Letter of Intent

Memorandum of Economic and Financial Policies and Technical Memorandum of understanding on the Program Supported under the Poverty Reduction and Growth Facility.

May 29, 2003

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

Dear Mr. Köhler:

Pakistan's government remains committed to pursue the economic strategy set out in the Interim Poverty Reduction Strategy Paper (I-PRSP), as updated by the recent progress report, supported by the Poverty Reduction and Growth Facility (PRGF) arrangement. This strategy will be developed into a longer-term vision for a set of policies aimed to allow higher sustainable growth and job creation, while reducing poverty, to be articulated in the full Poverty Reduction Strategy Paper (PRSP) to be completed around mid-2003.

The Pakistani authorities held discussions with Fund staff in March–May 2003 for the fifth review under the PRGF Arrangement. Based on these discussions, the attached Memorandum of Economic and Financial Policies (MEFP) reviews economic developments and policy implementation through December 2002 and beyond under the arrangement, updates the macroeconomic framework, and discusses the financial policies and structural reform program for the remainder of the fiscal year 2002/03, and for FY 2003/04 to the extent possible. It supplements the MEFP dated November 22, 2001 as well as the supplementary MEFPs dated March 12, 2002, June 18, 2002, October 16, 2002, and February 8, 2003.

All performance criteria for end-December 2002 and for January/February 2003 were met, except for the continuous performance criterion on tax exemptions for which a waiver was granted on the occasion of the fourth review. A performance criterion regarding the preparation of a revised financial improvement plan for the Water and Power Development Authority (WAPDA) by mid-April 2003 was only partially observed, as the plan did not indicate at that time contingency measures that were subsequently developed with the assistance of Fund and World Bank staff. We now expect privatization of Habib Bank to take place by end-2003, as we had to re-invite expressions of interest for transparency reasons and given renewed investor interest. On this basis, and in view of the policies set out in the attached memorandum, the government requests a waiver for the partial nonobservance of the structural performance criterion related to WAPDA, modification of the structural performance criterion related to Habib Bank, and the completion of the fifth review. We expect the sixth review under the arrangement to be completed by end-September 2003.

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 memorandum are adequate to achieve the objectives of the program. However, we stand 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 of Economic and Financial Policies
Technical Memorandum of Understanding

PAKISTAN

Memorandum of Economic and Financial Policies for October 2002–June 2003 and Outlook for FY 2003/04

I. Developments During October 2002–March 2003

1. **Building on the progress made in establishing a stable macroeconomic environment, the government will continue implementation of a reform agenda aimed at higher sustainable growth and job creation, while reducing poverty.** Its vision will be reflected in the full Poverty Reduction Strategy Paper (PRSP), which is currently under preparation with close participation of provincial and local governments, as well as civil society institutions (as detailed in our recent PRSP preparation status report). A draft PRSP summary was discussed with development partners during the Pakistan Development Forum in mid-May 2003. With the domestic security situation improving, and the military forces along the border with India gradually being reduced on both sides, the security environment has become more favorable for implementing such a reform agenda; any fallout and risks arising from the Middle East crisis appear manageable.

2. **Macroeconomic targets for FY 2002/03 are broadly on track.** Inflation fell to 2.2 percent in the year to April 2003. Export and import growth remain high, and with an improved outlook for agriculture and accelerating industrial sector growth, real GDP growth will reach at least 4.5 percent for fiscal year 2002/03. Remittances and private capital inflows continue to be strong. The State Bank of Pakistan (SBP) has begun to reduce its purchases of foreign exchange on the interbank market, given a comfortable level of foreign exchange reserves of $9.2 billion at end-April 2003 (7.4 months of imports), and having accumulated another $0.8 billion at end-March 2003 earmarked for repayment of certain expensive external debts. The Pakistani rupee continued to appreciate gradually against the U.S. dollar, but depreciated against the euro, and in real trade-weighted terms. All quantitative performance criteria through end-2002 were met (Table 1(a)).

3. **The end-December 2002 fiscal deficit target was met with comfortable margins, and we are confident to have met the end-March and to be on track for the end-June 2003 target.** The Central Board of Revenue (CBR) met its revenue target for both December 2002 and March 2003, reflecting a buoyant economy and administrative improvements. Nontax revenue through December was roughly on target, despite shortfalls in receipts from the Water and Power Development Authority (WAPDA), the National Highway Authority (NHA), and lower-than-budgeted profit transfers from the SBP. Interest payments were much lower than projected due to the recent fall in interest rates and the appreciation of the Pakistani rupee. According to preliminary (unreconciled) data, social sector spending ("I-PRSP expenditure") during July–December 2002 rose by 45 percent over the same period of the preceding year, coming close to its target level. External financing was lower than projected, but domestic financing was nonetheless curtailed on account of the reduced overall

financing needs, with bank debt being reduced more than envisaged. We expect similar trends through the remainder of the current fiscal year, with expenditure overruns for WAPDA and the Karachi Electric Supply Corporation (KESC) (see below) and defense offset notably by higher nontax receipts.

4. **The monetary targets for end-2002 have also been met by comfortable margins.** Net foreign assets (NFA) of the banking system continued to grow at a rapid pace, while private sector credit picked up significantly. Thus broad money growth remained strong at 17 percent in the year through December. Similar trends continued through February 2003. Reserve money grew by 10 percent through December, reflecting sterilization efforts by the SBP, but growth has accelerated since. The yield on 6-month treasury bills fell to 1.6 percent in early April, as banks remain highly liquid. The rediscount rate, at 7.5 percent, remained positive in real terms.

5. **Structural measures through mid-April 2003 were broadly taken as programmed (Tables 2(a) and 2(b)), except mainly for some lacunae in the revised Financial Improvement Plans (FIPs) for WAPDA.** The gas pricing framework has been fully published (as specified in the February 2003 MEFP)[1] to enhance transparency, and is being implemented. In particular, in line with the framework, wellhead prices (including for the government-owned PPL fields) were adjusted on January 1, 2003. On the basis of total revenue requirements of the utilities, an average consumer price increase of 0.8 percent has been worked out and is awaiting final approval. Work on an annual core welfare indicator survey was launched in February 2003, as a cornerstone of monitoring intermediate social outcome indicators used to measure progress under the PRSP. The new cabinet will soon consider the comprehensive anti-corruption strategy, including specific action plans and timelines, prepared by the National Accountability Bureau (published at **www.nab.gov.pk**). A committee involving various stakeholders (government, business community, NGOs, academia, etc.) has been set up to steer its implementation. However, only part of the WAPDA and KESC electricity tariff increases authorized by NEPRA to offset the surge in fuel cost during January–March 2003, and which were to become effective in early April, were notified by the government, and only in May. In the government's view, electricity tariffs have become unbearably high in relation to incomes and socio-political considerations ruled out making households bear the burden of the exceptional and temporary surge in fuel cost reflecting the war in Iraq. Revised FIPs for FY 2002/03 and FY 2003/04 for WAPDA were provided to Fund staff on April 15, except that contingency measures were only developed subsequently in consultation with Fund and World Bank staff (see below).

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[1] See **www.mpnr.gov.pk/ddg** and **www.ogra.org.pk**.

6. **The financial performance of the large public enterprises[2] for the quarter of October–December 2002 was broadly in line with the targets formulated under their respective FIPs, except for the two power utilities**. As in the preceding quarter, WAPDA defaulted on its entire debt service obligations to the government for the quarter, reflecting substantial shortfalls in cash receipts. According to WAPDA's accounts (published in February 2003 as per program commitments, see **www.finance.gov.pk**), the shortfall in receipts reflects in the main: the nonpayment of bills by customers in the Federally Administered Tribal Areas (FATA); shortfalls resulting from insufficient tariff adjustments; and an increase in receivables from provincial governments. On a positive note, supplier arrears outstanding from the previous years were reduced substantially and technical/nontechnical line losses improved compared to the first quarter of 2002/03. While KESC achieved substantial progress in collection rates, it made only marginal progress in reducing line losses.

II. Economic and Financial Policies for the Remainder of FY 2002/03 and FY 2003/04

A. Macroeconomic Framework for 2002/03 and 2003/04

7. **The macroeconomic framework for the current and next fiscal years remains broadly unchanged from the February 2003 MEFP**. The framework for FY 2003/04 aims to further enhance public-debt sustainability, reduce vulnerability to shocks, and create room for the needed increase in public human development expenditure and private investment. Inflation will be kept at or below 4 percent in 2003/04, while growth would slightly accelerate to 5 percent. Remittances and private capital inflows are projected to decline next year, as the portfolio shift underlying the exceptionally high inflows during the current year is expected to wind down. Among the various risks to the macroeconomic outlook, the temporary oil price spike associated with the war in Iraq so far has had limited impact on the budget and balance of payments. If a reversal of private capital flows were to occur (for example, because of regional security factors), it would be met by allowing a market-based exchange rate depreciation and financial tightening, with reserves used only sparingly to maintain orderly market conditions.

8. **Monetary policy remains geared toward maintaining low inflation, within a flexible exchange rate regime**. While we plan to further use the opportunity provided by temporarily high capital/remittance inflows to bolster our reserves, we will continue to limit intervention in the foreign exchange market so as to curb money supply growth and contain sterilization cost. This approach will be complemented by the early repayment of expensive external debt. We continue to closely monitor good and asset price developments, and will tighten monetary policy should inflationary pressures emerge. The monetary program for

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

2003/04 is based on cautious assumptions regarding money demand, with broad money and reserve money growing by 11 percent.

9. **The 2003/04 budget proposal to be submitted to parliament in June 2003 will aim at a further reduction of the deficit and public debt (as a share of GDP).** While further rationalizing nonpriority expenditure and containing defense spending to 3.6 percent of GDP, the budget will raise social and poverty-related expenditures to 4.2 percent of GDP as envisaged in the I-PRSP. A more ambitious reduction of defense spending is not feasible, as surveillance of the Western border in the context of combating terrorism is actually increasing and tensions on the Eastern border have not completely abated. The budget will include an allocation for the restructuring of the insolvent Industrial Development Bank of Pakistan (IDBP) and Allied Bank Limited (ABL) (at a cost of 0.5 percent of GDP), to allow the effective transfer of ownership to the private sector (or liquidation). On the revenue side, we will eliminate all remaining withholding tax exemptions on interest income, and seek to widen General Sales Tax (GST) coverage to additional service categories. No new tax exemptions will be granted, and with the approval of parliament, at least 20 income tax exemptions will be eliminated by July 1, 2003. This step will limit remaining income tax exemptions to mostly those related to nonprofit organizations, to those granted under international or bilateral agreements or to constitutional post holders, and most importantly, to pension benefits. The latter will be addressed as part of an overall reform of the pension system being elaborated with support from the Asian Development Bank (AsDB), to be implemented with the 2004/05 budget. The 2003/04 budget will be based on realistic assumptions about the performance of public sector enterprises (PSE), underpinned by indicative quarterly targets on the deficits (accrual basis) of WAPDA and KESC (see below). Against this background, and given that due to this year's large-scale sterilization, zero SBP profits are expected, achieving the deficit of 3.5 percent of GDP originally envisaged under the PRGF program is unrealistic, as it would not allow for the needed increase in social and development spending and other priority outlays. We will therefore aim at an underlying budget deficit for FY 2003/04 of 4.0 percent of GDP, and 4.5 percent including the outlays for the privatization of IDBP and ABL. This would still constitute a sizeable adjustment in the underlying deficit compared to the 2002/03 target, yield a significant decline in the public debt to GDP ratio, and should prevent a repeat of this year's experience of ad-hoc measures to accommodate slippages in PSE finances.

10. **There are two risks to the outlook, and in particular to the fiscal objectives for FY 2003/04.** The first arises from the regional tensions which have not fully wound down by end-2002 as assumed under the program's fiscal projection. The second risk is that the utilities' deficits could be higher than expected, for example because another spike in fuel cost will make pass-through to electricity tariffs impossible, triggering additional transfers from the budget to the utilities (see below). To protect the budget against such risks, we would, in the event, adjust other nonpriority expenditure and/or take appropriate revenue action while protecting key social spending.

B. Structural Policies

11. Building on substantial progress to date in liberalizing the economy and improving governance, we will deepen our structural reform program. Additional structural benchmarks and performance criteria for June–December 2003 are outlined in Table 2(b).

Domestic energy prices

12. We will pursue the regular adjustment of various energy prices to reflect world market developments. For petroleum products, this will involve fortnightly adjustments in line with import cost, while maintaining stable average tax rates. For gas (wellhead and consumer prices), it will involve application of the gas pricing framework agreed with the World Bank through half-yearly adjustments, including the elimination of cross-subsidies by end-2004. For electricity, KESC and WAPDA will adjust tariffs as provided under the NEPRA Act, and the government will notify NEPRA's determinations within 14 days during FY 2003/04, except that downward adjustments will not be notified until and unless final data are available showing that WAPDA's and KESC's respective cumulative accrual deficits during the preceding quarter have been at or below the target levels specified in Table 1(b), starting with the adjustment related to fuel costs during April–June 2003. We will furthermore prepare by October 2003 an action plan, in consultation with the World Bank, to establish by end-2003 a transparent regulatory framework for the setting of electricity tariffs, that in particular (a) clarifies the respective roles of the government, NEPRA, and the power companies (including the new distribution companies) in the setting of tariffs, and (b) limits departures in actual tariff adjustments by distributors from NEPRA's determination based on the current procedures to well-specified cases of exceptional temporary spikes in oil prices; this will involve providing clear guidance to NEPRA on the tariff policy for the new distribution companies. Relevant elements of this action plan will be incorporated into the government's economic program.

Tax policy and tax administration

13. **The CBR reform process is broadly on track.** Key recommendations from recent FAD technical assistance missions on tax and customs administration reform will be implemented with a view to increasing the number of taxpayers, raising voluntary compliance and increasing the efficiency of the audit and enforcement functions, including through the issuance of rules requiring the reporting of all interest income to the tax authority and of rules enabling the CBR's sales tax auditors to assess tax liabilities of nonfilers on the basis of presumptive methods, as already possible for income tax. We are also accelerating preparations for the introduction of full self-assessment in 2003/04 (including through setting up a steering committee to coordinate the needed steps), and are finalizing a comprehensive strategy specifying detailed plans to overhaul CBR's business procedures. Looking ahead, we plan to open a second Large Taxpayers Unit (LTU) in Lahore by mid-2004. Our customs administration reform strategy aims at increasing voluntary compliance through self-assessment, service-orientation, a fully automated environment that minimizes face-to-face

contacts, risk-based verification techniques, and parameter-based verification and audit. We will place special emphasis on strengthening the post-release verification and audit capabilities, as well as the intelligence and investigation program which will assist in developing risk criteria. While this reform strategy is long term in nature, we will introduce a pilot project in Karachi port by April 2004. Among other things, the pilot will involve entry processing on a 24-hour basis.

14. **A strategy to contain the "Benami" practice** (whereby assets are held in the name of a person that is not the true beneficiary) has been elaborated with a view to enhancing compliance with taxes and supporting Customer Due Diligence for banks. As first steps, a taskforce has been constituted which will consult with stakeholders and provincial governments on specific legislation needed to contain "Benami" transactions; its recommendations will be provided to the cabinet by end-October 2003 with a view to submitting it by end-2003 to parliament.

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

15. **We plan to finalize the PRSP by mid-2003**, incorporating the experience gained from the I-PRSP process. The PRSP will put additional emphasis on some important institutional causes of poverty, such as lack of assets held by the poor, lack of a functioning justice system, and deep-rooted gender issues; include a first costing of the health and education targets; and be based on a broader participatory approach, including consultation with civil society and within the federal and provincial cabinets. Based on recent progress in developing systems to monitor 12 intermediate social outcomes, we have published a first report on such outcomes in March 2003 (www.finance.gov.pk), spelling out the underlying baselines, the data collection mechanisms and the format of publication, and quarterly developments (to the extent data are available). The mechanisms for collecting data will include an annual Core Welfare Indicator Questionnaire (CWIQ) survey being developed with assistance from the World Bank that will be timed to provide input in the formulation of local, provincial, and federal budgets; the first CWIQ results will be available in January 2004, providing input for the FY 2004/05 budgets. This will complement expenditure controls at the local level to ensure that the devolution process actually improves social service delivery. We also continue working on an assessment of the poverty and social impact of energy pricing reforms with assistance from the World Bank. Following the recent establishment of an actuarial unit, we have started work on a contributory pension scheme for new recruits in the civil service, and on the next pay and pension reform package. As a first step, we will align more closely the General Provident Fund (GPF) interest rate with market rates from July 1, 2003.

16. **The implementation of the Accountable Fiscal Management Framework is proceeding.** The government will soon submit to parliament the draft fiscal responsibility law. We will publish the 2003/04 federal budget and report 2003/04 fiscal data based on both the old format and the new accounting model (NAM) for the federal government and the North West Frontier Province (NWFP), and issue the 2004/05 budget call on the basis of

NAM for all provinces, as well as the federal government. We will continue with the 2003/04 budget the traditional practice (Taamir-e-Pakistan Program) of allowing members of parliament to select a few projects for their constituency within the development budget (for altogether 0.1 percent of GDP), which will be executed through normal channels. We see this tradition as helpful in bringing local development concerns into the formulation of the development budget and in strengthening links between parliamentarians and their constituencies, thereby strengthening democracy. The ongoing preparatory work on a new revenue-sharing arrangement between the federation and the provinces should help to bring about an allocation of resources to the local governments that is more in line with their respective expenditure responsibilities. We will seek to re-invigorate the Pakistan Improvement of Financial Reporting and Accounting (PIFRA) project, strengthen the Controller General of Accounts, and ensure uniform expenditure tracking by districts, as well as pre-auditing of all transactions through the District Accounts Offices. Various actions (with support from U.K.'s Department for International Development(DFID)) are being taken toward establishing a medium-term budget framework, as detailed in the February 2003 MEFP.

Public enterprises and privatization

17. **The privatization drive has been slowed by limited investor interest due to weak global equity markets and regional political uncertainties.** We nonetheless expect to complete the sale of Pakistan State Oil (PSO) within the next few months. For Habib Bank Limited, one investor has been prequalified. To make the process more transparent, and given signs of renewed interest by investors, we have re-invited expressions of interest by end-June 2003. As a result, completion of the sale by end-June 2003 will not be feasible, and could shift to later in 2003. We therefore request modification of the related structural performance criterion. Regarding KESC, we remain open for discussing a negotiated sale with the only remaining qualified investor (who has put discussion on hold for the time being), but also explore the options of unbundling KESC and selling the power generation component, and/or contracting private management. In the meantime, we will continue to forcefully implement its FIP. However, mainly due to insufficient gas supplies to KESC (requiring additional use of expensive furnace oil), slower-than-expected progress in reducing line losses, and insufficient tariff levels, KESC's deficit (on an accrual basis) for FY 2002/03 will exceed the FIP target by around PRs 3 billion and reach PRs 14 billion; in view of higher investment needed to reduce line losses and improve collection, the FIP for FY 2003/04 aims to contain the deficit to PRs 15 billion. The restructuring of PIA is proceeding as detailed in the February 2003 MEFP, and in particular the divestiture of noncore activities (hotels, etc.) has started. A new policy framework for fixed-line telephony is expected to be adopted by the cabinet in the coming months. It will encourage competition and remove regulatory uncertainty, to facilitate the privatization of the telecom company (PTCL).

18. **WAPDA's financial situation remains unsustainable**. To a large extent, this reflects huge upfront payments under the contracts with the independent power producers (IPPs), which will decline over the coming years; large investments to complete the Ghazi Barotha hydropower station, which will start operating in FY 2003/04 and lower costs

by reducing reliance on imported fuel; and the nonpayment of bills in FATA. At the same time, there is a need for strong reform of WAPDA itself to improve operational efficiency and reduce large line losses. A medium-term projection quantifying the outlook for WAPDA will be prepared in the coming months and will further develop measures to contain costs, increase efficiency, and spell out tariff policies.

19. **In the meantime, we have prepared, in consultation with the World Bank, revised FIPs for FY 2002/03 and FY 2003/04.** The revised plans specify and quantify efforts to improve bill collection, including by initiating the metering of users in FATA (starting with commercial, industrial, and public consumers), to achieve collection of at least PRs 2 billion on FATA bills in FY 2003/04. The FIPs include quarterly financial targets for FY 2003/04 (see Table 1(b)), based on a baseline fuel cost of PRs 13,806 per ton, and a detailed timetable regarding WAPDA's restructuring process. As explained above, downward tariff revisions will be conditional on meeting the preceding quarter's cumulative deficit target. Barring exceptional circumstances in the oil market, NEPRA-authorized upward revisions will be notified. The revised FIPs aim to contain WAPDA's deficit for FY 2002/03 at PRs 21 billion (on an accrual basis as defined in the Technical Memorandum of Understanding (TMU)), limit government-guaranteed domestic borrowing to PRs 13 billion, and reduce the stock of payables to suppliers and IPPs to PRs 6.4 billion by end-June 2003. For FY 2003/04, the FIP aims at reducing WAPDA's accrual deficit to PRs 19 billion, while reducing the stock of payables to PRs 4.6 billion. This deficit will be largely covered by budget subsidies, and it will refrain from any domestic borrowing. Regarding the unbundling process, we now expect the legal transfer of WAPDA's assets and liabilities to its corporate successors to be delayed to end-2003, given delays to obtain lender's consent from official lenders and legal and administrative complications in establishing WAPDA's title to certain assets. Meanwhile, the successor distribution, generation, and transmission companies will file with NEPRA for determination of tariffs, based on financial projections being elaborated with World Bank assistance. We expect the new tariffs to be determined by January 2004 (and apply from July 2004).

Trade policy

20. **We will further liberalize the trade system with a view to rationalizing the tariff regime in the medium term**. We will prepare a plan by end-2003 for the gradual reduction in tariff levels for those industries enjoying exceptional high levels of protection, keeping in view contractual obligations.

Financial sector reforms

21. **We will pursue the implementation of the financial sector reform strategy, regrettably without any input from the Financial Sector Assessment Program mission that continues to be delayed**. By June 2003, a decision on the disposal of the 49 percent government stake in ABL will be taken and implemented. We will seek to privatize or, failing that, liquidate, the insolvent IDBP, with support from the World Bank and AsDB. Given the growing involvement of the private sector in wheat marketing, the stock of

outstanding commodity operations (government-guaranteed bank credit extended to various public commodity boards) will be reduced to at most PRs 95 billion by June 2003 and PRs 85 billion by June 2004. In the context of an AsDB-supported reform of governance in the nonbank financial sector, we are in the process of hiring consultants to help with (a) the computerization (to be completed by December 2005) and reorganization of the administration of the National Saving Scheme (NSS) (to be completed by October 2004); and (b) the reform of NSS instruments (to be completed by October 2004). We will continue during 2003/04 to apply the formula linking NSS instruments to PIB yields, with the next step to become effective on July 1, 2003.

22. **A draft anti-money laundering law incorporating best practices and FATF recommendations will be presented to cabinet by June 2003**. In the meantime, a number of tools to combat money laundering and terrorist financing are already in place, including (a) giving the Anti-Narcotic Force the authority and powers to investigate and prosecute drug-related money transactions; (b) more effective know-your-customer (KYC) regulations to provide more detailed guidelines to banks/DFIs for customer due diligence; similar regulations explicitly preventing criminal use of banking channels for the purpose of money laundering activities and other unlawful trades, by requiring banks to properly investigate transactions which are out of character with the normal operation of the account involving heavy deposits/withdrawals/transfers; (c) active participation as a member in Asia-Pacific Group on Money Laundering (APGML); (d) technical cooperation arrangements with several bilateral and multilateral organizations; and finally (e) compliance with several resolutions passed by the UN, freezing the accounts of entities that are guilty of terrorist activities; the SBP has so far has frozen 24 accounts of individuals/entities, amounting to PRs 591 million.

III. Other Issues

Program financing

23. **The program remains fully financed in FY 2002/03 and FY 2003/04**. We will ensure that conditions attached to expected loan disbursements of the World Bank and AsDB are met. Most bilateral agreements with the Paris Club creditors have been signed, a few remaining ones are expected to be concluded by mid-2003. Debt swaps for social expenditure and outright debt cancellation are being discussed with some creditors, and the U.S. implemented the cancellation of about $1 billion of debt in April 2003. We will ensure that implementation of any swaps will be consistent with the financial program. A $100 million loan from the foreign branches of one of the nationalized banks has been restructured, as part of the planned private sector involvement.

Data issues

24. The World Bank is assisting us in completing the remaining steps needed to participate in the General Data Dissemination System (GDDS). To improve data dissemination and move closer to subscribing to the Special Data Dissemination Standard (SDDS), we plan to meet by end-2003 the requirements of quarterly national accounts and of

a regular survey on wage earnings. We have started to post on the SBP website data on reserves and foreign currency liquidity in accordance with the SDDS template. By end-2003, we will formally establish the Pakistan Bureau of Statistics (PBS) consolidating various existing agencies. PBS will be granted greater autonomy to enhance the quality and credibility of our statistics.

Program monitoring

25. We propose to continue monitoring of the program through quarterly reviews. The sixth review (combined with the seventh review) will focus on the FY 2003/04 budget and the medium-term reform strategy for the power sector. We propose the ninth disbursement (subject to the eighth review) in an amount of SDR 86.1 million for December 20, 2003 based on end-September 2003 quantitative performance criteria, and the tenth disbursement (subject to the ninth review) in an amount of SDR 86.1 million for March 20, 2004 based on end-December 2003 data. We intend to request at the time of the next review (scheduled for end-September/early October 2003) the seventh and eighth disbursements under the arrangement. The proposed additional structural performance criteria/benchmarks for June–December 2003 and the proposed end-September 2003 and end-December 2003 quantitative performance criteria and indicative targets are listed in Tables 1(b) and 2(b), respectively. An updated TMU to apply for test dates after July 1, 2003 is attached.

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

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

	Outstanding Stock End-Jun. 2002	Prog. End-Sep. 2002	Adj. Prog. End-Sep. 2002	Act. End-Sep. 2002	Prog. End-Dec. 2002	Adj. Prog. End-Dec. 2002	Act. End-Dec. 2002	Prog. End-Mar. 2003	Prog. End-Jun. 2003
Net foreign assets of the SBP (floor in millions of U.S. dollars)*	2,321.0	320.0	122.7	2,203.0	497.0	253.2	3,629.0	809.0	4,327.0
				(In billions of Pakistani rupees)					
Net domestic assets of the SBP*	445.4	-0.2	4.8	-124.4	8.8	17.1	-152.8	-13.2	-181.2
Overall budget balance (floor)*	…	-56.4	-64.4	-44.4	-98.7	-106.7	-62.3	-142.3	-178.4
Net government bank borrowing*	514.1	-4.4	15.5	-12.7	-15.9	6.7	-34.0	-38.6	-29.2
CBR revenue (floor)*	…	90.0	…	90.4	199.5	…	203.1	309.0	458.9
Net banking sector claims on public sector enterprises*	82.0	7.0	…	-5.5	11.7	…	-7.0	16.3	20.0
Social- and poverty-related spending ("I-PRSP budgetary expenditure") (floor)	…	35.4	…	29.3	70.8	…	66.5	114.3	161.0
WAPDA accrual balance									-20.7
KESC accrual balance									-14.1
				(In millions of U.S. dollars)					
Outstanding stock of short-term external debt owed or guaranteed by the government and the SBP*	209.0	500.0	…	194.3	500.0	…	410.5	500.0	500.0
Contracting or guaranteeing of noncessional medium-term and long-term debt by the government* 2/	…	600.0	…	88.8	600.0	…	148.8	600.0	650.0
Accumulation of external payments arrears (continuous performance criterion during the program period)*	…	0.0	…	0.0	0.0	…	0.0	0.0	0.0
SBP's forex reserves held with foreign branches of domestic banks (outstanding stock)	65.0	100.0	…	51.6	100.0	…	56.3	100.0	100.0
Of which: other than current account*	0.0	0.0	…	0.0	0.0	…	0.0	0.0	0.0
Stock of outstanding foreign currency swap and forward sales between SBP and residents*	280.0	400.0	…	50.0	400.0	…	45.0	400.0	400.0
Memorandum items:									
Net external program financing	…	447.5	…	236.6	597.4	…	342.7	689.1	365.5
Of which: privatization proceeds	…	50.0	…	10.0	100.0	…	184.0	150.0	234.0
External cash budget grants	…	36.4	…	50.0	106.6	…	117.5	193.0	238.5
Daily cash reserve requirements ratio (in percentage points)	4.0	4.0	…	4.0	4.0	…	4.0	4.0	4.0
Special cash reserve requirements ratio on foreign currency deposits (in percentage points)	20.0	20.0	…	15.0	20.0	…	15.0	15.0	15.0
Outstanding KESC borrowing (in billions of rupees) 3/	0.0	…	…	0.0	…	…	4.0	…	0.0

Source: Pakistani authorities.

1/ The relevant variables are defined in the Technical Memoranda of Understanding (TMU) dated June 18, 2002 (and as amended during the third and fourth reviews) and May 29, 2003, and are subject to adjustors specified in the TMU. For variables marked "*" the end-September 2002, end-December 2002, end-March 2003, and end-June 2003 program flows represent ceilings (or floor, if indicated) that constitute performance criteria. All other targets are indicative.

2/ Excluding PRGF loans.

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

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

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

	Projected Stock End-Jun. 2003	Prop. prog. End-Sep. 2003	Prop. prog. End-Dec. 2003	Proj. End-Mar. 2004	Proj. End-Jun. 2004
Net foreign assets of the SBP (floor in millions of U.S. dollars)*	8,205.0	495.0	833.0	1,515.0	1,691.0
		(In billions of Pakistani rupees)			
Net domestic assets of the SBP*	203.1	-12.6	13.4	-19.5	-23.6
Overall budget balance (floor)*	...	-77.0	-126.3	-163.7	-179.2
Net government bank borrowing*	485.0	43.5	53.1	40.9	14.2
CBR revenue (floor)*	...	92.2	218.1	347.5	510.0
Net banking sector claims on public sector enterprises*	102.0	1.0	2.7	4.3	6.0
Social- and poverty-related spending ("I-PRSP budgetary expenditure") (floor)	...	40.7	81.4	131.4	185.1
WAPDA accrual balance		5.3	-3.9	-19.6	-19.2
KESC accrual balance		-4.4	-8.2	-12.4	-15.3
		(In millions of U.S. dollars)			
Outstanding stock of short-term external debt owed or guaranteed by the government and the SBP*	...	500.0	500.0	500.0	500.0
Contracting or guaranteeing of noncessional medium-term and long-term debt by the government* 2/	...	600.0	600.0	600.0	600.0
Accumulation of external payments arrears (continuous performance criterion during the program period)*	...	0.0	0.0	0.0	0.0
SBP's forex reserves held with foreign branches of domestic banks (outstanding stock)		70.0	70.0	70.0	70.0
Of which: other than current account*	0.0	0.0	0.0	0.0	0.0
Stock of outstanding foreign currency swap and forward sales between SBP and residents*	...	400.0	400.0	400.0	400.0
Memorandum items:					
Net external program financing	...	105.9	59.3	153.9	267.0
Of which: privatization proceeds	...	25.0	50.0	75.0	100.0
External cash budget grants	...	22.5	55.6	78.1	111.1
Daily cash reserve requirements ratio (in percentage points)	4.0	4.0	4.0	4.0	4.0
Special cash reserve requirements ratio on foreign currency deposits (in percentage points)	15.0	15.0	15.0	15.0	15.0

Source: Pakistani authorities.

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

2/ Excluding PRGF loans.

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

Measures	Timing	Status as of April 30, 2003	Related to
I. Structural Performance Criteria			
Publish quarterly progress reports on implementation of financial improvement plan of WAPDA/successors.	November 30, 2002 for the quarter July–September 2002; February 28, 2003 for the quarter October–December 2002, and May 31, 2003 for the quarter January–March 2003.	Observed so far. Second report on WAPDA (and other major public enterprises) published on the Ministry of Finance website in February 2003.	
No new (as per status of March 1, 2003) exemptions or special privileges regarding income tax, custom duties, or GST to be granted, no new regulatory import duties to be imposed (except for anti-dumping measures), and all time bound exemptions and regulatory import duties to lapse without extension, except for existing contracts and exemptions based on international commitment.	Continuous		
Preparation of revised WAPDA FIP for FY 2002/03 and FY 2003/04, aimed at containing WAPDA's deficit in FY 2002/03 and substantially reduce it in FY 2003/04, as detailed in the February 2003 MEFP, para. 19.	April 15, 2003	Partially observed. Revised FIPs prepared, but contingency measures specified only in May.	6th disbursement
Submit to parliament a fiscal responsibility law, including (a) fiscal rules aimed at reducing consolidated government debt (federal and provincial) to below 60 percent of GDP within 10 years from the date of promulgation; and (b) the transparency and reporting requirements proposed in the draft published in July 2002.	June 1, 2003		7th disbursement
Privatize Habib Bank Limited through effective transfer of majority ownership to private investors.	June 30, 2003	Unlikely to be met as bidding process recently reopened. Modification requested.	8th disbursement
Eliminate all exemptions from withholding tax on interest income, including for NSS instruments.	June 30, 2003		8th disbursement
Establish formulaic link between rates of return on General Provident Fund and PIB yields.	June 30, 2003		8th disbursement

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

Measures	Timing	Status as of April 30, 2003	Related to
II. Structural Benchmarks			
Quarterly published progress reports on implementation of Poverty Reduction Strategy, including "I-PRSP expenditure," as well as on progress in (a) establishing institutional framework for I-PRSP monitoring; (b) preparation of full PRSP; and (c) developing baseline data and monitoring framework for intermediate indicators.	To start end-December 2001 for 2001/02 Q1 data, and continued on the basis of the same quarterly schedule throughout FY 2001/02 and FY 2002/03.	Done so far. Sixth report published in March 2003.	
Make model income tax office for small and medium taxpayers in Lahore fully operational.	October 31, 2002	Done.	
Amend SBP Act to strengthen central bank autonomy, in particular in the area of reserve management, per Safeguard Assessment recommendations.	October 31, 2002	Partially met. Amendments published in Gazette of Pakistan on November 4, 2002 strengthen autonomy but less than recommended.	
Publish first report on intermediate social outcomes as detailed in para. 16 of the MEFP.	March 31, 2003	Done.	
Prepare strategy to reduce scope for abuse of practice of holding ownership under different names ("Benami").	March 31, 2003	Done.	
Prepare specific proposals for further tax policy reforms to be implemented with the 2003/04 budget, including a substantial list of remaining income tax exemptions from the CRITO list to be abolished.	March 31, 2003	Partially met. Proposals communicated to staff orally, but list of exemptions not finalized.	
Make effective power purchase agreements between GENCOs and NTDC, and NTDC and DISCOs, in the context of the unbundling of WAPDA.	April 30, 2003	Delayed to end-2003	
Complete legal transfer of assets and liabilities to the various WAPDA successor companies (GENCOs, NTDC, and DISCOs).	June 30, 2003	Delayed to end-2003.	

1/ Conditionality as of the Executive Board's conclusion of the fourth review under the PRGF arrangement (IMF Country Report No. 03/54).

Table 2(b). Pakistan: Additional Structural Performance Criteria and Benchmarks Under the PRGF Arrangement as Proposed for the Fifth Review

Measures	Timing	Related to
I. Structural Performance Criteria		
KESC or WAPDA downward electricity tariff adjustments determined by NEPRA not to be implemented unless cumulative quarterly deficit targets of KESC, respectively WAPDA, for the preceding quarter were observed.	Continuous from June 30, 2003	
Elimination, with the approval of parliament, of at least 20 income tax exemptions.	July 1, 2003	8th disbursement
Promulgation of federal budget for FY 2003/04 consistent with a consolidated overall budget deficit (excluding grants) not exceeding PRs 179.2 billion.	July 1, 2003	8th disbursement
Preparation of an action plan to establish by end-2003 a transparent regulatory framework for the setting of electricity tariffs, that in particular (a) clarifies the respective roles of the government, NEPRA, and the power companies (including the new distribution companies) in the setting of tariffs, and (b) limits departures in actual tariff adjustments by distributors from NEPRA's determination based on the current procedures to well-specified cases of exceptional temporary spikes in oil prices.	October 31, 2003	9th disbursement
Privatize Habib Bank Limited through effective transfer of majority ownership to private investors.	December 31, 2003	10th disbursement
II. Structural Benchmarks		
Effectiveness of amendments to the tax regulations to enable sales tax auditors to assess for nonfilers tax liabilities on the basis of indirect methods of determination, such as reconstructed income statements and presumptive criteria, and to authorize the CBR to make and order for assessment of tax, penalty, and additional tax on the basis of these criteria.	July 1, 2003	
Issuance of CBR circular to require reporting by financial institutions of all interest income to the tax authority, effective from July 1, 2003.	July 1, 2003	
Publication for the federal government and NWFP of the 2003/04 budget according to the old accounting model and the new accounting model (NAM).	July 1, 2003	
Decision by Cabinet on future of the National Anti-Corruption Strategy (see MEFP, para. 5).	August 1, 2003	
Submission to cabinet by the "Benami" taskforce of a report setting out the results of consultation with stakeholders and provincial governments and proposing specific legislation to limit enforceability of "Benami" transactions and holdings.	October 31, 2003	

PAKISTAN

Technical Memorandum of Understanding on the Program Supported Under the Poverty Reduction and Growth Facility

(May 29, 2003)

1. With effect from July 1, 2003, this Technical Memorandum of Understanding (TMU) describes the monitoring under the PRGF-supported program. In the case of performance criteria, it applies to test dates beyond July 1, 2003. The main changes from the February 2003 TMU involve the monitoring of WAPDA's and KESC's deficits, and a simplification of the adjuster related to external program financing. Throughout, unless otherwise stated, "government" is meant to comprise the federal and provincial governments, except in relation to the external debt ceiling performance criteria, where it also comprises local governments, public sector enterprises, and government-owned banks. The latter refers to enterprises or banks in which the government holds a direct majority ownership interest (that is equity participation of above 50 percent).

I. Definitions of Monitoring Variables

Valuation of foreign exchange denominated assets and liabilities

2. For the purposes of monitoring under the program, all assets and liabilities as well as debt contracted, denominated in SDRs or in currencies other than the U.S. dollar, will be converted into U.S. dollars at rates prevailing as of February 28, 2003, as published in the International Financial Statistics (IFS). The U.S. dollar value of all foreign assets and liabilities, as well as external program financing and cash grants, will be converted into Pakistani rupees at the end-February 2003 exchange rate of PRs 58.1 per $1.

3. **Reserve money** (RM) is defined as the sum of: currency outside scheduled banks (deposit money banks); scheduled banks' domestic cash in vaults; scheduled banks' required and excess rupee and foreign exchange 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 and the provincial governments and the SBP staff retirement accounts.

4. **Net foreign assets (NFA) 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 be consistent with the IMF Data Template on International Reserves and Foreign Currency Liquidity. Gold will be valued at SDRs 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, international organizations, and deposits of foreign nonbank financial institutions (NBFI).[1]

5. **Net domestic assets (NDA) of the SBP** are defined as the difference between RM and the NFA of the SBP.

6. **Net borrowing from the banking system by the government** is defined as the difference between the banking system's claims on the central, provincial, and local governments and the deposits of the central, provincial, and local governments with the banking system (including district government funds balances). For the purposes of this memorandum, claims on government exclude: credit for commodity operations; government deposits exclude outstanding balances in the Zakat Fund; and balances in the various privatization accounts kept by the government in the banking system. The stock of bonds which were issued to banks in substitution of outstanding nonperforming loans to certain public entities, and which are being fully serviced by the government, are included in banking system claims on government (for example, bonds issued in 1995, 1996, and 1998 by GCP, RECP, CEC, TCP to UBL, Habib Bank, and NBP).

7. The definition of the **overall budget deficit (excluding grants)** under the program will be the consolidated budget deficit excluding grants, and including the operations of district governments financed from local funds. It will be measured by the sum of (a) total net financing to the federal, provincial, and local governments; and (b) total external grants to the federal and provincial governments. The former is defined as the sum of net external budget financing (defined below), net borrowing from the banking system (as defined above), and net domestic nonbank financing (defined below). The latter is defined as the sum of project grants, the Pakistani rupee counterpart of the Saudi Oil Facility, cash external grants for budgetary support, and capital grants reflecting the principal amounts of external debt cancellation or swaps.

8. **Net external budget financing** is defined as net external program financing minus privatization, plus all other external loans for the financing of public projects or other federal or provincial budget expenditures, and plus transfers of external privatization receipts from the privatization account to the budget. **Net external program financing** is defined to include external privatization receipts; budget support loans from multilateral (other than the IMF, but including the World Bank's BSAC and any World Bank and Asian Development Bank (AsDB) provincial structural adjustment loans), official bilateral, and private sector sources; rescheduled government debt service and change in stock of external debt service arrears net of government debt amortization due on foreign loans, the latter including any accelerated amortization including related to debt swaps or debt cancellation recorded as

[1] The definition of NFA 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.

capital grants. It includes foreign loans onlent to financial institutions and companies (public or private) and emergency relief lending. Program financing excludes all external financing counted as reserve liabilities of the SBP (defined above). Amounts assumed for net external program financing and external grants are provided in Tables 1(a) and 1(b).

9. **Net domestic nonbank financing of the budget** is defined as: domestic privatization receipts transferred from the privatization accounts to the budget, plus the change, during each fiscal year, in the stock of (a) permanent debt, which consists of nonbank holdings of prize bonds, all federal bonds and securities; plus (b) floating debt held by nonbanks; plus (c) unfunded debt, which consists of National Savings Scheme (NSS) debt, Postal Life Insurance, and the General Provident Fund (GPF); plus (d) stock of deposits and reserves received by the government (public accounts deposits); plus (e) suspense account; plus (f) any other government borrowing from domestic nonbank sources net of repayments; minus (g) government deposits with NBFIs. 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 and other relevant government debt is valued at discount value.

10. **Net claims of the banking system on public sector enterprises** comprise the banking system's claims on all public sector enterprises (excluding credit for commodity operations) and credit and holding of corporate paper, netted against outstanding deposits on the special account with the SBP for payments on public enterprises' rescheduled debt.

External debt

11. The performance criterion on contracting or guaranteeing of medium-term and long-term nonconcessional external debt by the government or the SBP applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (adopted by the IMF Executive Board on August 24, 2000), but also to commitments contracted or guaranteed for which value has not been received.[2] Excluded from this

[2] The definition of debt set forth in No. 9 of the guidelines reads as follows: "(a) For the purpose of this guideline, the term "debt" will be understood to mean a current, that is, not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, that is, advances of money to obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, that is, contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, that is, arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made

(continued)

performance criterion are (a) foreign currency deposit liabilities of the SBP; and (b) the outstanding stock of debt of Foreign Exchange Bearer Certificates (FEBCs), Deposit Bearer Certificates (DBCs), and Foreign Currency Bearer Certificates (FCBCs). The performance criterion setting a limit on the outstanding stock of short-term external debt refers to debt (as defined in footnote 2) with original maturity of up to and including one year. Medium- and long-term external debt comprises debt with initial maturity of over one year.

12. **Nonconcessional borrowing** is defined as borrowing with a grant element of less than 35 percent, following the methodology set out in SM/96/86. The discount rates used to calculate the grant element will be the six-month and ten-year Commercial Interest Reference Rates (CIRRs) averages, as computed by the Policy Development and Review Department of the IMF. Six-month CIRRs are updated mid-February and mid-August (covering the six-month period preceding the date of update) and the ten-year CIRRs averages are updated mid-December (covering a period of 10 years preceding the date of the update). Six-month CIRRs averages are to be used for loans whose maturity is less than 15 years, while ten-year CIRRs averages are to be used for loans whose maturity is equal or more than 15 years.

13. **Poverty-related and social public spending ("I-PRSP expenditure")** consists of federal, provincial, and district government spending under the current budget and the Public Sector Development Program (PSDP), as defined in Table 2.

14. **The accrual balance of WAPDA, respectively KESC**, for the purposes of program monitoring, are defined as the cash balance (including the GST-subsidy but before other subsidies, grants, or other transfers from the government) minus any net change in the stock of payables to suppliers or to the government (on account of taxes or debt service due) plus foreign-financed investment. The cash deficit will be measured from below the line as the change in outstanding debt (bank and nonbank) plus gross government subsidies, grants, or other transfers.

II. ADJUSTORS

15. The floors on the **NFA of the SBP** and ceilings on the **NDA of the SBP, respectively,** will be adjusted (a) upward/downward (respectively downward/upward) by the cumulative excess/shortfall in net external program financing (as defined below and Table 1(a)); and (b) upward/downward (respectively downward/upward) by the cumulative excess/shortfall in external cash budget and capital grants resulting from debt cancellation and debt swaps (as defined below; Table 1(b)).

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during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property. (b) Under the definition of debt set out in point 9(a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (for example, payment on delivery) will not give rise to debt."

16. The ceiling on **net bank borrowing by the government** will be adjusted downward/upward by the cumulative excess/shortfall in net external program financing plus external cash budget and capital grants resulting from debt cancellation and debt swaps; and upward by any downward adjustment in the floor on the budget balance in conjunction with higher I-PRSP expenditure or the restructuring of IDBP and ABL as set out below. The ceiling will also be adjusted upward by the increase in net claims of the banking system on the government resulting from the takeover of NBFI by a scheduled bank.

17. The ceilings on the NDA of the SBP will also be adjusted downward/upward by the amount of (a) banks' Pakistani rupee reserves freed/seized by any reduction/increase of the daily CRR relative to the baseline assumption; (b) banks' reserves freed/seized by any reduction/increase in the total reserve requirements on foreign currency deposits relative to the baseline assumption; and (c) any reduction/increase in the reservable deposit base that is related to definitional changes, as per the following formula: $\Delta NDA = \Delta rB_0 + r_0\Delta B + \Delta r\Delta B$, where r_0 denotes the reserve requirement ratio prior to any change; B_0 denotes the level of the reservable deposits in the initial definition; Δr is the change in the reserve requirement ratio; and ΔB denotes the change in the reservable deposits as a result of definitional changes.

18. The floor on the **consolidated overall budget balance (excluding grants)** will be adjusted downward for the cumulative excess in external cash budget grants and capital grants resulting from debt cancellation or debt swaps for up to PRs 5 billion at end-September 2003, PRs 10 billion at end-December 2003, PRs 15 billion at end-March 2004, and PRs 20 billion at end-June 2004. Downward adjustments in the floor will have to be matched by identical increases in actual budgetary I-PRSP expenditures above the program levels (Table 2). The floor will be adjusted upward for any outstanding bank borrowing or bond issue undertaken by KESC or WAPDA during FY 2003/04. The floor will be adjusted downward by the budgeted dividends from PTCL or OGDC, respectively, should dividends not be paid following effective privatization of PTCL or OGDC, respectively; this adjustment will be capped at PRs 20 billion. The floor will also be adjusted downward by the amount of outlays related to the restructuring of IDBP (for up to PRs 12 billion) and ABL (for up to PRs 8 billion), which for end-June 2004 would only become applicable if the transfer of ownership of IDBP has become effective or liquidation has been filed for IDBP, respectively transfer of the remaining government holdings in ABL to the private sector has become effective.

19. The ceiling on **net claims of the banking system on public sector enterprises** will be adjusted downward by the amount of net claims reclassified as claims on the private sector as a result of the privatization of any public enterprise.

III. Program Reporting Requirements

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

- Monthly provisional statements on federal tax and nontax revenue, within one month.

- Deposits into and withdrawals from the privatization accounts for each quarter, within one month. Withdrawals will be reported with the following breakdown (a) those which constitute budgetary use of privatization proceeds; (b) those which constitute costs of privatization; and (c) other (with explanation of the purpose of other withdrawals), as well as with the breakdown between domestic and external privatization receipts.

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

- Monthly (unreconciled) provisional data on federal expenditure and net lending (with separate data on disbursements and repayments), within one month.

- Quarterly statement on consolidated budgetary expenditure, with federal data approved by the Auditor General Pakistan Revenue (AGPR), within two months.

- Quarterly provisional data (from AGPR and AG) on social sector and poverty-related budgetary expenditures, as defined below (Table 2), as well as on the subcategories eligible for additional grant-financed expenditure, as defined in Table 2, within six weeks.

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

- Quarterly data on WAPDA receivables (as per Table 3 of the June 2002 TMU) within one month.

- Monthly provisional data on external budget financing, including proceeds from the Saudi Oil Facility, and cash external grants for budget support (as defined below) as well as capital grants related to debt write-off/swaps, within one month.

- Quarterly reporting on the FIPs of KESC (as per Table 3), Pakistan International Airlines, Pakistan Steel Mill Corporation, Pakistan Railways (as per Tables 4–6), and for WAPDA and its successor entities within two months (as per table 7.)

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

    (i) monetary survey;
    (ii) accounts of the SBP;
    (iii) consolidated accounts of the scheduled banks;
    (iv) banks' lending to the government;

(v) detailed table on net foreign assets (both for the SBP and scheduled banks);
(vi) detailed table of scheduled banks' reserves with the SBP.

- The same tables as in the preceding item, but on an end-quarter basis (last business day), both at current and program exchange rates, within four weeks.

- SBP Table on outstanding stock of foreign currency deposits, amended to include the classification of new FCA according to the residency of the holder.

- Daily data on exchange rates (interbank, retail market, and Telegraphic Transfers for SBP purchases on the retail market), SBP's sales and purchases in the foreign exchange markets, swaps and forward outright sales, within two business days.

- Monthly data on the outstanding stock of the SBP's forward foreign currency operations, including swaps and outright forward sales and purchases, within two weeks. The terms of any new transactions (including rollover/renewal of existing ones) 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, within one month.

- Monthly data on net bank claims on public enterprise as per attached list and including details on the six autonomous bodies, within one month. The data will show separately the total amount of direct credit and bank holdings of corporate bonds.

- Monthly data on SBP direct or bridge loans to nationalized banks in the context of the restructuring and privatization operation, within four weeks.

- Monthly data on any other quasi-fiscal operations undertaken by the SBP, on behalf of the government.

- Monthly data on SBP holding of discounted export finance credit under the export finance scheme, within one month.

- Monthly data on outstanding credit to agriculture under the Agriculture Mandatory Credit Targets, within one month.

- Monthly data on scheduled banks' credit for commodity operations, with separate subcategories for Pakistan Agricultural Storage and Services Corporation (PASSCO) and Punjab Provincial Food Department operations, within four weeks.

- The following data on external debt, within six weeks:

  (i) Quarterly stock of public- and publicly-guaranteed external debt (including deferred payments arrangements), by maturity (initial maturities of up to and including one year, and over one year), by creditor and by debtor (central government and publicly guaranteed);

(ii) Quarterly contracting or guaranteeing of nonconcessional medium- and long-term government debt; and

(iii) Information on any rescheduling on public- and publicly-guaranteed debt reached with creditors, within one month.

- Quarterly data on external payments arrears on public- and publicly-guaranteed debt with details as in (i) of the preceding item, within six weeks.
- Copies of new or revised ordinances/circulars regarding changes in: tax policy, tax administration, foreign exchange market regulations, and banking regulations no later than three days after official issuance, or notification that ordinances have been posted on the Central Board or Revenue (CBR) and SBP websites.
- Copies of official notification of changes in gas and electricity tariffs (automatic or structural) and in ex-refinery petroleum product prices as well as of gas and petroleum surcharges/levies.
- Monthly data on the import parity prices as well as central depot prices of the six major oil products, within one month.
- Quarterly data on KESC and WAPDA loans and debt outstanding, within one month.
- Quarterly data on the number of government pensioners, the number of accounts, and the total amount invested in the new pensioners' benefit accounts, within two months.

Table 1(a). Pakistan: Net External Program Financing FY 2002/03 and FY 2003/04

(In millions of U.S. dollars)

	(Cumulative from July 1, 2002)						(Cumulative from July 1, 2003)			
	Sep. 2002 Prog.	Sep. 2002 Act.	Dec. 2002 Prog.	Dec. 2002 Act.	Mar. 2003 Prog.	Jun. 2003 Prog.	Sep. 2003 Prog.	Dec. 2003 Prog.	Mar. 2004 Prog.	Jun. 2004 Prog.
Program financing (a+b+c+d+e+f-g-h+i)	447.5	236.6	597.4	342.7	689.1	365.5	105.9	59.3	153.9	267.0
(a) World Bank	185.0	202.0	215.0	202.0	400.0	202.0	125.0	250.0	375.0	500.0
(b) AsDB loans	235.0	128.0	385.0	303.0	455.0	331.0	100.0	200.0	300.0	400.0
(c) Other multilaterals	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(d) Bilateral loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(e) Commercial bank borrowing	100.0	35.5	200.0	84.5	300.0	335.5	100.0	200.0	300.0	400.0
Of which: IDB	100.0	35.5	200.0	84.5	300.0	335.5	100.0	200.0	300.0	400.0
(f) Privatization receipts	50.0	10.0	100.0	184.0	150.0	284.0	25.0	50.0	75.0	100.0
(g) Amortization due	393.0	410.1	790.9	981.0	1,346.2	1,710.4	244.1	740.8	996.1	1,233.0
Multilateral creditors	130.7	134.7	270.6	272.0	400.6	531.6	151.1	290.5	453.8	589.9
Bilateral creditors	184.9	196.7	302.0	331.8	467.3	577.4	3.3	15.9	18.3	29.4
Of which: debt cancellation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Commercial creditors	49.5	50.2	169.7	327.4	397.7	499.5	74.0	403.0	477.0	551.0
Other (military)	27.9	28.5	48.6	49.8	80.6	101.9	15.7	31.4	47.0	62.7
(h) Accelerated amortization							0.0	0.0	0.0	0.0
(i) Debt service rescheduled/arrears	270.5	271.2	488.3	550.2	730.3	923.4	0.0	100.0	100.0	100.0
Multilateral creditors	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Bilateral creditors	245.9	246.0	440.3	401.0	656.6	826.3	0.0	0.0	0.0	0.0
Commercial creditors	0.0	0.0	0.0	100.0	0.0	0.0	0.0	100.0	100.0	100.0
Other (military)	24.6	25.2	48.0	49.2	73.7	97.1	0.0	0.0	0.0	0.0

Table 1(b). Pakistan: External Grants for FY 2002/03 and FY 2003/04

(In millions of U.S. dollars)

	(Cumulative from July 1, 2002)						(Cumulative from July 1, 2003)			
	Sep. 2002 Prog.	Sep. 2002 Act.	Dec. 2002 Prog.	Dec. 2002 Act.	Mar. 2003 Prog.	Jun. 2003 Prog.	Sep. 2003 Prog.	Dec. 2003 Prog.	Mar. 2004 Prog.	Jun. 2004 Prog.
External cash budget grants	36.4	50.0	106.6	117.5	193.0	238.5	22.5	55.6	78.1	111.1
United States	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
European Union	13.1	0.0	21.9	0.0	21.9	0.0	0.0	0.0	0.0	0.0
Japan	19.0	0.0	19.0	0.0	64.0	64.0	22.5	22.5	45.0	45.0
United Kingdom	0.0	0.0	57.0	0.0	57.0	57.0	0.0	33.1	33.1	66.1
Other	4.3	50.0	8.7	117.5	50.1	117.5	0.0	0.0	0.0	0.0
Saudi Oil Facility	164.3	189.0	325.6	396.0	484.7	671.4	134.4	268.8	403.2	537.6
Project grants	25.2	26.6	50.4	40.4	35.5	69.3	26.5	53.1	79.6	106.1
Capital Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0