In the last Executive Board discussion on Pakistan, Directors welcomed the steps the authorities were taking to strengthen fiscal reporting. Noting that Pakistan's balance of payments position was fragile, Directors expressed the hope that the authorities could move forward expeditiously with a bold and wide-ranging reform program designed to achieve a high and sustainable growth path that could be supported by resources from the Fund. Directors felt that any new program would need to contain bold reforms that addressed the

---

[1] The staff held discussions with the Finance Minister, the Commerce Minister, the Governor of the State Bank of Pakistan (SBP), the Secretary General of the Ministry of Finance, the Deputy Chairman of the Planning Commission, the Finance Secretary, and other senior officials. Mr. Ahmed (OED) participated in the discussions. The staff team comprised Ms. Eken (Head), Messrs. Husain and Helbling (all MED), Messrs. Taube and Klingen (FAD), Messrs. Ronci and Buchanan (PDR), and Mmes. Catany and Itam (Assistants, MED). The missions overlapped with technical assistance missions headed by Messrs. Cotterell (STA), Keen (FAD), and Ouanes (MAE), and were assisted by Mr. Mansur, the Fund's Senior Resident Representative in Pakistan. Mr. Panzer (World Bank) and members of the World Bank and the Asian Development Bank (AsDB) resident missions also participated in the meetings.

[2] The relevant Board papers are EBS/99/72 (5/7/99) and Supplement 1 (5/21/99), and EBS/98/231 (12/29/98) and Supplements 1 (1/13/99), 2 (1/14/99), and 3 (1/22/99). Pakistan's relations with the Fund are described in Appendix I, and with the World Bank in Appendix II.

[3] The relevant Board papers are EBS/00/65 (4/5/00) and Supplement 1 (4/26/00).

structural weaknesses in the economy, rely heavily on up-front policy actions to signal commitment to implementation, and be owned by the authorities.

4. Pakistan has had a series of adjustment and reform programs supported by Fund arrangements during the past decade. Policy implementation and economic performance have been disappointing. Tax revenue performance has repeatedly fallen short of program targets, public sector indebtedness—both external and domestic—has continued to rise, the external position has remained fragile, and economic growth has been low, while the number of people living in poverty has increased and Pakistan's social indicators remain weak (Table 1). This weak performance stems in large part from the failure of successive governments to carry through sustained reforms to improve the efficiency of the tax system, meaningfully increase the extremely limited number of taxpayers, promote and diversify the structure of exports, and attract private sector investment. Sanctions imposed by bilateral official creditors following Pakistan's nuclear tests in May 1998 exacerbated the fragile external position, and triggered a debt crisis that had been looming during much of the 1990s.

5. The new government, shortly after assuming office in October 1999, announced that it would make a clean break from the past by forcefully implementing reforms to address these long-standing structural problems facing the economy. They set forth a wide-ranging reform agenda aimed at reducing poverty, improving governance, and sustaining a high rate of economic growth. While a number of steps have already been taken (as summarized in Appendix III), the design and sequenced implementation of a comprehensive policy package will take additional time to finalize. In the meantime, with the macroeconomic situation becoming even more fragile recently, a stabilization program—supported by Fund resources—needed to be put in place urgently to stem pressures on the rupee and return official reserves to more comfortable levels. The proposed program also contains many structural measures, culminating in several important reforms in the fiscal area with the 2001/02 budget, which are intended to pave the way for a medium-term successor program that could be supported under the PRGF.

6. In the attached letter dated November 4, 2000, the authorities request the approval of a Stand-By Arrangement until end-September 2001 in an amount of SDR 465 million in support of their economic program for 2000/01. The accompanying Memorandum on Economic and Financial Policies (MEFP) reviews economic developments and policies in 1999/2000, discusses the macroeconomic framework for the program, and describes the underpinning stabilization and structural policy measures.

II. Performance and Policies in 1999/2000

7. **Overall economic performance in 1999/2000 benefited from favorable supply conditions in the domestic agricultural sector.** However, adverse developments in Pakistan's terms of trade, particularly the sharp rise in world oil prices, a decline in external financing, including from the international financial institutions (IFIs), private capital outflows, and a loosening of the stance of macroeconomic policies weakened the external position and further increased the economy's vulnerability to shocks (Tables 2 and 3).

8. **Growth and inflation performance in 1999/2000 was generally favorable.** According to preliminary estimates, real GDP growth picked up to 4.8 percent in 1999/2000, compared with 3.1 percent in the previous year (Chart 1 and Appendix IV).[4] Overall growth was buoyed by a 7 percent expansion in agricultural output, with bumper cotton and wheat harvests more than offsetting the effect of a decline in sugarcane output on agricultural production. Domestic manufacturing of sugar fell sharply as a result, contributing to a contraction in overall large-scale manufacturing activity by 0.8 percent. Activity in other large-scale manufacturing sectors rose by 5.8 percent, compared with an increase of 4.6 percent in 1998/99, with the textile sector registering particularly strong growth. Despite upward adjustments in domestic petroleum products prices, the stable rupee-dollar exchange rate and the decline in non-oil commodity prices helped moderate consumer price inflation to 3.6 percent (annual average), from 5.7 percent in the previous year. Excluding food and fuel prices, the underlying 12-month rate of inflation declined steadily over the course of the year.

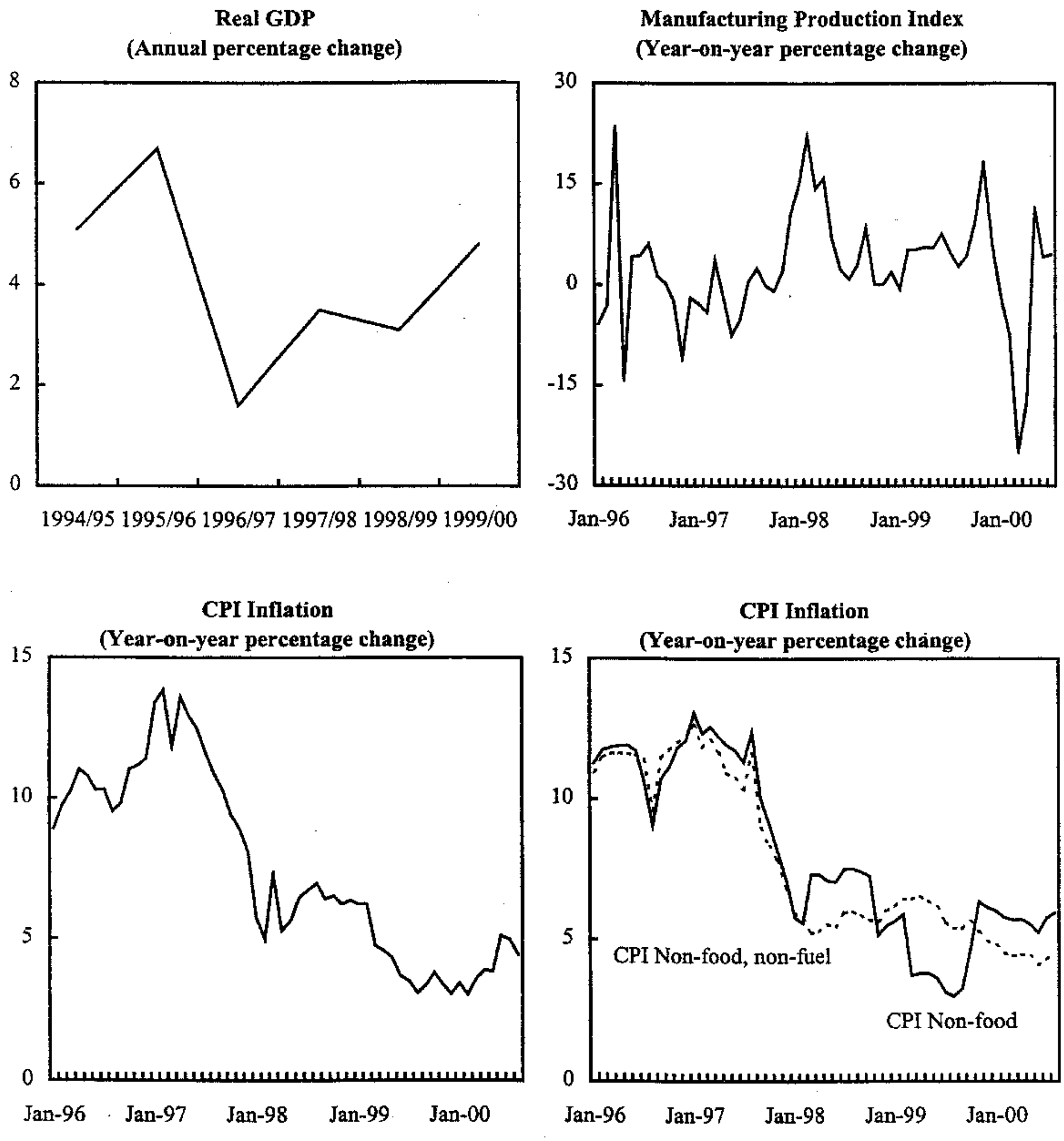
9. **Notwithstanding a major contraction in the external current account deficit, a sharp deterioration in the capital account resulted in a marked weakening in the overall external balance during 1999/2000.** The current account deficit (including official transfers) narrowed to US$1 billion (1.6 percent of GDP), from US$2.2 billion (3.8 percent of GDP) in 1998/99, despite a deterioration in the terms of trade by 9.5 percent (which, by itself, would have widened the trade deficit by 1.5 percent of GDP) during the year (Table 4 and Chart 2). Improved external demand conditions and increased domestic textile production—which benefited from the buoyant cotton crop—maintained export growth at 8.5 percent in U.S. dollar terms. The US$1.2 billion increase in the value of oil imports due to higher world prices was broadly offset by lower food, defense, and project aid-related imports. As a result, total imports were flat in U.S. dollar terms. Increased workers' remittances (private transfers) also improved the recorded current account balance.[5] In the capital account, while bilateral official financing flows were positive, net flows from multilateral creditors declined sharply and private outflows were substantial, reflecting cautious investor sentiment. Consequently, gross official reserves declined to US$0.9 billion (equivalent to 4.2 weeks of imports of goods and nonfactor services) at end-June 2000, from US$1.7 billion (7.8 weeks of imports) a year earlier. The value of the rupee in the interbank foreign exchange market was held constant against the U.S. dollar during the year, which, together with the expansionary monetary stance, contributed to the steady decline in official reserves (Chart 3). The rupee also held firm against

---

[4] The quality of Pakistan's national accounts statistics is weak. The consistency of the preliminary growth statistics for 1999/2000 with other macroeconomic data is examined in Appendix IV. The program to improve national accounts data is discussed in Section V below.

[5] As information on the nature and volume of workers' remittances through the kerb market are not available, these remittances are estimated on the basis of past trends in the expansion of resident's foreign currency accounts and purchases from the kerb market by the State Bank of Pakistan (SBP). Any deviation between estimated and actual remittances through the kerb market is recorded, on a net basis, in the errors and omissions component of the balance of payments. SBP purchases from the kerb market amounted to US$1.6 billion in 1999/2000, compared with US$0.5 billion in 1998/99.

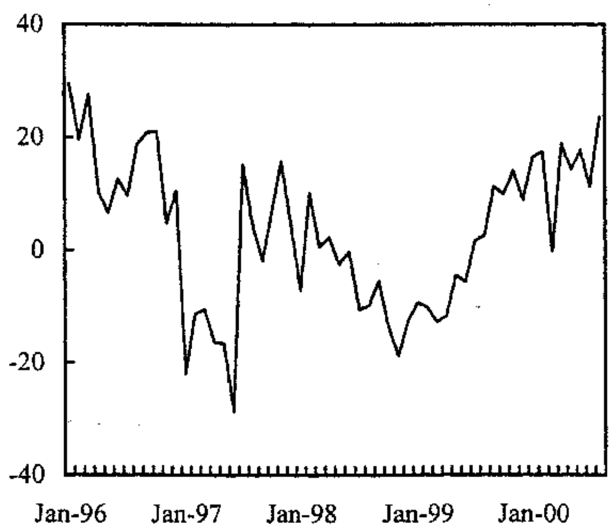
Chart 1
Pakistan: Output and Inflation, 1994 - 2000



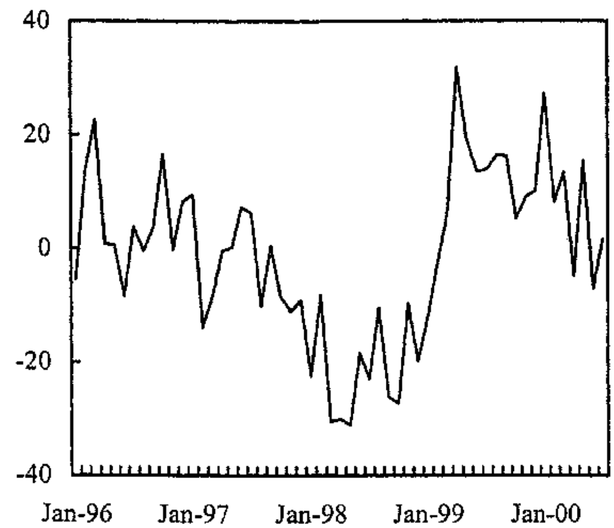
Source: Data provided by the Pakistan authorities.

Chart 2
Pakistan: External Sector Developments, 1994 - 2000

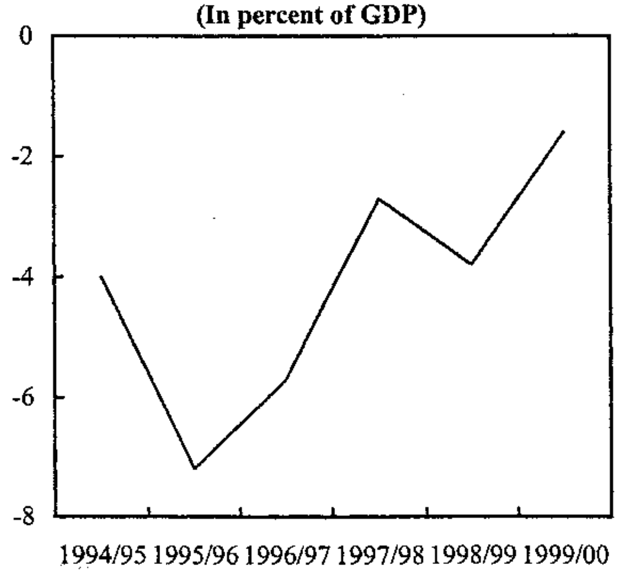
Exports 1/
(Year-on-year percentage change)



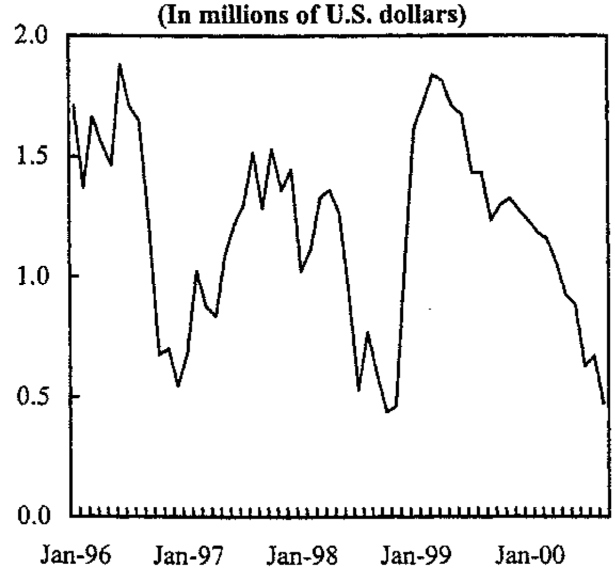
Imports 1/
(Year-on-year percentage change)



Current Account 2/
(In percent of GDP)

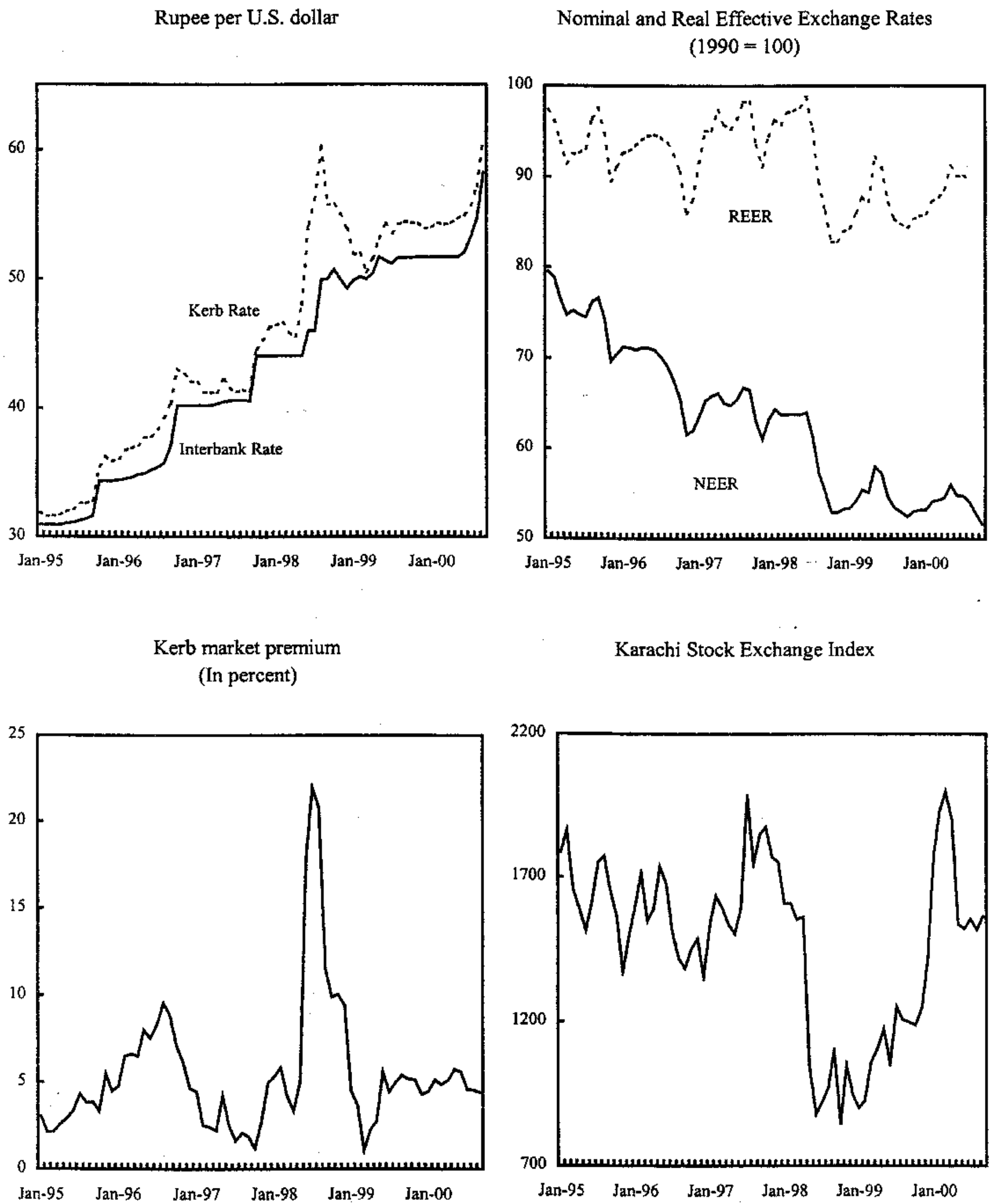


Gross Official Reserves 3/
(In millions of U.S. dollars)



Source: Data provided by the Pakistan authorities.
1/ Customs basis.
2/ Including official transfers.
3/ Excluding short-term swap and forward commitments.

Chart 3
Pakistan: Exchange Rate and Stock Market Developments, 1995-2000



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

the dollar in the kerb market in 1999/2000. The average value of the rupee in real effective terms during 1999/2000 was broadly unchanged from its average value in the previous year. The external debt to GDP ratio amounted to 58 percent, while scheduled external debt service amounted to 64 percent of exports and private transfers, which is extremely high.[6]

10. **Following a sizable fiscal consolidation in 1998/99, the budgetary position deteriorated in 1999/2000**. The budget deficit of the consolidated government widened to 6.5 percent of GDP, from 6.1 percent of GDP in the previous year (Table 5 and Chart 4).[7] This was due to a number of factors, including the delayed adjustments in domestic petroleum prices, which lowered petroleum-related revenue by 0.7 percent of GDP;[8] an increase in the government's interest bill (by 0.4 percent of GDP); the settlement of accumulated tax refund arrears (0.3 percent of GDP); and provincial transfers to municipal governments in lieu of local taxes that were abolished at the beginning of the fiscal year (0.6 percent of GDP). In addition, while defense spending declined by 0.2 percent of GDP, a lapse in expenditure control mechanisms allowed defense outlays to exceed the budgeted level by 0.3 percent of GDP. Partly offsetting these effects on the budgetary position were higher nontax revenue (0.4 percent of GDP, mainly on account of higher profit transfers from the SBP), further cuts in development expenditure and net lending (0.4 percent of GDP), collections from a tax amnesty scheme (0.3 percent of GDP), and an increase in Central Board of Revenue (CBR) tax receipts (0.2 percent of GDP). The increased tax collection came from sales taxes, both on account of stronger collection effort as well as a broadening of the GST base.[9] Collection of income taxes, customs duties, and excise taxes declined in relation to GDP. Past cumulative primary budget deficits and exchange rate-related valuation effects have resulted in a large stock of net public debt (92 percent of GDP at end-1999/2000), and the associated interest bill increased to 7¾ percent of GDP.[10] During the last two years, the debt-to-GDP ratio stabilized, as primary surpluses roughly offset the valuation effects of the rupee depreciation in 1998/99.

---

[6] External debt and debt service after rescheduling amounted to 32 percent of current foreign exchange receipts. The ratios of the present value of public and publicly-guaranteed external debt to exports and of short-term debt to gross reserves at 240 percent and 460 percent, respectively, are very high. A discussion of debt and debt sustainability issues in Pakistan is provided in the Selected Issues paper.

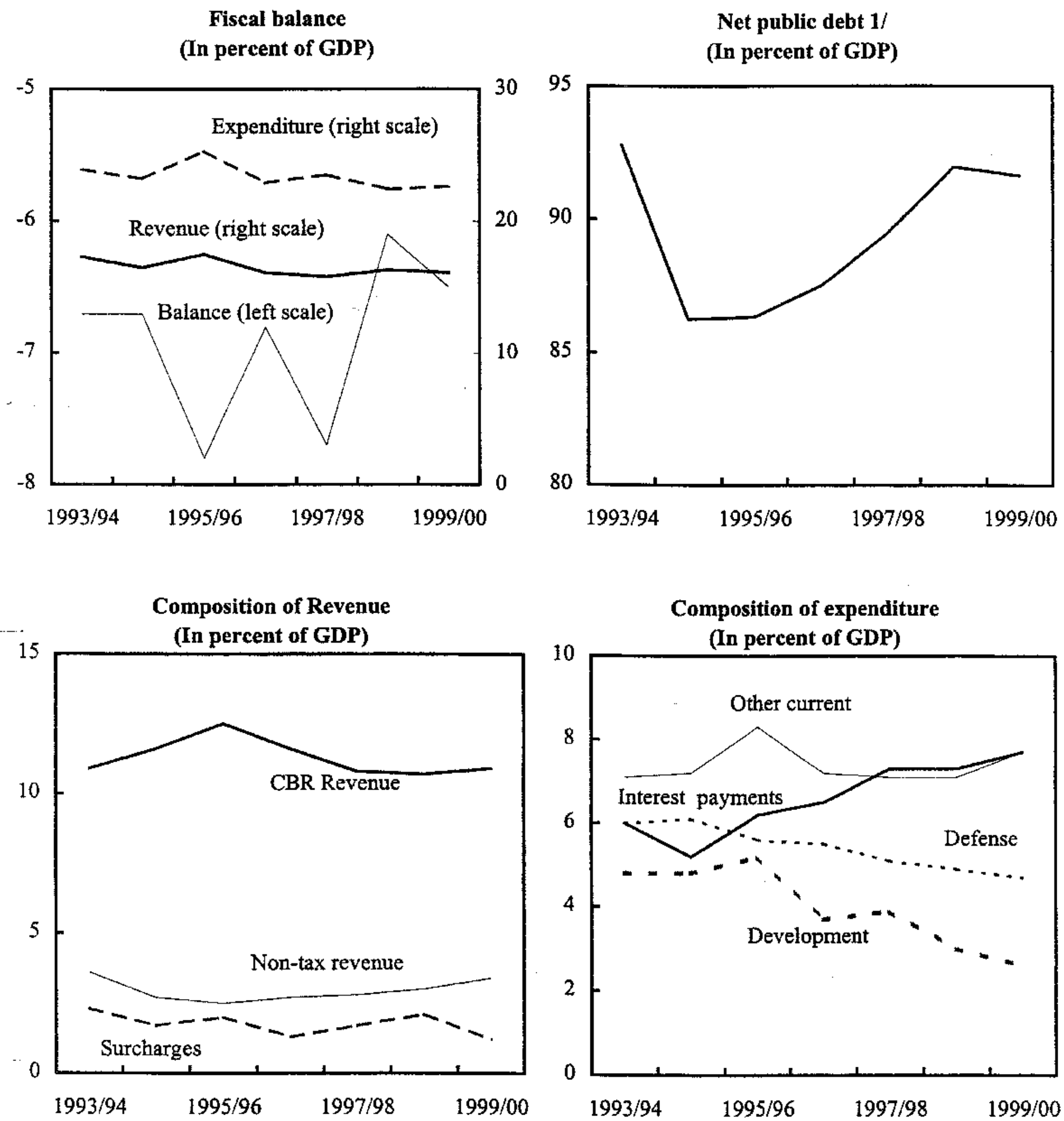
[7] Following the fiscal data misreporting episode, historical data on the fiscal accounts going back to 1993/94 have been revised. The main features of the revised data are summarized in Box 1.

[8] The decline in the petroleum surcharge was partly offset by collections related to the GST extension to petroleum products in August 1999.

[9] A review of tax reform and revenue performance over the past decade is provided in the Selected Issues paper.

[10] Net public debt equals gross public debt minus government deposits with the banking system, which have been increasingly sharp since January 1999 because of a buildup in debt relief counterpart deposits.

Chart 4
Pakistan: Fiscal Developments, 1993 - 2000



Source: Data provided by the Pakistan authorities.

1/ Gross public debt less government deposits with the banking system.

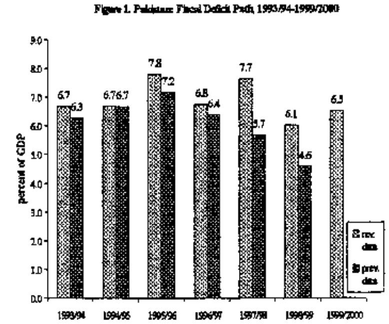
Box 1. Revision of Fiscal Data, 1993/94–1998/99

The revision of the fiscal accounts for the years 1993/94–1998/99 has now been completed with technical assistance from the Fund. An initial round of revisions focusing on the years 1998/99 and 1997/98 had concluded that the deficit was 1.5 and 2 percent of GDP, respectively, larger than previously reported (see EBS/00/65).

Fiscal deficits in the period 1993/94–1996/97 were also revised upward, albeit by a smaller margin (by about 0.5 percent of GDP in all years except for 1994/95 where the deficit remained unchanged). While deficit corrections in 1997/98 and 1998/99 were driven mainly by the interest bill and defense expenditure financed from additional nonbank sources,[1] the pattern was less clear than in the preceding years. Expenditure tended to be revised upward on account of development expenditure, the interest bill, and defense outlays. Revenue was generally reduced due to lower nontax revenues and also lower CBR revenues, although revenue related to the petroleum/gas surcharges was larger than previously reported. The associated additional financing came mainly from nonbank sources in 1993/94, external sources in 1995/96, and the banking system in 1996/97.

The revised deficit path shows the deficit peaking at 7.8 percent of GDP in 1995/96 followed by a period marked by uneven success of consolidation efforts. Previously reported data had suggested strong and sustained fiscal consolidation setting in after the deficit had touched 7.2 percent of GDP in 1995/96 (see Figure 1).[2]

Figure 1. Pakistan: Fiscal Deficit Path, 1993/94-1999/2000



Fiscal consolidation was mainly brought about by compressing development expenditure/net lending (from 5.2 percent of GDP in 1995/96 to 2.6 percent in 1999/2000) and reducing military spending (from 5.6 percent of GDP in 1995/96 to 4.7 percent in 1999/2000). These effects more than compensated for pressures from a rising interest bill (from 6.2 to 7.7 percent of GDP) and declining revenues (from 17.5 to 16.1 percent of GDP) in the wake of tariff reductions (see Table 5).

Inadequate reconciliation processes in the past have meant that not all expenditures and revenues have been properly recorded in the audited accounts, from which the revised fiscal data series has been constructed. This leads to unidentified expenditures over the period ranging between –0.3 to +0.7 percent of GDP. The authorities are continuing to carry out some work to explain major past discrepancies, but highest priority has been given to reestablishing reconciliation processes, which should lead to better quality fiscal data in the future.

---

[1] In 1997/98, higher than previously reported development expenditure and lower revenues were also important factors.

[2] In the series "previously reported data", deficits in percent of GDP differ from figures reported in earlier Fund documents reflecting GDP revisions.

11. **A program has been launched to improve the financial performance of public enterprises and prepare them for eventual privatization.** Corporate and financial restructuring plans for many key enterprises were drawn up and, for the Pakistan Steel Mills, Pakistan Railway, and power sector enterprises, implementation commenced. In addition, corporate management structures were put in place. As a result, the financial position of many enterprises has already begun to turn around. Although the net operating surplus (including interest charges) of the seven large enterprises remained flat in relation to GDP in 1999/2000,

the net surplus and current balance of five of the seven enterprises increased by 0.3 percent of GDP (Table 6).

12. **The stance of monetary policy was eased during the course of the year in response to the moderation in inflation and weak private sector credit growth.** Treasury bill yields were cut by around 3 percentage points during the year to 7.0–7.5 percent, and the SBP's discount rate was lowered by 2 percentage points to 11 percent (Chart 5). Banks responded by reducing their holdings of government securities and increasing their excess reserves. At the same time, demand for cash picked up in response to cuts in banks' deposit interest rates (by about 2 percentage points) as well as the launch of an intensified loan recovery campaign and the tax survey and registration drive. As a result, reserve money growth surged to 25 percent by end-1999/2000, from under 8 percent at end-1998/99 (Table 7). Broad money growth also picked up to 9.4 percent—approximately equal to the pace of expansion of nominal GDP—with the increase in currency in circulation more than offsetting a more subdued expansion in banking system deposits, which was dampened by a continued drawdown in residents' frozen foreign currency deposits (FCDs) (Table 8). Correspondingly, the money multiplier fell sharply as the ratio of currency to deposits climbed to 34 percent in June 2000, compared with 29 percent in June 1999. On the assets side, net bank borrowing by the government to finance the budget deficit and an expansion in bank credit to finance commodity operations (related to the procurement of the bumper wheat crop) accounted for around two thirds of the growth in broad money. Notwithstanding the cut in banks' lending rates by 1.0–1.5 percentage points, credit to the private sector grew by only 2.5 percent, reflecting a variety of factors as detailed in Appendix IV.

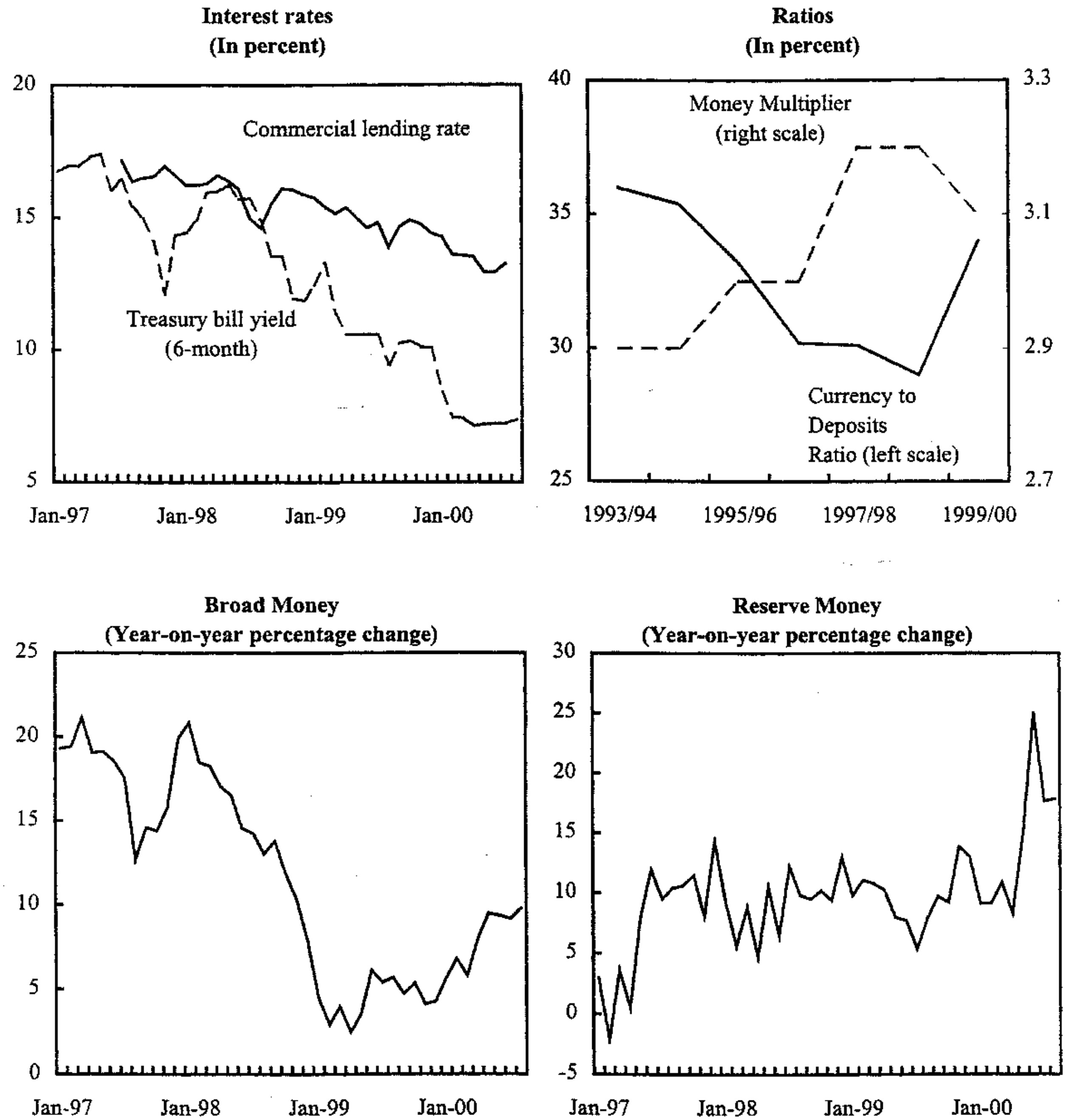
13. **A number of important structural reform measures were implemented during 1999/2000** in the fiscal, financial, international trade, agriculture, energy, and public enterprise sectors, as detailed in the attached MEFP. In particular, the GST was extended to petroleum products, natural gas, and electricity. All tax whitener schemes were withdrawn through the removal of immunity from tax probe of newly invested funds. A major tax survey and registration drive was launched in an effort to widen the tax base. A mechanism for adjusting domestic prices of petroleum products on a quarterly basis in response to international price movements was put in place in December 1999. Prices for furnace oil, which accounts for 40 percent of domestic petroleum consumption, were freed from July 2000. In addition to the intensified loan recovery campaign, reforms in the financial sector included cuts in interest rates on National Savings Schemes (NSS) instruments by an average of 5.5 percentage points since May 1999, reducing the spread between returns on NSS instruments and those for other instruments.[11]

14. **In some critical areas, however, reforms to address structural weaknesses in the economy did not move forward at the previously envisaged pace.** The enforcement of the

---

[11] Returns on NSS instruments are presently 11–14 percent, depending on the type of instrument and how long it is held.

Chart 5
Pakistan: Monetary Developments, 1993 - 2000



Source: Data provided by the Pakistan authorities.

GST in the retail sector was postponed and retailers were given the option to pay a turnover tax in lieu of the GST. The extension of the GST to agricultural inputs was also delayed. In addition, the tax administration drive appears to have lost some momentum, as reflected in the steady moderation in the growth of tax revenue during the course of 1999/2000. Moreover, progress in financial restructuring and privatizing state-owned entities—especially in the banking, gas, petroleum, and power sectors—has been slow.

III. Macroeconomic Adjustment and Reform Program for 2000/01

15. **The discussions on the macroeconomic outlook and policy framework for 2000/01, which took place against the background of a further decline in official reserves and the continuing hike in international oil prices, were cast in a medium-term framework (discussed in Section IV below).**[12] The authorities indicated that the principal immediate objective of economic and financial policies was to stabilize the macroeconomic situation while they pressed ahead with structural reforms, which would enhance the economy's growth potential and reduce poverty over the longer term. They were cognizant of the need to allow the exchange rate to adjust and tighten monetary policy in order to strengthen the external position. They also recognized the importance of consolidating the fiscal position and accelerating the implementation of structural reforms to pave the way for high and sustainable private sector-led growth. In the discussions, the staff emphasized that, in view of the vulnerable balance of payments position, the authorities would need to stand ready to further tighten monetary policy should external pressures reemerge and sustain a strong revenue effort throughout the year to meet the budget deficit targets. Further measures would be needed if the envisaged revenue gains were not to materialize and social and poverty-related expenditures were to be safeguarded. The staff also emphasized that a substantial acceleration of structural reforms, particularly in the power, gas, and banking sectors, would be necessary to build investor confidence and ensure the disbursement of related program loans from the World Bank and the AsDB that had been built into the financing elements of the 2000/01 program.

A. Macroeconomic Framework

16. **Underlying macroeconomic conditions are expected to improve in 2000/01.** Manufacturing activity is expected to pick up, driven by continued buoyancy of the textile sector as domestic input supply and external demand conditions remain favorable. While early indications suggest that agricultural output will remain strong, aided by recent policy measures to liberalize this sector and improve its productivity on a sustained basis, agricultural growth is likely to moderate from the exceptionally high pace of last year. Consequently, overall real GDP growth is expected to be around 4.5 percent, slightly slower than in 1999/2000. Inflation

[12] Reserves fell to about US$450 million (net of short-term swap and forward commitments), equivalent to two weeks of imports, at end-September 2000. A supplement to the staff report providing an update of developments in the first quarter of 2000/01 will be circulated prior to the Board meeting.

is expected to temporarily pick up to 6.5 percent (annual average) on account of the pass through of the depreciation of the rupee to domestic prices, adjustments to electricity tariffs and domestic natural gas and petroleum products prices during the course of the year, and the carryover effects of structural price increases (petroleum products, medicines, and wheat issue price) undertaken during the second half of last year. On the basis of the balance of payments projections (discussed below), which hinge on substantial official financing and sharply reduced private sector outflows brought about by improved market sentiment based on implementation of the Fund-supported program, gross official reserves would rise to US$1.74 billion at end-June 2001, equivalent to 7.3 weeks of imports of goods and nonfactor services.

B. Exchange Rate Policy and Exchange System

17. **A more flexible exchange rate policy that allows the exchange rate to respond to market forces clearly needs to be put in place.** Looking forward, Pakistan's low level of official reserves, the vulnerability of the balance of payments, including the continued dependence on sizable inflows of external financing, and the liberalization of the trade system envisaged over the medium term, suggest that a flexible exchange rate regime is required to avoid a significant misalignment of the rupee and large, possibly destabilizing, exchange rate adjustments (see Box 2). The authorities recognized that in view of the critical balance of payments situation and to facilitate a smooth transition to a market-determined exchange rate, a sizable up-front exchange rate adjustment would form a key element of the macroeconomic stabilization program. To this end, the rupee had been allowed to depreciate by 5 percent against the U.S. dollar in late July 2000, and by a further 7 percent in late September. By October 6, the rupee had depreciated by 15.5 percent against the dollar and 11 percent in nominal effective terms from its level in May 2000. Subsequently, banks started requiring a cash margin of 30 percent for import letters of credit, which resulted in an appreciation of the interbank rate and a widening of the spread between the interbank and kerb market rates. More recently, the cash margin requirement has been removed, and the interbank exchange rate has been depreciated somewhat[13] and the spread has narrowed slightly. The authorities expect that the recent trend will continue in the coming weeks.

18. **The role of market forces in determining the external value of the rupee is being enhanced.** All margin requirements for opening import letters of credit that were imposed in October 1999 and the unofficial trading band governing interbank foreign exchange transactions have been withdrawn. The recommendations of a recent MAE technical assistance mission are to be implemented in a phased manner. These recommendations include: (a) withdrawing the requirement that all interbank trades be backed by underlying commercial

---

[13] The rupee depreciated by about 1 percent in the interbank market during November 14–15, the two days following the removal of the cash margin requirement.

Box 2. Was the Rupee Misaligned?

Pakistan's balance of payments is characterized by large external financing needs, which have been persistent and are expected to remain large during the next few years, while economic activity has remained weak. This has raised questions about a possible rupee misalignment and real exchange rate prospects.

Relative prices. The CPI-based real effective exchange rate index implies that the rupee has, on average, been slightly depreciating during much of the 1990s, the average annual rate was about 0.5 percent (Chart 2). The real depreciation accelerated in 1998/99 with the substantial nominal rupee depreciation before returning again to the 1990s average rate last year. On this basis, an overvaluation of the rupee would be difficult to establish.

Trade and current account performance. Developments in recent years provide mixed evidence regarding misalignment:

- Pakistan's merchandise export performance deteriorated significantly during the 1990s, especially when compared to the 1980s or the performance of other countries in Asia during the 1990s. Export volumes stagnated, export product upgrading and diversification remained limited, and the share of Pakistan's exports in developing countries' exports declined. Similarly, openness as measured by the ratio exports and imports over GDP also declined during the second half of the 1990s.

- The overall trade performance during 1994/95–1999/2000 was contained despite the deteriorating export performance, as import volumes also fell relative to GDP growth, the average real GDP growth rate declined, and the terms of trade generally improved (except in 1999/2000).

- With the steady increase in net external liabilities, net investment income as a percent of GDP has decreased steadily in recent years. The external current account progressively deteriorated during the 1990s although the improvements in 1999/2000 may have marked the beginning of a trend reversal.

Competitiveness Indicators for Competitors. A comparison of Pakistan's real exchange rate with that of three important competitors—Bangladesh, India, and Sri Lanka—suggests that Pakistan's relative price competitiveness has remained broadly unchanged since the early 1990s.

Equilibrium considerations. The continued rise in net external liabilities during the 1990s led to higher resource transfers from Pakistan to nonresidents because of increasing debt service obligations. Everything else being equal, this would have implied a continuously depreciating equilibrium real exchange rate, suggesting that the minor actual real depreciation during most of 1990s may have been insufficient.

Assessment Based on a review of standard indicators, the case for a rupee misalignment in 1999/2000 can be made primarily on the grounds of equilibrium considerations. Looking forward, prospects are that the balance of payments situation will remain difficult. In addition, the envisaged trade liberalization measures would reduce effective rates of protection, the equivalent of a real appreciation. To manage the balance of payments constraints, given continued large net factor service payments (also as a percent of GDP), total net exports as a percent of GDP must increase. Merchandise exports will need to make the main contribution. Staff calculations based on the estimation of a simple export equation (and the assumed growth paths for domestic real GDP and foreign demand) suggest that on average, a real depreciation of about 3–4 percent would be consistent with a 1 percentage point improvement in the ratio of merchandise exports to GDP. The contribution of merchandise imports can be expected to be quite minor in light of very low estimates for the price elasticity of import demand in Pakistan. Following the recent adjustment in the external value of the rupee, a flexible, market-based nominal exchange will be needed to mitigate the risk of a medium-term misalignment of the rupee.

transactions;[14] (b) increasing banks' Nostro limits, which would permit them to take more sizable foreign exchange positions;[15] and (c) changing the SBP's practice of spot dealing in foreign exchange from a same-day value basis to two-day value, in line with the internationally accepted standard. Implementation of the latter in December 2000 has already been announced; the authorities expect to start implementing the other two measures during the latter half of 2000/01, taking into account the actual developments in official reserves and the exchange markets.

19. **The authorities have committed to limiting their intervention in the forward foreign exchange market.** They commented that foreign exchange markets had become unsettled in the period immediately following the recent exchange rate adjustments. In an effort to prevent sharp gyrations in the market, they had engaged in short-term swap and outright forward transactions.[16] In the event, official reserves declined to US$391 million (net of short-term forward and swap commitments) in early October, before rising to US$455 million by end-October. The authorities indicated that they would not engage in outright forward transactions involving the rupee once the program was approved by the Board, and that swap operations would be curtailed. The authorities also indicated that, apart from these swap and forward commitments, reserves were liquid and unencumbered. More specifically, they reaffirmed that their reserves held with overseas branches of Pakistani banks were fully liquid. Recognizing the staff's concern over the liquidity of official reserves, however, they agreed that issues related to reserve management—including the liquidity of official reserves held with Pakistani banks abroad—could be reviewed in the context of the upcoming Stage Two of the Fund's safeguards assessment (discussed below). Moreover, an adjuster to the net foreign assets target of the SBP has been included in the program; any increase in the SBP's holdings of reserves with Pakistani banks abroad over the end-June 2000 level (US$545 million) will be reflected in an increase in the net foreign assets target of an equal amount.

20. **The authorities agreed that the depth of the interbank foreign exchange market would be further enhanced by redirecting their purchases of foreign exchange from the kerb market to the interbank market.** While the SBP's purchases in the kerb market—and the subsequent sale of foreign exchange in the interbank market—entail a significant cost for

---

[14] While this requirement, which was introduced in June 1999, may have been effective in containing speculative activity, it also appears to have sharply reduced turnover in the interbank market. Withdrawal of this requirement would help develop the market and enhance its smooth operation.

[15] Nostro limits are defined as banks' balances held abroad on account of trading activities, excluding funds related to new foreign currency deposits and special exporters' accounts. The limit for each bank is presently set at 20 percent of paid-up capital.

[16] As of mid-October 2000, the SBP's outstanding short-term swap and outright forward commitments amounted to US$175 million. Of this, US$23 million represented commitments from 1998/99 that come due in October–November 2000.

the SBP, the authorities were of the view that the fragile balance of payments position precluded a sharp reduction in such purchases by the SBP (Box 3). They pointed to the experience in recent months, when market conditions had prompted the SBP to scale back its kerb purchases, and noted that a corresponding increase in foreign currency inflows through the interbank market had not materialized. Nevertheless, the authorities felt that a gradual reduction in kerb market purchases over the medium term was a desirable objective.

21. **The existence of parallel foreign exchange markets gives rise to the possibility of a multiple currency practice**, as defined under the Fund's Articles of Agreement. The authorities explained, however, that only cash transactions were permitted in the domestic kerb market, and all current account transactions were required to go through the interbank market. Despite these regulations, however, some current transactions did in fact go through the kerb market. In the authorities' view, such transactions took place in the kerb market either because the kerb market provided more efficient service for these transactions—such as remittances by overseas Pakistani workers to family member in remote areas—or if the underlying transaction was illegal, such as smuggling. The authorities did not believe that the spread between the interbank and kerb rates was a major factor in determining individuals' choice between the two markets. The authorities noted that many of the kerb dealers also had a sizable overseas network, and that it was difficult for the SBP to regulate cross-border flows related to domestic kerb market transactions. While subscribing to the objective of gearing policies to limit the spread between the interbank and kerb exchange rates, the authorities observed that as long as the rupee was not fully convertible in the capital account and there was demand for foreign exchange related to capital flight, a shadow exchange rate would persist. The authorities acknowledged that legitimate transactions had on occasion been diverted from the interbank market to the kerb market under exceptional circumstances. They undertook not to divert legitimate current transactions in the future, and reiterated their commitment to allow all legitimate current transactions to go through the interbank market. In this connection, the authorities also undertook to allow the free flow of funds for current account transactions and to avoid undue delays in payments and transfers for such transactions arising from official actions or administrative requirements.

C. Monetary Policy and Financial Sector Reforms

22. **The monetary policy stance has been tightened to support the transition to a market-oriented, flexible exchange rate regime, quell speculative pressure against the rupee while building up official reserves, and keep inflation in check.** Treasury bill yields have been raised by 3–4 percentage points to 10¼–11½ percent since June 2000, the SBP's discount rate has been increased from 11 percent to 13 percent, and banks' cash reserve requirement has been raised by 2 percentage points to 7 percent. Following the interest rate hike, most of which took place in late September-early October, reserves have begun to accumulate and the rupee has appreciated slightly in both the interbank and kerb markets.

Box 3. The Kerb Market for Foreign Exchange in Pakistan

An informal market for foreign exchange, known as the "kerb" market, has existed in Pakistan for several decades. The size of the market grew as exchange restrictions were eased in the late 1980s and 1990s and the SBP began to license moneychangers to deal in cash foreign exchange transactions.

Regulatory environment and market infrastructure

There are 481 authorized moneychangers at present, although the top five account for the bulk of transactions in the kerb market. In addition, there are reportedly some 400 unlicensed moneychangers. Apart from a minimum capital requirement—equivalent to US$1,000 for single branch offices and US$5,000 for multiple branch operations—to obtain a license and the requirement that buy and sell rates be posted at branch premises, moneychangers are not subject to SBP regulations.

The large moneychangers have vast branch networks across Pakistan. Several moneychangers have overseas offices to facilitate transactions with nonresidents. While moneychangers' licenses permit them to engage only in domestic cash transactions, in practice many also provide rupees to clients domestically in exchange for the foreign currency equivalent abroad. Similarly, many moneychangers provide foreign currency to clients' agents abroad in exchange for the receipt of the rupee equivalent from clients domestically. In addition to facilitating transactions that are not permitted through the banking system, market reports suggest that moneychangers typically complete cross-border transactions more quickly and efficiently than commercial banks.

Foreign exchange supply and demand in the kerb market

While data on transactions in the kerb market are not available, private estimates of the scale of foreign exchange inflows (through both authorized as well as unauthorized money-changers) are in the range of US$4–6 billion annually. This would be consistent with estimated average daily turnover of about US$12–20 million, compared with average daily turnover of almost US$100 million in the interbank foreign exchange market. The exchange rate of the rupee against the U.S. dollar in the kerb market has traditionally been more depreciated than the rupee-dollar exchange rate in the interbank market. The kerb market premium has generally been in the range of 2–9 percent, except in mid-1998, when it rose to over 20 percent.

According to market reports, the bulk of the supply of foreign exchange to the kerb market comes from expatriate Pakistanis wishing to remit transfers to family members living in Pakistan. In addition, some inflows likely relate to under invoiced or illegal exports. On the demand side, a large share of foreign exchange purchases from the kerb market are reportedly linked to payments for smuggled imports of consumer goods and to capital flight. Also, as kerb market transactions are not documented, some of the demand for foreign exchange likely stems from those who wish to evade taxes. Until the freeze of foreign currency accounts (FCAs) in May 1998, a sizable component of demand in the kerb market related to residents wishing to obtain foreign exchange for deposit into their FCAs. (Residents' FCAs rose by about US$1 billion annually during 1992/93–1997/98; new FCAs increased by US$0.5 billion a year during 1998/99–1999/2000.)

SBP intervention in the kerb market

Starting in late 1998, the SBP has purchased foreign exchange from the kerb market. The purchases amounted to US$0.5 billion in 1998/99 and US$1.6 billion in 1999/2000. On the basis of data in the SBP's income statement, the SBP paid an average premium of about 5 percent over the interbank rate for its purchases of foreign exchange from the kerb market. Aside from this direct market intervention, the SBP has on occasion temporarily suspended kerb market operations (most recently for one week immediately following the change in government in October 1999) and reportedly leaned on moneychangers to resist "excessive" rupee depreciation during periods of pressure on the rupee.

23. **Reserve money growth in 2000/01 is targeted at 3 percent.** Demand for reserve money is expected to stabilize during the year as the effects of the freeze of foreign currency deposits unwinds, and the hike in interest rates is expected to induce banks to reduce their excess reserves with the SBP and raise their holdings of government securities. At the same time, higher interest rates and the gradual wearing off of the special factors that boosted the demand for cash last year are projected to lower currency growth. Consequently, the currency to deposits ratio is projected to decline to 31.4 percent at end-June 2001.

24. **Broad money growth is projected to increase in line with the projected pace of expansion of nominal GDP.** Banking system deposits are expected to increase by 13.5 percent during the year, reflecting higher deposit interest rates, lower demand for cash, and the cuts in NSS interest rates over the past year, which should encourage reintermediation of funds to the banking system. As a result, the ratio of deposits to broad money is projected to rebound by end-2000/01; the money multiplier, while climbing, would remain below its level at end-1998/99 and earlier. The monetary projections are consistent with an expansion in private sector credit of over 11 percent, contributing to over one-half of broad money growth in 2000/01. Together with increased self-financing of investment by textile units, this should be adequate to facilitate the envisaged increase in gross private capital formation. The buildup in the banking system's net foreign assets is projected to account for a further one-half of the expansion in broad money, while net credit to the government for budgetary support is programmed to decline.

25. **In view of the high degree of uncertainty surrounding the money demand projections, the monetary targets may need to be adjusted during the year** if unforeseen developments in the money multiplier materialize or if private capital inflows are significantly stronger than expected. If, for example, the currency-to-deposit ratio does not decline along the envisaged path, implying a lower money multiplier than projected, the targeted growth of reserve money may prove to be too tight. Similarly, higher-than-envisaged private capital inflows may warrant higher reserve money growth if these inflows also reflect considerably stronger growth than presently projected and, consequently, higher money demand. Indeed, higher money demand may need to be accommodated in such circumstances by greater foreign exchange purchases in view of the low level of official reserves. The first review under the program will provide an opportunity to undertake adjustments in the financial program on the basis of monetary developments during the first half of 2000/01.

26. **There should be scope for a cut in interest rates later in the year,** once confidence begins to strengthen following an agreement on an external financing package. The mission cautioned, however, that a premature move could rekindle speculative pressures against the rupee and compromise the gross official reserves targets. The authorities emphasized that, in their view, the envisaged buildup of reserves was of paramount importance, and that any cut in interest rates would be undertaken only if the net foreign assets and net domestic assets targets were met with comfortable margins. They also indicated that, if warranted by market developments, they stood ready to raise interest rates further.

27. **As regards structural reforms in the financial sector, rationalization of the NSS aimed at reducing financial market segmentation is underway.** The measures in this area that have been taken recently, as well as those that are to be implemented during the coming year, are described in the attached MEFP. While agreeing that the NSS needed to be better targeted toward poor urban and rural savers, and that NSS rates of return needed to be linked to market interest rates, the authorities felt that the NSS had a useful role to play in mobilizing the saving of its target client base. In this context, they expressed concern that sudden changes to the NSS could give rise to a reemergence of pyramid saving schemes. Thus, the authorities favored a phased approach to NSS reform. They noted that the new professional management of the Central Directorate of National Savings (CDNS), which had been put in place in September 2000, had been asked to devise a new line of market-based instruments by the start of the 2001/02 fiscal year. In this context, the authorities requested technical assistance from the Fund on the design of the new instruments and on how to link them with market returns. The authorities indicated that the tax-exempt status of income from new investments in NSS instruments will be removed from July 2001, together with the promulgation of a new income tax law. In the meantime, before the new instruments come onstream, the market orientation of new issuances of existing instruments is to be enhanced by linking by January 1, 2001, returns on Defense Savings Certificates (DSCs) to market yields on new long-term government bonds, which are to be launched by end-2000.[17]

28. **The subsidy element of the export finance scheme (EFS) is to be further narrowed by end-2000/01.** As explained in the attached MEFP, the list of items eligible for financing under the EFS has been reduced and the subsidy element of the EFS declined over the past year. To avoid any widening of the subsidy in the near term, the authorities undertook to raise the EFS rate on a quarterly basis (from end-2000) in line with the developments in the average 6-month treasury bill yield during the previous quarter. The authorities indicated that the need for the EFS would diminish once the new Foreign Currency Export Facility (FCEF), which will be supported by a loan from the AsDB, became operational. The FCEF, expected to be in place by end-2000, would enhance small- and medium-sized enterprises' access to trade finance through a dollar-based window at commercial banks. To enhance the relative attractiveness of the FCEF, the subsidy element of the EFS will be eliminated by end-2000/01. In this connection, the authorities undertook to raise the EFS rate at that time to an amount at least 1.5 percentage points above the average treasury bill yield during the previous quarter.

29. **Rules governing new foreign currency deposits with commercial banks are to be liberalized.** Since June 1999, banks have been required to place the funds associated with the mobilization of new foreign currency deposits (net of any amount lent in foreign currency domestically) with the SBP. The SBP places these funds abroad, does not count them as part of its official reserves, and publishes data on the outstanding amount regularly.[18] The

[17] DSCs account for about 40 percent of the outstanding stock of NSS instruments.

[18] New foreign currency deposits placed with the SBP amounted to US$445 million as of October 23, 2000.

authorities explained that the placement requirement had been imposed in response to concern that some banks were investing such funds in risky investments overseas. Prudential regulations governing such investments were being finalized, and the placement requirement would be withdrawn by end-March 2001, once the external position had stabilized.

30. **Measures are also being taken to enhance the commercial orientation of the banking system and improve its financial position.** In addition to an intensified loan recovery drive, nationalized commercial banks' (NCBs) balance sheets are to be further strengthened with the aid of the newly established Corporate and Industrial Restructuring Corporation. Moreover, professional management is now in place in each of the NCBs, and consolidation of their work forces and branch networks is proceeding. The authorities commented that the banking supervision system had been upgraded, and that banks' compliance with prudential regulations and indicators of their financial soundness were now monitored on a more thorough and frequent basis. While the banking system's nonperforming loans (NPLs) have continued to edge upward, partly in response to stricter accounting and auditing standards,[19] NCBs' NPLs have declined over the past two years and, according to banks' own audits, all but one met the minimum capital adequacy ratio of 8 percent as of end-1999.[20] The authorities indicated, however, that banks' audits were not necessarily reliable, and that a thorough examination of Habib Bank Limited (the largest NCB) had revealed that it was undercapitalized; the SBP injected capital of PRs 8.8 billion into Habib Bank Limited in June 2000. Looking ahead, the preparatory process for privatizing banks has been accelerated with a view to disposing of the remaining government stakes in Allied Bank and Muslim Commercial Bank by end-March 2001. The sale of a strategic stake in one of the remaining NCBs by end-June 2001 is also envisaged. A plan to restructure and consolidate the development finance institutions has been drawn up, which will pave the way for their eventual privatization. The authorities have requested participation in a Financial Sector Assessment Program (FSAP) in 2001, and have said that the FSAP recommendations would guide future reforms in the financial sector. While noting that specific reform plans in the banking sector would be discussed in the context of the FSAP, the mission emphasized that bank restructuring was essential to ensure banks' long-term financial viability and their privatization would be contingent on placing the NCBs on a sounder footing.

31. **Necessary preparations are underway to implement the Supreme Court's December 1999 decision requiring substantial progress in transforming the financial system to conform with Islamic principles.** A commission on the transformation of the financial system has been set up. The commission will prepare a transformation plan, which will suggest necessary amendments in the legal framework governing the operations of

---

[19] From 1998, banks were required to adopt new standards, including the disclosure of loan classification and provisioning, the suspension of interest accruals on NPLs, and the Basle system of defining capital adequacy.

[20] The ratio of defaulted loans to the total loan portfolio declined from 20.8 percent in 1996 to 16.5 percent in 1999 for domestic banks.

financial institutions and study the feasibility of launching new instruments and institutions. Recognizing the potential impact on market sentiment of uncertainty over the nature of the transformation, the authorities emphasized that the transformation would be undertaken with adequate preparation and in a manner that would minimize disruption to the financial system. They remarked that all international debt obligations would continue to be serviced.

D. Fiscal Policy and Reforms

32. **The authorities are committed to reducing the budget deficit in 2000/01 to 5.2 percent of GDP** (PRs 185.7 billion). The deficit reduction—which amounts to 1.3 percentage points of GDP—is to be achieved despite lower profit transfers from the SBP (by 0.5 percent of GDP) and increased social spending (discussed below). As described in the attached MEFP, a series of measures to increase tax collection, including steps to widen the tax base and contain current expenditures are being implemented to support the fiscal consolidation process. On the basis of current estimates, tax revenue is expected to rise by 1.1 percent of GDP to 13.8 percent of GDP in 2000/01, while total revenue is projected to rise by 0.4 percent of GDP to 16.5 percent of GDP. Current spending is expected to decline by 1.3 percent of GDP, due to the lower interest bill (by 1 percent of GDP), reflecting in part the decline in domestic interest rates last year, and a reduction in defense spending (by 0.3 percent of GDP). Following a review in consultation with the World Bank, of the Public Sector Development Program (PSDP), development expenditure and net lending has been targeted to increase by 0.4 percent of GDP. The ratio of net public debt to GDP is projected to increase to 93 percent at end-2000/01, from 90 percent at end-1999/2000, despite the increase in the primary surplus to 1.5 percent of GDP and lower interest payments (in relation to GDP). The depreciation of the rupee raises the domestic currency value of outstanding external debt in relation to GDP by about 6.5 percentage points in 2000/01.

33. **The fiscal projections include a sizable increase in social and poverty-related spending**, reflecting the importance the authorities attach to reducing poverty. Allocations for social and poverty reducing components under the PSDP and current expenditures under the Social Action Program and the Food Support Program have been increased by 28 percent in 2000/01, equivalent to 0.4 percent of GDP. The authorities expect that these expenditures should help cushion the impact on the poor of the necessary price increases and exchange rate depreciation and avoid an increase in the incidence of poverty. Nevertheless, the level of these expenditures at 2.8 percent of GDP is still low, continuing to be constrained by the large debt burden and the limited revenue base.

34. **Steps are being taken to reduce widespread poverty in Pakistan.** Approximately one-third of the population presently lives below the poverty line, up from about one-fifth in the late 1980s.[21] In the near term, the poor are likely to be adversely affected by the projected increases in domestic prices of major food items (particularly wheat, dairies, cereals, and

[21] A survey of the literature assessing the poverty situation in Pakistan is provided in the Selected Issues paper.

cooking oil), increases in the cost of household energy consumption, better enforcement of the GST, and the extension of the GST to agricultural inputs. In addition, the real earnings of those employed in the informal and nontraded sectors, many of whom are poor, are likely to fall. While the expansion in social and poverty-related spending should help cushion the impact of these factors on the poor, a more comprehensive strategy to reduce poverty, including through a broadening of the social safety net, will need to be implemented for the medium term. In this context, the authorities have prepared, through a broad consultative process, a draft interim poverty reduction strategy paper (IPRSP). This document describes the poverty situation in Pakistan, key elements of the proposed poverty reduction strategy, a roadmap for preparing the full PRSP (by January 2002), and mechanisms for monitoring and evaluating the poverty situation.

35. **Tax performance in the first quarter appears to be slightly weaker than envisaged, although indications are that the shortfall could be reversed.** Preliminary data indicate a small shortfall of some PRs 2.6 billion in CBR revenue for the first fiscal quarter, compared with envisaged collections of PRs 82.6 billion. This relates largely to direct tax collections; all other tax receipts have performed in line with, or better than, expectations. The authorities explained that the shortfall in income tax receipts owes to the extension of the filing deadline from end-September to November 20, which was necessitated by a delay in the release of the new income tax form. They are confident that most, if not all, of the shortfall will be made up in the second quarter.

36. **Cushions have been built into the budgetary projections, expenditure control mechanisms have been strengthened, and the authorities have identified contingency measures that will be implemented as needed to protect the deficit target** (as detailed in the MEFP). The authorities considered that the conservative assumptions used to project the interest bill, revenue from the extension of the GST to agricultural inputs, and taxation of agricultural incomes, together with the likely increase in natural gas prices later in the year, provided some, albeit limited, cushion of up to 0.2 percent of GDP. Steps taken from the beginning of this fiscal year to improve fiscal monitoring and control include: establishment of a process of more frequent consultations between budget officials and spending units; strengthened fiscal accounting and reporting procedures; improved budgeting and monitoring of interest payments; and initiation of monthly monitoring of defense spending. As regards contingency measures, the authorities have identified PRs 7 billion in potential cuts in the PSDP. Line ministries have been instructed to limit spending to PRs 5 billion below the level envisaged under the program through December 2000. Following a mid-year review in January, necessary expenditure cuts will be announced if revenue performance is found to be short of program targets. Quarterly quantitative targets for social and poverty-related spending have been established under the program to ensure that allocations for such spending will be protected from cuts during 2000/01.

37. **On the structural side, several initiatives are underway to strengthen tax administration and taxpayer registration,** including the issuance of taxpayer identification numbers and the tax survey and registration drive, as detailed in the MEFP. The latter has

boosted public awareness and acceptance of the need to widen the tax base. While the drive is still in the early stages of implementation, the authorities expect a major boost to both revenues and taxpayer registration over the longer term. In the near term, however, they recognized that the magnitude of revenue gains from the drive was uncertain and, in light of the mission's reservations regarding potential short-term gains, they agreed to employ conservative estimates in projecting budgetary revenue increases in 2000/01 stemming directly from the drive. Rather, most of the projected increase in CBR revenue (around 0.9 percent of GDP) was based on specific measures in certain sectors taken in conjunction with the drive. These included, for example, legislative and regulatory changes to curb spurious and fraudulent GST refund claims in the textile sector, procedural changes to prevent the underpayment of GST by steel mills, mechanisms to enhance collection from the stock of GST arrears, increased use of the new audit management information system at the CBR, and the commencement of audits for filings under the income tax self assessment scheme.

38. **A number of steps are being taken to minimize the risk that the survey and registration drive places an excessive burden on the already strained tax administration and audit capacity of the CBR.** The administration of the drive has been separated from regular tax administration within the CBR. In addition, the authorities intend to strengthen the existing large taxpayer units in Karachi and Lahore that focus on enterprises in the textile and cement sectors, and to extend the focus to large taxpayers in other sectors. Other measures to improve tax administration, including the formation of a special committee to formulate a specific strategy and implementation schedule, are described in the attached MEFP.

39. **The sales tax net has been further widened through the extension of the GST to services.** Some services that are now subject to the GST were previously not taxed, while others were previously subject to excise taxes, which have been withdrawn. The authorities explained that their preference would have been to levy the GST at the federal level on all services. However, under the constitution, only provinces were empowered to levy sales taxes on certain services, while the right to tax other services (such as transportation and telecommunications)—albeit not through a sales tax—was conferred to the federal government. Hence, the GST has been extended to most services through identical provincial ordinances, while excise taxes in VAT mode have been levied on transportation and telecommunication services. A workable revenue-sharing arrangement between the federal and provincial governments has also been put in place. The authorities agreed to consider enhancing the legal framework at the time of the next National Finance Commission award (which determines revenue sharing arrangements among the federal and provincial governments) to ensure that tax rates and coverage of the GST on services remain identical across provinces in the future.

40. **The authorities recognize that the enforcement of the GST in the retail sector is critical for encouraging upstream registration and enhancing the tax revenue benefits of the GST.** To this end, they have undertaken to withdraw the turnover tax option for retailers above the PRs 5 million threshold from the start of the 2001/02 fiscal year. To ensure that the transition to the GST proceeds smoothly, a GST education campaign for retailers and traders is

being launched, and record-keeping and filing requirements under the turnover tax have been enhanced.

41. **The authorities have also undertaken to extend the GST to agricultural inputs in a phased manner, commencing in the current fiscal year.** In the first phase, which is to be implemented by end-March 2001, the GST will be extended to urea fertilizers and pesticides. The second phase, which will go into effect by September 1, 2001, will encompass all other agricultural inputs. The authorities were of the view that the favorable supply conditions in the agricultural sector over the past year, and the associated rise in agricultural incomes, would facilitate public acceptance of this measure. Nevertheless, the timing of the two phases had been chosen to coincide with the crop cycle to minimize the effect of the tax on farmers' liquidity position.

42. **Taxation of agricultural incomes has been enhanced with the introduction of a two-tier tax from this fiscal year.** The tax, which was promulgated by the provinces with their 2000/01 budgets, consists of a fixed land-based tax as well as an income tax on large farmers (details of the tax are contained in the attached MEFP). The authorities explained that minimum thresholds for the land-based component of the tax had been introduced by some provinces for administrative efficiency reasons. While observing that the exemption limit for agricultural income had been set at twice that for nonagricultural incomes on account of the higher volatility of agricultural incomes and the larger number of dependents in agricultural households, they stressed that agricultural income would be clubbed with nonagricultural income for rate purposes. The authorities also noted that the budgetary projections for 2000/01 conservatively envisage about the same revenue, in nominal terms, from agricultural taxes as last year.

43. **A fundamental overhaul of the income tax system is underway and a new income tax law is to be promulgated with the 2001/02 budget.** The authorities indicated that their aim was to move to a simple income tax based on genuine self-assessment with minimal exemptions and a less distorting rate structure. Moreover, the number of withholding taxes would be sharply reduced under the new law and the tax treatment of different types of financial instruments would be equalized. An income tax reform committee has been established and will submit a preliminary report to the Finance Minister by end-December 2000. Its final report and a draft law are to be submitted to the cabinet by end-March 2001.

44. **Structural reforms in the fiscal area have been geared toward reducing GST, customs duty, and income tax exemptions.** The gradual widening of the GST net has reduced the number of exempt sectors. Once the measures envisaged through September 2001 are implemented, only standard exemptions will remain. Customs exemptions, which had been granted through 49 Statutory Regulatory Orders (SROs), have been rationalized in the 2000/01 budget. The authorities indicated that they would allow time bound SROs to lapse and that the timetable for the phasing out of exemptions under the deletion policy agreed with foreign investors would be strictly adhered to. Income tax exemptions, including those related to

income from financial instruments, are to be rationalized or eliminated in the context of the new income tax law.

45. **As several of the structural tax reforms are likely to improve the provinces' budgetary position, measures are being taken to prevent a loss of fiscal discipline at the provincial level.** Provinces have benefited from certain changes in the tax structure, including the extension of the GST to petroleum products, electricity, and services as well as the agricultural income tax. Moreover, provinces are expected to mobilize increased revenue as a result of streamlining and rationalization of their own taxes, particularly in the area of property tax, where realistic valuation tables are being drawn up. To maintain provincial fiscal discipline, many of the expenditure responsibilities related to development spending have been transferred to the provinces. Public accounts committees, modeled after the Federal Public Accounts Commission, have also been established in each province to ensure accurate and timely monitoring of provincial fiscal developments. If warranted by developments during the year, the federal government can require provinces to accelerate repayments of federal government loans.

E. Other Structural Reforms

46. **Public enterprise reform is proceeding with a view to reducing enterprises' burden on the budget and preparing them for eventual privatization.** Direct budgetary costs related to the enterprises, excluding enterprise investment financed through the budget, are projected to decline to around 1.4 percent of GDP in 2000/01,[22] from 1.7 percent in 1999/2000. In the power sector, measures to enhance the performance of the two major enterprises—the Water and Power Development Authority (WAPDA) and the Karachi Electricity Supply Corporation (KESC)—are being implemented with support from the World Bank and the AsDB.[23] The Ministry of Water and Power, on behalf of both WAPDA and KESC, has filed for a tariff increase that includes the introduction of an automatic tariff adjustment clause to improve their financial viability, which has been eroded by exchange rate adjustments and changes in fuel prices. Notifications for the increase are expected to be issued by end-November 2000. In the meantime, an interim tariff adjustment of 7.5 percent on average has been granted. Nevertheless, KESC will be faced with a sizable cash flow shortfall,

[22] This includes a PRs 10 billion cushion for shortfalls in debt servicing to the government.

[23] While WAPDA's liquidity situation remains difficult on account of large overdue receivables, mainly from public sector entities, the ongoing operational and financial restructuring has substantially improved the financial position of WAPDA's power wing. At end-June 2000, public sector arrears to WAPDA amounted to about PRs 34 billion (1 percent of GDP), of which about PRs 10 billion was accounted for by KESC and about PRs 15 billion by the Sindh province. Modalities for settling public sector arrears to WAPDA have been agreed and are being implemented. As regards KESC, weak corporate governance and a high incidence of electricity theft, billing fraud, and collection problems have resulted in continuous operational deficits, thereby eroding KESC's equity capital. Corporate and financial restructuring plans are being formulated and implemented to tackle these issues.

which will need to be partly covered through bank borrowing with a government guarantee.[24] In the gas sector, a plan to raise both wellhead and end-user prices is being finalized, in consultation with the World Bank, to facilitate the privatization of gas sector enterprises. In the meantime, noncore businesses of these enterprises are being separated and sold off to a private investor. One such privatization was completed in September 2000, fetching the equivalent of about US$6 million.

47. **Tariff disputes with the Independent Power Producers (IPPs), which had clouded investor sentiment toward Pakistan, are in the process of being resolved.** Tariffs have been renegotiated with 12 IPPs, and the terms of the memoranda of understanding are being implemented. The dispute over management of the Kot Addu Power Corporation (KAPCO), in which a controlling stake was sold to foreign investors in 1996, has effectively been resolved through the signing of a memorandum between WAPDA and the foreign investors. The only remaining tariff dispute relates to the Hub Power Corporation (HUBCO). Discussions are underway between the parties related to a revised tariff offer made by HUBCO on September 10, 2000, which would form part of an overall settlement of all outstanding issues. The World Bank staff is facilitating the discussions.

48. **The medium-term trade liberalization program is to be built around a pre-announced series of further cuts in the maximum tariff rate and in the number of tariff slabs.** [25] As of July 2001, the maximum tariff rate will be cut to 30 percent and the number of nonzero tariff slabs will be reduced to four. From January 2003, the maximum tariff rate is to be further reduced to 25 percent, while the number of tariff slabs will be lowered to three. To ensure that domestic industry has adequate time to adjust to the more liberal trade regime, the tariff reductions plans, and the dates they will go into effect, have been announced. These measures will build on the recent reduction in SROs, elimination of import deposit requirements on imports of certain goods, and the removal of most differential excises on domestically produced and imported goods where the effective tariff (tariff plus the differential in excises) exceeded the maximum tariff rate. At present, the effective tariff rate exceeds the maximum rate for eight goods, on which differential excises have been replaced by regulatory duties as a temporary measure. Once the anti-dumping legislation is enacted—envisaged by end-2000—the regulatory duties on these eight goods will be eliminated and, where appropriate, anti-dumping duties will be imposed. In addition, the authorities undertook to remove all remaining differential excises—where the effective tariff is within the maximum—by July 2001. The authorities are also committed to phasing out remaining nontrade barriers on

[24] The program incorporates PRs 7.5 billion in government-guaranteed credits to KESC related to its cash flow shortfall.

[25] The simple average tariff rate declined from 61 percent in 1992 to 24 percent in 1999, while the maximum tariff rate declined from 65 percent to 35 percent. The number of slabs was reduced from 7 in 1997 to 5 in 1999. Pakistan also maintains a variety of nontariff barriers, including lists of prohibited exports and imports, which have been substantially reduced in recent years. A description of Pakistan's trade system is presented in the Selected Issues paper.

imports—except the ones related to health, security, environment and religious reasons—as soon as the balance of payments position improves.[26] They intend to meet with the WTO Committee on Balance of Payments Restrictions in the second half of November to continue discussing the phasing-out of trade restrictions. The authorities have also commissioned a number of sectoral studies, with the aim of identifying areas in which tariff anomalies exist and tariff regulations and other structural issues are adversely affecting the competitiveness of domestic industry.

49. **Efforts are being made to eradicate child labor in Pakistan.** In 1996, there were about 3.3 million children between ages 5 and 14 that were economically active on a full-time basis. Most child employment takes place in rural areas, and about one-third of the employed children are literate. The Government of Pakistan has been engaged in cooperation with international organizations and local NGOs in programs to eliminate child labor, and has signed a memorandum of understanding with the ILO to undertake a National Program for the Elimination of Child Labor (IPEC). Presently, IPEC Pakistan is implementing the following major programs: (a) elimination of child labor from the soccer ball, surgical instruments, and carpet industries; (b) elimination of bonded labor; (c) provision of nonformal education and pre-vocational training to children in hazardous work; and (d) a drive to mobilize 1,500 primary school teachers in the Northwest Frontier Province. In addition, a Child Labor Unit has been established under the Ministry of Labor to monitor progress in tackling issues related to child labor and the Child Care Foundation of Pakistan has been formed to coordinate the establishment and/or augmentation of education and health facilities offered by industry.

50. **Improving governance and enhancing transparency are central objectives of the authorities' reform agenda.** A number of specific steps in this regard, which are outlined in the attached MEFP, are being implemented. These include the National Devolution Plan, which seeks to enhance local-level participation in government spending priorities through decentralization; a program to improve economic governance through monitoring of public expenditure and increase accountability of public officials; and programs to reform the civil service, police, and judiciary. The civil service reform program, which has commenced with the restructuring of the CBR, is to extend to all federal economic ministries by March 2001, and to the rest of the federal secretariat by 2002/03. With the objective of improving fiscal transparency, the authorities have completed the fiscal transparency questionnaire, and the staff has prepared a fiscal module of the Report on the Observance of Standards and Codes (ROSC). The authorities have agreed to publish this report.

---

[26] In 1998, the government agreed with the WTO to phase out all quantitative restrictions on imports. Subsequently, the authorities had to suspend the implementation of the phasing-out schedule due to the adverse balance of payments position. See phase-out plan (WT/BOP/N/40 of November 12, 1998) and Pakistan's notification to the WTO (WT/BOP/N/51 of July 7, 2000).

F. Balance of Payments Outlook and External Financing Issues

51. **After a sharp contraction in 1999/2000, the external current account deficit is expected to remain at about 1.6 percent of GDP in 2000/01**, despite a projected further deterioration in the terms of trade equal to 0.4 percent of GDP. Exports are projected to increase largely due to improvements in crops and cotton manufactures, following the recent measures to liberalize the agricultural sector, combined with the continued recovery of demand in Pakistan's main Asian trading partners. While imports of intermediate goods are projected to increase as a result of higher crude oil prices (see Box 4) and a recovery in domestic demand, the increase would be partially offset by a decline in wheat and fertilizer imports as domestic production rises, expected low fertilizer prices, and the completion of energy sector projects and consequent reduction in project-related imports. Total private transfers are projected at about the same level as in 1999/2000. Private transfers through the interbank market are expected to recover strongly as expectations of further exchange rate adjustments dissipate, including in response to the recent tightening of the monetary policy stance.

Box 4. Impact of Oil Prices on Trade and Inflation

During 1999/2000, average world market prices for crude oil increased by 85 percent to US$ 24 per barrel, increasing Pakistan's inflation rate as measured by the consumer price index (CPI) by about 0.6 percentage points and leading to a deterioration in the terms of trade of about 11.5 percent.[1] At the same time, the oil import bill (including petroleum products) increased by 2 percentage points of GDP. In 2000/01, the projected path of oil prices implies a further deterioration in the terms of trade of about 2 percent, an increase in the CPI inflation by about 0.4 percentage points. Price effects are projected to increase the oil import bill by 0.4 percent of GDP.[2]

Terms of Trade and Trade Balance

	1998/99	Est. 1999/00	Proj. 2000/01
Terms of trade			
(In percent change)			
Total	4.1	-9.5	-2.1
Excluding crude oil	-0.9	1.9	0.7
Impact of terms of trade on trade balance			
(In percent of GDP)			
Total	...	-1.6	-0.4
Excluding crude oil	...	0.6	0.0

Source: Fund staff estimates.

[1] It should be noted that domestic prices of petroleum products rose less than world market prices for crude oil; decreases in world market prices in 1997/98 were also not fully passed on to consumers. This explains the relatively small effect on the domestic CPI and the seemingly absent effects on growth in 1999/2000.

[2] On the upside, private transfers, which are in large part workers' remittances, could be higher than projected since the rise in oil prices might well increase private transfers from Pakistani workers in oil-producing countries.

52. **External financing needs in 2000/01 are sizable.** In addition to the current account position, the external financing needs reflect the envisaged buildup of reserves, the large debt obligations coming due (US$3.5 billion), and the assumed clearance of outstanding arrears. Given the capital account projections, which incorporate conservative assumptions regarding private capital inflows—including those related to commercial credits (US$543 million),[27] foreign direct investment (US$515 million), and suppliers' credits (US$150 million)—the staff estimates a gross exceptional financing requirement of about US$4 billion (equivalent to US$2.1 billion on a net basis) in 2000/01 (Tables 9, 10, and 11). To meet this requirement, the program foresees exceptional financing support from the private sector, the IFIs, and bilateral creditors.[28] Regarding **financing from the private sector**, following the restructuring of commercial loans[29] in 1998/99–1999/2000 and Eurobond obligations[30] in 1999/2000, the authorities are negotiating two loans totaling US$145 million from commercial banks to public enterprises (both loans are for 300 days). They will seek rollover of US$500 million deposits from Bank of China at the NBP and of 75 percent of US$1.1 billion foreign currency deposits of institutional investors falling due in 2000/01. With regard to **financing from IFIs**, the authorities envisage US$350 million from the World Bank under a Structural Adjustment Loan in support of the reform program in the power, gas, and banking sectors, and in the areas of privatization and governance,[31] and some US$525 million from the AsDB in the form of program loans covering agriculture, trade, energy, legal system, microcredit and small- and medium-sized enterprises. To ensure the disbursements of these loans, the authorities intend to implement expeditiously the related reform programs. From **bilateral sources**, the government obtained the rolling over for two years of a US$250 million deposit from the Kuwait

---

[27] In addition to the US$413 million in short-term loans to Pakistan State Oil (PSO) from the Islamic Development Bank (IDB) that was already in the pipeline, financing of US$130 million to PSO from the IDB has been arranged (US$50 million with one-year maturity and US$80 million on a six-month rollover basis).

[28] As the timing of several elements of the external financing package is uncertain, the program also includes an adjuster of up to US$250 in the quarterly net foreign assets targets (and, by an offsetting amount, in the net domestic assets targets) for a shortfall in program financing of up to US$250 million. In the event of a larger shortfall, which may not be temporary, additional adjustment effort would be required to keep the program on track.

[29] Restructured loans amounted to US$929 million, of which US$777 million involves the rolling over of trade finance facilities on an annual basis for three years (till end-June 2002), which included a step-up in the margin over LIBOR from 100 basis points in the first year, and to 125 basis points and 150 basis points in the second and third years, respectively. Of the remaining amount, US$102 million was rescheduled with a grace period extending to end-December 2002 and repayments thereafter in six equal annual installments. In addition, a US$50 million contracted from an investment bank in September 1998 was rolled over beyond 2000.

[30] Under the restructuring agreement, previous bonds were exchanged for a new issue with six-year maturity, three-year grace period, and four equal annual repayments starting on November 15, 2002. About 99 percent of bondholders opted for the new debt instrument and the government does not intend to repay the remaining old bonds on terms more favorable than the new issue.

[31] The World Bank staff is discussing whether it may be possible to undertake the prospective adjustment loan on International Development Agency (IDA) terms.

Investment Authority at the SBP initially falling due in August 2000. The government will also seek further rolling over of a US$150 million deposit from the Central Bank of U.A.E. deposits at the SBP falling due in December 2000. To close the remaining financing gap in 2000/01, the authorities intend to approach the Paris Club and other bilateral and commercial creditors for a rescheduling of public and publicly-guaranteed debt (Table 11).[32] They have already initiated discussions with the Paris Club and other bilateral creditors.

53. **An additional avenue of financing by the private sector, not included in the exceptional financing estimates above, relates to the IPPs.** Under Pakistan's 1994 power policy, foreign investors set up private power plants under power purchase agreements (PPAs) with WAPDA. Following the emergence of tariff disputes in 1998/99, the commissioning dates of several IPPs under construction were delayed, tariffs of 12 IPPs were renegotiated, some projects needed to be financially restructured to cover cost overruns caused by the delays, and WAPDA, as instructed by the courts, has paid lower charges to HUBCO and KAPCO than those agreed under the original PPAs. For most IPPs, this has translated into a lower-than-anticipated return on equity and, consequently, lower profit remittances abroad than envisaged under the PPAs,[33] as well as lower debt repayments. The revised tariff schedules now in place for most of the IPPs also imply a sizable reduction in private sector outflows in the form of lower profit remittances over the life of the project.

IV. Medium-Term Macroeconomic Outlook

54. **The medium-term macroeconomic outlook is predicated on the achievement of further fiscal consolidation, maintenance of a competitive, market-based exchange rate, and steadfast implementation of structural reforms.** The principal macroeconomic objectives over the medium term are: (a) a steady increase in growth to 6 percent by 2003/04; (b) a gradual decline in inflation to about 3.5 percent; and (c) a buildup of foreign exchange reserves to the equivalent of three months of imports of goods and nonfactor services. The envisaged consolidation of the budget deficit—to 3 percent of GDP by 2003/04—is built on a steadily rising tax revenue-to-GDP ratio, reflecting a simpler and more broad-based tax system and improved tax administration. Largely on account of increased public saving, gross national saving is projected to rise to over 17 percent of GDP in 2003/04. Gross capital formation is expected to rise to about 17.5 percent of GDP by 2003/04, as the investment environment and profitability improves with the enhanced external competitiveness and macroeconomic stability under the program, and taking into account the external financing constraints

---

[32] On January 1999, the government reached an agreement with Paris Club creditors to reschedule debt obligations on pre-cutoff debt (cutoff date is September 1997) coming due between January 1999 and December 2000 plus arrears up to December 1998. The second phase of the agreement—covering the period March 1 to December 31, 2000—was not implemented in the absence of an active arrangement with the Fund.

[33] While accurate estimates of the reduction in IPPs' profit transfers are not available, market analysts suggest that WAPDA saved about PRs 20–40 billion (US$400–US$800 million) in 1998/99–1999/2000 because of the delays in commissioning and by paying lower-than-envisaged tariffs.

(discussed below). In light of evidence from earlier episodes of growth recoveries in Pakistan and current levels of capacity utilization, this increase in investment would be consistent with the projected acceleration in growth. Despite the improvement in the budgetary position, net public debt is projected to decline only modestly, from about 94 percent of GDP in 2000/01 to about 86 percent of GDP in 2003/04.[34] While saving in interest payments and containment of defense outlays should allow increased social and poverty-related spending, the persistently high public debt burden is likely to continue to constrain progress in reducing poverty.

55. **The external current account position is projected to improve over the medium term, narrowing to a deficit of 0.1 percent of GDP by 2003/04.** Export volume growth is expected to be sustained at around 8 percent a year, while import volume growth is projected at about 7 percent a year. The real depreciation during the course of 2000/01 and projected gradual improvement in the terms of trade, largely due to an expected decline in crude oil prices, over the medium term should allow Pakistan to maintain its market share in export markets and benefit from stronger demand from its main trading partners.[35] Private transfers are projected conservatively to be maintained at the level recorded in 1999/2000.

56. **The capital account is also projected to improve substantially over the medium term, but the financing requirement will remain large.** While identified official inflows are projected to remain broadly stable over the projection period, net private inflows are expected to strengthen following the implementation of the reforms under the program. Despite the envisaged improvements in the current and capital accounts, and taking into account the targeted buildup of gross official reserves to the equivalent of three months of imports of goods and nonfactor services by 2003/04, the financing gaps remain sizable (US$2.0 billion in 2001/02 to US$1.4 billion in 2003/04). This assumes servicing of debt obligations to all creditors as they come due, repayment of foreign currency deposits of institutional investors, the Bank of China, the Kuwait Investment Authority, and the Central Bank of U.A.E., as well as the phasing out of the Saudi oil financing facility by mid-2002 (these payments amount to about 4 percent of GDP over the projection period). This scenario suggests that public and publicly-guaranteed external debt should decline slowly to about 50 percent of GDP by 2003/04, compared with 55 percent of GDP in 2000/01 (Table 12).

57. **With full implementation of the program and continued reform efforts that could be supported by the international financial community, Pakistan should be able to service its obligations to the Fund.** Although the Fund's exposure to Pakistan would rise to SDR 1.4 billion by the end-September 2001 if all purchases under the Stand-By Arrangement are made, Pakistan's liabilities to the Fund would represent no more than 5 percent of total

---

[34] The decrease is less than the sum of the cumulative primary surpluses (about 9 percentage points of GDP) and dynamic interest gains (about 6 percentage points) during the period because these gains are partly offset by valuation losses on external debt stemming from the projected depreciation of the rupee.

[35] An analysis of Pakistan's export trends in the 1980s and 1990s is presented in the Selected Issues paper.

public and publicly-guaranteed debt, and less than 13 percent of annual exports of goods and services (excluding private transfers) over the projection period (Tables 13 and 14). After declining in 2001/02, total debt service obligations to the Fund (repurchases and charges) would increase, but remain below 3 percent of annual exports of goods over the projection period.

58. **Downside risks to the medium-term program could undermine progress towards balance of payments viability and debt sustainability**. The achievement of these objectives hinges on a few key factors, including a recovery of growth, fiscal adjustment, and export growth, which may not evolve as envisaged. For example, the rebound in confidence, which would result in a sizable increase in investment, or improvements in investment efficiency stemming from structural reforms, could lag and growth may remain sluggish. Fiscal adjustment efforts could suffer a setback if the substantial revenue efforts prove difficult to sustain or if the needed increase in social and pro-poor expenditures were to be effected without appropriate restraint on overall expenditure. This would in turn make the realization of the projected decline in domestic interest rates difficult, with consequences for economic growth. Export growth could be held back by exogenous factors such as weather and external demand conditions. The realization of any of these risks could cause the economy's path to divert away from debt sustainability and balance of payments viability (Box 5). Meanwhile, the overall external financial vulnerability would remain at its current precarious level, and the dilemma between fiscal adjustment and the need for increased social and poverty-related expenditures would only intensify.

V. Statistical Issues, Misreporting, and Technical Assistance

59. **Efforts are being intensified to improve the quality, timeliness, and reporting of data with technical assistance from the Fund.** Data are particularly weak in the fiscal and national accounts and, to a lesser extent, in the area of external debt statistics (Appendix V). These data weaknesses could complicate the timely and accurate monitoring of economic developments and impair the formulation of appropriate and effective policy responses to developments in the domestic economy.

60. **Revised historical fiscal data indicate that Pakistan was in breach of its obligations to provide accurate information on at least two occasions during 1993/94–1996/97**. On April 28, 2000, at the Executive Board Meeting convened to review the misreporting of fiscal data by Pakistan to the Fund during 1997/98 and 1998/99, Directors urged the authorities to finalize the data reconciliation process for the years prior to 1997/98. The revision of Pakistan's fiscal data for 1993/94–1996/97 has been completed recently with technical assistance from the Fund. As a result of the revisions, fiscal deficits in the period

Box 5. Debt Sustainability and BOP Viability—Sensitivity Analysis

The gradual improvement towards debt sustainability and balance of payments viability in the medium-term program hinges on a few key factors, including a growth recovery, fiscal adjustment, and export growth. To assess the risks associated with different time paths for the main macroeconomic variables, staff performed a sensitivity analysis by subjecting three parameters to small perturbations:

Higher domestic interest rates. To sustain the budget financing, higher domestic real interest rates may be needed. The sensitivity analysis assumes that real interest rates on the domestic public debt are 1 percentage point higher throughout 2000/01-2003/04 while external budget financing remains unchanged. Compared to the baseline scenario, the overall budget deficit would increase by about 0.4-0.5 percentage points of GDP. Accordingly, the net public debt at end-2003/04 would only decline to 87.9 percent of GDP.

Lower export growth. Export growth may be held back by factors such as weather conditions (through its effects on the cotton crop) or external demand. The sensitivity analysis assumes that the export volume growth rate is 1 percentage point lower throughout 2000/01-2003/04. Compared to the baseline, the external current account balance would gradually widen from 0.1 percentage point of GDP in 2000/01 to 0.5 percentage points in 2003/04. Total external debt would only decrease to 227 percent of current foreign exchange receipts.

Lower GDP growth. The rebound in real GDP growth may lag if the underlying driving forces do not materialize as envisaged. The sensitivity analysis assumes that the real GDP growth rate (at factor cost) remains at the average observed during the 1990s throughout 2000/01-2003/04, with corresponding decreases in export volume growth rates. The net public debt would then only decline by 2 percentage points of GDP compared to the end-1999/2000 level while total external debt would decrease to 236 percent of current foreign exchange receipts.

Pakistan: Risks to the Medium-Term Program-Sensitivity Analysis

	1999/2000	2000/01	2001/02	2002/03	2003/04
Higher domestic real interest rates					
Implied interest rate on public debt (in percent)	9.0	8.8	8.6	8.3	8.2
Budgetary balance (in percent of GDP)	-6.5	-5.6	-4.8	-4.1	-3.5
Net public debt (in percent of GDP)	91.6	94.2	93.1	91.3	87.9
Lower export volume growth					
Export volume (annual percentage change)	11.5	11.2	7.2	6.7	7.2
Real GDP at factor cost (annual percentage change)	4.8	4.4	4.8	5.3	5.7
Current account balance (in percent of GDP)	-1.6	-1.7	-1.4	-1.1	-0.8
Total external debt 1/	281.6	268.5	256.2	243.3	226.6
Debt service 1/ 2/	35.2	29.1	29.4	25.9	25.9
Lower GDP growth					
Real GDP at factor cost (annual percentage change)	4.8	4.4	4.4	4.4	4.4
Export volume (annual percentage change)	11.5	12.2	6.2	4.3	4.6
Budgetary balance (in percent of GDP)	-6.5	-5.2	-4.4	-3.7	-3.3
Primary budgetary balance (in percent of GDP)	1.2	1.5	2.5	2.9	3.2
Net public debt (in percent of GDP)	91.6	93.9	93.0	91.6	89.5
Current account balance (in percent of GDP)	-1.6	-1.6	-1.3	-1.3	-1.1
Total external debt 1/	281.6	266.3	255.4	247.4	236.2
Debt service 1/ 2/	35.2	28.9	26.7	26.4	26.9

1/ In percent of current foreign exchange receipts.
2/ Before additional rescheduling or debt restructuring.

1993/94–1996/97 appear to have been misreported and were revised upward in all years except for 1994/95. The government's audited accounts, on the basis of which the revisions to the annual fiscal data were undertaken, are available only on an annual basis. As a result, the revision of historical quarterly fiscal data is not possible. In the absence of revised quarterly fiscal data, it is not possible to make a full assessment of the applicability of the misreporting framework for the period from July 1, 1993 to June 30, 1997. However, given that year-end consolidated data are available, a determination of whether misreporting occurred with regard to the performance criteria applicable to this period (i.e., end-June performance criteria) is possible. In this regard, Pakistan's failure to provide accurate information regarding the end-June 1994 performance criterion on bank borrowing for budgetary support constituted a breach of Pakistan's obligation under Article VIII, Section 5. Similarly, its failure to provide accurate information regarding the overall budget deficit and bank borrowing for budgetary support for the end-June 1996 performance criteria also was in breach of this obligation.[36]

61. **The authorities have taken a number of steps to enhance the quality and transparency of the public accounts,** in line with the recommendations of an FAD technical assistance mission on fiscal reporting issues. These recommendations, together with the authorities' actions to implement them, are summarized in Appendix VI. While the fiscal data reporting and accounting procedures now in place should be adequate for program monitoring purposes, vigilance over reporting and reconciliation practices will be needed to ensure that discrepancies in the fiscal data do not arise in the future. The authorities are aware of the statistical implications of the devolution of fiscal operations to provincial levels and are also in the process of upgrading reporting standards of provincial fiscal data for adequate monitoring of the proposed program. The authorities have participated in the fiscal module of the ROSC. The ROSC report has identified a number of areas where fiscal transparency could be enhanced; these recommendations, as well as the authorities' plans to implement them, are also described in Appendix VI.

62. **Pakistan's national accounts statistics are subject to a number of weaknesses which compromise the accuracy of data on the level, and the growth rate, of overall GDP.** Recent STA technical assistance missions have found that the key issues are: (a) use of an obsolete base year (1980/81); (b) extensive use of fixed ratios and growth rates in some sectors (including small-scale manufacturing and certain services); and (c) use of single deflation techniques to measure real value added in most sectors. In line with the missions' recommendations, the authorities have adopted an action plan to improve the quality and frequency of national accounts statistics. This plan, which will include the implementation of 22 sectoral research studies to collect data, is to be completed in June 2002. The plan will culminate with the production of a new quarterly GDP series, with a 1999/2000 base year,

---

[36] In both instances, as in Pakistan's previous incidents of misreporting, it would have been within Pakistan's ability to report these data. While a conclusive determination cannot be made in the absence of revised quarterly data, it is likely that Pakistan also failed to provide accurate information regarding performance criteria for the intra-fiscal year performance criteria.

from the 2002/03 fiscal year. The phased completion of the first nine sectoral studies during the 2000/01 fiscal year is a structural benchmark under the program.

63. **The external debt database also requires improvement and increased automation.** While progress has been made in reconciling historical data on flows reported in the balance of payments accounts with the stock figures in the external debt database, the timely reconciliation of recent information continues to be impeded by the manual updating procedures that are in place and the limited familiarity with the database amongst the relevant staff. To address these issues, the authorities plan to put in place a fully computerized debt management system, covering both external as well as domestic debt, managed by a centralized debt management unit by end-2001.

64. **The absence of data on foreign exchange flows through the kerb market, and of informal sector activity more generally, also hampers the analysis of economic developments**. If private estimates of the volume of inflows into the kerb market are correct, and if these inflows are almost entirely related to remittances by expatriate workers, Pakistan's true external current account balance may well be significantly better than indicated by available data, and private capital outflows may be considerably higher. As regards the size of the informal sector, private estimates indicate that this sector accounts for one-third to one-half of the entire economy. Hence, statistics relating to the formal sector likely provide only a partial picture of developments in the economy as a whole.

65. **As required under the policy on safeguards assessments (BUFF/00/48), a Stage One assessment has been completed.** The assessment, based solely on documentation provided by the authorities, was conducted at headquarters and concluded that the safeguards in place at the SBP may not be adequate to manage resources, including Fund disbursements. The staff's preliminary findings indicate that SBP's external audit mechanism, financial reporting framework, and internal controls system are areas with possibly high vulnerabilities. It should be noted, however, that this preliminary assessment may be affected by the current unavailability of certain types of documentation required for a definitive assessment.

66. **In accordance with the provisions of the safeguards policy in such cases, a Stage Two (on-site) assessment is scheduled to be completed by the end of the year** to confirm or modify the preliminary findings of Stage One. If critical vulnerabilities in the areas of external or internal audit, the financial reporting framework, or the system of internal controls are found to exist, they will be addressed before the first review of the program; other remedial actions may need to be taken during the duration of the arrangement. The Board will be informed of the conclusions of the on-site assessment and of the measures recommended to address identified vulnerabilities in the staff report for the first program review.

VI. ACCESS, PHASING, AND PROGRAM MONITORING

67. **An access of SDR 465 million, equivalent to 45 percent of Pakistan's quota (55 percent of quota on an annual basis), is proposed under the Stand-By Arrangement.** The staff views such an access under the Fund arrangement as appropriate in light of: (a) the large balance of payments need, reflecting in part the need to build up reserves and the large debt payments coming due (see Table 11); (b) the strength of the authorities' stabilization efforts and the supporting structural reforms; and (c) the need to boost market confidence, which will be essential for the successful implementation of the program.

68. **A moderate front-loaded phasing of the purchases under the Stand-By Arrangement is proposed,** taking into account the currently low level of official reserves, the need to boost market confidence for the program to succeed, and the implementation of several key measures as prior actions. More specifically, the following phasing of access is proposed: SDR 150 million following the Board approval of the Stand-By Arrangement and SDR 105 million each after meeting the end-December 2000, end-March 2001, and end-June 2001 performance criteria and the completion of the related reviews.

69. **The program will be closely monitored**. The attached MEFP introduces quantitative performance criteria for end-December 2000 and end-March 2001, and indicative targets for end-June 2001 (Table 1 of the attached MEFP). It also establishes structural performance criteria and benchmarks, as detailed in Table 2 of the attached MEFP. In addition, the program contains quarterly reviews, including those of financing assurances. Prior actions were set for the issuance of the staff report for the Executive Board's consideration of the authorities' request for a Stand-By Arrangement, as listed in Table 3 of the attached MEFP. According to the information received from the authorities, all prior actions have been implemented.

VII. STAFF APPRAISAL

70. During the past decade, policies in Pakistan failed to adequately address the structural weaknesses in the economy. While attempts at reform were made a number of times, these were not comprehensive and were not followed through. In addition, the frequent changes in government in recent years exacerbated the difficult economic situation. As a result, the external position remained fragile, public sector indebtedness rose, the investor climate did not improve, economic growth remained low, and poverty increased. The current government, after taking office in October 1999, announced its intention to implement a bold and comprehensive reform agenda, involving a broad consultative process, to address these issues.

71. In 1999/2000, macroeconomic performance was favorable in several respects. Economic growth picked up, inflation eased, and, despite the unfavorable terms of trade shock, the external current account deficit narrowed. However, the budgetary position worsened with weaker-than-envisaged revenue performance and expenditure overruns; the large financing needs of the budget together with easing of monetary policy during 1999/2000 led to a surge in reserve money; and a deterioration in the capital account resulted in a marked weakening in the external position. On the structural side, a comprehensive reform agenda has been developed

and measures were implemented, particularly in the fiscal, international trade, agriculture, and energy sectors. However, tax administration weakened, implementation of certain tax reforms was postponed, and progress in reforming state-owned entities and preparing them for privatization was slow.

72. The decline in official reserves, the continued large external financing requirements, and the depreciation of neighboring countries' currencies undermined the policy of keeping the exchange rate stable against the U.S. dollar. In the circumstances, the relatively loose monetary conditions towards the end of 1999/2000 fueled speculation against the Pakistan rupee, and official reserves declined to dangerously low levels in early 2000/01. To stabilize the external position in the short term and lay the basis for achieving over the medium term sustainable high rates of growth, the authorities have adopted a program of macroeconomic policies and structural reforms. The latter is envisaged to pave the way for a medium-term program that could be supported under the PRGF.

73. Crucial elements of the stabilization program in the short term are exchange rate and monetary policies. The significant depreciation of the rupee in recent months and the authorities' commitment to allow the exchange rate to be determined by the market are welcome. The smooth and efficient functioning of the foreign exchange market will be aided by the implementation of measures recommended by the recent MAE mission, by reducing SBP purchases of foreign exchange from the kerb market, and by avoiding outright forward transactions by the SBP. The staff also recommends that the sale of foreign exchange by the SBP in the interbank market be strictly limited to smoothing short-term fluctuations related to lumpy transactions.

74. With the recent increases in treasury bill yields, discount rates, and reserve requirements, the monetary policy stance has been tightened significantly since end-September to quell speculative pressures against the rupee, support the transition to a market-oriented exchange rate regime, and resist inflationary pressures that result from the depreciation of the rupee. Although some scope for interest rate reductions is expected later in 2000/01, staff cautions against such a move before the targets for net foreign assets and net domestic assets are met with comfortable margins. The monetary program for 2000/01 has been based on conservative assumptions, while allowing adequate credit expansion to the private sector. Given the continued uncertainties with regard to the demand for money, developments will need to be kept under close watch and the policy stance adjusted as needed, including the programmed growth in reserve money.

75. The budget deficit is targeted to decline to 5.2 percent of GDP in 2000/01, an improvement of 1.3 percent of GDP relative to the 1999/2000 outcome, notwithstanding the higher social and poverty-related spending. Although a series of measures to increase tax collections, contain expenditures, and improve tax administration has been implemented to support fiscal consolidation, there are uncertainties regarding their effectiveness. Therefore, the staff urges the authorities to monitor developments closely and respond expeditiously with additional measures as needed to ensure that the deficit ceiling is observed. The budget

projections leave little room for slippages in scheduled payments among federal and provincial governments, government agencies, and the state-owned electricity companies. The staff welcomes the intention of the authorities to implement an increase in electricity tariffs in November in line with World Bank staff recommendations as well as to restructure KESC. In light of the envisaged government support to KESC through government guarantees of its borrowings, the staff cautions against engagement in extensive off-budget transactions through the accumulation of contingent liabilities.

76. Fiscal consolidation needs to continue over the medium term through broadening the revenue base and improving its buoyancy to reduce public debt and release resources for the private sector. To this end, fiscal reforms are essential. While important steps have already been taken, much remains to be done: the extension of GST to large retailers and agricultural inputs; the overhaul of the income tax ordinance; a further strengthening of tax administration; and finalization of an action plan for civil service reform. The authorities are urged to put the outstanding reform measures in place as scheduled under the program so as to start reaping their benefits in the next fiscal year. With regard to the ongoing tax registration drive, the staff is of the view that to maximize its benefits, high priority should be given to the administration of large taxpayers who contribute most to the revenue gap. As regards the proposed decentralization, which is still at an early stage, it will be essential for the authorities to ensure a reallocation of resources between the federal and provincial levels of government that is commensurate with their responsibilities.

77. With regard to structural reforms in other areas, the staff notes that Pakistan's trade system remains relatively restrictive and welcomes the authorities' trade liberalization plan and its early announcement. While acknowledging the potential benefits of sectoral studies to identify and address structural weaknesses in the economy, the staff cautions against allowing industrial policy to guide trade policy. In the financial sector, the staff recommends expeditious implementation of the envisaged reforms of the NSS and the export finance scheme as well as measures to enhance the commercial orientation of the banking system and improve its financial position. The staff encourages the authorities to undertake a full audit of the NCBs by accounting firms operating on international accounting standards in order to estimate future bank recapitalization needs. The envisaged participation in the FSAP will help identify and prioritize recommendations to promote financial sector reforms and financial stability more broadly. The staff welcomes the progress made in resolving the IPP issues, including the recent agreement with KAPCO, and urges the authorities to resolve the remaining tariff dispute with HUBCO, which is critical for restoring investor confidence. Although reforms in the areas of privatization, the energy sector, and governance are not tightly linked to the short-term performance of Pakistan's economy, their expeditious implementation is important in promoting the private sector, attracting foreign investment, and enhancing efficiency. Moreover, progress in implementing these reforms is essential as associated financing from the World Bank and AsDB are important components of the financing package of the 2000/01 program.

78. Notwithstanding the modest buildup in official reserves and the relatively small current account deficit, the gross external financing requirement is large, indicating a major capital account problem. The authorities in 2000/01 intend to obtain financing from the World Bank and the AsDB in support of structural reform efforts and a rescheduling of public and publicly-guaranteed debt owed to bilateral creditors. The authorities' financing strategy also incorporates elements to stem private sector outflows, including through new loans from commercial banks, rollover of FCDs of institutional investors, and rollover of deposits at the NBP. The envisaged financing package nevertheless implies a withdrawal by the private sector compared with the net inflows from bilateral and multilateral creditors. However, in assessing private sector involvement, account needs to be taken of the substantial reduction of IPPs' outflows related to the revised tariffs and delayed commissioning.

79. Significant progress has been made in addressing data-related issues, in particular in revising historical fiscal data series and improving data compilation processes in the fiscal accounts. The strong commitment of the authorities to improving the quality, timeliness, and reporting of data is welcome, and the momentum gained in these areas must be maintained in the period ahead. While significant progress has been made in addressing data related issues and the risk of recurrence of misreporting has been reduced significantly, data weaknesses could complicate the ability to monitor developments under the program. The authorities' commitments to enhance the transparency of economic and financial policies, including through publication of the MEFP and the fiscal module of the ROSC, are also welcome.

80. The 2000/01 program entails significant risks, many of which also apply to the medium-term macroeconomic framework. First, the required fiscal adjustment is sizable and comes largely from increased tax revenue, as scope for reducing budgetary expenditures in the short run is limited. The revenue projections assume an increase in federal tax revenue that is substantially higher than that achieved in the past, and they rely in large part on improvements in tax administration, an area where the authorities have a weak track record. Second, the economy is vulnerable to a variety of shocks, and the confidence intervals surrounding the program's projections for Pakistan's terms of trade are wide, with implications for the current account balance and external financing requirements. Third, the external financing package, which involves a request for debt rescheduling as well as financing from multilateral organizations conditional upon implementation of specific reform agendas, is also subject to significant risks. Shortfalls in external financing could constrain imports and affect growth performance with implications for fiscal performance. Fourth, it is difficult to predict how quickly and to what extent investor confidence will be restored, increasing private remittances and capital inflows. Moreover, Pakistan's past track record with Fund-supported programs is weak. If any of these risks were to materialize, the viability of the balance of payments and the sustainability of public debt dynamics could be compromised. Consequently, meaningful progress in reducing poverty would be difficult to achieve.

81. Despite the above-mentioned risks, in the staff's view, the proposed program for 2000/01 merits support because: (a) it embodies important stabilization measures, of which many are already in place; (b) the program's structural content is relatively strong and includes

preparatory measures essential to launch a major reform initiative with the next budget; (c) the program takes into account the need for social expenditures to safeguard the poor; (d) in view of the uncertainties, some cushion has been built into the program; and (e) it includes important steps to improve data quality and transparency, which will be monitored on an ongoing basis. Accordingly, and in light of the continued close monitoring envisaged, the staff recommends the approval of the Stand-By Arrangement.

82. As explained above, there exists in Pakistan an interbank market and a kerb market for foreign exchange. Although there have been current transactions in the kerb market, the authorities have confirmed that by law, all current transactions are in fact required to take place in the interbank market. They have also undertaken in the MEFP to ensure that all legitimate current account transactions are allowed to go through the interbank market in the future. Staff will continue to monitor this situation closely for possible multiple currency practices under Article VIII, Section 3 of the Articles.

83. As regards the misreporting of fiscal data during 1993/94–1996/97, in view of the remedial actions taken by the authorities since the discovery of discrepancies in the fiscal data in January 2000, which are intended to ensure that such episodes of misreporting do not recur, the staff believes that no further actions are called for at this stage. Consistent with the existing policy on publication of misreporting cases, these instances of misreporting should be made public.

84. It is proposed that the next Article IV consultation with Pakistan be held on the standard 12-month cycle.

VIII. Proposed Decision

The following decision is proposed for adoption by the Executive Board:

1. The Government of Pakistan has requested a Stand-By Arrangement in an amount equivalent to SDR 465 million for the period November 29, 2000 through September 30, 2001.

2. The Fund approves the Stand-By Arrangement for Pakistan set forth in EBS/00/230, Supplement 1 and decides that purchases may be made under the arrangement, on the condition that the information provided by Pakistan on the implementation of the measures specified in Table 3 of the Memorandum of Economic and Financial Policies attached to the letter dated November 4, 2000 is accurate.

3. The Fund waives the limitation in Article V, Section 3(b)(iii) of the Articles of Agreement.

Table 1. Pakistan: Social Indicators

	Latest single year			Latest single year (1990–97)	
	1970–75	1980–85	1990–98	South Asia	Lower-income
Population					
Total population, mid-year (in millions)	71.0	94.8	131.6	1,304.6	3,536.4
Growth rate (percent annual average)	3.2	2.7	2.4	1.9	1.6
Urban population (percent of population)	26.4	29.8	35.9	27.7	30.5
Total fertility rate (births per woman)	...	7.0	4.9	3.4	3.1
Unemployment (as percentage of total labour force)	...	3.7	5.4	...	...
Income					
GNP per capita (1995 U.S. dollars)	263.4	350.2	488.5	430.0	520.0
Consumer price index (1995 = 100)	19.8	42.4	130.6	130.6	136.2
Food price index (1995 = 100)	...	39.3	129.5	122.7	140.8
Social indicators					
Public expenditure					
Health (percent of GDP)	...	...	0.9	0.8	1.3
Education (percent of GDP)	...	2.1	2.7	2.0	3.2
Education					
Gross primary school enrollment rate (in percent of age group)					
Total	39.5	43.7	74.0	100.0	107.0
Male	52.7	55.7	101.0	110.0	112.0
Female	25.5	30.4	45.0	90.0	102.0
Gross secondary school enrollment rate (in percent of age group)	14.7	17.2	47.5	49.0	56.0
Illiteracy rate (as percentage of population aged 15 and above	75.8	68.2	56.0	47.0	31.0
Access to safe water (in percent of population)					
Total	...	38.0	60.0	77.0	73.0
Urban	75.0	84.0	85.0	83.0	...
Rural	5.0	28.0	56.0	75.0	...
Immunization rate (percent under 12 months)					
Measles	...	23.0	74.0	81.0	80.0
DPT	...	30.0	74.0	87.0	82.0
Life Expectancy at birth (years)					
Total	50.6	56.2	63.3	62.3	63.0
Male	50.6	55.6	61.5	61.7	61.9
Female	50.5	56.9	62.6	63.1	64.3
Mortality					
Infant (per thousand live births)	142.0	127.0	91.0	75.0	68.0
Children under 5 years (per thousand live births)	183.0	161.0	120.0	89.0	92.0
Adult (15–59 years)					
Male (per 1,000 population)	339.5	282.5	172.0	220.0	235.0
Female (per 1,000 population)	381.1	290.9	152.0	213.0	208.0

Source: World Bank, World Development Indicators 1999.

Table 2. Pakistan: Macroeconomic Framework, 1995/96–2003/04

	1995/96	1996/97	1997/98	Prel. 1998/99	Est. 1999/00	Prog. 2000/01	Projections 2001/02	2002/03	2003/04
	(Annual changes in percent)								
Output and prices									
Real GDP at factor costs	6.6	1.7	3.5	3.1	4.8	4.5	5.0	5.5	6.0
Partner country demand	3.8	3.8	2.3	2.0	3.8	3.8	3.2	3.4	3.4
Consumer prices (p.a.)	10.8	11.8	7.8	5.7	3.6	6.0	4.7	4.1	3.5
GDP deflator (factor costs)	8.2	13.5	7.7	5.9	3.2	6.0	4.7	4.1	3.5
Partner country consumer prices 1/	3.7	-3.3	-4.5	-0.2	1.7	1.4	2.5	2.6	2.5
Import prices 1/ 2/	4.6	-2.3	-7.4	-3.5	3.3	1.7	0.5	1.3	1.4
Rupees per U.S. dollar (p.a.)	8.8	16.2	10.7	17.0	3.2	11.7	5.8	4.8	3.2
	(In percent of GDP)								
Savings and investment									
Gross national savings	11.8	12.3	15.0	11.2	13.3	13.9	15.1	16.3	17.4
Public 3/	-0.5	-2.1	-2.6	-1.1	-2.0	-0.5	0.7	1.7	2.6
Private	12.3	14.4	17.7	12.3	15.3	14.3	14.4	14.6	14.7
Gross capital formation	19.0	18.0	17.7	15.0	15.0	15.5	16.2	16.9	17.5
Public 3/	8.3	6.1	5.6	5.0	4.5	4.7	4.9	5.2	5.4
Private	10.8	11.9	12.2	9.9	10.5	10.8	11.3	11.7	12.1
Savings-investment balances	-7.2	-5.7	-2.7	-3.8	-1.6	-1.6	-1.1	-0.6	-0.1
Public 3/	-8.8	-8.2	-8.2	-6.1	-6.5	-5.2	-4.2	-3.5	-2.8
Private	1.6	2.5	5.5	2.4	4.9	3.5	3.1	2.8	2.7
Public finances									
Budgetary revenue	17.5	16.1	15.8	16.3	16.1	16.5	17.6	18.2	18.6
Budgetary expenditure	25.3	22.9	23.5	22.4	22.6	21.8	22.0	21.8	21.7
Budgetary balance	-7.8	-6.8	-7.7	-6.1	-6.5	-5.2	-4.4	-3.6	-3.0
Primary balance	-1.7	-0.3	-0.3	1.3	1.2	1.5	2.5	2.9	3.3
Net public debt	86.3	87.5	89.4	91.9	91.6	93.8	92.3	89.9	86.4
Net domestic public debt	43.2	43.6	46.0	44.3	45.9	42.8	41.2	38.9	37.1
Implicit interest rate on public debt (percent) 4/	8.1	8.6	9.2	8.9	9.2	8.2	8.0	7.8	7.6
In real terms (growth-adjusted) 4/	-5.5	-5.9	-1.0	0.1	0.0	-3.1	-1.9	-2.1	-2.1
Monetary sector	(Annual changes in percent of initial stock of broad money)								
Net foreign assets	-4.9	-2.5	-2.7	1.6	1.5	5.6	...	...	...
Net domestic assets	18.7	14.7	17.3	4.5	7.8	5.7	...	...	...
Of which:									
credit to the private sector	7.6	7.3	8.1	8.5	1.4	6.9	...	...	...
Of which:									
net credit to government	6.0	7.5	4.5	-3.9	3.1	-1.2	...	...	...
Broad money	13.8	12.2	14.5	6.2	9.4	11.3	...	...	...
6-month treasury bill rate (in percent, p.a.) 5/	12.8	15.6	15.1	12.5	8.8	...	...	...	...
Inflation-adjusted (in percent; p.a.) 6/	2.0	3.8	7.3	6.8	5.3	...	...	...	...

Table 2. Pakistan: Macroeconomic Framework, 1995/96–2003/04

	1995/96	1996/97	1997/98	Prel. 1998/99	Est. 1999/00	Prog. 2000/01	Projections 2001/02	2002/03	2003/04
	(In percent of GDP)								
External sector									
Merchandise trade balance	-5.8	-5.0	-3.0	-3.6	-2.3	-1.8	-1.3	-0.8	-0.3
Merchandise exports	13.1	12.9	13.5	12.9	13.3	15.3	16.1	17.0	17.7
Merchandise imports	18.9	17.9	16.5	16.5	15.6	17.1	17.4	17.8	18.0
Current account excluding official transfers	-7.6	-6.1	-3.1	-4.1	-1.9	-1.8	-1.3	-0.9	-0.4
Current account including official transfers	-7.2	-5.7	-2.7	-3.8	-1.6	-1.6	-1.1	-0.6	-0.1
	(In percent of current foreign exchange receipts 7/)								
Total public and private external debt	279.9	280.1	270.2	323.1	281.6	266.2	251.1	234.6	214.0
Actual debt service 8/	44.6	56.4	55.8	43.7	35.2	28.9	29.0	25.4	25.2
Implicit interest rate (in percent) 9/	5.3	5.3	5.2	4.2	4.8	5.1	4.9	4.6	4.5
In real terms (growth-adjusted) 9/	2.5	2.5	1.5	20.0	-8.6	-4.6	-2.1	-3.0	-3.7
Gross reserves (millions of U.S. dollars) 10/	2,053	1,141	932	1,672	916	1,740	2,084	2,761	3,442
In weeks of next years' imports (G&S)	7.4	4.4	3.9	7.8	4.2	7.3	8.3	10.3	12.0
In percent of short-term external debt 11/	27.2	15.2	9.6	37.4	21.6	71.6	82.9	107.5	143.5
In percent of broad money	6.7	3.8	3.4	5.8	3.4	6.4	...	...	...
Memorandum items:									
Real effective exchange rate (percentage change)	-0.5	-0.9	3.6	-9.1	-0.5	-7.1	-3.0	-3.0	-2.0
Terms of trade (percentage change)	-7.3	0.3	6.0	4.1	-9.5	-2.1	2.4	2.0	1.6
Real per-capita consumption (percentage change)	2.2	1.9	-3.0	5.2	0.9	2.0	1.4	1.9	2.4
GDP at market prices (PRs billion)	2,120	2,428	2,678	2,914	3,182	3,543	3,895	4,277	4,693

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

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

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

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

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

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

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

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

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

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

10/ Excluding gold and foreign assets relating to foreign currency deposits contracted after May 1998 (FE25s).

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

Table 3. Pakistan: Indicators of External and Financial Vulnerability, 1995/96–2000/01

(In percent of GDP, unless otherwise noted)

	1995/96	1996/97	1997/98	1998/99	1999/2000	2000/01	
						Latest	Projections
Financial indicators							
Net public debt	85.0	85.8	88.1	93.1	90.3	...	92.9
Broad money (percent changes, 12-month basis)	13.8	12.2	14.5	6.2	9.4	10.4	11.3
Private sector credit (percent changes, 12-month basis)	15.0	14.2	13.7	16.2	2.5	5.8	11.1
180-day treasury bill yield (in percent)	12.8	15.8	15.2	13.1	8.6	11.0	...
180-day treasury bill yield, real (in percent)	2.0	4.0	7.4	7.4	5.1	7.0	...
External Indicators							
Exports (percent changes, 12-month basis in US$)	7.1	-2.6	4.2	-10.8	8.5	23.5	14.5
Imports (percent changes, 12-month basis in US$)	16.7	-6.4	-8.4	-6.7	-0.1	17.3	9.3
Terms of trade (percent changes, 12-month basis)	-7.3	0.3	6.0	4.1	-9.5	...	-2.1
Current account balance	-7.2	-5.7	-2.7	-3.8	-1.6	...	-1.6
Gross official reserves (in millions of U.S. dollars) 1/ 2/	2,840	1,834	1,549	2,218	1,460	...	...
In months of imports of goods and services	10.3	7.0	6.6	10.3	6.7	...	...
In percent of broad money	9.3	6.1	5.7	7.6	5.4	...	...
In percent of short-term external debt 3/	37.6	24.4	16.0	49.6	34.5	...	...
Gross official foreign exchange reserves (in millions of U.S. dollars) 2/	2,053	1,141	932	1,672	916	630	1,740
Total external debt (in millions of U.S. dollars)	34,684	35,767	35,782	36,003	35,591	...	36,845
Of which:							
public- and publicly-guaranteed debt	28,121	28,709	21,000	30,012	31,010	...	33,686
Of which:							
short-term external debt	7,556	7,507	9,670	4,473	4,234	...	2,429
In percent of exports of goods and services 4/	279.9	280.1	270.2	323.1	281.6	...	266.2
Actual debt service (In percent of exports of goods and services) 4/ 5/	44.6	56.4	55.8	43.7	35.2	...	28.9
Exchange rate (rupees per US$, period average)	33.33	38.71	42.85	50.13	51.72	56.90	...
Real exchange rate (percentage change, 12-month basis)	-0.5	-0.9	3.6	-9.1	-0.6	1.7	...
Financial market indicators							
Karachi Stock Exchange index							
End-of-period	1,677	1,593	880	1,055	1,521	1,489	...
Period average	1,628	1,505	1,653	985	1,477	1,539	...

Sources: Pakistan authorities; and Fund staff estimates based on authorities' data.

1/ Including gold.

2/ Excluding foreign assets relating to foreign currency deposits contracted after May 1998 (FE25s) and swap or forward operations.

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

4/ Exports of goods and services including workers' remittances.

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

Table 4. Pakistan: Medium-term Balance of Payments, 1995/96–2003/04

	1995/96	1996/97	1997/9	1998/99	Est. 1999/2000		Prog. 2000/01		Projections 2001/02	2002/03	2003/04
					(In millions of U.S. dollars)						
Current account (excl. official transfers)	**-4,820**	**-3,851**	**-1,922**	**-2,382**	**-1,143**		**-1,088**		**-851**	**-592**	**-296**
Current account balance	**-4,593**	**-3,562**	**-1,702**	**-2,188**	**-1,008**		**-984**		**-704**	**-420**	**-94**
Trade balance	-3,704	-3,145	-1,868	-2,086	-1,435		-1,134		-826	-554	-237
Exports f.o.b.	8,311	8,096	8,433	7,526	8,163		9,355		10,251	11,336	12,551
Imports f.o.b	-12,015	-11,241	-10,301	-9,612	-9,598		-10,489		-11,077	-11,890	-12,788
Services (net)	-3,499	-3,662	-3,264	-2,573	-2,771		-2,939		-2,980	-2,938	-2,955
Of which : interest payments	-1,631	-1,745	-1,763	-1,460	-1,676		-1,753		-1,774	-1,648	-1,622
Private transfers (net)	2,383	2,956	3,210	2,277	3,062		2,985		2,956	2,899	2,896
Of which : Workers' remittances	1,461	1,409	1,490	1,060	983		1,100		1,200	1,300	1,415
Official transfers (net)	227	289	220	194	135		105		147	172	202
Capital account	**4,163**	**2,530**	**1,421**	**-807**	**-2,879**		**189**		**444**	**707**	**700**
Public medium- and long-term capital	936	747	1,001	922	-660		19		209	135	-200
Project and nonproject loans	681	199	726	572	127		15		264	246	-164
Disbursements 1/	2,364	1,996	2,617	2,610	2,095		1,779		1,779	1,700	1,780
Amortization	-1,683	-1,797	-1,891	-2,038	-1,968		-1,764		-1,515	-1,454	-1,944
Commercial banks and IDB	104	54	399	-370	-170		-26		-52	-108	-15
Other	151	494	-124	720	-617	2/	30		-3	-3	-21
Net public sector short-term (net)	180	30	173	-894	-254	3/	223		-94	2	20
Private medium- and long-term (net)	1,700	1,493	735	466	278		107		213	430	569
Private short-term (incl. errors & omissions)	1,347	260	-488	-1,301	-2,243	4/	-160		116	139	311
Overall balance, before debt relief granted	**-431**	**-1,032**	**-281**	**-2,995**	**-3,887**		**-795**		**-260**	**286**	**605**
Financing	**431**	**1,032**	**281**	**2,995**	**3,887**		**795**		**260**	**-286**	**-605**
Reserve assets (increase -)	395	1,199	148	-1,254	209		-1,017		-491	-677	-681
State Bank of Pakistan (including FE25s)	624	926	194	-807	380		-1,017		-491	-677	-681
Deposit money banks	-229	273	-46	-447	-171		0		0	0	0
Use of Fund credit (net)	36	-167	133	430	-287		-242		-195	-336	-406
Exceptional Financing	0	0	0	3,819	3,964		2,054		945	727	482
Accumulation of Arrears	0	0	0	0	462		-462	5/	0	0	0
Debt Relief Public Debt and Publicly Guaranteed	0	0	0	1,406	987		0		0	0	0
Repayment of Arrears	0	0	0	0	-63		-55		0	0	0
Rollover of FDCs and deposits at SBP & NBP	0	0	0	1,362	1,872	6/	-276	7/	-698	-798	-500
Principal and Interest Arrears Paid	0	0	0	0	-56		0		0	0	0
Eurobond rescheduling	0	0	0	0	610		0		0	-155	-155
Additional Commercial Bank borrowing	0	0	0	0	0		145		0	0	0
Possible Additional Financing from IFIs	0	0	0	0	0		1,350		140	0	0
Others (inc. Fund)	0	0	0	0	0		475		140	0	0
Bridge financing	0	0	0	218	0		-23		0	0	-195
Financing gap	0	0	0	0	0		1,673	8/	2,035	1,680	1,349
End-period gross official reserves (excl. gold)	**2,053**	**1,141**	**932**	**1,740**	**1,358**		**2,375**		**2,866**	**3,543**	**4,224**
End-period gross official reserves 9/	**2,053**	**1,141**	**932**	**1,672**	**916**		**1,740**	9/	**2,084**	**2,761**	**3,442**
(In weeks of imports of goods and nonfactor services	7.4	4.4	3.9	7.8	4.2		7.3		8.3	10.3	12.0
					(In percent of GDP)						
Current account (excl. official transfers)	**-7.6**	**-6.1**	**-3.1**	**-4.1**	**-1.9**		**-1.8**		**-1.3**	**-0.9**	**-0.4**
Current account balance	**-7.2**	**-5.7**	**-2.7**	**-3.8**	**-1.6**		**-1.6**		**-1.1**	**-0.6**	**-0.1**
Trade balance	-5.8	-5.0	-3.0	-3.6	-2.3		-1.8		-1.3	-0.8	-0.3
Exports f.o.b.	13.1	12.9	13.5	12.9	13.3		15.3		16.1	17.0	17.7
Imports f.o.b.	-18.9	-17.9	-16.5	-16.5	-15.6		-17.1		-17.4	-17.8	-18.0

Table 4. Pakistan: Medium-term Balance of Payments, 1995/96–2003/04

	1995/96	1996/97	1997/9	1998/99	Est. 1999/2000	Prog. 2000/01	Projections 2001/02	2002/03	2003/04
					(Annual percentage change)				
Exports f.o.b.	7.1	-2.6	4.2	-10.8	8.5	14.5	9.6	10.6	10.7
Imports f.o.b.	16.7	-6.4	-8.4	-6.7	-0.1	9.3	5.6	7.3	7.6
Export volume	5.4	4.2	9.7	-7.7	11.5	12.2	8.2	7.9	8.2
Import volume	10.6	-3.4	-0.3	0.5	-6.7	5.3	6.9	6.8	6.7
Terms of trade	-7.3	0.3	6.0	4.1	-9.5	-2.1	2.4	2.0	1.6

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

1/ Includes all financing from Saudi Arabia for oil imports that has already been agreed through 2001/02; future IBRD, IDA and AsDB disbursements are included in exceptional financing.
2/ Eurobond repayment in 1999/00 shown as capital outflow, with rescheduling shown in exceptional financing
3/ Includes repayment of US$300 million in UAE's deposits.
4/ Includes repayment of FCDs held in banks and non-bank financial institutions in 1999/2000 (reschedulings of US$1.1 billion shown as exceptional fin
5/ Consists of accumulated arreas from July to September 2000 (U$375 million) less clearance of all arrears to bilateral creditors from March to September 2000 (US$837 million).
6/ Includes US$1.1 billion in FCDs, US$300 million in deposits at the SBP, and US$500 million in deposits at the NBP.
7/ Includes repayment and roll over of the Kuwait deposit due August 2000.
8/ The financing gap is assumed to be filled with a flow rescheduling by Paris Club creditors and other bilateral creditors covering arrears accumulated as of September 30, 2000 (US$837 million) and maturities falling due October 2000-June 2001 (US$836 million) on pre-cutoff debt.
9/ Excludes FE25s and swap operations.

Table 5. Pakistan: Summary of Consolidated Federal and Provincial Budgetary Operations, 1993/94–2000/01

	Revised Actual						Prel. Actual	Prog.
	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01
	(In billions of Pakistan rupees)							
Total revenue	269.4	307.4	370.6	391.7	423.0	474.9	512.6	585.2
Tax revenue	213.4	256.3	318.4	326.3	349.0	388.8	405.6	487.7
Of which:								
CBR revenue	169.7	215.7	264.2	281.1	288.7	311.4	346.6	430.2
Surcharges	35.8	31.3	42.6	31.2	46.3	61.9	38.9	33.0
Nontax revenue	56.0	51.1	52.2	65.4	74.0	86.1	107.0	97.5
Of which:								
SBP profit transfer:	5.0	15.0	14.0	11.0	18.0	8.0	30.0	16.4
Total expenditure	373.8	432.7	536.7	556.2	628.0	651.2	718.9	770.9
Current expenditure	298.7	343.4	425.9	465.8	522.5	563.5	636.2	663.7
Of which:								
Interest	94.0	96.4	131.0	157.7	196.3	213.3	245.1	239.0
Defense	94.0	113.3	119.3	132.4	136.2	143.5	150.4	157.5
Development and net lending	75.1	89.3	110.7	90.4	105.5	87.7	82.7	107.2
Budget balance	-104.4	-125.2	-166.1	-164.5	-205.0	-176.3	-206.3	-185.7
Financing	104.4	125.2	166.1	164.5	205.0	176.3	206.3	185.7
External	24.0	31.2	38.8	25.0	38.8	147.0	73.6	130.9
Domestic	78.4	82.9	115.3	139.5	166.2	29.3	132.8	54.8
Bank	23.1	36.4	51.7	72.5	48.0	-75.0	40.0	-16.8
Nonbank	55.3	46.5	63.6	67.1	118.1	104.3	92.8	71.6
Privatization proceeds	2.0	11.1	12.0	0.0	0.0	0.0	0.0	0.0
	(In percent of GDP)							
Total revenue	17.3	16.5	17.5	16.1	15.8	16.3	16.1	16.5
Tax revenue	13.7	13.7	15.0	13.4	13.0	13.3	12.7	13.8
Of which:								
CBR revenue	10.9	11.6	12.5	11.6	10.8	10.7	10.9	12.1
Surcharges	2.3	1.7	2.0	1.3	1.7	2.1	1.2	0.9
Nontax revenue	3.6	2.7	2.5	2.7	2.8	3.0	3.4	2.8
Total expenditure	23.9	23.2	25.3	22.9	23.5	22.4	22.6	21.8
Current expenditure	19.1	18.4	20.1	19.2	19.5	19.3	20.0	18.7
Of which:								
Interest	6.0	5.2	6.2	6.5	7.3	7.3	7.7	6.7
Defense	6.0	6.1	5.6	5.5	5.1	4.9	4.7	4.4
Development and net lending	4.8	4.8	5.2	3.7	3.9	3.0	2.6	3.0
Budget balance	-6.7	-6.7	-7.8	-6.8	-7.7	-6.1	-6.5	-5.2
(excluding net lending)	-7.1	-6.9	-8.2	-6.9	-7.6	-6.8	-6.9	-5.5
Memorandum items:								
Primary balance (in percent of GDP)	-0.7	-1.5	-1.7	-0.3	-0.3	1.3	1.2	1.5
Social and poverty-related expenditures (in percent of GDP)	...	2.1	2.2	2.2	2.5	2.4	2.4	2.8
GDP (in PRs billions)	1,561	1,866	2,120	2,428	2,678	2,914	3,182	3,543

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

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

(In millions of Pakistan Rupees)

	1995/96	1996/97	1997/98	Prel. 1998/99	Prov. 1999/2000	Prog. 2000/01
Net operating surplus (incl. interest charges) 1/	**26,771**	**1,885**	**-2,150**	**26,706**	**23,879**	**33,604**
WAPDA	16,037	-8,282	-7,993	17,678	4,903	4,878
KESC	-470	-6,781	-6,857	-7,364	-12,374	-7,964
OGDC	3,316	5,034	3,875	3,849	10,422	9,850
SSGCL	-69	-302	-1,156	-1,030	-773	1,014
SNGPL	166	241	-250	-222	93	645
PTCL	11,042	13,566	12,407	17,567	22,962	23,266
Railways	-3,251	-1,592	-2,177	-3,772	-1,354	1,915
Gross savings 2/	**44,107**	**23,370**	**28,649**	**56,592**	**52,408**	**61,195**
WAPDA	24,890	5,546	9,625	33,704	18,945	19,973
KESC	2,374	-5,062	-4,709	-4,638	-9,546	-4,510
OGDC	3,790	5,234	6,690	6,000	13,857	11,286
SSGCL	1,710	2,042	2,406	2,802	2,772	4,859
SNGPL	1,821	2,249	2,466	2,695	3,001	3,541
PTCL	12,774	14,952	14,348	19,802	24,733	24,131
Railways	-3,251	-1,592	-2,177	-3,772	-1,354	1,915
Gross capital expenditure	**70,730**	**68,258**	**56,654**	**43,184**	**42,384**	**74,272**
WAPDA	31,064	21,652	22,959	19,185	15,942	33,899
KESC	10,261	9,031	6,278	2,386	2,674	4,442
OGDC	3,710	13,342	5,187	2,707	2,871	9,985
SSGCL	4,299	1,968	2,697	1,215	979	3,150
SNGPL	4,945	6,722	4,487	2,466	2,343	4,096
PTCL	12,828	12,828	12,828	11,776	15,558	15,500
Railways	3,623	2,715	2,219	3,450	2,017	3,200
Overall balance 3/	**-41,711**	**-60,238**	**-49,271**	**-7,779**	**-13,244**	**-36,112**
WAPDA	-14,109	-25,235	-24,473	3,967	-8,656	-26,399
KESC	-10,731	-15,812	-13,135	-9,750	-15,048	-12,406
OGDC	80	-8,108	-700	1,746	8,445	190
SSGCL	-3,760	-1,292	-2,045	-262	-185	-789
SNGPL	-4,531	-6,222	-4,102	-2,049	-1,833	-3,189
PTCL	-1,786	738	-421	5,791	7,404	7,766
Railways	-6,874	-4,307	-4,395	-7,222	-3,371	-1,285
			(In percent of GDP)			
Net operating surplus	1.3	0.1	-0.1	0.9	0.8	0.9
Of which: WAPDA	0.8	-0.3	-0.3	0.6	0.2	0.1
Gross savings	2.1	1.0	1.1	1.9	1.6	1.7
Of which: WAPDA	1.2	0.2	0.4	1.2	0.6	0.6
Capital expenditure	3.3	2.8	2.1	1.5	1.3	2.1
Of which: WAPDA	1.5	0.9	0.9	0.7	0.5	1.0
Overall balance	-2.0	-2.5	-1.8	-0.3	-0.4	-1.0
Of which: WAPDA	-0.7	-1.0	-0.9	0.1	-0.3	-0.7

Source: Pakistan authorities; and Fund staff estimates.

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

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

3/ Revenue minus expenditure.

Table 7. Pakistan: Accounts of the State Bank of Pakistan, 1995/96–2000/01

	1995/96	1996/97	1997/98	1998/99	1999/2000				2000/01			
					Sept.	Dec.	Mar.	Jun.	Prel.	Program		
									Sep.	Dec.	Mar.	Jun.
	(End-of-period stocks in billions of Pakistan rupees)											
Net foreign assets	11.9	-11.1	-48.6	-42.5	-49.7	-55.9	-49.2	-55.1	-82.4	-63.3	-46.4	-4.6
Net domestic assets	298.1	358.1	418.1	440.4	449.1	524.4	506.6	552.9	551.2	526.6	513.3	517.4
Net claims on government	187.7	231.3	223.7	257.8	276.8	338.0	350.0	391.0	391.8	381.0	371.0	371.0
Of which:												
Budgetary support	200.2	246.7	242.2	279.6	298.8	361.4	374.3	414.6	416.1	406.6	394.6	392.6
Claims on nongovernment	42.8	41.6	40.8	56.1	53.8	52.2	51.1	51.2	57.5	45.9	41.6	40.7
Claims on scheduled banks	66.0	89.9	158.5	187.2	182.3	192.9	186.7	193.4	187.2	190.4	191.4	196.4
Privatization account	-8.7	-3.5	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9
Other items, net	10.4	-1.0	-2.0	-57.7	-60.9	-55.8	-78.3	-79.8	-82.4	-87.8	-87.8	-87.8
Reserve money	310.1	347.0	369.5	398.0	399.4	468.5	457.4	497.8	468.8	463.3	466.9	512.8
Of which:												
Banks' reserves	49.9	77.9	71.4	85.2	88.6	99.0	89.9	114.7	102.5	99.7	95.1	109.9
Currency	253.4	262.0	291.7	306.6	304.1	363.1	361.2	375.1	355.7	355.2	363.1	394.0
	(Changes in percent of initial stock of reserve money)											
Net foreign assets	-7.5	-7.4	-10.8	1.7	-1.8	-3.4	-1.7	-3.2	-5.5	-1.6	1.7	10.1
Net domestic assets	17.1	19.3	17.3	6.0	2.2	21.1	16.6	28.3	-0.3	-5.3	-8.0	-7.1
Of which:												
Budgetary support	14.2	15.0	-1.3	10.1	4.8	20.6	23.8	33.9	0.3	-2.0	-4.0	-4.0
	(Changes over 12 months; in percent)											
Reserve money	9.6	11.9	6.5	7.7	9.7	13.0	10.9	25.1	17.4	-1.1	2.1	3.0
Banks' reserves	8.7	56.4	-8.4	19.3	24.6	13.6	22.9	34.7	15.7	0.8	5.8	-4.2
Currency	9.3	3.4	11.3	5.1	6.4	13.7	9.0	22.4	16.9	-2.2	0.5	5.0

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

Table 8. Pakistan: Monetary Developments, 1995/96–2000/01

	1995/96	1996/97	1997/98	1998/99	1999/2000				2000/01			
					Sept.	Dec.	Mar.	Jun.	Prel.	Program		
									Sep.	Dec.	Mar.	Jun.
	(End-of-period stocks in billions of Pakistan rupees)											
Net foreign assets	-37.5	-61.2	-90.1	-70.7	-69.9	-68.7	-54.5	-50.9	-78.8	-48.7	-18.3	27.8
Net domestic assets	976.2	1,114.4	1,296.4	1,351.3	1,335.6	1,385.7	1,375.6	1,451.5	1,476.1	1,480.8	1,500.8	1,531.1
Net claims on government	468.9	542.3	597.5	551.4	557.8	553.4	555.1	629.6	653.3	612.0	609.5	614.9
Of which:												
Net bank borrowing	434.1	504.6	552.4	505.9	516.8	518.8	530.0	545.8	581.8	552.2	565.7	529.1
Commodity operations	47.4	53.1	63.7	67.3	63.1	58.0	49.4	107.4	95.8	85.4	67.4	107.4
Net claims on nongovernment	531.1	602.8	697.5	816.7	791.9	837.6	841.2	842.8	842.0	891.6	914.1	939.0
Of which:												
Private sector	478.7	546.8	632.0	734.7	719.7	762.2	768.9	753.2	761.4	794.8	815.7	836.5
Privatization account	-8.7	-3.5	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9
Other items, net	-15.1	-27.1	4.3	-13.9	-11.2	-2.3	-17.8	-17.9	-16.3	-19.9	-19.9	-19.9
Total liquidity (broad money)	938.7	1,053.2	1,206.3	1,280.5	1,265.7	1,317.0	1,321.0	1,400.6	1,397.2	1,432.1	1,482.5	1,558.9
	(Changes in percent of initial stock of broad money)											
Net foreign assets	-4.9	-2.5	-2.7	1.6	0.1	0.2	1.3	1.5	-2.0	0.2	2.3	5.6
Net domestic assets	18.7	14.7	17.3	4.5	-1.2	2.7	1.9	7.8	1.8	2.1	3.5	5.7
Of which:												
Net bank borrowing by govt.	6.0	7.5	4.5	-3.9	0.8	1.0	1.9	3.1	2.6	0.5	1.4	-1.2
Net claims on private sector	7.6	7.3	8.1	8.5	-1.2	2.1	2.7	1.4	0.6	3.5	5.1	6.9
	(Changes over 12 months; in percent)											
Broad money	13.8	12.2	14.5	6.2	4.7	4.3	5.8	9.4	10.4	8.7	12.2	11.3
Net domestic assets	18.7	14.2	16.3	4.2	1.6	2.6	5.0	7.4	10.5	6.9	9.1	5.5
Net bank borrowing by govt.	12.9	16.2	9.5	-8.4	-10.3	-7.0	2.7	7.9	12.6	6.5	6.8	-3.1
Net claims on private sector	15.0	14.2	13.7	16.2	17.5	9.9	8.8	2.5	5.8	4.3	6.1	11.1

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

Table 9. Pakistan: External Financing Requirements, 1998/99-2003/04 1/
(in millions of U.S. dollars)

		Prel.	Prog.		Projections	
	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
Gross external financing requirements	**-10,490**	**-7,615**	**-5,489**	**-4,284**	**-4,164**	**-4,213**
Current account	-2,188	-1,008	-984	-704	-420	-94
Reserve assets (increase -)	-1,254	209	-1,017	-491	-677	-681
State Bank of Pakistan	-807	380	-1017	-491	-677	-681
Deposit money banks	-447	-171	0	0	0	0
Amortization before rescheduling	-6,901	-6,529	-3,246	-2,895	-2,730	-3,031
Public and publicly guaranteed debt	-3,942	-3,322	-2,226	-2,222	-2,121	-2,500
Private debt	-2,959	-3,207	-1,020	-673	-609	-531
Repayments to the Fund	-147	-287	-242	-195	-336	-406
Identified capital inflows	**6,671**	**3,651**	**3,435**	**3,339**	**3,437**	**3,731**
Public medium- and long-term capital	3,765	2,137	1,909	1,797	1,718	1,780
Project and nonproject loans	2,610	2,095	1,779	1,779	1,700	1,780
Commercial bank loans	14	27	50	0	0	0
Other official capital	1,141	15	80	18	18	0
Public sector short-term borrowing	205	271	559	540	540	540
Private medium- and long-term	902	869	689	758	927	997
Private short-term (including errors & omissions)	1,222	374	278	244	252	414
Disbursements from the Fund	577	0	0	0	0	0
Exceptional Financing (net)	**3,819**	**3,964**	**2,054**	**946**	**727**	**482**
1. Official Sector	**1,556**	**1,686**	**833**	**-160**	**-400**	**0**
Accumulation of Arrears to Paris Club and non-Paris Club Bilateral	0	462	-462 2/	0	0	0
Debt Relief Public Debt and Publicly Guaranteed	1,406	987	0	0	0	0
Repayment of arrears	0	-63	-55	0	0	0
Net Roll-over of UAE and Kuwait Central Banks' Deposits at SBP	150	300	0	-300	-400	0
Net Roll-over of Deposits at SBP from Kuwait Central Bank	0	0	0	0	-250	0
Rollover of Kuwait Central Bank's Deposits at SBP	0	0	250	250	0	0
Repayment of rescheduled Kuwait Central Bank's deposits at SBP 2/	0	0	-250	-250	-250	0
Net Roll-over of Deposits at SBP from UAE Central Bank	150	300	0	-300	-150	0
Rollover of UAE Central Bank's Deposits at SBP	150	300	150	150	0	0
Repayment of rescheduled UAE Central Bank's deposits at SBP 2/	0	0	-150	-450	-150	0
Additional IFI Disbursements	0	0	1,350	140	0	0
World Bank	0	0	350	0	0	0
AsDB	0	0	525	0	0	0
Other (including IMF)	0	0	475	140	0	0
2. Private Sector	**2,263**	**2,278**	**-452**	**-929**	**-553**	**-867**
Roll-over of Institutional Non-Residents FCDs (FE-45)	1,212	1,072	-1,072	-796	-398	0
Possible additional rollover of FE45s	0	0	796	398	0	0
Net Roll-over of Deposits at NBP from Bank of China	0	500	0	0	0	-500
Rollover of Bank of China's Deposits at NBP	0	500	500	500	500	0
Repayment of Resch.Bank of China's Deposits at NBP 2/	0	0	-500	-500	-500	-500
Debt Relief from Commercial Banks	834	152	-298	-531	0	-17
Principal and Interest Arrears Paid	0	-56	0	0	0	0
Rescheduling of Bonds	0	610	0	0	-155	-155
Additional Borrowing	0	0	145	0	0	0
Bridge Financing	218	0	-23	0	0	-195
3. Financing Gap	**0**	**0**	**1,673** 3/	**2,035**	**1,680**	**1,349**

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

1/ See Table 4 for explanatory notes.

2/ Consists of accumulated arreas from July to September 2000 (U$375 million) less clearance of all arrears to bilateral creditors from March to September 2000 (US$837 million).

3/ The financing gap is assumed to be filled with a flow rescheduling by Paris Club creditors and other bilateral creditors covering arrears accumulated as of September 30, 2000 (US$837 million) and maturities falling due October 2000-June 2001 (US$836 million) on pre-cutoff debt.

Table 10. Pakistan: Public and Publicly-Guaranteed External Debt and Debt Service Due, 2000/01- 2001/02 1/

(in millions of U.S. dollars)

	Outstanding Debt as of end-June 2000	Outstanding Arrears as of end-June 2000	Debt Service Due 2000/01	Debt Service Due 2001/02	Accumulation of Arrears July-Sept. 2000
Total Public and publicly guaranteed debt 2/	**29,428**	**462**	**3,794**	**3,717**	**375**
Principal	...	329	2,467	2,402	278
Interest	...	133	1,327	1,315	97
Debt to multilateral ceditors (including IMF)	12,073	0	1,449	1,379	0
Multilaterals	10,577	0	1,137	1,098	0
Principal	...	0	683	605	0
Interest	...	0	454	493	0
IMF 3/	1,496	0	312	281	0
Repurchases	...	0	242	195	0
Charges	...	0	70	86	0
Debt to bilateral creditors and suppliers (including military debt)					
Medium- and long-term	14,215	462	1,604	1,340	375
Principal	...	329	1,080	895	278
Interest	...	133	524	445	97
Of which:					
Paris Club creditors 4/	11,064	418	1,213	1,135	338
Principal	...	298	889	749	249
Interest	...	120	324	386	89
Other creditors	3,151	44	242	205	37
Principal	...	31	192	146	29
Interest	...	13	51	59	8
Interest on Rescheduling			149	0	
Of which:					
Debt contracted after September 1997	4,343	0	245	277	0
Principal	...	0	...	99	0
Interest	...	0	...	178	0
Debt to commercial banks (excluding bonds)	1,230	0	399	792	0
Medium-term debt	560	0	114	96	0
Principal	...	0	76	52	0
Interest	...	0	38	44	0
Short-term debt	671	0	285	696	0
Principal	...	0	219	616	0
Interest	...	0	66	80	0
Other	1,910	0	342	206	0
Principal	...	0	167	39	0
Interest	...	0	175	167	0
Memorandum items:					
Non-guaranteed debt of the private sector (excluding FCDs)	2,842		1,233	779	
Principal	...		1,020	673	
Interest	...		213	106	
Institutional FCDs (FE-45) maturing 3/	1,836		276	398	
Deposits of foreign banks with SBP	1,435		0	0	

Sources: Ministry of Finance of Pakistan; multilateral creditors; and Fund staff estimates.

1/ Fiscal year ending in June.

2/ Excluding liabilities of the State Bank of Pakistan other than to the IMF, and government bearer certificates in foreign currency. These bearers certificates issued on a tap basis, can only be encashed in local currency since end-May 1998.

3/ Under the assumptions of the program.

4/ Includes debt to all creditos residents of Paris Club member countries.

Table 11. Pakistan: External Financing by Creditor Group, 1998/99–2000/01

(In million of U.S. dollars)

	Total Stock of Debt 1/	Flows		
	End-June 2000	1998/99	1999/2000	Prog. 2000/01
Current account		**-2,188**	**-1,008**	**-984**
Reserves assets (increase -)		**-1,254**	**209**	**-1,017**
Total net financing	**34,156**	**3,441**	**799**	**328**
Net IMF financing	**1,483**	**430**	**-287**	**233**
Net other multilateral financing	**10,767**	**574**	**162**	**660**
World Bank (net)		195	26	154
Disbursements		683	311	493
Amortization		-488	-285	-339
AsDB (net)		381	151	579
Disbursements		725	388	825
Amortization		-344	-238	-246
Others (net)		-2	-14	-73
Disbursements		27	27	26
Amortization		-29	-41	-99
Net bilateral official financing	**13,067**	**1,554**	**1,651**	**-287**
Disbursemsnt		1,175	1,368	1,310
Amortization		-1,177	-1,404	-1,080
Accumulation of arrears		0	462	-462
Debt relief		1,406	987	0
Repayment of arrears		0	-63	-55
Net Roll-over of UAE and Kuwait Central Banks' Deposits at SBP		150	300	0
Net private sector financing	**8,839**	**883**	**-727**	**-278**
Commercial Banks and IsDB (net)		-863	-219	248
Credit		211	119	543
Debt service		-1,074	-338	-295
Institutional FCDs		-1,315	-1,831	-280
Credit		165	61	0
Debit		-1,480	-1,892	-280
Bond holders (net)		319	-822	-21
Other private sector (net)		480	-134	227
Roll-over of Institutional Non-Residents FCDs (FE-45)		1,212	1,072	-1,072
Additional rollover of FE45s		0	0	796
Net Roll-over of Deposits at NBP from Bank of China		0	500	0
Debt Relief from Commercial Banks		834	152	-298
Principal and Interest Arrears Paid		0	-56	0
Rescheduling of Bonds		0	610	0
Additional Borrowing		0	0	145
Bridge Financing		218	0	-23
Financing gap 2/		**0**	**0**	**1,673**

Sources: Pakistani authorities; and Fund staff estimates.

1/ Total debt public and private, excluding deposit liabilities of the State Bank of Pakistan.
2/ The financing gap is assumed to be filled with a flow rescheduling by Paris Club creditors and other bilateral creditors covering arrears accumulated as of September 30, 2000 (US$ 837 million) and maturities falling due October 2000-June 2001 (US$836 million) on pre-cutoff debt.

Table 12. Pakistan: Summary of Public External Debt and Debt Service, 1995/96–2003/04

	1995/96	1996/97	1997/98	1998/99	999/2000	Prog. 2000/01	Projections 2001/02	2002/03	2003/04
Total public and publicly guaranteed external debt	**28,121**	**28,709**	**29,000**	**30,480**	**31,010**	**33,766**	**34,890**	**35,619**	**35,289**
Medium- and Long-term Debt	24,967	25,726	25,776	26,607	27,262	29,562	30,835	31,898	31,954
Project & nonproject aid	22,275	23,145	23,042	23,101	23,834	23,939	24,287	24,630	24,466
Commercial banks and IDB	647	701	1,100	730	560	534	482	374	359
Other 1/	2,045	1,880	1,634	2,776	2,868	5,089	6,066	6,894	7,129
Short-term Debt (by initial maturity)	1,619	1,667	1,809	2,049	2,253	2,476	2,382	2,384	2,404
Commercial banks and IDB	873	418	298	583	671	945	869	889	909
FEBCs and DBCs	496	414	328	196	147	129	111	93	93
Deposits of non-residents with the SBP	250	835	1,183	1,270	1,435	1,402	1,402	1,402	1,402
Fund credit and loans 2/	1,535	1,316	1,415	1,825	1,496	1,729	1,674	1,337	932
Service of medium- and long-term public and publicly guaranteed debt	3,174	3,644	3,286	3,546	3,585	3,333	3,189	3,224	3,716
Of which: to the Fund 2/	289	369	237	191	347	312	281	414	467
Amortization	2,201	2,679	2,282	2,569	2,452	2,082	1,762	1,898	2,365
Of which: to the Fund 2/	241	319	195	147	287	242	195	336	406
Interest	973	965	1,004	977	1,133	1,251	1,428	1,325	1,351
Of which: to the Fund 2/	48	50	42	44	60	70	86	78	62
Interest on public and publiclyguaranteed short-term debt	80	89	70	96	94	75	89	39	36
Total public and publicly guaranteed external debt	**44.2**	**45.8**	**46.4**	**52.4**	**50.4**	**55.1**	**54.7**	**53.3**	**49.7**
Long-term	39.2	41.0	41.3	45.8	44.3	48.2	48.4	47.7	45.0
Short-term	2.5	2.7	2.9	3.5	3.7	4.0	3.7	3.6	3.4
Fund credit and loans 2/	2.4	2.1	2.3	3.1	2.4	2.8	2.6	2.0	1.3
Service of medium- and long-term public and publicly guaranteed debt	5.0	5.8	5.3	6.1	5.8	5.4	5.0	4.8	5.2
Amortization	3.5	4.3	3.7	4.4	4.0	3.4	2.8	2.8	3.3
Interest	1.5	1.5	1.6	1.7	1.8	2.0	2.2	2.0	1.9
Interest on public and publiclyguaranteed short-term debt	0.1	0.1	0.1	0.2	0.2	0.1	0.1	0.1	0.1
Total public and publicly guaranteed external debt	**227.0**	**224.8**	**219.0**	**273.5**	**245.4**	**243.7**	**235.2**	**223.3**	**204.3**
Of which: Fund credits and loans 2/	12.4	10.3	10.7	16.4	11.8	12.5	11.3	8.4	5.4
Service of medium- and long-term public and publicly guaranteed debt	25.6	28.5	24.8	31.8	28.4	24.1	21.5	20.2	21.5
Of which: to the Fund 2/	2.3	2.9	1.8	1.7	2.7	2.3	1.9	2.6	2.7
Amortization	17.8	21.0	17.2	23.1	19.4	15.0	11.9	11.9	13.7
Of which: to the Fund 2/	1.9	2.5	1.5	1.3	2.3	1.7	1.3	2.1	2.3
Interest	7.9	7.6	7.6	8.8	9.0	9.0	9.6	8.3	7.8
Of which: to the Fund	0.4	0.4	0.3	0.4	0.5	0.5	0.6	0.5	0.4

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

1/ Includes FCBCs, Eurobonds, Military debt and Special U.S. dollar bonds, and part of the financing gap, which is assumed to be covered by exceptional financing to the government
2/ Includes the possible use of Fund resources in 2000/01 and 2001/02.

Table 13. Pakistan: Indicators of Fund Credit, 1999/2000–2007/08 1/

	1999/00	Prog. 2000/01	Projections 2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Outstanding Fund Credit									
In millions of SDRs	1,132	1,308	1,266	1,014	712	410	156	71	13
In millions of U.S. Dollars	1,496	1,728	1,684	1,357	958	554	211	96	18
In percent of:									
Quota	109.5	126.5	122.5	98.1	68.9	39.6	15.1	6.8	1.3
GDP	2.4	2.8	2.6	2.0	1.3	0.7	0.3	0.1	0.0
Exports 2/	12.3	13.0	11.9	8.9	5.8	3.6	1.4	0.6	0.1
Public and publicly guaranteed debt	4.8	5.1	4.8	3.8	2.7	1.6	0.6	0.3	0.1
Debt service to the Fund									
In millions of SDRs	233	237	212	310	348	336	274	96	66
In millions of U.S. Dollars	347	312	281	414	467	453	370	130	90
In percent of:									
Exports 2/	2.7	2.3	1.9	2.6	2.7	3.0	2.4	0.8	0.6
Gross official reserves	37.8	17.9	13.5	15.0	13.6	13.2	10.8	3.8	2.6

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

1/ Under the assumptions of the program.

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

Table 14. Pakistan: Fund Position, 1999/00-2003/04
(In millions of SDRs)

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

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

Pakistan: Fund Relations
As of October 31, 2000

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

II. General Resources Account:	SDR Million	%Quota
Quota	1,033.70	100.0
Fund Holdings of Currency	1,679.69	162.5
Reserve position in Fund	0.10	0.0

III. SDR Department:	SDR Million	%Allocation
Net cumulative allocation	169.99	100.0
Holdings	12.76	7.5

IV. Outstanding Purchases and Loans:	SDR Million	%Quota
Stand-by arrangements	97.11	9.4
Extended arrangements	196.27	19.0
Contingency and Compensatory	352.70	34.1
SAF arrangements	32.78	3.2
PRGF arrangements	393.02	38.0

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
EFF	10/20/1997	10/19/2000	454.92	113.74
PRGF	10/20/1997	10/19/2000	682.38	265.37
Stand-by	12/13/1995	09/30/1997	562.59	294.69

VI. Projected Obligations to Fund: (SDR Million; based on existing use of resources and present holdings of SDRs):

	Overdue		Forthcoming			
	10/31/2000	2000	2001	2002	2003	2004
Principal	...	48.2	137.1	201.8	279.7	150.5
Charges/Interest	...	12.5	43.5	37.0	25.2	14.8
Total	...	60.7	180.6	238.8	304.9	165.3

A. Nonfinancial Relations

VII. Exchange System

Over the last few years, Pakistan implemented a fixed exchange rate system with periodic step devaluation to compensate for the inflation differential with major trading partners. On July 21, 1998, a dual exchange system was introduced consisting of a fixed official exchange rate at PRs 46 per US$1 and a floating interbank market exchange rate (FIBR). Under this system, all authorized transactions were effectively conducted at the so-called "composite rate" which was the weighted average of the FIBR and the official exchange rate. In addition, since May 28, 1998, withdrawals from foreign currency accounts have only been allowed in rupees (at the official exchange rate). Also, an advance import deposit of 30 percent was introduced on July 12, 1998; it has been subsequently reduced to 20 percent on January 9 and 10 percent on January 24, 1999, and was eliminated on February 24, 1999. On May 19, 1999, the official exchange rate of PRs 46 per U.S. dollar was eliminated and the exchange rate system unified, with all international transactions conducted at the FIBR. As of October 31, 2000 the FIBR was PRs 57.25 per U.S. dollar.

VIII. Last Article IV Consultation

The last Article IV consultation discussions were held in Islamabad and in Washington during September–November 1998. The staff report (EBS/98/231 and Supplements 1, 2, and 3) together with Pakistan's request for the second annual arrangement under the Enhanced Structural Adjustment Facility, the second review under the Extended Fund Facility and request for purchase under the Compensatory and Contingency Financing Facility was discussed by the Executive Board on January 14, 1999. In concluding the 1998 Article IV consultation, the Executive Board adopted the following decisions: Decisions No. 11883-(99/7), No. 11884-(99/7), No. 11885-(99/7), and No. 11886-(99/7). The third review under the extended arrangement was completed on May 24, 1999.

IX. Recent Technical Assistance

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

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

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

X. Resident Representative

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

Pakistan: Relations with the World Bank Group

Background

1. IBRD and IDA have made 96 loans and 141 credits to Pakistan since 1952, totaling US$6,016.1 million, and US$4,919 million respectively (net of cancellations). Of these amounts, US$2,836 million has been repaid and US$1,044.6 million remain undisbursed. Current total obligations to the Bank stand at US$6,902.4 million, of which US$3,813.3 million are IDA and US$3,089.02 million are IBRD as of 30 September, 2000. IDA credits constitute 60.6 percent and IBRD loans 39.4 percent of the Bank portfolio in fiscal 2001. IFC's disbursed own account portfolio is currently US$453m million in 45 companies of which US$108 million is in equity and the balance of US$345 million in loans. Among the forty five portfolio companies, sixteen are in arrears, with principal of US$93m overdue as of end-April 2000. The B Loan portfolio is currently US$269 million in 13 companies, with a strong concentration in the power sector. MIGA's gross exposure in Pakistan is US$143 million, making Pakistan the seventh largest country in MIGA's portfolio. Of this exposure approximately 60 percent relates to guarantees for financial sector projects; 22 percent for power projects; 17 percent for telecom projects; and 1 percent for a manufacturing project.

2 IBRD and IDA assistance to Pakistan steadily increased during the 1980s, with average annual commitments growing from about US$255 million in the early 1980s to US$730 million during FY1988–91, owing in large part to substantial adjustment lending supporting the government's reform program. In FY 1992–93, new commitments slowed to about US$400 million per annum, reflecting delay in reaching agreement on new adjustment lending and slow progress in finalizing a large power development loan. New commitments in FY 1995-96 averaged about US$583 million but dropped to US$85 million of IDA commitments only in FY97. In FY 98 IDA commitments increased to US$558 million, while IBRD lending was restored to a level of US$250 million. This reflected substantial lending in support of reform programs in banking, irrigation and drainage and the second phase of the Social Action Program. In November 1998, after a partial lifting of the G7 sanctions the Bank and the Government agreed on a one tranche Structural Adjustment Loan (US$350 million), in support of the balance of payments, and an IDA credit of US$90 million to the Pakistan Poverty Alleviation Fund.

3. The composition of IBRD/IDA lending has shifted significantly in recent years, reflecting an increasing emphasis on human development. In FY1980–90, 28 percent of total commitments went to agriculture, (including irrigation), 27.5 percent to electric power/energy/oil and gas, and 19 percent to industry/telecommunications and transport while the social sectors accounted for 7 percent (education, health, nutrition and population). Over the last decade, commitments to the social sectors averaged 20 percent while commitments to agriculture declined to 14 percent, with electricity, energy and oil and gas remaining around 27 percent, and industry/telecommunications and transport falling to 7.5 percent.

4. Since the 1998 balance of payments crisis IFC has approved one new investment of US$50 million in a US$100 million Trade Enhancement Facility. It has restructured its existing portfolio, canceling a third of its approved investments in 23 companies. More than a third of its disbursed portfolio is in five IPP companies. The other main areas of investment have been financial institutions (20 percent), cement (19 percent) and textiles (10 percent). MIGA has not issued any new guarantees to Pakistan since May 1998.

Program Focus

5. The overriding objective of the Bank Group's assistance strategy is to help Pakistan reduce poverty through achieving macroeconomic stability, improving human development, building a competitive environment for private sector development and sustainable growth and strengthening governance. As set out in the 1998 CAS Progress Report, in addition to supporting reforms with adjustment lending, the Bank will continue a program of investment lending, economic and sector work and other lending/advisory services with a view to helping Pakistan invest in people, raise productivity and promote sustainable economic growth.

6. The Bank undertakes a wide variety of activities in support of this strategy. In addition to maintaining an active dialogue on fiscal reform and public expenditure restructuring the Bank reviews annually the public investment program. Through studies on provincial finances, the Bank is encouraging a stronger provincial resource mobilization effort and greater devolution of social and other public services to local governments, communities and the private sector. The Bank is also working with interested provincial governments to improve their public revenue and expenditure management and has recently completed a public expenditure review for the Punjab provincial government.

7. In the social sectors support to the Social Action Program continues to be the main vehicle through which the Bank supports improvements to quality and access of education, health and water and sanitation facilities. The Bank is assisting the Government in preparation of its Poverty Reduction Strategy Paper, through technical advice, but also through concurrent work on a Poverty Assessment which is expected to be complete in FY02.

8. The Bank continues to support Pakistan with banking sector reform, following on from a Banking Sector Adjustment Loan in December 1997 (disbursed by March 1998). Policy dialogue in the sector continues through ex post supervision of the BSAL and through preparation of Financial Sector Updates, one of which was completed in FY00. Similarly an active engagement is maintained in the power sector, through supervision of several key projects, including the Power Sector Development project, to assist the Government improve efficiency and governance arrangements in order to enhance investor confidence and generate growth. To promote sustainable agricultural development, the Bank is supporting key institutional changes and investments that will create an incentives regime and competitive environment to promote sustainable growth of the sector. The main thrust of assistance to date has been through support to the irrigation and drainage sectors through the

National Drainage Program. The Bank is working on other initiatives to improve the efficiency of the water conveyance system through institutional and policy reforms and in FY01 aims to support this through an On-Farm Water Management project in the North West Frontier Province (to be followed in FY02 by projects in other provinces), and in preparation of the Punjab Irrigation Systems Improvement project. To support sector wide policy and institutional reforms we are working with the Government on an Agricultural Sector Investment Project that will assist in implementing reforms and carry out an investment program for research and extension in the context of improving effectiveness of public expenditure in agriculture. The Bank is also working with the Government on possible assistance to community driven small infrastructure projects, building on the existing Community Infrastructure Project in NWFP.

9. To undertake this program effectively, the Bank Group is working to more fully involve communities, the private sector, and Pakistani NGOs in its programs. Partnership with these groups is necessary for both the Bank Group and the government to deliver results on the ground faster.

10. Successful implementation of the program has called for strategic alliances among IBRD/IDA, IFC and MIGA. IBRD and IDA are focusing their assistance strategy on improving governance, institutional development and critical public investments for private sector led growth including in the social sectors. IFC will continue to support restructuring of existing client companies, and will selectively support new investments in sectors of strategic importance to Pakistan's future economic growth. MIGA's insurance coverage for the political risks faced by private investor in Pakistan complements the Bank and IBC's assistance to the private sector, and will target mainly projects which can yield high development effects.

New Commitments by the Bank Group

11. Subsequent to the October 12 change in Government the Bank, along with the IMF, has engaged in a high level policy dialogue with the new Government on a wide range of macroeconomic and structural issues, including poverty reduction, public expenditures, power, oil and gas and non bank financial sectors. During discussions with the Government a range of areas for potential Bank assistance have been identified including in areas such as capacity building, provincial based strategies, technical assistance for reforms in oil and gas, taxation and devolution, and assistance with reform in the social sectors. It is expected that a Country Assistance Strategy will be completed in FY02.

12. The Bank Group monitors the government's progress toward and pace of macroeconomic and structural reforms. If the government is taking concrete action to maintain macroeconomic stability, achieve its fiscal targets and continue to move forward on structural reforms, Bank Group assistance levels can be raised.

13. Total annual new IBRD and IDA commitments including guarantees in coming fiscal years could average between US$550 million and US$750 million, depending on the pace

and depth of structural reforms. IBRD guarantees could be a part of this program so long as Pakistan remains creditworthy for IBRD lending. IFC will continue to focus on managing its existing portfolio, but is considering a couple of new investments this FY in the financial sector, including a request by the Government to participate in and support the privatization of a nationalized commercial bank. Other new investment opportunities include the development of gas resources and information technology. Although IFC has been a heavy investor in power generation in the past, the current situation of oversupply and contractual disputes with government will prevent IFC from investing in power generation in the near future. However, IFC will explore other opportunities to support private provision of infrastructure if the policy environment improves, and is ready to support the privatization process through advisory and investment work. MIGA's readiness to support infrastructure projects also depends on the policy environment and the development effects the project would generate. MIGA would like to expand its portfolio into manufacturing, IT and other priority areas such as SMEs.

Technical assistance by the World Bank

14. Many Bank financed projects have major technical assistance elements built into project design, including the Telecommunications Regulation and Privatization project with a net commitment of US$25 million, and the Project to Improve Financial Reporting and Auditing, with a net commitment value of US$28.8 million. Under the latter project Bank technical assistance is being utilized to improve public sector management procedures, such as financial reporting, procurement and auditing capacity. Bank financing is also supporting restructuring and institution building within a number of public sector agencies, including WAPDA, and federal and provincial education and health ministries. In FY00 the Bank approved a US$500,000 Institutional Development Fund (IDF) grant to assist the Government develop and implement policy reform in the oil and gas sectors. This year IDF grants have been approved to assist the Government improve tax administration through strengthening and realigning the Central Board of Revenue and to support the National Reconstruction Bureau with selected aspects of the devolution initiative including the provincial-local fiscal transfer system and local government financial management.

15. Bank technical assistance is also supporting improvements and the establishment of regulatory frameworks in Pakistan, especially in the power, telecommunications and banking sectors. Small amounts of technical support are also provided in the areas of HIV/AIDS and immunization, transport sector policy and provincial health strategies. It is anticipated that the Bank will provide technical assistance to support Pakistan's privatization program in the future through supporting the work of the Privatization Commission in areas such as telecommunications, water and sewerage, gas and banking.

Pakistan: Financial Relations with the World Bank Group Statement of Loans and Credits
As of 30 September, 2000

(in millions of U.S. dollars)

	IBRD	IDA	Total
1. Original Principal	6,975	5,698	12,674
2. Cancellations	959	779	1,738
3. Disbursements to date	5,605	4,399	10,004
4. Repayments	2,344	492	2,836
5. Undisbursed	405	639	1,045
6. Exchange Adjustment	139	0	139
7. Borrowers Obligation	3,089	3,813	6,902

Pakistan: Structural Reforms Effected Since October 1999

Fiscal reforms

1. A comprehensive tax survey and documentation exercise was initiated to increase revenue generation by broadening the tax base.

2. Agricultural wealth has been subjected to taxation along with nonagricultural wealth.

3. A new agricultural income tax has been introduced by pronvinces with particular focus on large farmers.

4. A reform committee has been established to prepare a new income tax law.

5. The audit capacity of the CBR was enhanced with the induction of 350 auditors over the past year.

6. A Tax Ombudsman's Office has been established.

7. All tax whitener schemes have been eliminated.

8. The GST has been extended to the services sector.

9. A number of exemptions in the area of GST, income tax, and customs duties have been eliminated and customs exemptions through 49 Statutory Regulatory Orders (SROs) have been reduced.

10. To enhance provincial fiscal discipline, Public Accounts Committees have been established at the provincial levels.

11. A Fiscal Monitoring Committee FMC has been established at the federal level to track fiscal developments and improve the quality of fiscal data. The committee will prepare and publish quarterly reports on fiscal developments and ensure accuracy of data by requiring verification by the AGPR.

12. A committee has been constituted which is working out the modalities for separation of Audit from Accounts.

13. The government introduced a new system of quarterly price adjustments for petroleum products, which allows for prices to change in line with world prices.

14. The Ministry of Finance and the Central Directorate of National Savings (CDNS) have improved the database for domestic debt.

Public enterprise reform and privatization

1. Professional corporate management structures have been put in place in public sector petroleum, gas, and power sector enterprises to enhance their revenue potential.

2. The government has initiated the financial restructuring of WAPDA, which has substantially improved its financial and operational position.

3. Significant restructuring has also started at KESC, Pakistan Railways, and Pakistan Steel Mills.

4. The Gas Regulatory Authority and the Petroleum Regulatory Authority have been established to regulate the two sectors.

5. The government has deregulated the prices of compressed natural gas and furnace oil.

6. A Privatization Law has been drafted to provide legal protection to the privatization process.

7. The Privatization Committee has prepared a timetable for privatization of companies in the telecommunication, banking, oil, gas, power, and other sectors, which has been approved by the Cabinet. It has been decided that non-core assets would be privatized prior to the privatization of major entities.

8. The government has already sold the LPG business of Sui Southern gas distribution company (SSGCL), to a foreign investor, for US$6 million.

Financial sector reforms

1. Interest rates on NSS certificates have been further reduced by an average of 3.5 percentage points.

2. A ban was imposed on institutional investors from purchasing NSS certificates in order to increase investment in the real economy.

3. Professional management has been put in place to manage the CDNS and a comprehensive audit and reconciliation exercise of the CDNS has been completed.

4. Work has been completed for launching long-term tradable government bonds. The yields on these bonds will serve as a benchmark for the returns to be offered on new Defense Savings Certificates.

5. An intensified loan recovery yielded 11 percent of the outstanding stock on non-performing loans in the banking sector.

6. In order to clean up the balance sheets of banks new financial institution, the Corporate and Industrial Restructuring Corporation (CIRC) was established with the aim of disposing off the nonperforming assets of Nationalized Commercial Banks (NCBs).

7. A plan to restructure and consolidate Development Finance Institutions (DFIs) has been formulated.

8. In order to strengthen regulatory control over stock exchanges and protect the interests of small investors, the Securities and Exchange Ordinance 2000 has been promulgated.

9. The Banking Companies Act has been amended to enforce capital adequacy ratios in line with international standards.

10. A shortfall in the SBP's capital and reserves, related to the revaluation losses on its net credit from the IMF, have been completely covered.

Trade liberalization

1. The maximum effective tariff rates that were in excess of the maximum tariff of 35 percent, due to excise differentials, have been reduced to no more than 35 percent for all but eight goods.

2. In order to prepare the private sector for increased competition the medium-term trade liberalization plan has been publicly announced.

3. Import liberalization measures have been adopted for agricultural and petroleum products.

4. Exports of all agricultural products, except wheat, have been liberalized.

5. The government has reduced its intervention in the agricultural markets.

Governance and transparency

1. A high level committee has been set up to guide the process of civil service reforms.

2. Increase autonomy has been granted to the Federal Public Services Commission for merit-based appointments and promotions.

3. The government has issued an ordinance to curb the menace of corruption and inefficiency. It allows for immediate disciplinary measures to be taken for corruption and inefficiency in the workplace.

4. The government has eliminated 1000 vacancies at CBR and suspended 1000 CBR staff members under corruption charges.

5. The National Accountability Bureau has been established with powers to investigate and prosecute matters relating to corruption.

6. A comprehensive Devolution Plan has been prepared to transfer administrative powers and responsibilities to local tiers of government.

7. Training of judges is being improved and automation of the judicial system is being enhanced under comprehensive judicial reforms.

8. The process of computerization of land records has been initiated.

Poverty and social development

1. The Integrated Rural and Urban Development Program (IRUDP) was launched, in the poorest districts of the countries, with an initial outlay of Rs. 15 billion to stimulate economic activity and generate employment.

2. Social and poverty related expenditures have been increased by 29 percent.

3. Special allocations were made for poverty alleviation projects for Azad Jammu and Kashmir and the Northern Areas.

4. The subsistence allowance from the Zakat Fund was raised from Rs. 300 to Rs. 500 per eligible person per month.

5. The Khushhal Bank has been established with the aim of providing micro credit to small and medium-sized enterprises (SMEs) and self-employed micro enterprises.

6. In order to provide adequate housing and meet basic needs, the House Building Finance Corporation approved investments of Rs. 916 million.

Pakistan: The Macroeconomic Consistency of the Growth Estimates for 1999/2000

Divergence between real GDP growth and changes in some other macroeconomic aggregates in 1999/2000 have raised questions about the macroeconomic consistency of the provisional growth estimates.

Growth and Monetary Aggregates

Comparing nominal GDP growth with that of key monetary aggregates to assess consistency yields mixed results. The growth of broad money (M2) was in line with the expansion in nominal GDP. Growth of private sector credit, however, was well below nominal GDP growth. This may be explained by the following factors:

- **Base effect**: As indicated by the GDP velocity of private credit, the estimated "credit intensity" of GDP in 1999/2000 is within the boundaries given by recent observations for the GDP velocity of private credit observed during the 1990s. It is rather the large credit growth observed during 1998/99 that needs to be explained. The acceleration in private credit growth may have included some "stress" lending relating to difficult economic conditions, which was reversed with the upswing in 1999/2000.

- **Low credit intensity in agricultural sector**: As growth in 1999/2000 was fundamentally based on an upswing in the agricultural sector, it was less credit intensive than usual. Also, as productivity increases were an important factor behind the upswing in the sector, one should not expect a proportional relation between growth in agricultural output and credit.

- **Unchanged working capital need of textile industry**: The market value of the cotton crop stagnated in 1999/2000 despite the sharp increase in crop production, as there was a sharp decrease in world market prices for cotton in the second half of 1999, especially in the last quarter—the time of the harvest.

- **Self-financed investment**: The increased investment in the textile industry was largely self-financed, partly because of increased profitability due to low prices for cotton input, partly because of credit rationing by banks. The latter is explained by the banks' overexposure to the sector, to which a large share of nonperforming loans is attributed.

- **Loan recovery and regulatory tightening**: The authorities intensified their loan recovery drive and tightened prudential regulations, which yielded recoveries of PRs 22 billion during November 1999–June 2000 (equivalent to 11 percent of the stock of nonperforming loans and 3 percent of credit to the private sector). This led to higher loan repayments on the one hand and a leftward shift of the loan supply schedule for given interest rates on the other hand.

- **Export finance scheme**: Rationalization of the export finance scheme, which reduced credit outstanding under the scheme by over 10 percent. Credit under the scheme account for about 10 percent of total credit outstanding.

Growth and imports

Balance of payments data suggest that imports in U.S. dollar terms stagnated in 1999/2000 and declined as a percent of GDP. Considering the much higher petroleum product imports in value terms, this would imply that other imports actually declined, which is difficult to reconcile with the growth acceleration. Some factors can at least partly explain this anomaly:

- • **Agro and textile based growth upswing**: The need for imports of raw materials and other inputs did not rise proportionally with the increase in GDP growth because the share of imported inputs in overall inputs for production is low in the agriculture and textile sectors compared to the shares of domestic raw materials or labor.

- **Supply-side and productivity driven growth upswing**: Typically, this kind of growth is associated with increased domestic savings with only a limited impact on imports.

- **Sharp reduction in food import volumes and world market prices**: The bumper crops and the decline in world market prices for edible oils led to a partial offset of the higher oil import bill. While imports of petroleum products rose from US$1458 million in 1998/99 to US$2807 in 1999/2000, wheat and edible oils imports decreased from US$1221 million to US$697 million.

- **Completion of power sector capacity expansion program**: The expansion of the generation capacity in the power sector is nearing completion. Many power plants were completed and commissioned in 1999/2000, which led to a sharp reduction in the imports of power sector equipment from US$235 million in 1998/99 to US$139 million.

- **Small share of consumer goods**: The share of consumer goods in overall recorded imports is relatively small, partly because of explicit and implicit trade barriers or high tariffs. As consumer goods are generally thought to account for a significant share in smuggled imports, the growth acceleration may have had less of an effect on recorded imports than usual.

- **Imports of inputs increased**: While import values fell for some goods because of special factors, other imports, especially those of raw materials and manufactures increased in value and volume terms, as expected. Other imports increased by

4.2 percent to US$6.6 billion in 1999/2000. For example, during the first three quarters in 1999/2000, imports of chemicals in volume terms rose by 11 percent, those of manufactured inputs by 4 percent, and those of raw materials other than fuels by 62 percent.

Assessment

Special factors can plausibly explain the divergence between real GDP growth and changes in some other macroeconomic aggregates. Nevertheless, concerns about the macro consistency of the growth estimates remain, especially that growth may be overstated. These concerns are related to the small set of production indicators used in the compilation of the estimates and to the lacking reconciliation with demand side indicators. The recently launched project for improving the national accounts aims to address this shortcoming through the compilation of a supply and use table.

Pakistan: Statistical Issues

1. Weaknesses in the coverage, quality, frequency, and timeliness of economic and financial data in several areas complicate the analysis of economic developments and may hamper timely policy implementation. The authorities are responsive to data requests. They report to the Fund, on a routine basis, monthly data on external trade, government tax revenues, government bank borrowing, and price indices with a lag of less than a month. Moreover, the authorities provide daily data through the resident representative's office on international reserves, exchange rates, and the Karachi Stock Exchange index with a one-day lag. The staff believes that, following the recent enhancements adopted by the authorities (see Appendix V), the data reporting and accounting procedures now in place should facilitate the production of data that are adequate for program monitoring purposes.

2. The authorities have implemented a series of measures to improve fiscal data reporting, including steps to enhance the quality and timeliness of data on public expenditures. In addition, the government will address remaining deficiencies in the national accounts through the use of results of the surveys of households and enterprises that are to be undertaken between October 2000 and June 2002, in the context of the action plan to improve national accounts statistics.

3. At present, the methodology for the compilation of national accounts extrapolates certain components of GDP using a variety of indicators and data sources that have limited coverage. The estimates for some activities, particularly small-scale manufacturing, dwelling services, and other services continue to be made using constant growth rates estimated from an outdated benchmark. In other areas, such as large scale manufacturing, the substantial changes introduced in mid-1998 to the previous estimates of sectoral output growth resulted in a significant revision in GDP growth for 1996/97. In addition, data on wages and employment are not reported; and systems for the compilation of quarterly GDP are not yet well developed.

4. The Federal Bureau of Statistics produces three price indices: CPI, WPI, and SPI (sensitive price indicator). The CPI and WPI are compiled on a monthly basis and have been rebased to 1990/91. The SPI is compiled on a weekly basis and consists of 46 essential commodities that are consumed by the lowest income group. Weights for the 46 items are the same as in the CPI.

5. The data on government finances have suffered from a lack of information on economic and functional classification of government outlays; and inadequate reporting by provinces on their fiscal operations. Moreover, the quality of fiscal data has been adversely affected by a lack of coordination between the Ministry of Finance and the Accountant General Pakistan Revenue in generating fiscal reports and lack of facility to compile data on commitments or accounts payable. In line with the recommendations of recent FAD and STA technical assistance missions, measures have been taken to address these issues and further steps are being implemented. In addition, the accounting model and chart of accounts to be adopted under the PIFRA project will overcome these deficiencies.

6. As regards the balance of payments statistics, the discrepancy between the customs data and those reported by the SBP would need to be addressed; and timely reporting on capital flows, including both official assistance and private investment flows, would be desirable. Pakistan has not reported balance of payment data for publication in the IFS since Q2 1998.

7. External debt statistics have been compiled for government and government-guaranteed debt by the Ministry of Finance and on private debt by the SBP. The balance of payments difficulties that surfaced since May 1998 revealed significant weaknesses in Pakistan's external debt reporting, as data were not available with required frequency and there was no comprehensive reconciliation of data collected by different departments. In that context, the authorities initiated a complete inventory of all public sector debt liabilities. Most of the public sector debt data are in a manual bookkeeping system. In 1996, the authorities began developing, with the assistance of the AsDB, a computerized debt management system, covering official assistance and supplier credits to Pakistan's public sector. The implementation of this project has recently been resumed, and the system is expected to become fully operational by end-2001.

Pakistan: Core Statistical Indicators
as of October 31, 2000

	Exchange Rates	Convertible International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/GNP	External Debt/Debt Service
Date of Latest Observation	10/31/00	10/31/00	June 2000	September 2000	September 2000	September 2000	September 2000	September 2000	1999/2000 Q4	1999/2000 Q4	1999/2000	1999/2000 Q2
Date Received	10/31/00	10/31/00	9/28/00	10/25/00	10/25/00	10/25/00	10/12/00	10/12/00	8/25/00	10/23/00	9/10/00	8/25/00
Frequency of Data	D	D	M	M	M	M	M	M	Q	Q	A	Q
Frequency of Reporting	D	D	M	M	M	M	M	M	V	V	A	V
Source of Update	A	A	A	A	A	A	N	N	A	A	A	A
Mode of Reporting	C	C	C	C	C	C	C	C	V	V	C	V
Confidentiality	C	B	C	C	C	C	C	C	C	C	C	C
Frequency of Publication	D	W	M	M	M	M	M	M	A	A	A	A

Pakistan: Technical Assistance on Fiscal Data and Transparency Issues

1. After the Government of Pakistan alerted the Fund to the need for substantial revisions to the fiscal accounts in January 2000, extensive technical assistance was provided to help revise historical data series and improve data compilation processes. In the span of nine months four missions from FAD and STA visited Islamabad to provide technical assistance on fiscal data and transparency issues.

2. Many of the underlying weaknesses in data compilation processes had been identified before, some of them as early as ten years ago. However, insufficient resolve to implement corrective actions on a sustained basis meant that little progress had been made until recently. Reform efforts gathered the necessary momentum when it became clear that data quality had deteriorated to the point where it began to impair the ability to make informed policy decisions and to monitor performance under Fund arrangements. It will be critical to maintain this momentum in the period ahead.

Fiscal Data

3. The technical assistance missions identified a general underlying weakness of the accounting system and the lack of coordination among units involved in providing and compiling data as the root cause for the unreliability of fiscal reports, although some specific problems were also pinpointed. There had been inadequate commitment either to timely observance of reporting obligations by line ministries or to the establishment of effective reconciliation of data. Standard procedures for cross-checking data sources and disciplined revisions of data were not observed. Long delays in the preparation of the Appropriation and Finance Accounts had compromised the Public Accounts Committee mechanism. Specific problems related to tracking the issuance of NSS debt instruments, the methodology of deriving non-bank holdings of government paper, taking into account the latest information on foreign financing flows, and the reporting of provincial government operations to the Ministry of Finance.

4. The authorities are now strongly committed to rectify these long-standing problems in a sustained and well-organized effort. They are implementing numerous steps, in line with the recommendations developed during the technical assistance missions. Some of these measures will improve the quality of fiscal data in the short run while others will gradually bear fruit over the medium term.

- All sources of budget financing together with the associated methodologies and data sources have been identified and the deficit is derived accordingly.

- Data on the funds raised through the issuance of the NSS instruments are routinely reconciled between the CDNS, the SBP, and the AGPR. A special audit of the CDNS has been completed and the managerial and technical caliber of CDNS staff is being upgraded.

- A clear schedule of reporting and reconciliation for each major revenue, expenditure, and financing item has been established and is being increasingly enforced from the highest level at the Ministry of Finance. Sanctions have been applied to principal accounting officers (departmental secretaries) that do not carry out monthly reconciliation procedures in a timely way. As a result the degree of reconciliation of monthly data between departments and the AGPR has increased from 40 percent to over 75 percent.

- Fiscal reports dating back to 1993/94 have been revised in line with the Appropriation and Finance Accounts prepared by the AGPR. Quarterly fiscal reports have been published for the January-March quarter of 2000. At present the AGPR commentary on reconciliation and data reliability is not published, but this element is to be incorporated in future reports.

- A Fiscal Monitoring Committee has been established at the federal level to coordinate fiscal monitoring and management and to direct efforts in improving data quality. It brings together key officials from the Ministry of Finance, the AGPR, and the SBP. It is being extended to include representatives from the provinces. Fiscal Monitoring Committees are also being set up at the provincial level.

- The authorities have agreed to ensure that suspense accounts are cleared as far as possible on a quarterly basis and that any uncleared balances will be noted in fiscal reports. They will also address the problem of non-recording of much development expenditure by the AGPR and reconciling intergovernmental payment flows.

- Speedy implementation of the World Bank-financed Pakistan Improvement to Financial Reporting and Audit project has been made a priority. The project involves computerization of the financial management information system, introduction of a new chart of accounts, and restructuring of the Pakistan Audit Office to bring about effective separation of auditing and accounting functions.

Fiscal Transparency

5. Pakistan has participated in the Report on Observance of Standard and Codes (ROSC) process. The report is presented to the Fund's Executive Board in the context of this Article IV consultation and is expected to be published soon. It concludes that although Pakistan has recently made progress in improving fiscal transparency, many of the requirements of the IMF Fiscal Transparency Code have yet to be met. Accordingly it recommends widening and deepening the information provided in the budget process as well as defining more clearly the roles of different levels of government and the relationship between government and commercial activities. It also emphasizes the need to strengthen the core fiscal accounting and reporting processes along the lines discussed above.

6. The range and quality of information provided in budget and accounts documents could be improved through:

- publishing a statement on government explicit contingent liabilities, contingencies associated with the privatization process, and guarantees related to private sector financing of infrastructure;

- reporting on tax expenditure;

- accounting more carefully for quasi-fiscal activities of public enterprises and the SBP;

- reporting on activities of all extrabudgetary funds (most of which are donor financed);

- making explicit the main economic assumptions underlying budget estimates;

- initiating a process of establishing a medium-term budget framework and performance oriented budgeting.

7. The roles and responsibilities of government vis-à-vis other sectors could be further clarified through:

- defining more precisely the revenue authority and expenditure responsibilities at each level of government;

- delineating better between general government activities and those of the nonfinancial and financial public sector.

- developing a Public Finance Act that defines more explicitly the role of the Ministry of Finance in fiscal management and puts more emphasis on performance.

November 4, 2000

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

Dear Mr. Köhler:

The Pakistan authorities have held discussions with Fund staff for a Stand-By Arrangement until end-September 2001 in support of the government's economic program for 2000/01. Based on these discussions, the attached Memorandum on Economic and Financial Policies (MEFP) reviews economic developments and policies in 1999/2000, and discusses the macroeconomic framework for the program, as well as the underpinning stabilization and structural policies. In support of the policies set out in the attached MEFP, the government requests that the Executive Board of the Fund approve a Stand-By Arrangement in an amount of SDR 465 million.

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. However, it stands ready to take any additional measures appropriate for this purpose, and will consult with the Fund in accordance with the policies of the Fund on such consultations.

Sincerely yours,

______s______
Shaukat Aziz
Minister of Finance and Economic Affairs

______s______
Ishrat Husain
Governor
State Bank of Pakistan

Attachments:
Memorandum on Economic and Financial Policies
Technical Memorandum of Understanding

GOVERNMENT OF PAKISTAN

Memorandum of Economic and Financial Policies, 2000/01

1. This Memorandum of Economic and Financial Policies (MEFP) reviews economic developments during 1999/2000 and describes Pakistan's macroeconomic and structural policy program for 2000/01.

I. Developments in 1999/2000

2. Favorable performance of the agricultural sector boosted real GDP growth to an estimated 4.8 percent in 1999/2000, compared with 3.1 percent during 1998/99. Agricultural output expanded by 7 percent, with bumper cotton and wheat harvests more than offsetting a decline in sugarcane output. The bumper cotton crop gave a welcome boost to the textile industry after three years of lackluster activity in this vital sector. However, industrial activity was dampened by a collapse in sugar production. As a result, large-scale manufacturing output growth contracted by 0.8 percent, compared with an increase of 3.7 percent during the previous year.[1] Notwithstanding increases in domestic petroleum products prices, the average rate of consumer price inflation eased further to 3.6 percent, from 5.7 percent in 1998/99. Food price inflation was even lower, aided by the decline in international nonoil commodity prices and the buoyant domestic output of food crops.

3. With the favorable supply conditions in the agricultural sector and the recovery in the textile sectors, Pakistan's external current account deficit narrowed from 3.8 percent of GDP in 1998/99 to 1.6 percent of GDP in 1999/2000 despite the sharp rise in world oil prices. Exports grew by 8.5 percent in U.S. dollar terms, as more favorable external demand conditions and the boost in textile production helped maintain buoyant export performance despite a decline in export unit values. The overall import bill was flat in 1999/2000, with the US$1.2 billion increase in oil imports caused by higher international petroleum prices offset by lower food, defense, and project aid-related imports. Kerb market purchases of foreign exchange by the State Bank of Pakistan (SBP) increased.[2] The capital account of the balance of payments turned sharply negative, however, driven mainly by a reversal in public medium- and long-term capital flows. As a result, gross official reserves declined from US$1.7 billion (equivalent to 7.4 weeks of imports of goods and nonfactor services) to US$0.9 billion (3.7 weeks of imports). The exchange rate of the rupee was held stable against the U.S. dollar through the year in an effort to maintain investor confidence amidst the

---

[1]Excluding sugar, large-scale manufacturing output grew by 5.8 percent in 1999/2000; the growth in 1998/99 was 4.6 percent.

[2]Kerb market purchases by the SBP amounted to US$1.6 billion in 1999/2000, compared with US$0.5 billion in 1998/99.

uncertain outlook for external financing. In real effective terms, the rupee remained roughly stable on average in 1999/2000 in relation to the previous year.

4. The consolidated government budget deficit widened to 6.5 percent of GDP in 1999/2000, from 6.1 percent of GDP in 1998/99, adversely affected by the delayed adjustments in domestic petroleum prices, an increase in the government's interest bill, an overrun in defense expenditures, the settlement of accumulated tax refunds, and additional provincial transfers to municipalities in lieu of abolished local taxes. Interest payments rose by 0.4 percent of GDP, while petroleum surcharge revenue fell by 1 percent of GDP.[3] These effects on the fiscal balance were partly offset by increased tax receipts of the Central Board of Revenue (CBR) by 0.2 percent of GDP; higher nontax revenue (0.4 percent of GDP); and lower development expenditure and net lending (0.4 percent of GDP). While a lapse in expenditure control mechanisms prevented the envisaged cut in defense spending from materializing, defense expenditure nevertheless declined by 0.2 percentage points in relation to GDP.

5. Broad money grew by 9.4 percent in 1999/2000, broadly in line with the pace of nominal GDP (9.2 percent). Deposits in the banking system, however, expanded by only 5.3 percent, with the expansion in rupee deposits exceeding somewhat the continued conversion of residents' frozen foreign currency deposits. Currency in circulation increased sharply, however, to almost 24 percent on a year-on-year basis in June 2000. This appears to have reflected an increased demand for cash following the launch of the intensified loan recovery and tax survey and registration drives. The decline in banks' deposit interest rates during the course of the year likely contributed to increased demand for cash. On the assets side, net bank borrowing by the government for budgetary support contributed to around one-third of the growth in broad money, as did a surge in bank credit towards the end of the fiscal year to finance the procurement of the bumper wheat crop. Private sector credit growth moderated to 2.5 percent in June 2000 (year-on-year basis), reflecting the dampening effect on net credit outstanding of the loan recovery drive; the associated cautious behavior of banks in approving new credits; rationalization of the Export Finance Scheme, which reduced outstanding credit under the scheme by over 10 percent; and increased self-financing by textile units, whose profitability benefited from the decline in raw cotton prices. The weak private credit growth and the continued moderation in inflation prompted the SBP to ease the monetary policy stance. Accordingly, treasury bill yields declined and reserve money growth picked up to 25 percent in June 2000. In the last quarter of 1999/2000, the rise in the government's budgetary financing needs, was lower than envisaged receipts of external financing, and reduced budgetary financing by commercial banks fueled reserve money growth.

[3]The extension of the GST to petroleum products, which resulted in a shift in fiscal revenue from petroleum surcharges to sales taxes, accounted for 70 percent of the decline in petroleum surcharge revenue in relation to GDP.

6. Notable progress was made in 1999/2000 in implementing structural reform measures in certain areas. On the fiscal side, the GST was extended to petroleum, gas, and electricity, and all tax whitener schemes were withdrawn. However, tax amnesty schemes have remained in place to allow those who had previously evaded taxes to settle their tax liability with a one-off payment. A major tax survey and registration campaign was launched to widen the tax base and facilitate vigorous enforcement of the GST in the retail sector from next year. A price adjustment mechanism for petroleum products has been in place since December 1999 to pass through developments in international import parity prices; four quarterly adjustments in response to international price developments have already taken place. In addition, important liberalization measures have been taken in the areas of international trade, agriculture, and petroleum. Restructuring plans have been developed for key public enterprises, and the implementation of reforms has commenced. Corporate management structures have been put in place in the petroleum, gas, and power sector enterprises. In the financial sector, the loan recovery drive has helped improve banks' financial position and the integration of financial markets has been aided by reforms of the National Savings Schemes (NSS).

II. Macroeconomic Objectives and Policies for 2000/01

7. The principal objective of economic and financial policies is the achievement of sustained economic growth of around 6 percent over the medium term, together with low inflation and a viable balance of payments position. To this end, policies will focus on fiscal reforms, including improved monitoring of the budgetary position, and measures to enhance the openness of the economy and export competitiveness. The macroeconomic targets for 2000/01 include: (a) real GDP growth of at least 4.5 percent; (b) annual average CPI inflation of about 6 percent, with a somewhat lower rate of underlying inflation; and (c) a buildup in official foreign exchange reserves to US$1.74 billion, equivalent to about 7.3 weeks of imports of goods and nonfactor services.

8. Agricultural output is expected to remain strong in response to policy measures to liberalize this sector and improve its productivity on a sustained basis, although output growth is projected to slow somewhat from the pace in 1999/2000. The growth momentum will be sustained by a pick-up in manufacturing growth, as the textile sector is expected to remain buoyant with favorable domestic supply and external demand conditions. Moreover, strengthened confidence should lead to a recovery in private investment. Inflation is expected to pick-up with the pass through of exchange rate and petroleum and gas price adjustments and the carry over effects of structural price increases (fuel, wheat issue price, and medicines) in the second half of 1999/2000. The external current account deficit is expected to remain at about 1.6 percent of GDP in 2000/01, despite a projected further deterioration in the terms of trade, equivalent to at least 0.3 percent of GDP. The adverse impact of high world oil prices on imports would be offset by continued strong export performance, partly reflecting the export of last year's excess agricultural crops. Improved investor sentiment is expected to be reflected in an increase in private investment inflows. Nevertheless, the external outlook and the envisaged buildup in reserves is predicated on inflows of exceptional financing of around US$4 billion (discussed below).

9. A competitive, flexible, and market-based exchange rate will be critical in achieving the external sector objectives. Aided by the removal of the unofficial trading bands in the interbank market in July 2000, the interbank exchange rate of the rupee against the U.S. dollar depreciated by 12 percent between end-May 2000 and October 25, 2000. Henceforth, the exchange value of the rupee will be determined by market forces. The depth of the interbank exchange market operations will be enhanced by the withdrawal of the requirement that all interbank deals are backed by approved commercial transactions. In addition, nostro limits on banks' balances held abroad on account of trading activities will be relaxed, and the SBP's practice of dealing for same day or "ready" value in foreign exchange will be changed to two-day value for spot dealing, in line with the internationally accepted standard. These measures, which will be implemented in a phased manner starting in the second half of 2000/01, are expected to lower the premium in the kerb market, inducing some inflows to move from the kerb market to the interbank market. Developments in the foreign exchange markets will be reviewed on a quarterly basis, with a view to ensuring a competitive, market-based exchange rate and to moving toward the cessation of SBP purchases from the kerb market over the longer term.

10. The government recognizes that the existence of two foreign exchange markets (the interbank and the kerb markets) could potentially lead to multiple currency practices and the breach of Pakistan's obligations under Article VIII, Section 3 of the Articles of Agreement. However, all current account transactions are, and will be, allowed to take place in the interbank market. The diversion of current transactions to the kerb market through official actions, which occasionally took place in the past under exceptional circumstances, will no longer occur. In the past, occasional delays in the approval of payments and transfers for current international transactions took place mainly due to administrative requirements. Currently, no such restrictions exist and, under the program, the government will not delay approval of payments and transfers for current account transactions or hinder the free flow of funds for current account transactions.

11. In order to achieve the reserves targets and keep inflation in check, a tighter monetary policy stance is envisaged for 2000/01, as reflected in the target for reserve money growth of 3 percent. Indeed, the monetary stance has already been tightened to quell speculative pressure against the rupee and support the transition to a flexible exchange rate regime; treasury bill yields have risen by over 3 percentage points since June 2000. As confidence strengthens with an agreement on an external financing package, the effects of the rupee depreciation on trade flows begin to take hold, and provided that the reserve money and reserve accumulation targets are being met, some easing of the interest rates may be possible. As regards broad money, the special factors—including the loan recovery drive, the launch of the tax survey and registration campaign, and the tax amnesty scheme—that led to an increase in the currency-to-deposit ratio to 34 percent in May 2000 (from 29 percent in June 1999) should start to wear off during 2000/01. As a result, with broad money growing in line with nominal GDP (11.3 percent) and the envisaged buildup in net foreign assets of the banking system, the improvement in banks' liquidity position should be sufficient to finance roughly 11 percent growth in private sector credit together with a moderate reduction in net claims on government.

12. Fiscal consolidation will be a critical component of macroeconomic policies in 2000/01. The target for the budget deficit has been set at PRs 185.7 billion (5.2 percent of GDP), an improvement of 1.3 percentage points from the estimated outturn for 1999/2000. The target is to be achieved primarily through increased tax collection built on a widening of the tax base and strict containment of current spending. On the revenue side, an increase in tax receipts by 1.1 percentage points of GDP relative to 1999/2000 will come from higher sales and direct tax receipts and gas surcharge revenue. Sales tax revenue is projected to rise on account of the full-year effect of the extension of the GST to petroleum, electricity, and gas, the amalgamation of various excise taxes into the GST net, and various legislative/regulatory changes and administrative improvements. Direct taxes will also expand as the tax base widens and documentation is enhanced. Revenue from the gas surcharge will benefit from the 15 percent increase of gas tariffs in June 2000. (Details of tax reforms are discussed below.) Nontax revenue is expected to decline by 0.6 percentage points of GDP, owing mainly to a decline in SBP profits.[4]

13. On the expenditure side, current spending will fall on account of lower interest expenditure,[5] reduced outlays on subsidies, and lower defense spending in relation to GDP. Development spending has been budgeted to increase by 0.4 percent of GDP. The budget also provides for one time expenditure of PRs 7.0 billion for the settlement of arrears from provincial governments, Federally Administered Tribal Areas (FATA), and agricultural tubewells in Baluchistan to the Water and Power Development Authority (WAPDA) as well as for some of the billings of Baluchistan and Azad Jammu and Kashmir (AJK) in FY 2000/01.

14. The 2000/01 budget takes into account the need to increase social expenditure and protect the poor from the impact of the economic stabilization measures under the program. To this end, social expenditures and poverty reduction programs under the Public Sector Development Program plus current expenditures for Social Action Program (SAP) and Food Support Program have been increased by 28 percent. As a result, these expenditures would account for 12.6 percent of total expenditures in 2000/01, compared with an average of 10.6 percent in the previous three years. With Zakat disbursements, which are outside the budget, social and poverty related expenditures are targeted to increase to 2.8 percent of GDP, from 2.5 percent of GDP in each of the previous two years.

---

[4]SBP profit transfers to the budget are expected to amount to PRs 16.5 billion (0.5 percent of GDP) in 2000/01, compared with PRs 31 billion (1 percent of GDP) in 1999/2000. The decline in SBP profit transfers owes principally to estimated exchange/revaluation losses of PRs 25.6 billion (0.7 percent of GDP) stemming from the depreciation of the rupee.

[5]Changes in treasury bill yields affect the government's interest bill with a lag, as interest is paid when the bills mature. Thus, the recent rise in treasury bill yields will only have a partial effect on the interest bill in 2000/01. Moreover, the 1999/2000 interest bill was bloated by the high yields prevailing in 1998/99 and early 1999/2000, as well as large encashment of National Defense Certificates held by institutional investors.

15. Following the overrun relative to the target for defense spending last year, adequate expenditure control mechanisms have been put in place to ensure that the defense budget remains within the agreed limit. This has been done after due consultation with the relevant departments, who will liaise closely with the Ministry of Defense on a regular basis, and progressive monthly expenditures will be monitored closely. The outcome of this exercise will be reported on a quarterly basis to the Fiscal Monitoring Committee of the Ministry of Finance. In addition, any virements (transfers of allocations across line items) will not be permitted without Ministry of Finance approval. Furthermore, to prevent underestimation of interest payments, detailed accounts related to NSS instruments have been used in calculating forthcoming obligations. In addition, various cushions have been included in the budget numbers to ensure the achievement of overall budgetary target in 2000/01 and to safeguard the budgeted social and poverty-related expenditures from cuts during the course of the year.

16. In view of the uncertainty surrounding the projected increase in tax revenue in 2000/01, contingency measures have been identified that will involve cuts in public spending (excluding social and poverty related-expenditures) if revenue falls short of program targets. The Ministry of Finance has issued instructions to line ministries to limit actual expenditures to PRs 5 billion below the level envisaged through end-December under the program.[6] A mid-year expenditure review exercise will be conducted in January 2001. This will entail bringing forward the revised estimate exercise to January, which is normally conducted once a year in May in the context of the annual budget preparation. On the basis of this review, if revenue performance is found to be in line with expectations, the amounts withheld would be released in the second half of the fiscal year. If, however, data on CBR revenue performance through December indicate that a shortfall is unavoidable, necessary expenditure cuts would be announced in consultation with line ministries. Potential cuts amounting to PRs 7 billion in the PSDP have been identified in the areas of infrastructure (PRs 3 billion), sports and culture (PRs 0.2 billion), corporations (PRs 3.5 billion), and others (PRs 0.4 billion). To ensure that social and poverty-related expenditures are protected, quarterly quantitative targets for this type of spending have been established under the program, and the Ministry of Finance will issue quarterly expenditure authorizations that are in line with these targets.

17. The overall financial performance of the seven large public sector enterprises—as measured by net operational revenue including interest charges—is expected to remain roughly unchanged at about 0.8 percent of GDP. Except for the Karachi Electricity Supply Corporation (KESC) and the Pakistan Railways, all enterprises are profitable. However, the net borrowing requirements of the seven large public sector enterprises are projected to rise because of increased capital expenditures in the energy sector, which are needed to improve and expand the distribution network in line with production capacity.

---

[6] Expenditure authorizations during the first half of the fiscal year have been limited to 40 percent of the annual allocation for non-SAP nondevelopment spending, 45 percent for non-SAP development outlays, and 50 percent for SAP-related development and nondevelopment expenditures.

III. Medium-term Outlook

18. Real GDP growth is expected to improve gradually to around 6 percent by 2003/04 and CPI inflation is envisaged to moderate steadily to 3.5 percent. Notwithstanding the projected pickup in private investment as confidence returns, the tight external financing constraint and the limited room to expand public investment imply that the overall investment rate is unlikely to increase much beyond 17–18 percent of GDP by 2003/04. Realization of the growth target would be predicated on enhanced productivity stemming from the redirection of investment to export-oriented sectors through structural reforms being implemented under the program. On the external side, the macroeconomic framework is built around a further narrowing of the current account deficit (excluding official transfers) to 0.1 percent of GDP and an increase in official reserves to the equivalent of 12 weeks of imports of goods and nonfactor services.

19. The achievement of these objectives will hinge on the achievement of further fiscal consolidation and the maintenance of a competitive and market-based exchange rate to ensure that the reserve target is met. The medium-term budgetary projections envisage a budget deficit of about 3 percent of GDP by 2003/04, supported by a steadily rising revenue-to-GDP ratio reflecting improved tax administration and a simpler, broad-based tax system. At the same time, further saving in interest payments and containment of defense outlays should allow increased social expenditures consistent with the objective of reducing poverty. The envisaged reduction in the budget deficit will result in a decline in net public debt from about 94 percent of GDP in 2000/01 to about 86 percent of GDP by 2003/04.

IV. Structural Reforms

20. Since taking office in October 1999, the new government has developed a comprehensive structural reform plan through a broad consultative process involving participation of business leaders, professionals, academics, nongovernment organizations, as well as government officials from the federal, provincial, and district levels. The main objectives of the program are rebuilding confidence of domestic and foreign investors, alleviating poverty, and promoting good governance. A number of key steps have already been implemented, signaling the government's resolve to break from the past and put the economy on a sound footing.

A. Fiscal Reforms

21. An important element of structural reforms in the fiscal area is the tax registration drive, which is aimed at increasing the documentation of the economy and improving tax compliance. Businesses and households in the most prosperous parts of the 13 largest urban areas in Pakistan have been required to complete a tax survey; 13 more are to follow. At the same time, a campaign is underway to issue the new National Taxpayer Number (NTN) to be used for all taxes. Audits will be conducted for up to 20 percent of all tax returns; a computerized process has been established for selecting businesses and individuals for audit.

22. The tax registration drive is expected to result in a significant expansion in the tax base and yield a substantial increase in tax collection over the medium term. Nevertheless, it is difficult to estimate the increase in tax revenue that will stem from the unprecedented drive; this will depend on whether or not it improves long-term confidence in the integrity and effectiveness of the tax administration. Consequently, the budgetary projections for 2000/01 incorporate an increase in tax revenue of PRs 30 billion (0.9 percent of GDP) in conjunction with complementary measures. These would comprise PRs 10 billion from increased income and wealth tax receipts and PRs 20 billion in higher sales tax collection. Complementary measures include the introduction of audits and minimum accounting requirements under the self-assessment scheme; subjecting agricultural wealth more fully to wealth tax; legislative/regulatory changes that will curb spurious and fraudulent GST refunds in the textile sector; procedural changes to prevent the underpayment of GST by steel mills; full exploitation of the newly available audit management information system; and collection from the increased stock of collectible GST arrears. The government expects that 50,000–100,000 new taxpayers would be brought under the GST/Income Tax net in 2000/01.

23. A fundamental overhaul of income taxation is to be undertaken. A reform committee has been established and a new law will be promulgated in the context of the 2001/02 budget. The aim of the overhaul is to move to a simple legislation based on genuine self-assessment, with minimal exemptions, less distorting rate structures, and limiting the number of withholding taxes to a few key ones. To ensure that the new law is ready for promulgation with the next budget, the income tax reform committee will submit its preliminary recommendations to the Minister of Finance by end-2000, and the final report, with a draft law, will be submitted to the cabinet by end-March 2001.

24. In the meantime, the direct tax base has been expanded through reform of agricultural income and wealth taxation. Agricultural wealth has been subjected to taxation together with nonagricultural wealth in 2000/01. In addition, the provincial budgets for 2000/01 included ordinances that introduced a two-tier agricultural income tax consisting of: (a) a fixed land-based tax; and (b) an income tax for an estimated 30,000 large farmers. Revenue from both components will accrue to the provinces, and the rates and schedules pertaining to both components have been fixed by the respective provincial governments. While recognizing that the efficiency of the land-based tax would be enhanced by extending the tax to all landholdings regardless of size, most provinces have opted for minimum thresholds due to high administrative costs associated with levying the tax on small landholdings. As regards the income tax component, the exemption limit for agricultural income has been set by all provinces at a level twice as high as that for nonagricultural income, in view of the higher volatility of agricultural income and the larger number of dependents per household. However, agricultural income will be clubbed with nonagricultural income for rate purposes. The agricultural income tax will be levied on income earned in 2000/01, and although the date for filing tax returns has not yet been fixed, filing will commence this fiscal year. The budget projections for 2000/01, however, incorporate a modest amount (PRs 4 billion, about the same nominal level as last year) in revenue from agricultural taxes.

25. On the sales tax side, the GST has been extended to various services that were previously subject to excise taxes, which have been withdrawn, as well as additional services that were previously not taxed. As the Constitution confers the right to tax most services to the provinces, this extension has required the enactment of provincial legislation. While the ordinances issued by each of the provinces with their 2000/01 budgets are identical, there is a risk that the coverage or the tax rates may deviate across provinces in the future. As such a deviation could compromise the viability of the tax, consideration will be given, at the time of the next National Finance Commission (NFC) award, to enhancing the legal framework to ensure that tax rates and coverage remain identical across provinces. Moreover, as revenue from the GST extension to these services accrues to the provinces, a workable revenue-sharing arrangement across provinces has been devised. Under the arrangement, the tax is administered by the Central Board of Revenue (CBR) across all provinces and territories in exchange for a 2 percent collection fee and the balance of 98 percent is transferred to the provinces on the basis of the current NFC award based on population. As the Constitution confers the right to tax transportation and telecommunications services to the federal government, but does not allow the federal government to impose a sales tax on these services, excise taxes in VAT mode have been levied on these services with the 2000/01 budget.

26. To realize the tax revenue benefits of enhanced documentation associated with the GST and to strengthen incentives for upstream registration, the extension of the GST to retailers with annual sales of over PRs 5 million will be enforced from the beginning of the 2001/02 fiscal year. In the meantime, to ease the transition of large retailers (those above the threshold) to the GST, the option to pay a 2 percent turnover tax instead of registering for the GST has been given for one year. The one-year transition period will ease the pressure on the administrative capacity of the CBR. To facilitate the meaningful extension of the GST from 2001/02, record-keeping and filing requirements under the turnover tax have been enhanced and a vigorous GST education campaign for retailers is being launched.

27. While the agricultural sector has already been subjected to enhanced direct taxation from this year, the favorable performance of agricultural output over the past year should facilitate the extension of the GST to agricultural inputs. This extension will be implemented in two phases, starting from March 2001. In the first phase, the GST will be extended to pesticides and urea fertilizers. In the second phase, which will be implemented by September 1, 2001, the GST will be extended to all agricultural inputs. The timing of the two phases has been chosen to coincide with the crop cycle, thereby minimizing the effect on farmers' liquidity position.

28. Exemptions in the areas of GST, income tax, and customs duties have been reduced considerably in recent years. Customs exemptions, which were granted through 49 Statutory Regulatory Orders (SROs), were reduced by 13 in the context of the 2000/01 budget. Time-bound SROs will be allowed to lapse and the timetable for exemptions under the deletion policy will be strictly followed. Furthermore, income tax exemptions, including those related to income from financial instruments, will be rationalized or eliminated in the context of the income tax and civil service reforms.

29. The structure of provincial taxation has been streamlined with a reduction in the number of provincial taxes and rationalization of the remaining taxes. On balance, this is expected to result in a modest revenue gain for the provinces, particularly from improved property tax collection. In addition, several of the structural tax reforms—including the extension of the GST to petroleum products, electricity, and services as well as the agricultural income tax—will result in an improvement in the provinces' budgetary position. To prevent a loss of fiscal discipline at the provincial level, many of the expenditure responsibilities related to development spending—including components of the urban/rural development and poverty alleviation programs as well as some smaller projects under the Public Sector Development Program (PSDP)—have been devolved to the provinces. As a result, provinces' share in spending under the PSDP will rise from 36 percent in 1999/2000 to 39 percent in 2000/01 (equivalent to an increase of 0.2 percent of GDP). If necessary, provinces can also be required to accelerate repayments of federal government loans. To further enhance provincial fiscal discipline, public accounts committees have been established at the provincial level, along the lines of the Federal Public Accounts Committee.

30. Measures are also being taken to improve the quality of tax administration. The process of assigning NTN to all taxpayers is expected to be completed by December 2000. Revised procedures, personnel improvements, and increased reliance on computerization will underpin the establishment of a more integrated, client-oriented, and functional tax administration. The audit capacity of CBR has been enhanced with the induction of an additional 350 auditors over the past year, and will be further increased with the hiring of at least 300 more auditors during 2000/01. To further increase audit capacity and to ensure fair treatment, taxpayers subject to audit have been given the option of choosing an external auditor from an approved list (subject to meeting half the cost). Special units that focus on large taxpayers will be created to enhance tax administration. In addition, the audit capacity of the CBR will be steadily increased. A special committee has been formed to look into these issues; it is expected to complete its report by end-2000, including a proposed implementation schedule. It is envisaged that a modern income tax administration based on genuine self-assessment will be in place by April 2002.

B. Public Enterprise Reform and Privatization

31. A major program to streamline, restructure, and corporatize public enterprises is underway either to reduce the burden associated with enterprises that place a drag on budgetary resources and complicate budget execution, or to enhance their revenue potential.[7] More generally, the program also aims at improving the efficiency and services of public sector enterprises and preparing some of them for privatization. Starting in 1999/2000, the program has focused on the power sector, the Pakistan Steel Mill, and the Pakistan Railways.

[7]Direct budgetary costs related to the enterprise sector, excluding the budgetary financing of their investment operations, are estimated to decline from about 1.7 percent of GDP in 1999/2000 to about 1.4 percent of GDP in 2000/01.

In the medium-term, the restructuring process will also be extended to the major companies in the gas sector.

32. The financial position of the power wing of WAPDA has improved substantially with the ongoing operational and financial restructuring supported by the World Bank. Nevertheless, the liquidity situation has remained difficult because of large overdue receivables from public and some private sector entities and the increase in furnace oil prices, which has eroded profit margins. After a long impasse, all involved parties have agreed on the modalities for the settlement of public sector arrears. For the large overdue receivables of Sindh, arbitration is required as Sindh disputes WAPDA's billing; the dispute is expected to be settled by end-November with the Finance Minister acting as the arbiter. Decisions on the settlement of arrears from other provincial governments, FATA, and agricultural tubewells in Baluchistan were reached recently and are now being implemented. The federal government will ensure that federal agencies and provinces will remain current on their electricity bills, including through deduction at source from the provincial share in tax revenue where necessary. To ensure financial viability and adequate working capital, WAPDA's electricity tariffs will need to increase in 2000/01. To this end, WAPDA submitted a filing for an automatic fuel and power purchase price adjustment clause to the National Electric Power Regulatory Authority (NEPRA) in August 2000 and will file for a structural price increase to address cost increases relating to exchange rate adjustment and the settlement with independent power producers (IPPs) during the fiscal year. In accordance with policy principles guiding NEPRA decisions, a notification of the tariff increase is expected to be issued in November 2000. In the meantime, NEPRA accorded a temporary tariff award to WAPDA.

33. The weak financial position of the KESC, which for many years has been running operational deficits that have eroded its equity capital, is also being addressed. The severe deterioration in corporate governance and the difficult law and order situation in Karachi, which have led to electricity theft, billing fraud, and collection problems on a large scale, are the main reason behind losses and liquidity problems, including large overdue payables to WAPDA, other suppliers, and the government. Financial control as well as operational and administrative efficiency will be strengthened through a corporate restructuring while the provision of army support to KESC will support the efforts to address the governance and collection problems. In addition, a sequence of tariff increases, the first of which is also to be approved by NEPRA in November 2000, will be needed to turn around the financial situation and improve the cash flow situation. Nevertheless, with overdue payables, upcoming amortization payments, and operational deficits in 2000/01 and 2001/02, KESC will be faced with a cumulative cash shortfall of about PRs 22.4 billion during 2000/01–2001/02, even if debt service liabilities are converted into equity (government) or rolled over and restructured. The shortfall is to be met through commercial bank borrowing with a government guarantee; bank borrowing of up to PRs 7.5 billion by KESC has been built into the monetary program for 2000/01. With the financial turnaround and a final financial restructuring to be supported by technical and financial resources from the AsDB, the privatization of KESC is targeted for December 2002.

34. The Privatization Commission (PC) has drawn up a timetable for the privatization of banks as well as enterprises in the gas, petroleum, power, and industrial sectors. Enterprises and banks are to be sold through competitive bidding and through listings on the stock exchanges. The PC estimates that privatization receipts could amount to US$4 billion over the medium term. The actual timing of privatization of each entity, however, will depend on a number of factors, including investor appetite. In the gas sector, for example, existing tariff policies at the consumer and the wellhead levels must be amended before the privatization process can be undertaken. This would involve a substantial increase in existing tariffs; the 15 percent increase in end-user gas prices effected in June 2000 should be seen as a step toward achieving the necessary tariff level. In all cases, some noncore assets would be divested prior to restructuring and privatization of the major entities; the LPG business of the Sui Southern gas distribution company (SSGCL) was sold to a foreign investor in September 2000, fetching about US$6 million.

C. Financial Sector Reforms

National Savings Scheme (NSS)

35. Reforms of the NSS have been launched in an effort to reduce financial market segmentation, encourage the deepening of the capital market, and reduce the cost of government borrowing. Institutional investors have been barred from purchasing NSS instruments from March 2000, and interest rates on NSS instruments have been reduced by an average of 5.5 percentage points since May 1999. A special audit of, and intensive reconciliation, at the Central Directorate of National Savings (CDNS) and its regional directorates is underway by the Central Audit Department, and is expected to be completed by end-October 2000.

36. Professional management of the CDNS has recently been put in place and its autonomy from the Ministry of Finance will be enhanced. The terms of reference for the new management of the CDNS include computerization and streamlining of NSS operations, and replacing the entire line of NSS instruments with new instruments that carry market-based rates of return by the start of the next fiscal year. The new NSS instruments will be designed to ensure consistency with the requirements that are adopted in this regard. In view of the recent rise in treasury bill yields and the envisaged upward pressure on banks' deposit rates, the differential between return on NSS and other financial instruments is expected to narrow further in the coming months. Thus, further cuts in NSS interest rates during 2000/01 are not envisaged, except perhaps at the long end of the maturity spectrum. Indeed, under current macroeconomic circumstances, it is important to maintain the attractiveness of rupee denominated assets to help avert the emergence of pressures on the rupee.

37. Meanwhile, progress is being made in developing the necessary supporting infrastructure for linking the new NSS instruments to market-based rates of return. Tradable long-term government bonds of 3-, 5-, and 10-year maturities will be launched in November 2000. These new bonds, which are aimed at the institutional investors that may no longer invest in NSS instruments, are to be sold through auctions to primary dealers. It is envisaged

that the market-determined yields on the new bonds will serve as a benchmark from January 1, 2001, for the returns that will be offered on new Defense Savings Certificates (DSCs), which account for about two-fifths of the outstanding stock of NSS instruments. The linked DSC rates will subsequently be adjusted on a semi-annual basis in response to movements in the benchmark yields. Returns on all other new issuance of NSS instruments will become market related by July 1, 2001, either by a link to the benchmark bond or by removing their "on tap" status. For the latter, the government will set targets for the mobilization of funds at the beginning of each fiscal year and adjust returns as warranted by market conditions.

38. The tax-exempt status of NSS instruments will be removed from the start of the 2001/02 fiscal year. From that point onwards, any new investments in NSS instruments will be taxed in the same manner as other financial instruments. The proposed change in the tax treatment of NSS instruments has been set to coincide with the envisaged promulgation of the new income tax law and the introduction of the new line of instruments.

39. Over the longer term, further rationalization of NSS operations—including through allowing retail investors access to the benchmark instrument—will be undertaken to facilitate the reintermediation of funds into the banking system and the capital market. Indeed, the outstanding stock of NSS instruments is expected to decline as the instruments held by institutional investors, which account for about one fourth of the total, mature. NSS operations will be focused more narrowly on the targeted client base of small savers in rural and poor urban areas; in this context, a survey to assess the socioeconomic profile of current NSS instrument holders is being undertaken. As the availability of commercial banking facilities and capital market instruments to these savers is limited, the absence of secure vehicles for saving could result in the re-emergence of unregulated pyramid saving schemes. Thus, NSS instruments are likely to continue to have a useful role to play in mobilizing their savings, similar to government-run saving schemes in operation in many countries, including several industrialized economies.

Banking sector and nonbank financial institutions

40. The financial health of the banking system has improved in recent years as a result of measures to enhance banks' commercial orientation and upgrade the banking supervision system. In addition, the intensified loan recovery drive, which has been in effect since mid-November 1999, has already yielded some PRs 22 billion in collections, equivalent to 11 percent of the outstanding stock of nonperforming loans of the banking system. The cleaning up of banks' balance sheets will be further aided by the newly established Corporate and Industrial Restructuring Corporation (CIRC), whose principal objective is to dispose of the nationalized commercial banks' (NCBs') nonperforming assets through industrial restructuring, mergers, and, if necessary, liquidation. A plan to restructure and consolidate the development finance institutions (DFIs) has also been formulated, with a view to improving their financial health, rationalizing and commercializing their operations, and paving the way for their eventual privatization.

41. To further enhance the commercial orientation of the banking system, the preparatory process for privatizing banks has been accelerated. It is envisaged that the remaining government stakes in Allied Bank and Muslim Commercial Bank will be sold by end-2000, and that one of the remaining NCBs will be privatized by end-March 2001.

Export Finance Scheme (EFS)

42. The scope of the EFS has been narrowed considerably over the past year with the reduction in the list of items that are eligible to receive financing through the scheme. In particular, exports of yarn and low count fabrics ceased to be eligible for financing under the EFS from end-1999, and exports of grey cloth are presently under a transitional arrangement by which financing under the EFS will be available at a rate of 10 percent (in comparison with 8 percent for other eligible exports).[8] The subsidy element of the EFS has narrowed considerably over the past two years as lending interest rates have declined. To avoid any widening of the subsidy in the near term, the EFS interest rate will be raised in line with developments in the average 6-month treasury bill yield during the previous quarter, starting from end-2000.

43. Recognizing the need for an integrated approach to trade finance with an emphasis on mitigating risk while enhancing credit access of small- and medium-sized enterprises, a new dollar-based window will be introduced by end-2000. This window, which will be known as the Foreign Currency Export Facility (FCEF), will be supported by a loan from the AsDB. The FCEF will address a number of problems that exist under the EFS, including the absence of effective risk mitigation mechanisms and a banking culture that does not accept export payment instruments (such as letters of credit) as adequate collateral, thereby impeding the private sector's provision of funds for developing new exporters, markets, and products. In order for the FCEF to catch on, the subsidized export finance through the EFS will be eliminated by end-2000/01.

Transition to Islamic financial system

44. The government is in the process of making the necessary preparations to implement the Supreme Court's December 1999 decision requiring the transformation of Pakistan's financial system to conform with Islamic financial principles. In this connection, a Commission on the Transformation of the Financial System has been established to formulate a transformation plan and suggest amendments in contracts and operations of financial institutions. Once the transformation is completed, all new domestic borrowing will be in accordance with Islamic financial principles; new instruments and institutions, as well as a legal framework, will need to be put in place for this purpose. All international debt obligations will continue to be serviced.

---

[8]Together, these items accounted for around 60 percent of the outstanding credit under the scheme at end-1999.

Foreign currency deposits (FCDs)

45. The requirement that banks place with the SBP their foreign currency funds (excluding those that have been lent domestically) mobilized through new foreign currency deposits (FCDs) will be liberalized. This requirement had been put in place in June 1999, in response to concern over the quality of banks' investments in assets abroad. Prudential regulations governing such investment are being finalized. It is envisaged that the placement requirement will be withdrawn by end-March 2001, after financial assistance from the international financial institutions (IFIs) has resumed.

Recapitalization of the SBP

46. A shortfall in the SBP's capital and reserves related to revaluation losses on its net credit from the IMF was completely covered in June 2000. The shortfall had emerged as the result of not revaluing the outstanding stock of IMF credit (related to disbursements under SAF and ESAF) in the SBP's rupee balance sheet in previous years. Thus, a revaluation of PRs 18.9 billion was effected in stages during the period June 1999–June 2000. Of this, PRs 15.5 billion was covered through the retention of SBP profits earned in 1999/2000, while the remainder was covered through the retention of profits earned in 1998/99. For the purpose of preparing the monetary accounts, all foreign assets and liabilities of the SBP—including its net IMF position—are being revalued on a monthly basis from the start of the 2000/01 fiscal year.

D. Trade Liberalization

47. A number of measures have been taken in recent months to liberalize trade. In particular, effective tariff rates that were in excess of the maximum tariff of 35 percent have been reduced to no more than 35 percent. Effective tariffs, measured as the import tariff rate plus the differential in excise taxes applied to domestically-produced and imported goods, previously had exceeded the maximum rate for some 40 items. The differential excises applied to these 40 items were adjusted in June 2000 for all items except the 8 on which differential excises had been applied as an anti-dumping measure in the absence of the relevant legislation in Pakistan. Once the WTO-consistent anti-dumping law is in place—envisaged by end-December 2000—the differential excises for these items will be withdrawn. Any remaining differential excises (for items where the effective tariff is within the maximum) will be removed by July 2001.

48. A number of other steps have also being taken to liberalize the trade regime. Exports of all agricultural products except wheat have been liberalized by August 2000 through the elimination of annual administrative approval requirements and minimum export prices. At the same time, the government has scaled down its interventions in agricultural products markets. In addition, all remaining margin requirements on import letters of credit have been removed. A number of sectoral studies have also been commissioned to come up with recommendations to improve sectoral performance by identifying and addressing structural weaknesses in the economy.

49. The government is firmly committed to further trade liberalization over the medium term in order to promote competitive and efficient industry, and boost investment in high value-added sectors in which Pakistan has a comparative advantage. It is recognized that reducing rates of effective protection and the anti-export bias of existing tariff policies will enhance industrial performance and investment efficiency. In order to convey a strong signal regarding the government's policy intentions and give the private sector some time to adjust to increased competition, the overall tariff reduction plan was publicly announced on October 25, 2000. In particular, this will involve a reduction in the maximum tariff rate to 30 percent from July 2001, and to 25 percent from January 2003. Moreover, the number of tariff slabs will be reduced from 5 at present to 4 in July 2001 and 3 in January 2003.

V. Governance and Transparency

50. Measures aimed at improving governance and enhancing transparency constitute a key element of the reform agenda. These include the formulation of a devolution plan to redistribute the balance of activities and responsibilities across the various tiers of government; measures to enhance the quality of public spending; reform of the civil service, police, and judiciary, with increased accountability of public officials; and improvements in financial management and the quality of the public and national accounts statistics.

51. The National Devolution Plan to decentralize the delivery of government services and enhance the role of local citizens' groups in setting priorities for government spending has been launched. The program envisages the creation of elected district level authorities and local councils. A review of revenue authority and expenditure responsibilities at each tier of government has recently been initiated. The decentralization plan will be supported by a strong framework to ensure that it does not lead to a loss of fiscal control as revenues are transferred to lower tiers of government ahead of expenditure responsibilities.

52. Economic governance is being improved through a wide-ranging program to enhance the quality of economic decision making and public spending. This is expected to curb wasteful spending, particularly under the Public Sector Development Program, and raise the accountability of officials responsible for public projects.

53. A program to reform the civil service and enhance its accountability has been formulated and will be implemented over the next two years. The autonomy of the Federal Public Services Commission (FPSC) is being strengthened. In addition, government officials' training programs are being revamped and the performance evaluation system is being revised to ensure that promotions are on a strict merit basis. Restructuring of government departments has commenced with the CBR, where 1,000 employees have been shed. Restructuring of the CBR has been entrusted to a task force, which will submit its recommendations by end-December 2000. This is to be followed with the restructuring of federal economic ministries by March 2001 and of the rest of the federal secretariat by 2002/03. An ordinance empowering the government to retire civil servants with more than 25 years of service has been promulgated, and a new ordinance to deal with corruption and inefficiency is also in place. A review of government employees' salary structure is expected

to be completed by June 2001. Under the judicial reform program, which was launched in 1998, the training of judges is being improved and automation of the judicial system is being enhanced. A Tax Ombudsman's Office has recently been established. A report on police reforms has been completed, and its recommendations are to be implemented during 2000/01.

54. Following the discovery of discrepancies in the fiscal accounts in late 1999, a number of measures have been put in place to improve financial management and enhance the transparency of economic and financial policies and data. A Fiscal Monitoring Committee (FMC) has been established at the federal level to track fiscal developments and direct efforts for improving the quality of fiscal data, and similar committees are being formed at the provincial level. The Accountant General Pakistan Revenue (AGPR) is now fully involved with the Budget Wing of the Ministry of Finance in the preparation of fiscal reports, which will henceforth be published on a quarterly basis with commentary on data quality. In addition, the implementation of the Pakistan Improvement of Financial Reporting and Accounting (PIFRA) project is being accelerated and a centralized debt management unit with a computerized debt management system will be put in place by end-2001.

55. A number of measures are underway to improve the transparency of economic and financial policies and data dissemination. The fiscal module of the IMF's ROSC has been completed, and its main recommendations are being implemented. In particular, efforts will focus on: (a) strengthening the core fiscal accounting and reporting procedures; (b) widening and deepening fiscal information provided in the budget process; and (c) defining more clearly the roles of different levels of government and the relationship between government and commercial activities. The government will also participate in the Financial Sector Assessment Program (FSAP) and take part in the production of related financial sector ROSCs during 2001. Moreover, in recognition of the weakness in the coverage, accuracy, and timeliness of national accounts statistics at present, a timebound plan to improve the quality and frequency of national accounts statistics has been developed. The plan envisages the completion of 22 sectoral reports by end-March 2002; the plan will culminate in the production of new national accounts statistics with the base year 1999/2000. The new national accounts will be completed by end-June 2002.

56. Stage one of the Fund's safeguards assessment has been completed, in collaboration with the Fund's staff. The principal recommendation emerging from this exercise was that the SBP's financial safeguards (audit, legal structure and independence, financial reporting and financial internal controls) need to be strengthened. Specific steps in this regard, as well as a timetable for their implementation, will be agreed during a stage two of the assessment, which is expected to be completed by end-January 2001.

VI. FINANCING ISSUES

57. The financial program outlined above is built on the assumption that about US$4 billion in gross exceptional financing would be available during 2000/01. It is envisaged that such financing could come from the private sector, the IFIs, and official bilateral creditors.

58. Regarding financing from the private sector, an agreement with commercial banks on the restructuring of commercial loans totalling US$929 million was reached in 1999. Of this total, US$777 million involves a rolling over of trade finance facilities on an annual basis for three years (concluding in June 2002), and includes a step-up in the margin over LIBOR from 100 basis points in the first year to 125 basis points and 150 basis points in the second and third years, respectively. Of the remaining amount, US$102 million was rescheduled with a grace period of up to end-December 2002 and repayments thereafter in six equal annual installments. In addition, a US$50 million loan from an investment bank, which was contracted in September 1998, has been rolled over beyond 2000.

59. Pakistan's three Eurobond obligations worth a total of US$608.3 million were voluntarily restructured in December 1999. Under the restructuring terms, previous bonds were exchanged for a new issue with six-year maturity, three-year grace period, and four equal annual repayments starting in November 15, 2002. Around 99 percent of bondholders opted for the new debt instrument. The government does not intend to repay the remaining old bonds on terms more favorable than the new issue.

60. New private sector financing is also being arranged. At this stage, two loans totaling US$145 million from commercial banks to public enterprises are being arranged; both loans are for 300 days. In addition to the US$413 million in loans from the Islamic Development Bank (IDB) that was already in the pipeline, financing of US$130 million from the IDB has been arranged (US$50 million with two-year maturity and US$80 million with a six-month rollover basis). Moreover, the government will seek rollover of US$500 million deposits from the Bank of China at the National Bank of Pakistan and of 75 percent of US$1.1 billion foreign currency deposits of nonresident institutional investors, which fall due in 2000/01.

61. The reform program in the power, gas, and banking sectors, and in the areas of privatization and governance, will be forcefully implemented to fulfill the conditionalities linked to the Structural Adjustment Loan from the World Bank. The government hopes that the World Bank could then disburse US$350 million in 2000/01 in support of these reform efforts. Expeditious steps will also be taken to allow the disbursement of some US$525 million from the AsDB during the current fiscal year in the form of program loans covering agriculture, trade, energy, legal system, microcredit and small- and medium-sized enterprises.

62. The government assured the rolling over for two years of US$250 million deposit from the Kuwait Investment Authority at the SBP initially falling due in August 2000. The

government will also seek further rolling over of US$150 million deposit from the Central Bank of the U.A.E. at the SBP falling due in December 2000.

63. To close the remaining financing gap, the government intends to approach the Paris Club and other bilateral creditors for a rescheduling of public and publicly guaranteed pre-cutoff debt on terms similar to the last rescheduling, including arrears and excluding amounts due under the last rescheduling.[9]

VII. Program Monitoring

64. The government is aware that purchases under the stand-by arrangement would be contingent on the observance of quantitative and structural performance criteria and the completion of reviews. The monitoring of the program by the Fund staff will also take into account indicative targets and structural benchmarks.

65. For purposes of monitoring the program for 2000/01, quantitative performance criteria and quantitative indicative targets that have been agreed are presented in Table 1, and structural performance criteria and benchmarks are set out in Table 2. The government has also implemented a number of measures as prior actions for the Board's approval of the arrangement; these are listed in Table 3. Purchases under the Stand-By Arrangement shall be subject to reviews to be completed in March 2001, June 2001 and September 2001. Quarterly external financing assurances reviews will also apply, as part of the regular reviews under the program. Definitions of each of the monitoring variables and, where necessary, of the qualitative performance criteria and benchmarks, together with reporting requirements and monitoring mechanisms are detailed in the attached Technical Memorandum of Understanding.

66. The government believes that the above described policies are adequate to achieve the objectives of the program and, on this basis, hereby requests approval of the stand-by arrangement. Moreover, the government stands ready to take any additional steps that may be necessary and will consult with the Fund on this matter in accordance with the Fund policies on such consultations.

[9] In January 1999, the government reached an agreement with the Paris Club creditors to reschedule debt obligations on pre-cutoff debt coming due between January 1999 and December 2000 plus arrears up to December 1998. The second phase of the agreement—covering the period March 1 to December 31, 2000—was not implemented in the absence of an active arrangement with the Fund. The government will seek the full rescheduling of arrears accumulated as of September 30, 2000 (US$837 million) and of maturities due during October 1, 2000–June 2001 regarding pre-cutoff debt only.

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

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

	Outstanding stock	Performance criteria		Indicative Targets
	End-June 2000	End-Dec. 2000	End-Mar. 2001	End-June 2001
Performance Criteria				
	(In billions of Pakistan rupees)			
Net foreign assets of the SBP 1/	-55.1	-8.2	8.7	50.5
Net domestic assets of the SBP 2/	552.9	-26.3	-39.6	-35.5
Overall budget deficit	206.4	103.8	152.8	185.7
Of which: net bank borrowing 3/	40.0	6.4	19.9	-16.7
CBR revenue	346.6	189.9	291.6	430.2
Credit to the seven major public enterprises 4/	44.5	6.5	9.5	11.5
Accumulation of budgetary arrears to WAPDA		0.0	0.0	0.0
	(In millions of U.S. dollars)			
Contracting of short-term public and publicly guaranteed external debt 5/	2,354	800	800	800
Contracting of nonconcessional medium- and long-term public and publicly guaranteed external debt 5/		2,000	2,500	3,000
Of which: External debt with an initial maturity of over one year and up to five years 5/		1,000	1,500	1,500
Accumulation of external payments arrears (continuous performance criterion during the program period)		0	0	0
Indicative Targets				
	(In billions of Pakistan rupees)			
Net domestic assets of the banking system 6/	1,451.5	29.3	49.3	79.6
Federal tax revenue 7/	386.8	207.5	317.2	465.7
Social and poverty-related spending 8/	76.3	48.5	77.9	97.5
Memorandum items:				
Net external budget financing 9/	73.6	71.5	87.0	130.9
	(In millions of U.S. dollars)			
Stock of non-resident institutional foreign currency deposits	784	740	583	583
Stock of frozen non-resident non-institutional foreign currency deposits with scheduled banks	329	204	142	79
Program financing				
BOP support loans 10/		570	567	1,060
Debt rescheduling		1,120	1,430	1,673
Stock of foreign exchange swaps of the SBP	756	652	652	652
External financing counted as SBP liability		139	220	214
Net foreign assets of the SBP (level; PRs bln)	-55.1	-63.3	-46.4	-4.6

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

1/ These floors will be adjusted: (a) upward by the rupee equivalent of the excess in program financing; (b) downward by the rupee equivalent of the shortfall in program financing provided that the SBP net foreign assets remain above PRs –78.0 billion at end-December 2000, above PRs –61.3 billion at end-March 2001, and above PRs –19.5 billion at end-June 2001; (c) upward by the rupee equivalent of the full amount of any privatization proceeds from abroad; and (d) upward by the rupee equivalent of the excess in nonresident institutional foreign currency deposits with SBP forward exchange cover above the end-August 2000 level (US$1,068 million), in foreign exchange swaps of the SBP above the end-August 2000 level (US$717 million), in outright forward sales of foreign exchange by the SBP above the end-August 2000 level (US$23 million), and in SBP foreign exchange reserves held with foreign branches of domestic banks above the end-June level (US$545 million).

2/ These ceilings will be adjusted (a) downward by the rupee equivalent of the excess in program financing; (b) upward by the rupee equivalent of the shortfall in program financing provided that the net domestic assets of the SBP remain below PRs 541.3 billion at end-2000, below PRs 528.2 billion at end-March 2001, and below PRs 532.3 billion at end-June 2001; (c) downward by the rupee equivalent of the full amount of any privatization proceeds from abroad used by the budget; and (d) downward by the rupee equivalent of the excess in foreign currency deposits with SBP forward exchange cover above the end-August 2000 level and in foreign exchange swaps of the SBP above the end-August 2000 level, in outright forward sales of foreign exchange by the SBP above the end-August 2000 level, and in SBP foreign exchange reserves held with foreign branches of domestic banks above the end-June 2000 level.

3/ These ceilings will be adjusted: (a) downward by the rupee equivalent of the excess in net external budget financing; (b) upward by the equivalent of any shortfall in net external budget financing provided that net bank borrowing by the government remains below PRs 21.1 billion at end-December 2000, below PRs 34.8 billion at end-March 2001, and below PRs –1.8 billion at end-June 2001; and (c) downward by the rupee equivalent of the amount of new privatization proceeds used by the budget.

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

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

6/ These ceilings include the rupee counterpart of external debt service due on rescheduled government and government guaranteed debt. These indicative ceilings will be adjusted: (a) downward by the rupee equivalent of the excess in program financing; (b) upward by the rupee equivalent of the shortfall in program financing provided that the net domestic assets of the banking system remain below PRs 1,495.5 billion at end-2000, below PRs 1,515.7 billion at end-March 2001, and below PRs 1,546.0 billion at end-June 2001; (c) downward by the rupee equivalent of the full amount of any privatization proceeds from abroad; and (d) downward by the rupee equivalent of the excess in foreign currency deposits with SBP forward exchange cover above the end-August 2000 level.

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

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

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

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

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

Measures	Timing
I. Structural Performance Criteria	
Implementation of the quarterly petroleum price adjustment mechanism for all major petroleum products as described in Section VI of the Technical Memorandum of Understanding.	December 15, 2000, March 15, 2001, and June 15, 2001
Ban on introduction of new GST exemptions and fixed-tax schemes under the GST.	Continuous during the program period
Publication of quarterly fiscal reports that have been verified by the Accountant General Pakistan Revenue (starting with the first quarter of 2000/01; reports are to be published no later than two months after the end of the quarter).	End-February 2001, end-May 2001, and end-August 2001.
GST extension to urea fertilizer and pesticides.	By end-March 2001
GST extension to all other agricultural inputs	By September 1, 2001
Promulgation of a new income tax law, that puts into place a global income tax with (a) a simpler rate structure for individuals; (b) uniform tax of all companies; (c) less emphasis on withholding and presumptive taxes; (d) fewer exemptions; and (e) replacement of investment incentives by a simple system of accelerated depreciation.	With the passage of the 2001/02 budget before end-July 2001
Extension of income tax to all new issuance of NSS instruments on the same basis as the income tax currently applies to other financial instruments.	With the passage of the 2001/02 budget before end-July 2001
The extension of GST to all retailers/traders above the PRs 5 million threshold.	With the passage of the 2001/02 budget before end-July 2001
The reduction of the maximum customs tariff to 30 percent and the number of tariff slabs to 4.	July 1, 2001
The elimination of interest subsidy element of the export finance scheme.	July 1, 2001
II. Structural Benchmarks	
Completion and publication of a special audit in line with international standards of the Central Directorate of National Savings.	End-October 2000
Establishment and implementation of a formula linking interest rates on new Defense Savings Certificates to the market-determined yield of the new government bond.	January 1, 2001

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

Measures	Timing
Enactment of the anti-dumping law that would lead to the withdrawal of the differential excises applied to domestically-produced and imported goods as an anti-dumping measure.	End-December 2000
Preparatory steps relating to the promulgation of a new income tax law with the 2001/02 budget:	
The income tax committee will submit its preliminary recommendations to the Ministry of Finance.	End-December 2000
The final report and a draft law will be submitted to cabinet.	End-March 2001
Establish basic reconciliation processes in all provinces. All provinces will produce quarterly reports for internal use and reporting to the MOF that are fully reconciled in terms of AG/Departmental accounts, clearance of suspense accounts, SBP and scheduled bank accounts, and provincial/federal records of intergovernmental flows.	Quarterly, starting end-March 2001 (covering data through December 2000)
Publication of public sector contingent liabilities as an annex to the Economic Survey.	By end-June 2001, with the economic survey presented prior to the 2001/02 budget
Publication of a schedule of tax expenditures as an annex to the Economic Survey.	By end-June 2001, with the economic survey presented prior to the 2001/02 budget
Initiate a review of Part A of the budget (covering costs of government services such as wages and salaries).	By end-December 2000
Establish a fiscal reform unit to build up technical capacity and more effective ownership of fiscal reform programs which would cover tax reform as well as public expenditure management reform.	January 2001
Send report on research studies in the framework of National Accounts Project to the Fund's Statistics Department according to the following schedule:	
Those related to fishing, shipping, and services.	End-March 2001
Those related to livestock, mining and quarrying, and public administration and defense.	End-June 2001

Table 3. Pakistan: Prior Actions

1. Depreciation of the PRs rupee/US$ exchange rate by 12 percent from its mid-May level of PRs 51.7 per US$1 (interbank buying rate);

2. An increase in treasury bill interest rates by at least 3 percentage points from their levels prevailing on September 18, 2000, with the 3-month treasury bill rate reaching at least 10.5 percent;

3. The announcement of the trade liberalization program involving: (i) a reduction in the maximum tariff rate to 30 percent from July 1, 2001 and to 25 percent from January 1, 2003; and (ii) a reduction in the number of tariff slabs from 5 (excluding 0 tariff slab) to 4 on July 1, 2001 and to 3 on January 1, 2003;

4. Separation of tax survey activities from normal sales tax administration at the Central Board of Revenue;

5. Adoption and publication of a time-bound action plan for improving national accounts, as well as provision of a report outlining the plan of the improvement of the National Accounts Project, including a draft allocation of the available budget, to the Statistics Department of the Fund;

6. Completion and publication of a special audit in line with international standards of the Central Directorate of National Savings;

7. Provision of sufficient information to allow for the completion of Stage-One of the Fund's safeguards assessment;

8. Publication of the fiscal report prepared by the Fiscal Monitoring Committee for the fourth quarter of 1999/2000 that have been verified by the Accountant General Pakistan Revenue;

9. Formation of the Provincial Public Accounts Committees;

10. Provision of CBR revenue data through end-September to the Middle Eastern Department of the Fund;

11. Adequate implementation of an orderly process to resolve the commercial dispute with HUBCO and actions to address dispute with KAPCO; and

12. Implementation of sufficient reform measures in the structural areas that are in the World Bank's domain to allow the World Bank to provide assurance of financial support.

PAKISTAN

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

(November 2000)

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

I. Quantitative Performance Criteria

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

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

- Non accumulation of external payments arrears.

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

A. Adjustments to the Net Foreign Assets of the SBP

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

- Upward by the rupee equivalent of the excess in program financing;

- Downward by the rupee equivalent of the shortfall in program financing provided that the SBP net foreign assets remain above PRs –78.0 billion at end-December 2000, above PRs –61.3 at end-March 2001, and above PRs –19.5 billion at end-June 2001;

- Upward by the rupee equivalent of the full amount of any privatization proceeds from abroad; and

- Upward by the rupee equivalent of the excess in nonresident institutional foreign currency deposits with SBP forward cover above the end-August 2000 level (US$1,068 million), in foreign currency exchange swaps of the SBP above the end-August 2000 level (US$717 million), in outright forward sales of foreign exchange by the SBP above the end-August 2000 level (US$23 million), and in SBP foreign exchange reserves held with foreign branches of domestic banks above the end-June 2000 level (US$545million).

B. Adjustments to the Net Domestic Assets of the SBP

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

- Downward by the rupee equivalent of the excess in program financing;

- Downward by the rupee equivalent of the full amount of any privatization proceeds from abroad used by the budget;

- Upward by the rupee equivalent of the shortfall in program financing provided that the net domestic assets of the SBP remain below PRs 541.3 billion at end-December 2000, below PRs 528.2 billion at end-March 2001, and below PRs 532.3 billion at end-June 2001; and

- Downward by the rupee equivalent of the excess in foreign-currency deposits with SBP forward exchange cover above the end-August 2000 level, in foreign exchange swaps of the SBP above the end-August 2000 level, in outright forward sales of foreign exchange by the SBP above the end-August 2000 level, and in

SBP foreign exchange reserves held with foreign brances of domestic banks above the end-June 2000 level.

C. Adjustments to Net Banking Borrowing

6. The ceiling on net bank borrowing by the government will be adjusted:

- Downward by the rupee equivalent of the excess in net external budget financing (defined below);
- Upward by the rupee equivalent of the shortfall in net external budget financing provided that net bank borrowing by the government remains below PRs 21.1 billion at end-December 2000, below PRs 34.8 billion at end-March 2001, and below PRs –1.8 billion at end-June 2001; and
- Downward by the rupee equivalent of the amount of any privatization proceeds used by the budget.

D. Adjustments to Credit to the Seven Major Public Enterprises

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

II. Indicative Targets

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

Adjustments to the net domestic assets of the banking system

9. The ceilings on the net domestic assets of the banking system will be adjusted:

- Downward by the rupee equivalent of the excess in program financing;

- Upward by the rupee equivalent of the shortfall in program financing provided that the net domestic assets of the banking system remain below PRs 1,495.5 billion at end-December 2000, below PRs 1,515.7 billion at end-March 2001, and below PRs 1,546.0 billion at end-June 2001;

- Downward by the rupee equivalent of the full amount of any privatization proceeds from abroad; and

- Downward by the rupee equivalent of the excess in foreign currency deposits with SBP with forward exchange cover above the end-August 2000 level.

III. Structural Performance Criteria

10. The following measures constitute structural performance criteria:

- Implementation of the quarterly petroleum price adjustment (program period) for all major petroleum products as described in Section VI below;

- Ban on introduction of new GST exemptions and fixed-tax schemes under the GST (continuous during the program period);

- Publication of quarterly fiscal reports that have been verified by the Accountant General Pakistan Revenue (program period, starting with the first quarter of 2000/01; reports are to be published no later than two months after the end of the quarter);

- GST extension to urea fertilizer and pesticides by end-March 2001 and to all other agricultural inputs by September 1, 2001;

- The promulgation of a new income tax law with the passage of the 2001/02 budget that puts into place a global income tax with: (a) a simpler rate structure for individuals; (b) uniform tax of all companies; (c) less emphasis on withholding and presumptive taxes; (d) fewer exemptions; and (e) replacement of investment incentives by a simple system of accelerated depreciation.;

- The extension of income tax to all new issuance of NSS instruments on the same basis as the income tax currently applies to other financial instruments with the passage of the 2001/02 budget;

- The extension of the GST to all retailers/traders above the PRs 5 million threshold with the passage of the 2001/02 budget;

- The reduction of the maximum custom tariff to 30 percent and the number of tariff slabs to 4 on July 1, 2001; and

- The elimination of the interest rate subsidy in the export finance scheme (in relation to the SBP's discount rate) on July 1, 2001. The subsidy will be measured as the difference between the export finance scheme interest rate less 1.5 percentage points and the average 6-month treasury bill yield prevailing in auctions during the previous quarter.

IV. Structural Benchmarks

11. The following measures constitute structural benchmarks:

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

- Establishment and implementation of a formula linking interest rates on new Defense Savings Certificates (DSCs) to the market-determined yield of the new government bond (January 1, 2001);

- Enactment of the anti-dumping law (end-December 2000); that would lead to the withdrawal of the differential excises applied to domestically-produced and imported goods as an anti-dumping measure.

- Preparatory steps relating to the promulgation of a new income tax law with the 2001/02 budget: (i) the income tax committee will submit its preliminary recommendations to the Ministry of Finance by end-2000; and (ii) the final report, with a draft law, will be submitted to the cabinet by end-March 2001; and

- Measures to improve national accounts statistics, as detailed in Section VI.

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

- Establish basic reconciliation processes in all provinces. All provinces will produce quarterly reports for internal use and reporting to the Ministry of Finance that are fully reconciled in terms of between Accountant General and departmental accounts, clearance of suspense accounts, SBP and scheduled bank accounts, and provincial/federal records of intergovernmental flows, starting end-March 2001 (covering data through December 2000).

- A statement of contingent liabilities should be published as an annex to the Economic Survey presented prior to the 2001/02 budget.

- A schedule of tax expenditures should be published as an annex to the Economic Survey presented prior to the 2001/02 budget.

- Initiate a review of Part A (covering cost of government services such as wages and salaries) of the budget by end-December 2000.

- Establish a fiscal reform unit in the Ministry of Finance by January 2001 to build up technical capacity and more effective ownership of fiscal reform programs which would cover tax reform as well as public expenditure management reform.

V. Financial Program Reporting Requirements

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

- Monthly statements on federal tax revenue.

- Deposits into and withdrawals from the privatization accounts for each quarter of 2000/01. Withdrawals are to be reported with the following breakdown: (i) those which constitute budgetary use of privatization proceeds; (ii) those which constitute costs of privatization; and (iii) other (please explain the purpose of other withdrawals).

- Quarterly statements on nontax revenue.

- Quarterly statements on capital receipts and disbursements, including repayments of bonds, recovery of loans from provinces and "others".

- Quarterly statement on consolidated budgetary expenditure.

- Quarterly data on social sector and poverty-related budgetary expenditures.

- Quarterly data on the stock of domestic government debt, broken down by instrument.

- Quarterly data on budgetary arrears to and from WAPDA.

- Quarterly data on external financing (as defined in paragraph 9 of the Annex), including project aid, commodity aid, food aid, and other nonproject financing (including suppliers' credit used by NHA).

- Quarterly data on the revenues and expenditures of the seven public enterprises as per the formats adopted in Tables 28 through 34 of the Recent Economic Developments paper (SM/97/253).

- The following monthly monetary data on a last-Saturday basis, both at current and program exchange rates:

  (a) monetary survey;
  (b) accounts of the State Bank of Pakistan (SBP);
  (c) consolidated accounts of the scheduled banks;
  (d) lending to the government; and
  (e) deposits of the government and of public sector enterprises on account of external debt service payments subject to rescheduling (in arrears).

- The same tables as in the preceding item, but on an end-quarter basis, both at current and program exchange rates.

- Monthly data on sales and purchases by the SBP in the kerb and interbank foreign exchange markets.

- Monthly data on the outstanding stock of the SBP's forward foreign currency operations, including swaps and outright forward sales and purchases. The terms of any new transactions will also be provided.

- Monthly data on the SBP's foreign exchange reserves, with details on the currencies, instruments, and institutions in which the reserves are held.

- Quarterly data on bank credit to the seven major public enterprises listed in Table 1 of the MEFP.

- The following quarterly data on external debt:

  (a) Stock of public and publicly guaranteed external debt (including deferred payments arrangements), with initial maturities of up to and including one year;

  (b) Loan-by-loan detail of the contracted new medium and long-term non-concessional public and publicly-guaranteed external debt with separate identification of the contraction of debt with an initial maturity of over one year and up to and including five years; grace periods and scheduled repayments; currency denominations; and interest rates;

  (c) Monthly data on external payments arrears on public and publicly guaranteed debt;

  (d) Monthly statements on rescheduling agreements on public and publicly guaranteed debt reached with creditors; and

(e) Monthly data on deposits in special accounts by public sector enterprises on account of rescheduled (or in arrears) publicly guaranteed debt service payments.

- Copies of new ordinances regarding changes in tax policy and administration no later than 3 days after official issuance, or notification that ordinances have been posted on the CBR website.

- Monthly data on the import parity prices of the seven major oil products listed in Table 1.

VI. Monitoring Mechanisms

A. Monitoring of Petroleum Products Price Adjustments

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

B. Monitoring of National Accounts Project

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

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

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

Definitions of the Monitoring Variables

Reserve money

1. Reserve money is defined as the sum of currency outside scheduled banks, scheduled banks' domestic cash in vaults, scheduled banks' (deposit money banks) required and excess deposits with the State Bank of Pakistan (SBP), and deposits of the rest of the economy with the SBP excluding those held by the federal government, the provincial governments, CEC, RECP, and counterpart funds.

Net foreign assets of the SBP

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

Net domestic assets of the SBP

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

Domestic liquidity

4. Domestic liquidity is defined as currency outside scheduled banks plus demand, time, and savings deposits of private residents held with the banking system in both domestic currency and foreign currency. Foreign currency deposits denominated in currencies other than the U.S. dollar will be converted into U.S. dollars at the market rates of the respective currencies prevailing on June 30, 2000 as published in IFS. The U.S. dollar value of foreign currency deposits will be converted into Pakistan rupees at end-September 2000, at the rate

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

of PRs 54.60 per U.S. dollar, at end-December 2000 at PRs 58.66 per U.S. dollar, at end-March 2001 at PRs 59.52 per U.S. dollar, and at end-June 2001 at PRs 59.66 per U.S. dollar.

Net foreign assets of the banking system

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

Net domestic assets of the banking system

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

Net borrowing from the banking system by the government

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

Overall budget deficit

8. The consolidated overall budget deficit—the excess of total budgetary expenditure over total budgetary revenue of the consolidated fund of the federal government and provincial governments—will be measured by the sum of: (a) budgetary use of privatization proceeds; and (b) total net financing to the federal and provincial governments. The latter is

[2]Government deposits do not include deposits in extra-budgetary government accounts with the banking system, including those related to privatization.

defined as the sum of net external financing (defined below), net borrowing from the banking system (as defined above), and net domestic nonbank financing (defined below).

Net external financing of the budget

9. Net external financing is defined as follows:

- All plan resources (grants and loans) enumerated in the 2000/01 Budget document "Estimates of Foreign Assistance", including Project Aid; Non-Food Commodity Aid; Food Aid; and Other Aid (Short-term Borrowings), including financing from the Islamic Development Bank.

- Net receipts from the issuance of foreign currency denominated debt including FEBC, DBC, and FCBC and special government dollar bonds. Net receipts from these bonds will be adjusted downward (upward) by the increase (decrease) in the stock of those bonds held by the banking system.

- The accumulation of arrears on public foreign currency debt (including military debt), since July 1, 2000.

- Debt relief associated with rescheduling of public debt (including military debt) owed to bilateral and commercial creditors.

- Receipts from the contracting other foreign currency government debt, not specified above.

Less:

- The repayment due of foreign loans enumerated in schedule II of the 2000/01 Budget document "Demands for Grants and Appropriations" (medium- and long-term debt); and

- The repayment due of short-term foreign credits enumerated in section II (Capital Receipts) of the 2000/01 Budget document "Explanatory Memorandum on Federal Receipts."

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

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

(In billions of Pakistani rupees)

	2000/01			
			Projection Cum. From July 1, 2000	
	Q1	Q2	Q3	Q4
External Financing (net)	22.3	71.5	87.0	130.9
External receipts	44.2	115.6	154.4	223.1
Project aid 2/	9.3	19.9	32.5	45.7
Commodity aid (non-food) 3/	0.0	22.2	23.6	51.7
Food aid	0.0	0.0	0.0	0.0
Other	19.1	42.5	65.6	86.5
Islamic Development Bank (loans)	8.0	18.5	26.2	31.2
Gulf countries (grant) 4/	11.0	23.7	36.6	49.9
F16	0.0	0.0	2.4	4.8
FCD conversion bonds	0.1	0.3	0.4	0.6
FEBCs/DBCs/FCBCs (net)	-0.7	-1.4	-2.1	-2.7
Amortization (due)	21.9	44.1	67.4	92.1
Arrears	-20.5	-20.5	-20.5	-20.5
Debt rescheduling	36.9	53.0	55.2	62.5
Memorandum items:				
Exchange rate (PRs/US$, quarterly average)	53.8	58.3	59.4	59.6

Sources: Ministry of Finance; and Fund staff projections.

1/ External financing data in Pakistani rupees is derived from quarterly data in U.S. dollars using quarterly average exchange rates, except in the cases of external financing related to issuance of foreign currency denominated debt and the Saudi oil facility. In those cases, financing is derived from the change in the rupee-denominated debt stock as reported by the SPB (which converts the debt stock into rupees at the exchange rate prevailing at issuance) and rupee deposits of refineries in the dedicated SBP account, respectively.
2/ Includes grants.
3/ Includes all AsDB and World Bank lending; assumes SAL disbursements in 2000/01 Q4.
4/ Assumes 80,000 barrels a day and US$29.5 per barrel.

Net domestic nonbank financing of the budget

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

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

Public and publicly guaranteed external debt

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

Nonconcessional borrowing

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

Program financings

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

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

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

(In millions of U.S. dollars)

	Sept. 2000	Dec. 2000	Mar. 2001	Jun. 2001
Program financing	86	570	567	1,060
World Bank loans	0	0	0	350
AsDB loans	0	380	405	525
Bilateral grants and loans	220	452	689	930
Saudi oil facility	205	422	640	862
Project grants	15	30	49	68
Additional commercial bank borrowing	0	45	95	145
Debt relief from commercial bank	0	0	-207	-298
Amortization to multilateral Creditors, excluding the IMF	-140	-320	-434	-617

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

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

(In millions of U.S. dollars)

	Sept. 2000	Dec. 2000	Mar. 2001	Jun. 2001
Total	-12.1	117.7	205.8	207.2
Deposit of NBP	66.0	66.0	66.0	-33.0
Fund disbursements	0.0	204.7	348.0	491.3
Repayments to the Fund	-78.1	-153.0	-208.2	-251.1

Budgetary arrears to WAPDA

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

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

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

Table 1. Pakistan: Automatic Petroleum Price Adjustment Formula

Product	IPP				CED/CD	Distribution margin	Freight margin	Dealer commission	Total surcharges 1/	GST	Fixed sales price (in PRs)	Increase in Fixed Sales Price (in percent)
	Jun-00	Jul-00	Aug-00	Average	Sep-00	Sep-00	Sep-00	Sep-00	Sep-00	Sep-00	Sep-00	Sep-00
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)=0.15*((5)+(6)+(7)+(8)+(9)+(10))	(12)=(5)+(6)+(7)+(8)+(9)+(10)+(11)	(13)
									(In PRs per liter)			
MS	9.33	9.22	10.21	9.59	0.88	0.61	0.75	0.57	12.19	3.69	28.29	2.86
HOBC	10.52	10.41	11.48	10.80	0.88	0.77	0.79	0.68	15.02	4.34	33.29	2.42
MTBE	15.78	16.65	16.11	16.18	0.88	0.98	0.95	0.81	15.03	5.22	40.06	2.00
SKO	9.87	10.84	12.77	11.16	0.00	0.19	0.83	0,00	0.00	1.83	14.01	24.51
HSD	9.65	10.33	12.55	10.84	0.25	0.30	0.98	0.35	0.73	2.02	15.47	14.59
LDO	9.68	9.93	11.77	10.46	0.04	0.18	0.97	0.00	0.00	1.75	13.40	21.82
JP-4	9.62	10.17	11.64	10.48	0.06	0.00	0.00	0.00	2.39	1.94	14.86	10.90

Sources: Ministry of Finance; and Fund staff estimates.

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

INTERNATIONAL MONETARY FUND

PAKISTAN

Article IV Consultation and
Request for Stand-By Arrangement
Supplementary Information

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

Approved by P. Chabrier and G. Russell Kincaid

November 28, 2000

1. This supplement provides an update on the latest economic developments, policy measures, and financing issues. It does not change the thrust of the Staff Appraisal.

2. **The latest data indicate that developments in output and inflation through October 2000 were in line with projections under the program.** Early data on cotton sold to ginneries suggest a strong cotton crop, and some analysts are projecting that last year's bumper harvest could be exceeded in 2000/01. Consumer price inflation remained steady at 4.6 percent (year-on-year) in October; food price inflation picked up slightly.

3. **Recent export developments are also broadly in line with program projections, while imports and workers' remittances are running higher than envisaged.** Exports were higher by 13.4 percent (in U.S. dollar terms) during the first four months of 2000/01 (July–October) over the corresponding period of 1999/2000, underpinned by a strong expansion in non-textile manufactured exports. Exports of textiles remained buoyant. Imports were 15.1 percent higher in July–October 2000 than in the corresponding period in 1999. Despite lower imports of edible oils and wheat, overall food imports rose by 25.7 percent, mainly on account of higher sugar imports. Higher prices pushed the increase in imports of petroleum products to 77 percent. Excluding petroleum products, the value of imports during July–October declined by 3.3 percent over the corresponding period last year. Workers' remittances through the interbank market increased by more than 25 percent in the first four months of 2000/01 (over the corresponding period of 1999/2000).

4. **The official reserves position has improved somewhat in recent weeks.** As of November 27, official reserves net of short-term swap and forward commitments amounted to US$577 million (equivalent to 2.4 weeks of imports of goods and nonfactor services), compared with only US$391 million in early October. Following the removal of the cash margin requirement on import letters of credit in mid-November, the rupee has depreciated

by 3.5 percent against the U.S. dollar in the interbank market, and by about 12 percent from its level in mid-May. Notwithstanding some pickup in the State Bank of Pakistan (SBP) purchases of foreign exchange from the kerb market in recent weeks, the spread between the interbank and kerb market exchange rates has narrowed to about 5.5 percent, from over 9 percent in early November.

5. **The growth in broad money during July–October was in line with program projections while credit to the private sector picked up markedly**. The expansion in private sector credit reflected increased demand associated with higher cotton arrival at ginneries and substantially higher prices of seed cotton compared with last year. As regards the central bank's balance sheet, the increase, on a temporary basis, in the cash reserve requirement (CRR) by 2 percentage points to 7 percent, was accommodated through an increase in reserve money; commercial banks reduced their holdings of treasury bills to meet their CRR and private sector credit demand.

6. **Tax collection by the Central Board of Revenue (CBR) during the first four months of 2000/01 fell PRs 3.9 billion short of the PRs 116.9 billion target under the program**. The shortfall in direct tax receipts, which was equal to the shortfall in overall CBR revenue, appears to relate partly to the repeated extension of the income tax return filing deadline. This deadline, originally set for end-September, has now been extended to end-November because of delays in distributing the new income tax forms. Among the other tax categories, a modest shortfall in GST collections, relative to program targets, was offset by higher excise duty collections; nevertheless, GST receipts in July–October 2000 were over 40 percent higher than in the corresponding period of 1999/2000. Customs duty receipts were in line with program targets. In response to the revenue developments, the authorities have stepped up tax collection efforts, including intensified follow-ups with sales tax nonfilers and appointment of additional judges and nonjudicial members to Appellate Tribunals to improve the collection of tax arrears.[1] Furthermore, since November GST on sugar is applied on actual, rather than on a notional price; on this account, the authorities estimate an increase in revenue of PRs 2 billion during this crushing season. In addition, an ordinance for amending the Sales Tax Act for creating a legal framework for limiting the sales of industrial raw materials and intermediaries by registered persons to nonregistered/non-enrolled persons has been submitted by CBR for promulgation.

7. **As regards overall budgetary performance, the provisional unreconciled fiscal accounts for the first quarter of 2000/01 indicate that the consolidated general government position is broadly on track**. The budget deficit is estimated to have remained below the program target by about PRs 10 billion (0.3 percent of annual GDP). Overall

---

[1] In regard to income tax, 647,345 returns had been filed by October 31. This number increased to 791,763 by November 20. The Government has decided that there will be no extension of tax amnesty scheme or filing of income tax returns after November 30; action against nonfilers will be initiated after that date.

revenue receipts were slightly below expectations (by less than PRs 1 billion), with a shortfall in CBR revenue of PRs 2 billion partly offset by higher nontax revenue. However, as the reconciled accounts, which are not yet available, will likely contain significant revisions, especially on external financing and provincial government outlays, the provisional accounts should be regarded as tentative.

8. **Revisions to the fiscal data for 1999/2000 imply a slightly smaller budget deficit of 6.4 percent of GDP, compared with 6.5 percent of GDP reported earlier** (Table 1). The revised data, which have recently been provided by the authorities following further reconciliation between data from the Ministry of Finance and the Accountant General Pakistan Revenue, indicate higher revenue and expenditure by about PRs 12 billion and PRs 10 billion, respectively (0.4 percent of GDP and 0.3 percent of GDP, respectively). The main revisions were to federal and provincial nontax revenue, which were revised upward by PRs 7 billion and PRs 4 billion, respectively, and to federal subsidies (mainly relating to the Water and Power Development Authority) and development spending, which were raised by PRs 6 billion and PRs 5 billion, respectively.

9. **A special audit of the Central Directorate of National Savings (CDNS) covering 1997/98 and 1998/99 has been completed and its findings have been published**. The audit report highlights a number of deficiencies, as well as some of the improvements that have been implemented recently, in the accounting, reporting, and reconciliation of data on the sales of National Savings Scheme (NSS) instruments. In particular, the audit reveals that regular reconciliation was not carried out between most National Savings Centers (NSCs) and the SBP, cash ceilings for the NSCs were often not observed, and no regular reconciliation was carried out between post office outlets and the SBP. According to the report, these and other deficiencies gave rise to discrepancies and provided opportunities for the misappropriation of funds.

10. **On financing issues**, the Paris Club has agreed to consider, in January 2001, rescheduling Pakistan's debt obligations to official bilateral creditors. The Asian Development Bank's (AsDB) Executive Board is scheduled to consider several program loans to Pakistan in late November and December. While the amount likely to be disbursed by end-2000 is somewhat lower than envisaged under the program, total disbursements from the AsDB in 2000/01 are still expected to be in line with program projections.

11. **The developments described above do not alter the thrust of the staff appraisal.** The revisions to the 1999/2000 fiscal data provides more assurance that the revenue target for 2000/01 can be achieved. Nevertheless, the shortfall in CBR revenue during the first four months of 2000/01 underscores the importance of efforts to strengthen tax administration and tax enforcement. The staff welcomes the additional measures to boost revenue performance, and recommends expeditious implementation of the contingency measures identified by the authorities. The higher-than envisaged growth in reserve money—partly a result of the increase in reserve requirements—underscores the need to closely monitor monetary

developments. The liquidity released by any cut in the CRR will need to be mopped up to keep reserve money growth within programmed targets. As regards the CDNS audit, the staff recommends that audits—covering a larger sample of sales outlets and also encompassing the 1999/2000 fiscal year—be undertaken on a regular basis with a view to tracking progress in improving data reporting and reconciliation procedures. On financing matters, Pakistan is likely to continue to accumulate external payments arrears on official bilateral debts until January 2001, at which time the Paris Club is scheduled to consider rescheduling Pakistan's external debt obligations. Hence, the text of the Stand-By Arrangement will be amended to allow the accumulation of arrears to bilateral official creditors until end-January 2001, at which time all arrears to bilateral official creditors would also need to be eliminated.

Table 1. Pakistan: Summary of Consolidated Federal and Provincial Budgetary Operations, 1998/99–2000/01

	Rev. 1998/99	Prel. 1999/2000	Rev. 1999/2000	Prog. 2000/01
	(In billions of Pakistan rupees)			
Total revenue	474.9	512.6	524.4	585.2
Tax revenue	388.8	405.6	406.8	487.7
Of which:				
CBR revenue	311.4	346.6	348.1	430.2
Surcharges	61.9	38.9	38.9	33.0
Nontax revenue	86.1	107.0	117.6	97.5
Of which:				
SBP profit transfer	8.0	30.0	30.0	16.4
Total expenditure	651.2	718.9	728.7	770.9
Current expenditure	563.5	636.2	640.2	663.7
Of which:				
Interest	213.3	245.1	243.3	239.0
Defense	143.5	150.4	150.8	157.5
Development and net lending	87.7	82.7	88.5	107.2
Budget balance	-176.3	-206.3	-204.3	-185.7
Financing	176.3	206.3	204.3	185.7
External	147.0	73.6	74.2	130.9
Domestic	29.3	132.8	130.1	54.8
Bank	-75.0	40.0	40.0	-16.8
Nonbank	104.3	92.8	90.2	71.6
Privatization proceeds	0.0	0.0	0.0	0.0
	(In percent of GDP)			
Total revenue	16.3	16.1	16.5	16.5
Tax revenue	13.3	12.7	12.8	13.8
Of which:				
CBR revenue	10.7	10.9	10.9	12.1
Surcharges	2.1	1.2	1.2	0.9
Nontax revenue	3.0	3.4	3.7	2.8
Total expenditure	22.4	22.6	22.9	21.8
Current expenditure	19.3	20.0	20.1	18.7
Of which:				
Interest	7.3	7.7	7.6	6.7
Defense	4.9	4.7	4.7	4.4
Development and net lending	3.0	2.6	2.8	3.0
Budget balance	-6.1	-6.5	-6.4	-5.2
(excluding net lending)	-6.8	-6.9	-6.8	-5.5
Memorandum items:				
Primary balance (in percent of GDP)	1.3	1.2	1.2	1.5
Social and poverty-related expenditures (in percent of GDP)	2.4	2.4	2.4	2.8
GDP (in PRs billions)	2,914	3,182	3,182	3,543

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

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT
EDITORIAL DIVISION
ROOM IS 7-1200 0433

Public Information Notice (PIN) No. 00/108
FOR IMMEDIATE RELEASE
December 14, 2000

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

IMF Concludes Article IV Consultation with Pakistan

On November 29, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Pakistan.[1]

Background

Over the last decade, long-standing structural weaknesses in the Pakistan economy—an inefficient tax system, narrow tax and export bases, substantial domestic and external debt, and low human capital—have held back growth, threatened financial stability, and resulted in widespread poverty. Economic adjustment and reform programs to address these weaknesses have, in the past, suffered from implementation slippages.

Overall economic performance in FY1999/2000 benefited from favorable supply conditions in the domestic agricultural sector.[2] Real GDP growth is estimated to have picked up to 4.8 percent in 1999/2000, compared with 3.1 percent in the previous year. The bumper cotton crop helped the textile sector to rebound. Despite upward adjustments in domestic petroleum products prices, the stable rupee-dollar exchange rate and the decline in non-oil commodity prices helped moderate consumer price inflation to 3.6 percent (annual average), from 5.7 percent in the previous year.

With the favorable domestic supply conditions, the current account deficit (including official transfers) narrowed to 1.6 percent of GDP, from 3.8 percent of GDP in 1998/99, despite a deterioration in the terms of trade. Improved external demand conditions and increased

---

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. In this PIN, the main features of the Board's discussion are described.

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

domestic textile production boosted export growth. Total imports in U.S. dollar terms were unchanged from 1998/99, as the US$1.2 billion increase in oil imports, which was due to higher world prices, was broadly offset by lower food, defense, and project aid-related imports. Higher workers' remittances (private transfers) also improved the current account balance.

The overall external position was weakened in 1999/2000 by a significant decline in external financing, including from the international financial institutions (IFIs) and private capital outflows. Gross official reserves declined to US$0.9 billion (equivalent to 4.2 weeks of imports of goods and nonfactor services) at end-June 2000, from US$1.7 billion (7.8 weeks of imports) a year earlier. The external debt to GDP ratio amounted to 58 percent at end-1999/2000, while the external debt service after rescheduling amounted to 32 percent of current foreign exchange receipts.

Following a sizable fiscal consolidation in 1998/99, the budget deficit of the consolidated government widened to 6.4 percent of GDP in 1999/2000, from 6.1 percent of GDP in the previous year. Factors contributing to the deterioration included delayed adjustment in domestic petroleum prices; an increase in the government's interest bill; the settlement of accumulated tax refund arrears; the elimination of some local taxes at the beginning of the fiscal year; and an overrun in defense spending. Partly offsetting these effects on the budgetary position were higher nontax revenue; further cuts in development expenditure and net lending; collections from a tax amnesty; and an increase in Central Board of Revenue tax receipts. During the last two years, the ratio of net public debt to GDP stabilized at about 92 percent, as primary surpluses roughly offset the valuation effects of the rupee depreciation in 1998/99.

The monetary policy stance was eased during 1999/2000 in response to the moderation in inflation and weak private sector credit growth. Treasury bill yields were cut by 3 percentage points to 7.0–7.5 percent, while the central bank's discount rate was lowered by 2 percentage points to 11 percent. At the same time, the increased budget deficit and a sharp expansion in commodity operations (related to the procurement of the bumper wheat crop) fueled a significant rise in net credit to government, which accounted for two-thirds of the overall growth in broad money.

A number of important structural reform measures were implemented during 1999/2000 in the areas of public finance, public enterprises, and in the financial, international trade, agriculture, and energy sectors. In particular, the GST was extended to petroleum products, natural gas, and electricity. All tax whitener schemes were withdrawn through the removal of immunity from tax probe of newly invested funds. A major tax survey and registration drive was launched in an effort to widen the tax base. A mechanism for adjusting domestic prices of petroleum products on a quarterly basis in response to international price movements was put in place in December 1999. For key public enterprises, corporate and financial restructuring plans were drawn up and, for the Pakistan Steel Mills, Pakistan Railways, and power sector enterprises, implementation has commenced. In addition to an intensified loan recovery campaign, reforms in the financial sector included cuts in interest rates on National Savings Schemes (NSS) instruments by an average of 5.5 percentage points since May 1999, which decreased the spread between returns on NSS instruments and those for other instruments and helped in reducing market segmentation. Prices for furnace oil, which accounts for 40 percent of domestic petroleum consumption, were freed from July 2000.

Executive Board Assessment

Executive Directors noted that Pakistan's macroeconomic performance over the past year was favorable in several respects. Growth had picked up, aided in large part by favorable crops, inflation had eased, and the external current account deficit had narrowed substantially despite a large terms of trade shock. In addition, several key structural reforms were implemented, including the introduction of the petroleum price adjustment mechanism, the withdrawal of tax immunities, and the launch of intensified loan recovery and tax registration campaigns.

Notwithstanding these favorable developments, Directors observed that a deterioration in the capital account of the balance of payments, together with an easing of monetary policy at the time when the exchange rate was held stable, had weakened the external position and caused the rupee to come under pressure. Also, the budgetary position had deteriorated because of expenditure overruns and continued weak tax administration, which had resulted in lower-than-envisaged revenue gains.

The key policy challenges for the period immediately ahead will be to maintain macroeconomic discipline and improve the competitiveness of the economy and public debt dynamics. If policies to achieve these objectives are steadily carried out over time, private sector confidence would likely improve and the economy would move to a higher and durable growth path, which is essential for reducing poverty. Directors, therefore, welcomed the authorities' resolve to break from the past and improve governance and implement far-reaching structural reforms resolutely.

Directors agreed that fiscal consolidation–especially an improved revenue effort–is essential for restoring macroeconomic stability. They welcomed the reorientation of public spending to poverty-related expenditures and saw this shift in budgetary priorities as key to sustaining public support for the overall reform effort. Directors supported the targeted reduction in the budget deficit through measures to raise tax collection, tighten expenditure control mechanisms, and improve tax administration. However, in view of the uncertainty surrounding the attainment of the growth objectives of the program and the effectiveness of some of the fiscal measures, Directors urged the authorities to maintain a close watch over revenue and expenditure developments, and to respond expeditiously with additional measures as needed, to ensure that the budgetary target is met, while safeguarding social and poverty-related spending.

Directors agreed that fiscal consolidation needs to continue over the medium term to reduce the public debt burden and create room for a much-needed expansion in social spending, aimed at reducing poverty on a lasting basis. They noted that, in the past, weaknesses in revenue performance have undermined efforts to reduce the fiscal deficit. Directors therefore emphasized that structural fiscal reforms to broaden the revenue base and improve its buoyancy, as well as cuts in less productive expenditure, will be essential. In particular, they urged the authorities to implement envisaged timetables for the extension of the General Sales Tax to the retail sector and agricultural inputs, the overhaul of the income tax law with the

2001/02 budget, the further strengthening of tax administration, and the finalization of the civil service reform plan. Directors considered that faster progress in the drive to register large taxpayers and better revenue collection from the agricultural sector will be essential for the overall fiscal effort. They also noted that strengthening the institutional capacity of the Central Board of Revenue would help the authorities in their efforts to enhance revenue collection. In order to maintain fiscal discipline at the provincial level, Directors recommended that, as the proposed fiscal decentralization proceeds, expenditure responsibilities for different levels of government be assigned commensurate with any reallocation of resources. In general, they considered that structural reforms would be essential for bringing about greater transparency in the regulatory environment and providing greater confidence in the efficient management of public resources.

Directors noted the significant depreciation of the rupee in recent months and the authorities' commitment to allow the exchange rate to be determined by market forces. In this regard, they noted the recent tightening of the monetary policy stance and its likely positive effect to stabilize the exchange rate. Directors cautioned against any premature cut in interest rates, particularly in view of the very low level of official reserves. They urged the authorities to press ahead with measures to develop and deepen the inter-bank foreign exchange market. In this connection, several Directors underscored the importance of measures to check the growth of the kerb market, including through a reduction in the State Bank of Pakistan's purchases of foreign exchange from this market. Observing that the existence of two foreign exchange markets in Pakistan gives rise to the possibility of a multiple currency practice, Directors urged the authorities to ensure that all legitimate current account transactions are allowed to go through the inter-bank market.

As regards other structural reforms, Directors welcomed, in particular, the envisaged reforms of the National Savings Scheme and the export finance scheme, and measures to enhance the commercial orientation and financial position of the banking system. They noted the progress that had been made in resolving tariff disputes with independent power producers and urged the expeditious resolution of the remaining dispute with Hub Power Corporation, which has clouded investor sentiment toward Pakistan. Directors welcomed the restructuring of state-owned enterprises, such as the Water and Power Development Authority and the Karachi Electric Supply Corporation, and stressed the importance of improving the management of these enterprises. They welcomed the announcement of the trade liberalization plan, which would help create a more competitive domestic environment. Looking forward, Directors underscored the importance of reforms in the areas of privatization, the energy sector, and governance to energize the private sector and attract foreign direct investment flows, thereby enhancing Pakistan's growth potential.

Directors noted the authorities' efforts to improve the quality, timeliness, and reporting of data—especially with respect to fiscal accounts. With continuing data weaknesses hampering the analysis of economic and financial market developments, they welcomed the authorities' plan to implement the recommendations of the fiscal module of the Report on the Observance of Standards and Codes and the launch of the program to improve national accounts statistics.

Directors regretted that the recently completed revisions to the historical fiscal data gave rise to incorrect data reporting to the Fund on at least two occasions during 1993/94-1996/97. These constituted breaches of Pakistan's obligations under Article VIII, Section 5 of the Articles of Agreement. However, in view of the remedial actions taken by the authorities since early 2000 to improve fiscal data accounting and reporting, including the audit of the operations of the Central Directorate of National Savings, Directors did not consider that any further actions were needed.

Directors welcomed the authorities' decision to publish the staff report.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Pakistan: Selected Economic and Financial Indicators, 1996/97–2000/01 1/

	1996/97	1997/98	Prel. 1998/99	Est. 1999/2000	Prog. 2000/01
	(Annual changes in percent)				
Output and prices					
Real GDP at factor costs	1.7	3.5	3.1	4.8	4.5
Consumer prices (annual average)	11.8	7.8	5.7	3.6	6.0
	(In percent of GDP)				
Savings and investment					
Gross national savings	12.3	15.0	11.2	13.3	13.9
Public	-2.1	-2.6	-1.1	-2.0	-0.5
Private	14.4	17.7	12.3	15.3	14.3
Gross capital formation	18.0	17.7	15.0	15.0	15.5
Public	6.1	5.6	5.0	4.5	4.7
Private	11.9	12.2	9.9	10.5	10.8
Public finances					
Budgetary revenue	16.1	15.8	16.3	16.5	16.5
Budgetary expenditure	22.9	23.5	22.4	22.9	21.8
Budgetary balance	-6.8	-7.7	-6.1	-6.4	-5.2
Primary balance	-0.3	-0.3	1.3	1.2	1.5
Net public debt	87.5	89.4	91.9	91.6	93.8
	(Annual changes in percent of initial stock of broad money)				
Monetary sector					
Net foreign assets	-2.5	-2.7	1.6	1.5	5.6
Net domestic assets	14.7	17.3	4.5	7.8	5.7
Of which:					
credit to the private sector	7.3	8.1	8.5	1.4	6.9
net credit to government	7.5	4.5	-3.9	3.1	-1.2
Broad money	12.2	14.5	6.2	9.4	11.3
6-month treasury bill rate (in percent, annual average) 2/	15.6	15.1	12.5	8.8	...
	(In percent of GDP)				
External sector					
Merchandise trade balance	-5.0	-3.0	-3.6	-2.3	-1.8
Merchandise exports	12.9	13.5	12.9	13.3	15.3
Merchandise imports	17.9	16.5	16.5	15.6	17.1
Current account including official transfers	-5.7	-2.7	-3.8	-1.6	-1.6
	(In percent of current foreign exchange receipts 3/)				
Total public and private external debt	280.1	270.2	323.1	281.6	266.2
Actual debt service 4/	56.4	55.8	43.7	35.2	28.9
Gross reserves (in millions of U.S. dollars) 5/	1,141	932	1,672	916	1,740
In weeks of next years' imports of goods and nonfactor services	4.4	3.9	7.8	4.2	7.3

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

1/ Pakistan's fiscal year runs from July 1 to June 30.
2/ In July 1996, 6-month treasury bills were replaced by 6-month short-term federal bonds.
3/ Defined as sum of receipts from exports of merchandise and services exports, and from private transfers.
4/ Scheduled debt service minus rescheduled debt service plus debt service on previously rescheduled debt.
5/ Excluding gold, foreign assets relating to foreign currency deposits contracted after May 1998 (FE25s), and foreign assets relating to short-term swap and forward operations.

EDITORIAL DIVISION
ROOM IS 7-1200 0433

Press Release No. 00/64
FOR IMMEDIATE RELEASE
November 29, 2000

International Monetary Fund
Washington, D.C. 20431 USA

IMF Approves US$596 Million Stand-By Credit for Pakistan

The Executive Board of the International Monetary Fund (IMF) today approved a Stand-By credit for Pakistan until end-September 2001 in an amount equivalent to SDR 465 million (about US$596 million) to support the government's economic program for 2000-01. The decision will enable Pakistan to draw SDR 150 million (about US$192 million) immediately.

In commenting on the Executive Board discussion, Mr. Horst Köhler, Managing Director, said:

"The Pakistan authorities have put in place an economic adjustment and reform program, for which financial support under a Stand-By Arrangement has been approved by the Fund's Executive Board. The program aims to move Pakistan on to a high and sustainable growth path by strengthening the balance of payments position, rebuilding official reserves, and reducing public sector indebtedness. To support these objectives, the government has strengthened macroeconomic policies and has developed a wide-ranging structural reform agenda that emphasizes revenue mobilization, improving investor confidence, poverty alleviation, and good governance. The reform agenda has been drawn from a broad consultative process. Substantial improvement in the collection and quality of data and transparency is an integral part of the program.

"The program envisages a reduction in the overall budget deficit in 2000/01 to 5.2 percent of GDP, from 6.4 percent in 1999/2000, with further consolidation over the medium term. The budget target is to be achieved through increased tax collections with a widening of the tax base, improved tax administration, and strict expenditure controls. Since there is significant uncertainty surrounding the short-term impact of revenue measures on the budgetary position, the authorities should stand ready to take additional measures if revenues fall short of expectations. Steps have also been taken to increase spending by close to one-third on poverty reducing programs and to curtail less productive spending. Looking forward, continued improvement in revenue performance will be crucial for reducing the public debt burden and allowing more resources for tackling poverty on a lasting basis.

"A key element of the program is the maintenance of a competitive and flexible exchange rate that is determined by market forces. The transition to the flexible exchange rate regime has been facilitated by an increase in short-term interest rates to quell speculative pressures on the rupee. Once these pressures subside and the reserve position improves, there should be scope for a reduction in interest rates.

"Continued progress with structural reform will be necessary for attracting private investment, achieving high growth, and alleviating poverty. On the fiscal side, broadening the tax base, strengthening tax administration, and reforming the civil service will be of particular importance. In addition, steps to integrate financial markets, improve the financial position of public enterprises and banks, liberalize international trade, accelerate privatization, and enhance governance will be critical.

"The financing of the program will involve participation of the international financial institutions, official bilateral creditors, and the private sector. The Asian Development Bank and the World Bank will consider adjustment loans in support of Pakistan's structural reform efforts. A meeting of the Paris Club is expected in January 2001 to consider a request by Pakistan for a rescheduling of both its accumulated arrears and its debt service payments to Paris Club creditors falling due during the program period on pre-cutoff debt. The Pakistan authorities intend to seek comparable treatment from all other official bilateral and private creditors.

"The successful implementation of the program and the finalization of major structural reform plans, together with key initial steps, could pave the way over time for medium-term financial support from the Fund under the Poverty Reduction and Growth Facility," Mr. Köhler said.

ANNEX

Background

Over the past decade, long-standing structural weaknesses in Pakistan's economy—an inefficient tax system and a narrow tax base, an undiversified export base, large stocks of public and external debt, and low human capital—began to drag on growth and threaten financial stability. Pakistan's record in macroeconomic stabilization and structural reforms during this period was mixed, and adjustment and reform plans suffered from slippages in their implementation.

The new government, which took office in October 1999, recognized the need for a clean break from the past and the forceful implementation of reforms to address the long-standing structural problems facing the economy. They set forth a wide-ranging reform agenda aimed at reducing poverty, revenue mobilization, improving governance, and sustaining a high rate of economic growth. While a number of steps have already been taken, the design and sequenced implementation of a comprehensive policy package will take additional time to finalize. In the meantime, however, the external financial situation had become even more fragile, partly because of large debt service payments and increased capital outflows, as well as loose macroeconomic policies. To stem pressures on the rupee and bring official reserves to more comfortable levels, a stabilization program—supported by Fund resources—was needed urgently.

Macroeconomic Policies Under the Program

The program targets a substantial increase in gross official reserves to US$1.74 billion at end-June 2001, equivalent to 7.3 weeks of imports of goods and nonfactor services, that is to be achieved through a flexible exchange rate policy, monetary tightening, fiscal adjustment, and substantial exceptional financing. Improvements in the balance of payments position will also be helped by increased exports and sharply reduced private sector capital outflows brought about by a rebound in investor confidence.

A key element of the program is a market-determined exchange rate policy, which will reduce risks related to the vulnerability of the balance of payments. To facilitate a smooth transition to a market-determined exchange rate, the authorities have allowed for a sizable up-front exchange rate adjustment and tightened the monetary policy stance.

The program targets a reduction in the budget deficit in 2000/01 by 1.2 percentage points of GDP to 5.2 percent of GDP that is to be achieved despite increased social spending. A series of measures to increase tax collection, including steps to widen the tax base and contain current expenditures, are being implemented to support the fiscal consolidation process. Allocations for social and poverty reducing expenditure have been increased by 28 percent in 2000/01, equivalent to 0.4 percent of GDP.

Structural Reforms

The program includes a comprehensive agenda of structural fiscal reforms. Several initiatives are underway to strengthen tax administration and enforcement, and taxpayer registration. The sales tax net is being widened through the extension of the GST to services and to agricultural inputs. Taxation of agricultural incomes has been enhanced with the introduction of a two-tier tax from this fiscal year, comprising a fixed land-based tax as well as an income tax on large farmers. A fundamental overhaul of the income tax system is underway, and a new income tax law aiming at establishing a simple income tax based on genuine self-assessment with minimal exemptions and a less distorting rate structure is to be promulgated with the 2001/02 budget. Finally, efforts are being made to reduce GST, customs duty, and income tax exemptions.

The ambitious structural reform agenda also extends to other areas. The financial and organizational restructuring of public enterprise reform is proceeding with a view to reducing enterprises' burden on the budget and preparing them for eventual privatization. The medium-term trade liberalization program is built around a pre-announced series of further cuts in the maximum tariff rate and in the number of tariff slabs. In the financial sector, the rationalization of the pricing and structure of debt instruments issued by the National Savings Scheme is underway and will help to reduce market segmentation. Measures are also being taken to enhance the commercial orientation of the banking system and improve its financial position.

Financing Needs

In addition to the IMF's stand-by credit, Pakistan's reform program will be supported by financing from the Asian Development Bank, the World Bank, bilateral official creditors, and the private sector. The Paris Club has agreed to consider, in January 2001, rescheduling Pakistan's outstanding arrears and upcoming debt obligations to Paris Club creditors.

Pakistan joined the IMF on July 11, 1950, and its quota[1] is SDR 1,033.7 million (about US$1,323 million). Its outstanding use of IMF financing currently totals about SDR 1,077 million (about US$1,379 million).

---

[1] A member's quota in the IMF determines, in particular, the amount of its subscription, its voting weight, its access to IMF financing, and its allocation of SDRs.

Pakistan: Selected Economic and Financial Indicators, 1996/97–2000/01 1/

	1996/97	1997/98	Prel. 1998/99	Est. 1999/2000	Prog. 2000/01
	(Annual changes in percent)				
Output and prices					
Real GDP at factor costs	1.7	3.5	3.1	4.8	4.5
Consumer prices (p.a.)	11.8	7.8	5.7	3.6	6.0
	(In percent of GDP)				
Savings and investment					
Gross national savings	12.3	15.0	11.2	13.3	13.9
Public	-2.1	-2.6	-1.1	-2.0	-0.5
Private	14.4	17.7	12.3	15.3	14.3
Gross capital formation	18.0	17.7	15.0	15.0	15.5
Public	6.1	5.6	5.0	4.5	4.7
Private	11.9	12.2	9.9	10.5	10.8
Public finances					
Budgetary revenue	16.1	15.8	16.3	16.5	16.5
Budgetary expenditure	22.9	23.5	22.4	22.9	21.8
Budgetary balance	-6.8	-7.7	-6.1	-6.4	-5.2
Primary balance	-0.3	-0.3	1.3	1.2	1.5
Net public debt	87.5	89.4	91.9	91.6	93.8
	(Annual changes in percent of initial stock of broad money)				
Monetary sector					
Net foreign assets	-2.5	-2.7	1.6	1.5	5.6
Net domestic assets	14.7	17.3	4.5	7.8	5.7
Of which: credit to the private sector	7.3	8.1	8.5	1.4	6.9
Of which: net credit to government	7.5	4.5	-3.9	3.1	-1.2
Broad money	12.2	14.5	6.2	9.4	11.3
6-month treasury bill rate (in percent, p.a.) 2/	15.6	15.1	12.5	8.8	...
	(In percent of GDP)				
External sector					
Merchandise trade balance	-5.0	-3.0	-3.6	-2.3	-1.8
Merchandise exports	12.9	13.5	12.9	13.3	15.3
Merchandise imports	17.9	16.5	16.5	15.6	17.1
Current account including official transfers	-5.7	-2.7	-3.8	-1.6	-1.6
	(In percent of current foreign exchange receipts 3/)				
Total public and private external debt	280.1	270.2	323.1	281.6	266.2
Actual debt service 4/	56.4	55.8	43.7	35.2	28.9
Gross reserves (in millions of U.S. dollars) 5/	1,141	932	1,672	916	1,740
In weeks of next years' imports (goods and serv	4.4	3.9	7.8	4.2	7.3

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

1/ Pakistan's fiscal year runs from July 1 to June 30.
2/ In July 1996, 6-month treasury bills were replaced by 6-month short-term federal bonds.
3/ Defined as sum of receipts from exports of merchandise and services exports, and from private transfers.
4/ Scheduled debt service minus rescheduled debt service plus debt service on previously rescheduled debt.
5/ Excluding gold, foreign assets relating to foreign currency deposits contracted after May 1998 (FE25s), and foreign assets relating to short-term swap and forward operations.