June 7, 2004

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. de Rato:

Pakistan's government remains committed to implementing the economic strategy set out in the Poverty Reduction Strategy Paper (PRSP), published in December 2003, supported by the Poverty Reduction and Growth Facility (PRGF) arrangement. The strategy aims to create an enabling environment for sustained high growth, job creation, and poverty reduction.

We held discussions with Fund staff in April 2004 for the eighth review under the PRGF arrangement. In light of these discussions, the attached Memorandum of Economic and Financial Policies (MEFP) reviews economic developments and policy implementation through December 2003 and beyond under the arrangement, updates the macroeconomic framework, and discusses the financial policies and the structural reform program for the remainder of 2004. It supplements the MEFP dated November 22, 2001, as well as the supplementary MEFPs dated March 12, 2002, June 18, 2002, October 16, 2002, February 8, 2003, May 29, 2003, and October 11, 2003.

All quantitative performance criteria for end-December 2003 were met. Moreover, structural performance criteria were met, except for minor deviations on (a) effective transfer of ownership of Habib Bank Limited by end-December 2003; (b) preparation of an action plan by end-October 2003 for establishing a transparent regulatory framework for regional electricity tariff setting by end-December 2003; (c) notification of electricity tariff adjustments within 30 days of the determination by the National Electric Power Regulatory Agency (NEPRA); (d) not implementing downward electricity tariff adjustment determined by NEPRA unless the respective utility met its accrual balance target in the previous quarter. The effective transfer of ownership of Habib Bank Limited took place in February 2004 upon request of the investor, although we had accepted the bid on December 29, 2003. While we had prepared the action plan for establishing a transparent electricity tariff policy in October 2003, the announcement of the electricity tariff guidelines for NEPRA was delayed until May 2004 to allow for comprehensive discussions with the World Bank on developing a financial recovery plan for the power sector. The downward tariff adjustment for the Karachi Electric Supply Company (KESC), determined by NEPRA in mid-January 2004, was notified only in mid-April after we had confirmed that the accrual balance of the preceding quarter was met and to allow time for discussions on the overall subsidy policy. Finally, we notified a downward electricity tariff adjustment for the Water and Power Development Authority (WAPDA) in November 2003, even though WAPDA missed its accrual balance target for end-September 2003, albeit by a very small margin. However, we delayed the notification until we were confident that WAPDA would meet its cumulative end-December 2003 target, which it did by a comfortable margin.

The government has also reassessed its needs for external nonconcessional borrowing. In particular, a larger-than-expected guarantee for external borrowing by Pakistan International Airlines (PIA) has been provided on favorable terms to proceed with its fleet renewal and build on its successful business turnaround. PIA should be able to service this loan out of its own resources. To accommodate this guarantee, the $500 million Eurobond issue and other smaller loans, we would need to increase the ceiling on contracting of nonconcessional loans to $1 billion, still less than prepayment of expensive external debt that we effected earlier this year.

On this basis, and in view of the policies set out in the attached MEFP, including the measures to strengthen our power sector reform strategy, the government requests waivers for the nonobservance of the structural performance criteria listed above, modification of the performance criterion discussed above, and the completion of the eighth review.

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

Sincerely yours,

/s/
Shaukat Aziz
Minister of Finance and Economic Affairs

/s/
Ishrat Husain
Governor
State Bank of Pakistan

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

PAKISTAN

Memorandum of Economic and Financial Policies for 2004

I. Introduction

1. Pakistan continues to make solid progress under its economic program supported by the current arrangement under the IMF's Poverty Reduction and Growth Facility (PRGF). Economic growth has recovered and is strengthening, while inflation has remained low. Fiscal and external vulnerabilities have been reduced through a reduction in fiscal imbalances. The debt situation continues to improve toward sustainable levels, while the strengthened external position has allowed the State Bank of Pakistan (SBP) to rebuild its international reserves.

2. Notwithstanding the economic successes, the challenges ahead include reducing poverty, creating job opportunities, and improving social indicators. We have outlined our strategy to meet these challenges in our Poverty Reduction Strategy Paper (PRSP) entitled "Accelerating Economic Growth and Reducing Poverty: The Road Ahead," which was completed by end-2003.

3. As part of our overall strategy described in the PRSP, this Memorandum of Economic and Financial Policies sets out our economic policies for the remainder of 2003/04 and for 2004/05. The government remains strongly committed to its reform agenda. We recognize that sound macroeconomic policies and further structural reforms are needed to create and maintain an environment conducive to private sector growth. We also recognize that while economic growth is necessary, it is not a sufficient condition to reduce poverty. Thus, apart from focusing on growth, our policies also aim to reduce poverty through greater social inclusion, including through human development and devolution of political and economic power.

II. Recent Developments

4. **Macroeconomic performance continues to be favorable.** The 5.3 percent economic growth target for 2003/04 (July–June) is expected to be exceeded, reflecting strong growth across all sectors. Twelve-month inflation reached 5.3 percent in March 2004, compared with 1.9 percent at end-June 2003, following a temporary surge in food prices in the last months of 2003. Inflation in July–March 2003/04 was 3.7 percent, slightly higher than in the same period a year before, but still below the 4 percent inflation target for 2003/04 as a whole.

5. **The external position remains strong.** Exports and imports (on f.o.b. basis) grew by 16.5 and 16.8 percent in U.S. dollar terms, respectively, in the first nine months of 2003/04, following very high growth rates in the previous year. This, coupled with still sizable private transfers, implies that the current account continues to show a sizable surplus. Despite a reduction in SBP purchases of foreign exchange in the interbank market in recent months and

the early repayment of loans to the Asian Development Bank (AsDB), equivalent to $1.1 billion, gross official reserves reached $11 billion by end-March 2004.

6. **Pakistan successfully re-entered international capital markets, with the issuance of a $500 million, five-year Eurobond in February 2004.** The overall setting for this issue proved favorable in view of Pakistan's improved fundamentals and the issue was four times oversubscribed. With a 6¾ percent coupon rate and issued at par, the yield spread was 370 bps over U.S. treasury bonds, significantly lower than prevailing yields on bonds of many other emerging economies, with similar, and in some cases better, credit ratings.

7. **All quantitative performance criteria for end-December 2003 have been met (Table 1(a)).** Similarly, almost all indicative targets for end-September and end-December have been met. Exceptions were the end-September and end-December targets for social- and poverty-related spending that were missed by a very small margin, though we believe that these preliminary data may somewhat understate actual expenditures. Reconciliation of preliminary expenditure data has typically resulted in some upward revisions, for example for 2002/03. Thus, there is a high probability that actual expenditure may have exceeded the end-September and end-December targets. However, full reconciliation is only done on an annual basis and not for quarterly data. Another exception is the end-September accrual balance target for the Water and Power Development Authority (WAPDA), which was missed, also by only a very small margin. However, the end-September shortfall in WAPDA's accrual balance was made up by end-December.

8. **Budget execution is on track.** The overall deficit (excluding grants) for the consolidated government was lower than programmed in the first half of 2003/04, with higher-than-targeted revenues and lower expenditures in most categories, except for defense. Revenue collection by the Central Board of Revenue (CBR) exceeded the end-December target by a comfortable margin. Preliminary data indicate that these trends have continued in recent months.

9. **Monetary growth continued to be strong, driven mainly by strong private sector credit growth.** Broad money grew by 18.5 percent in 2003, while reserve money grew by 16.5 percent. Credit to the private sector accelerated to 28.5 percent. This rapid pace of monetary expansion reflects a much stronger-than-expected increase in money demand. Meanwhile, the strong credit growth appears to reflect the buoyant economy, low interest rates, and ample liquidity in banks. The rate of monetary and credit expansion remained high in the first few months of 2004.

10. **Further progress was made in implementing structural reform measures, although some delays occurred** (Table 2(a)). In the area of tax policy and administration, the introduction of universal self-assessment has been successful. Guidelines for presumptive taxation of nonfilers under the sales tax were issued in December 2003. No new exemptions have been granted regarding income tax, customs duties, or the general sales tax (GST). Significant progress has been made toward opening an additional large taxpayer unit (LTU)

in Lahore and five medium taxpayer units (MTU) in regional centers. Work for compiling a database of taxpayers covered by these new units was completed in March 2004. We expect that the National Finance Commission award, when finalized, will strengthen and consolidate the devolution process by allocating a larger share of the divisible tax pool to provinces.

11. In the **energy sector**, an action plan for establishing a transparent regulatory framework for the setting of electricity tariffs was prepared by late October 2003, with a view to implementing these actions in the following months. However, the implementation of this plan has been delayed, and the petitions for the determination of structural tariffs for WAPDA's successor entities, filed by end-June 2003 with the National Electric Power Regulatory Agency (NEPRA), are all still pending for the distribution entities (the transmission and most of the generation petitions have now been finalized). We are working closely with the World Bank to develop a medium-term recovery plan for the sector. Electricity tariffs were reduced in November 2003 in accordance with the automatic tariff adjustment, despite that WAPDA had missed its accrual balance target under its Financial Improvement Plan (FIP) in the preceding quarter, albeit by a very small margin. The financial performance of both WAPDA and the Karachi Electric Supply Company (KESC) improved significantly in the last quarter of 2003, however, largely reflecting a greater availability of hydro power in the case of WAPDA, but also a reduction in technical and operational losses. As a result, both entities met the end-December targets under their FIPs by considerable margins.[6] Notification of the electricity tariff for KESC, determined by NEPRA in mid-January 2004 under the automatic tariff adjustment, has been notified on April 15, 2004. The delay was mainly due to discussions on overall subsidy policy and confirmation of the accrued balance of the preceding quarter.

12. In the area of **financial sector** reform, a bid for a majority stake in Habib Bank Limited (HBL) was accepted on December 29, 2003. The transfer of ownership was completed by end-February 2004, and the new owner has taken over HBL's management. With this transaction, nearly 80 percent of the country's banking sector assets are now in private hands. National Savings Schemes (NSS) rates were adjusted on January 1, 2004, to better align them with interest rates on Pakistan Investment Bonds (PIB).

III. Economic and Financial Policies for the Remainder of 2003/04 and 2004/05

A. Macroeconomic Framework

13. **We are aiming for economic growth of above 6 percent annually, over the medium term, to significantly reduce poverty.** This is ambitious, but achievable. Economic growth in 2003/04 is expected to be about 6.4 percent, while for 2004/05, a growth rate of

[6] The financial performance of Pakistan International Airlines and Pakistan Steel Mills also exceeded targets under their FIPs in the first half of 2003/04, contrary to that of Pakistan Railways, which suffered from a sharp drop in oil transport and a reduction in tariffs for transit trade to Afghanistan.

6.5 percent could very well be realized, building on the current momentum and provided that external demand and local weather conditions remain favorable. Average inflation for 2003/04 is expected to be close to, or moderately above, the 4 percent target. Inflation will be targeted not to exceed 5 percent in 2004/05.

B. Fiscal Policy

14. **Prospects for meeting the overall 2003/04 budget targets are good.** We expect CBR revenue to slightly exceed the target of PRs 510 billion (11.4 percent of GDP), while lower spending on domestic interest and a slightly lower-than-budgeted need for transfers to public sector enterprises are expected to result in savings for the year as a whole. These savings could be offset partially by higher-than-budgeted defense spending, primarily due to increased activity along the Afghan border. All in all, the consolidated government overall deficit (excluding grants) will not exceed PRs 179 billion (4 percent of GDP) and is expected to be less than that. Bank financing of the budget will be limited to PRs 82 billion. The government is determined to meet its fiscal targets and will be ready to take additional steps, including expenditure cuts, in the event of any unexpected weakening in revenue performance in the last quarter.

15. **We are fully aware that the budget for 2004/05 will need to balance the need for accelerating growth through increased social and development spending and further debt reduction.** We believe that both of these objectives can be achieved with the right mix of fiscal policies. We will submit a 2004/05 federal budget to parliament that will limit the consolidated government overall deficit (excluding grants) to PRs 199.2 billion (equivalent to 4 percent of GDP). Provided growth remains strong, this will be sufficient to further reduce the ratio of public debt to less than 80 percent, consistent with our projections outlined in the PRSP and the draft Fiscal Responsibility Law, which is expected to be approved by parliament during 2004. The continued decline in the debt ratio will contribute to further lowering the claim of debt service obligations on scarce government resources. We will have to maintain defense outlays at 3.9 percent of GDP to meet the newly arisen challenges along the Afghan border. At the same time, we remain committed to our PRSP agenda and will also increase social- and poverty-related spending in 2004/05 to PRs 278 billion (5.6 percent of GDP). To create the necessary fiscal space for this, fiscal policy will continue to need to focus on strengthening revenue collection and reducing subsidies to loss-making public enterprises by improving their performance. We expect CBR revenue to grow somewhat faster than nominal GDP growth to PRs 576 billion, as a result of past and ongoing reforms (see below).

16. **We have endeavored to expeditiously reduce the external debt burden through early repayments of $1.1 billion in expensive debt, refinancing, and to restore our credit ratings in the global capital market.** At the same time, we have re-entered international capital markets through an issuance of a $500 million, five-year sovereign bond, with a view to establish an effective international pricing benchmark to facilitate foreign investors in gauging Pakistan risk. In addition, we needed to extend a guarantee for borrowing by PIA on

highly favorable terms to proceed with its fleet renewal and build on its successful business turnaround. In the event, the contracting of new nonconcessional external debt will exceed the limit agreed under the existing PRGF arrangement for June 2004. In light of the rationales for these new borrowing needs, and given our improving debt capacity (including on account of the prepayment), we request that the limit in the contracting of nonconcessional loans be increased to $1 billion.

C. Monetary and Exchange Rate Policy

17. **Monetary policy will remain geared toward maintaining low inflation.** The risks for a further upsurge in inflation are expected to be limited because of weak import prices of most nonenergy products, the strong Pakistani rupee, and the positive outlook for agricultural output. Nevertheless, with average inflation close to the target, and given the rapid pace of monetary expansion, including strong growth of private sector credit, rising wholesale and asset prices, and the very low level of short-term interest rates, the SBP will continue to carefully monitor inflation developments. The SBP has already tightened its policy stance slightly in the last few months—short-term interest rates have already begun to rise marginally—and will be ready to tighten further should any renewed inflationary pressures arise. In addition, the SBP has reduced its purchases in the foreign exchange market in recent months to help slow down the rate of monetary expansion and contain inflationary pressures. For the months ahead, SBP operations in the foreign exchange market will be limited to smooth short-term fluctuations, and the SBP will not resist sustained pressures for the Pakistani rupee/U.S. dollar exchange rate to appreciate.

18. **Monetary projections for end-June 2004 have been revised to take into account the stronger-than-envisaged demand for money so far in 2003/04.** Broad money is now expected to grow by about 17½ percent in 2003/04. The indicative monetary program for 2004/05 assumes a modest further strengthening in money demand, with broad money and reserve money growing by 12.8 percent and 9.3 percent, respectively.

D. Structural Policies

Tax policy and administration

19. **We will continue to build on the considerable progress already made in tax policy and administration reform.** The 2004/05 budget will contain measures removing income and sales tax exemptions, as well as other base-broadening measures, yielding a total of PRs 5 billion. In addition, we intend to implement an action plan on extending GST coverage to additional services after approval of the cabinet and provincial governments /legislatures. Furthermore, in line with our strategy to rationalize our tax and tariff regime, in order to stimulate private investment, the 2004/05 budget will continue to reduce the corporate income tax rates, as per the pre-announced roadmap in the income tax ordinance, reduce excise rates on certain products, and rationalize import duties on raw materials and equipment. Following the success of the LTU in Karachi, a second LTU will be established

in Lahore by end-August 2004. In addition, two MTUs will be made operational by end-June 2004, and three more are going to be established in regional centers by end-August. A pilot customs house in Karachi will begin its operations by end-June 2004, featuring 24-hour processing of entry, electronic filing of declarations by importers on a self-assessment basis, and parameter and risk-based auditing.

Public expenditure management and transparency

20. A more regular monitoring of social indicators will help our efforts to increase the effectiveness of social- and poverty-related spending. A full Core Welfare Indicators Questionnaire (CWIQ), covering 77,000 subjects throughout the country, started in June 2004. The results from this survey will become available in time to serve as input for the 2005/06 budget discussions. We have broadened the definition of social- and poverty-related spending to include law and order, justice, and rural electrification; as the PRSP consultation process made it clear that these policy areas are important for addressing rural poverty.

21. **We aim to make further progress in strengthening expenditure management and fiscal transparency**. In 2003/04, we released budgetary funds on a timely basis, and thus allowed ministries to operate without facing financing constraints. Consequently, we were able to largely execute our spending plans on social and poverty-related expenditures, as well as the Public Sector Development Program (PSDP). Further improvements have been made in reconciliation of fiscal data. With support from the U.K.'s Department for International Development (DFID), we have begun developing a medium-term budget framework. A pilot costing and projection exercise was undertaken to improve budgeting health and population welfare ministries. Based on lessons learned, consultancy support is being arranged to develop a costing model that can assist the two ministries in budgeting their expenditure. Subsequently, the model will be rolled out to all other ministries. A Government Finance Statistics (GFS) compatible New Accounting Model (NAM) is being used for the 2004/05 budget for the federal government. The North West Frontier Province is undertaking this exercise in a parallel mode. The NAM-based accounting is being introduced in the provinces in a phased manner.

22. **Further progress is being made in the implementation of our national anti-corruption strategy.** The National Accountability Bureau (NAB) has been focusing on raising awareness, enforcement, and prevention. The NAB is working in close coordination with the provincial anti-corruption agencies. Vigilance units have been set up in several government departments, to which the NAB provides support. An awareness campaign has been started with workshops and discussions in civil service academies, banks, and other private sector bodies, and a broad media campaign was started in January 2004. We will continue our efforts to contain the "*Benami*" practice (whereby assets are held in the name of a person who is not the true beneficiary). The "*Benami*" task force submitted its report to the cabinet in October 2003, and we will start implementing the recommendations after approval by the Cabinet and provinces and initiate legislation to prohibit "*Benami*" transactions and holdings.

Financial sector

23. A Financial Sector Assessment Program (FSAP) has been conducted to assess the strengths and vulnerabilities of Pakistan's financial sector. The FSAP will form the basis for a Financial System Stability Assessment (FSSA) that will be included with the documents provided to the IMF's Executive Board for the eighth review under the PRGF. The Cabinet has approved, in principle, a new anti-money laundering legislation. We will submit the draft law to the cabinet and subsequently to parliament by end-2004, at the latest.

24. As part of our strategy to transform the NSS into a modern savings institution, NSS rates will be adjusted semi-annually in line with changes in prevailing PIB yields for corresponding maturities, starting on July 1, 2004, as described by the formula in the attached amendments to the TMU. Over time, we intend to transform the NSS into a modern savings institution, probably in the form of a mutual fund.

Energy sector, public enterprises, and privatization

25. **We hope to accelerate reforms in the power sector.** While the financial performance of WAPDA and KESC has been better than envisaged in their FIPs, progress in addressing underlying structural problems through improved bill collection—notably in the Federally Administered Tribal Areas (FATA)—reducing losses, and tariff reform has proven to be very difficult. In light of this, the government is working with the World Bank within the framework of a Poverty Reduction Support Credit (PRSC) to prepare a medium-term adjustment program for the sector. This program will aim to eliminate the sector's drain on the budget by improving governance and accountability, including by accelerating privatization, reducing costs, reforming tariff and subsidy policies, and establishing a policy framework that ensures that investments are fully funded to achieve expanded access, increased reliability, and lower costs necessary to support rapid economic growth.

26. **We are in the process of re-articulating our electricity tariff framework.** As a first step, the government will issue the broad principles of regional electricity tariff determination by end-May 2004. In addition, we will announce our subsidy policy for regional tariff setting and its financing in July 2004. This framework, which is being prepared in close consultation with the World Bank, will allow for differentiated electricity tariffs by region, with tariffs based on cost of production and services (including capital cost). The principles will clarify the respective roles of the government, NEPRA, and the power companies in the setting of tariffs, and they will limit departures in actual tariff adjustments by distributors from NEPRA's determination to well-specified cases of exceptional temporary spikes in oil prices.

27. **NEPRA will determine the structural tariffs for each of WAPDA's successor entities based on the newly established tariff framework.** In addition, electricity tariffs for KESC and WAPDA (and its successor companies) will continue to be adjusted each quarter in line with NEPRA's Automatic Tariff Adjustment. The government will notify tariffs as

determined by NEPRA within 30 days; new tariffs will take effect on the day of notification. However, any downward tariff adjustments in the last quarter of 2003/04, or the first quarter of 2004/05, will not be notified until and unless final data are available showing that WAPDA's and KESC's respective cumulative accrual deficits during the preceding quarter have been at or below the levels targeted in Table 1(a).

28. **Following the notification of the (structural) tariffs, individual Financial Recovery Plans (FRPs) will be finalized for the WAPDA successor companies.** These FRPs will be prepared in close coordination with the World Bank and will be finalized no later than end-July 2004. They will set detailed multiyear operational and financial targets and include both short-term actions to facilitate improvements in financial viability and a medium-term plan to advance the privatization of the sector and enhance competition. In addition to preparing FRPs, we will improve the management environment for the WAPDA successor companies by making them report directly to the ministry of water and power as the active shareholder. We will also strive to appoint professional management to head the successor entities and will provide them with measurable targets and an adequate incentive structure to reward overperformance and deal effectively with underperformance.

29. **We will also continue with the regular adjustment of other energy prices to reflect world market developments.** For petroleum products, this will continue to involve fortnightly adjustments in line with import costs, while maintaining stable average tax rates, except for exceptional spikes in international prices. For gas (wellhead and consumer prices), it will involve application of the gas pricing framework agreed with the World Bank through semiannual adjustments.

30. **We will continue with our privatization program.** Since the fall of 2003, we sold a majority share in HBL, as noted above, and successfully launched public offerings of shares in the National Bank of Pakistan, the Oil and Gas Development Company Limited, and the Sui Southern Gas Corporation Limited. For the near future, we expect to sell majority stakes in Pakistan State Oil, National Refinery Limited, KESC, Faisalabad Electric Supply Corporation, and the Jamshoro generation company, as well as a minority stake in Pakistan International Airlines, Pakistan Petroleum Limited, and Kot Addu Power Company Limited through public offerings.

IV. OTHER ISSUES

Program financing

31. **The program remains fully financed through end-2004.** We will ensure that conditions attached to expected loan disbursements of the World Bank and AsDB are met. All (but one) bilateral agreements with the Paris Club creditors have been signed, with the remaining one (with the Russian Federation) expected to be concluded soon. Discussions are ongoing with creditors on debt swaps (cancellations) for additional social expenditures. We

will keep Fund staff informed about the discussions with creditors and ensure that implementation of any swaps will be consistent with the financial program.

Program monitoring

32. **The ninth review will be the last one under the current arrangement.** The ninth review will be based on end-June 2004 data and will allow for the tenth disbursement in the amount of SDR 172.28 million on, or after, September 20, 2004. The proposed structural performance criteria and benchmarks for April–August 2004 and revised quantitative performance criteria and indicative targets for end-June 2004 are listed in Tables 2(b) and 1(a), respectively.

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

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

	2003	2003						2004			
	End-June	End-September			End-December			End-March			End-June
	Stock	Prog.	Adj. Prog.	Act.	Prog.	Adj. Prog.	Act.	Prog.	Adj. Prog.	Prel. Est.	Rev. Prog.
Net foreign assets of the SBP											
(floor in millions of U.S. dollars)*	8,068.4	495.0	246.4	708.4	833.0	390.2	1,191.7	996.0	185.8	1,048.2	1,489.0
					(In billions of Pakistani rupees)						
Net domestic assets of the SBP*	201.3	-12.6	1.8	-52.4	13.4	39.1	7.2	-1.3	45.8	41.7	-10.5
Overall budget balance (floor)*	…	-77.0	-77.0	-41.7	-126.3	-126.3	-33.7	-163.7	-163.7	-71.2	-179.2
Net government bank borrowing*	511.2	43.5	57.5	9.9	53.1	78.9	-9.7	40.9	100.2	53.6	20.2
CBR revenue (floor)*	…	92.2	...	95.3	218.1	...	230.9	347.5	...	354.6	510.0
Net banking sector claims on public sector enterprises*	69.1	1.0	...	-17.2	2.7	...	-24.9	4.3	...	-32.8	6.0
Social- and poverty-related spending											
(“I-PRSP budgetary expenditure”)	…	40.7	...	39.5	81.4	...	80.2	131.4	...	128.6	185.1
WAPDA accrual balance	…	5.3	...	5.0	-3.9	...	3.0	-19.6	...	-3.9	-19.2
KESC accrual balance	…	-4.4	...	-3.8	-8.2	...	-6.6	-12.4	...	-8.2	-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	...	250.9	500.0	...	189.6	500.0	...	138.8	500.0
Contracting or guaranteeing of noncessional medium-term											
and long-term debt by the government* 2/	…	600.0	...	104.2	600.0	...	454.2	750.0	...	954.2	1,000.0
Accumulation of external payments arrears (continuous											
performance criterion during the program period)*	…	0.0	...	0.0	0.0	...	0.0	0.0	...	0.0	0.0
SBP’s forex reserves held with foreign branches of											
domestic banks (outstanding stock)		70.0	...	69.8	70.0	...	68.4	70.0	...	69.8	70.0
Of which: other than current account*	0.0	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*	…	400.0	...	45.0	400.0	...	45.0	400.0	...	45.0	400.0
Memorandum items:											
Net external program financing	…	105.9	...	-164.2	59.3	...	-461.7	-239.1		-1,084.0	132.7
Of which: privatization proceeds	…	25.0	...	0.0	50.0	...	0.0	75.0	...	198.7	100.0
External cash budget grants	…	22.5	...	44.0	55.6	...	133.8	148.3	...	183.0	148.3
External capital grants	...	0.0	...	0.0	0.0	...	0.0	0.0	...	0.0	0.0
External privatization budget receipts	…	17.2	...	0.0	51.6	...	0.0	86.1	...	0.0	120.5
Daily cash reserve requirements ratio											
(in percentage points)	4.0	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)	15.0	15.0	...	15.0	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-December 2003, and end-June 2004 program flows represent ceilings (or floors, if indicated) that constitute performance criteria. All other targets are indicative.

2/ Excluding PRGF loans.

Table 1(b). Pakistan: Quantitative Targets, September 2004–June 2005 1/

(Cumulative flows from July 1, 2004, unless otherwise specified)

	2004	2004		2005	
	End-June Stock Proj.	End-Sept. Proj.	End-Dec. Proj.	End-Mar. Proj.	End-Jun. Proj.
Net foreign assets of the SBP (floor in millions of U.S. dollars)	9,861.1	208.8	-194.5	7.5	-52.5
		(In billions of Pakistani rupees)			
Net domestic assets of the SBP	204.8	-8.9	39.3	61.3	75.4
Overall budget balance (floor)	...	-78.5	-115.9	-160.1	-199.2
Net government bank borrowing	...	15.0	30.0	70.0	90.0
CBR revenue (floor)	...	110.0	255.0	400.0	576.0
Net banking sector claims on public sector enterprises	36.3	1.0	2.0	3.0	4.0
Social- and poverty-related spending (“I-PRSP budgetary expenditure”) 2/	...	59.8	119.2	159.2	278.0
Memorandum items:		(In millions of U.S. dollars)			
Net external program financing	...	247.7	-823.6	-809.9	-926.2
Of which: privatization proceeds	...	0.0	0.0	99.0	99.0
External cash budget grants	...	0.0	315.0	315.0	330.0
External capital grants	...	0.0	0.0	0.0	0.0
External privatization budget receipts	...	...	...	...	15.0
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. All program flows are indicative ceilings or floors as indicated.

2/ Expanded definition as described in the December 2003 PRSP.

Table 2(a). Pakistan: Structural Performance Criteria and Benchmarks Under the PRGF Arrangement for the Eighth Review

Measures	Timing	Status as of April 15, 2004
I. Structural Performance Criteria		
No new exemptions (as per status of March 1, 2003) or special privileges regarding income tax, custom duties, or GST to be granted, no new regulatory import duties to be imposed (except for anti-dumping measures), and all time bound exemptions and regulatory import duties to lapse without extension, except for existing contracts and exemptions based on international commitment.	Continuous	Observed.
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	Not observed. Electricity tariffs for WAPDA were reduced in November 2003, despite that the quarterly accrual balance target for Q1 was missed by a small margin. However, the decrease took place only once it became clear that targets for the first half of the year would be respected. Accrual balance targets for the first half of the year were met comfortably.
Publish quarterly progress reports on implementation of financial improvement plan of WAPDA/successors.	November 30, 2003 for the quarter July–September 2003, February 29, 2004 for the quarter October–December 2003, May 31, 2004 for the quarter January–March 2004, and August 31, 2004 for the quarter April–June 2004.	Observed for the first, second, and third quarters.
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	Partially observed. An action plan was prepared on time. However, the plan stated that the framework for regional tariff setting would be announced by end-February 2004, rather than by end-December 2003.
Privatize Habib Bank Limited through effective transfer of majority ownership to private investors.	December 31, 2003	Not observed. A bid was accepted on December 29, 2003. Transfer of ownership and management, however, was completed by end-February 2004.

Table 2(a). Pakistan: Structural Performance Criteria and Benchmarks
Under the PRGF Arrangement for the Eighth Review (concluded)

Measures	Timing	Status as of April 15, 2004
Adjust NSS rates to reflect PIB yields according to formula set in the amendment to the Technical Memorandum of Understanding (TMU).	January 1, 2004	Observed.
Government to notify electricity tariff adjustments determined by NEPRA within 30 days of their determination (effective on day of notification).	Continuous from January 1, 2004	Not observed. Downward tariff adjustment for KESC determined by NEPRA on January 15, 2004 was notified on April 15, 2004.
II. Structural Benchmarks		
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	Observed. Submitted to cabinet in October 2003.
Submit to cabinet an action plan on extending the coverage of the GST to additional services.	February 29, 2004	Now targeted for end-July 2004.
Establish a new formula in consultation with Fund staff that will align NSS rates to government bonds of the same maturity.	March 31, 2004	New formula was established in April 2004.

Table 2(b). Pakistan: Structural Performance Criteria and Benchmarks
Under the PRGF Arrangement for the Ninth Review

Measures	Timing	Related to
I. Structural Performance Criteria		
No new exemptions (as per status of March 1, 2003) or special privileges regarding income tax, custom duties, or GST to be granted, no new regulatory import duties to be imposed (except for anti-dumping measures), and all time bound exemptions and regulatory import duties to lapse without extension, except for existing contracts and exemptions based on international commitment.	Continuous	
KESC or WAPDA downward electricity tariff adjustments determined by NEPRA not to be implemented unless cumulative quarterly deficit targets of KESC, respectively WAPDA, for the preceding quarter were observed.	Continuous	
Publish quarterly progress reports on implementation of financial improvement plan of WAPDA/successors.	May 31, 2004 for the quarter January–March 2004, and August 31, 2004 for the quarter April–June 2004.	10th disbursement
Government to notify electricity tariff adjustments determined by NEPRA within 30 days of their determination (effective on day of notification).	Continuous	
Propose to Parliament removing income and sales tax exemptions and adopt other tax-base broadening measures yielding a total of PRs 5 billion in estimated revenues in the context of the 2004/05 budget.	June 30, 2004	10th disbursement
Set up a pilot customs house in Karachi that will involve entry processing on a 24-hour basis, electronic filing of declarations by importers on a self-assessment basis, and parameter and risk-based audits.	June 30, 2004	10th disbursement
Promulgation of a federal budget for FY 2004/05 consistent with a consolidated overall budget deficit (excluding grants) not exceeding PRs 199.2 billion.	June 30, 2004	10th disbursement
Adjust NSS rates to reflect PIB yields according to formula set in the amendment of the Technical Memorandum of Understanding (TMU).	July 1, 2004	10th disbursement
Announce tariff and subsidy policy for regional electricity tariff setting, as further specified in paragraph 26 of the MEFP.	July 31, 2004	10th disbursement

Table 2(b). Pakistan: Structural Performance Criteria and Benchmarks
Under the PRGF Arrangement for the Ninth Review (concluded)

Measures	Timing	Related to
Publish Financial Recovery Plans for WAPDA and its successor entities, prepared in consultation with the World Bank, including financial targets for the power utilities, as specified in paragraph 28 of the MEFP.	July 31, 2004	10th disbursement
II. Structural Benchmarks		
Set up two additional medium taxpayers units.	June 30, 2004	
Open second large taxpayers unit in Lahore	August 31, 2004	

Table 3(a). Pakistan: Net External Program Financing FY 2003/04 and FY 2004/05

(In millions of U.S. dollars)

	(Cumulative from July 1, 2003)							(Cumulative from July 1, 2004)			
	Sep. 2003 Prog.	Sep. 2003 Act.	Dec. 2003 Prog.	Dec. 2003 Act.	Mar. 2004 Prog.	Mar. 2004 Prel. Est.	Jun. 2004 Prog.	Sep. 2004 Proj.	Dec. 2004 Proj.	Mar. 2005 Proj.	Jun. 2005 Proj.
Program financing (a+b+c+d+e+f-g-h+i)	105.9	-170.1	59.3	-461.7	-239.1	-1,084.0	132.7	247.7	-823.6	-809.9	-926.2
(a) World Bank	125.0	0.0	250.0	0.0	100.0	0.0	500.0	350.0	440.0	490.0	540.0
(b) AsDB loans	100.0	125.7	200.0	243.6	300.0	243.6	400.0	100.0	290.0	360.0	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	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	0.0
(e) Commercial bank borrowing and Eurobonds	100.0	0.0	200.0	8.3	225.0	508.3	300.0	87.0	175.0	262.0	350.0
Of which: IDB	100.0	0.0	200.0	8.3	225.0	8.3	300.0	87.0	175.0	262.0	350.0
(f) Privatization receipts	25.0	0.0	50.0	0.0	75.0	198.7	100.0	0.0	0.0	99.0	99.0
(g) Amortization due	244.1	295.8	740.8	813.6	1,039.1	998.2	1,267.3	289.3	828.6	1,120.9	1,415.2
Multilateral creditors	151.1	157.8	290.5	303.0	453.8	421.9	589.9	168.0	336.0	504.0	672.0
Bilateral creditors	3.3	28.6	15.9	60.2	18.3	69.6	29.4	35.3	70.5	105.8	141.0
of which debt cancellation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Commercial creditors	74.0	57.4	403.0	398.4	515.0	454.7	589.0	72.0	393.0	468.0	543.0
Other (Military)	15.7	52.0	31.4	52.0	52.0	52.0	59.0	14.1	29.1	43.2	59.2
(h) Accelerated amortization	0.0	0.0	0.0	0.0	0.0	1,136.4	0.0	0.0	1,000.0	1,000.0	1,000.0
(i) Debt service rescheduled/arrears	0.0	0.0	100.0	100.0	100.0	100.0	100.0	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	0.0
Bilateral creditors	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Bilateral creditors (Jan. 2001)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Bilateral creditors additional debt relief	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Commercial creditors	0.0	0.0	100.0	100.0	100.0	100.0	100.0	0.0	100.0	100.0	100.0
Other (Military)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Table 3(b). Pakistan: External Grants for FY 2003/04 and FY 2004/05

(In millions of U.S. dollars)

	(Cumulative from July 1, 2003)							(Cumulative from July 1, 2004)			
	Sep. 2003 Prog.	Sep. 2003 Est.	Dec. 2003 Prog.	Dec. 2003 Est.	Mar. 2004 Prog.	Mar. 2004 Prel. Est.	Jun. 2004 Prog.	Sep. 2004 Proj.	Dec. 2004 Proj.	Mar. 2005 Proj.	Jun. 2005 Proj.
External cash budget grants	22.5	44.0	55.6	133.8	148.3	183.0	148.3	0.0	315.0	315.0	330.0
United States	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	300.0	300.0	300.0
European Union	0.0	12.0	0.0	12.1	47.1	12.1	47.1	0.0	0.0	0.0	15.0
Japan	22.5	0.0	22.5	0.0	35.0	35.5	35.0	0.0	0.0	0.0	0.0
United Kingdom	0.0	32.0	33.1	71.7	66.1	85.4	66.1	0.0	15.0	15.0	15.0
Other	0.0	0.0	0.0	50.0	0.0	50.0	0.0	0.0	0.0	0.0	0.0
Saudi oil facility	109.2	147.0	218.4	275.0	417.0	302.0	538.0	0.0	0.0	0.0	0.0
Project grants	26.5	5.0	53.1	26.5	35.3	30.5	47.0	11.7	42.3	65.7	90.0
Capital grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Amendments to the Technical Memorandum of Understanding

1. In the first sentence of paragraph 16 (original numbering of the May 29, 2003 version), "less external privatization receipts as reported in the balance of payments, plus external privatization receipts as reported in the fiscal accounts of the consolidated government" will be inserted after "The ceiling on **net bank borrowing by the government** will be adjusted downward/upward by the cumulative excess/shortfall in net external program financing."

2. Paragraph 15 (new numbering after the amendments made in the sixth and seventh reviews) will be replaced with: "For purposes of the performance criterion on applying the revised formulas on adjusting NSS rates to reflect PIB yields, the formulas are defined as follows:

For Special Savings Certificates (3 years), the yield is set as

$$Y_3 = (3 * AP_3 + Z) / 3 + 0.45$$

With AP_3 being the average annual PIB yield realized over the last 6 months:

$$AP_3 = \sum (\text{amount realized in auction } j) / (\text{amount realized over last 6 months}) * P_{3,j}$$

And $P_{3,j}$ being the annual 3-year PIB yield realized in auction j (coupon rate is semi-annual)

$$P_{3,j} = (2 * \text{coupon rate} * \text{bid amount}) / \text{amount realized}$$

For Regular Income Certificates (5 years), the yield is set as

$$Y_5 = AP_5 + 0.45$$

With AP_5 being the average annual 5-year PIB yield realized over the last 6 months:

$$AP_5 = \sum (\text{amount realized in auction } j) / (\text{amount realized over last 6 months}) * P_{5,j}$$

And $P_{5,j}$ being the annual 5-year PIB yield realized in auction j (coupon rate is semi-annual):

$$P_{5,j} = (2 * \text{coupon rate} * \text{bid amount}) / \text{amount realized}$$

For Defense Savings Certificates (10 years), the yield is set as

$$Y_{10} = [[(1 + AP_{10} / 100)^{2*10} * (1 + Z/100)]^{1/10} -1] * 100 + 0.45$$

With AP_{10} being the average semi-annual 10-year PIB yield realized over the last 6 months:

$$AP_{10} = \sum (\text{amount realized in auction } j) / (\text{amount realized over last 6 months}) * P_{10,j} / 2$$

And $P_{10, j}$ being the annual 10-year PIB yield realized in auction j (coupon rate is semi-annual):

$$P_{10, j} = (2 * \text{coupon rate} * \text{bid amount}) / \text{amount realized}$$

Where:

- n = maturity in years
- Y_n = yield on NSS instrument with n-year maturity (in percent)
- $P_{n, j}$ = yield on PIB with n-year maturity realized in auction j (in percent)
- AP_n = average yield on PIB with n-year maturity (in percent)
- Z = zakat rate (in percent) withheld on principle and yield at time of encashment or maturity (2.5)"