

EBS/01/197
Supplement 2

CONFIDENTIAL

December 21, 2001

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Pakistan—Poverty Reduction and Growth Facility—Three-Year Arrangement**

Attached for the records of Executive Directors is the text of the three-year arrangement for Pakistan under the Poverty Reduction and Growth Facility, as agreed at Executive Board Meeting 01/125 (12/6/01).

Att: (1)

Other Distribution:
Department Heads

Pakistan: Three-Year Arrangement Under the Poverty Reduction and Growth Facility

Attached hereto^{*} is a letter (the “Letter”) dated November 22, 2001, with an attached Memorandum of Economic and Financial Policies for 2002–2004 (the “Memorandum”) and a Technical Memorandum of Understanding on the Program (the “Technical Memorandum”), from the Minister of Finance and Economic Affairs and the Governor of the State Bank of Pakistan requesting from the International Monetary Fund as Trustee of the Poverty Reduction and Growth Facility Trust (“the Trustee”) a three-year arrangement under the Poverty Reduction and Growth Facility, and setting forth:

- (a) the objectives and policies of the program that the authorities of Pakistan intend to pursue during the three-year period of the arrangement;
- (b) the objectives, policies and measures that the authorities of Pakistan intend to pursue during the first year of the arrangement; and
- (c) understandings of Pakistan with the Trustee regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Pakistan will pursue for the second and third years of the arrangement.

To support these objectives and policies, the Trustee grants the requested three-year arrangement in accordance with the following provisions, and subject to the provisions applying to assistance under the Poverty Reduction and Growth Facility Trust.

1. (a) For a period of three years from December 6, 2001, Pakistan will have the right to obtain loan disbursements from the Trustee in a total amount equivalent to SDR 1,033.7 million, subject to the availability of resources in the Poverty Reduction and Growth Facility Trust.

(b) Disbursements under this arrangement shall not exceed the equivalent of SDR 344.58 million until December 5, 2002 and the equivalent of SDR 689.14 million until December 5, 2003.

(c) During the first year of the arrangement:

- (i) the first disbursement, in an amount equivalent to SDR 86.16 million, will be available, upon approval of this arrangement, at the request of Pakistan;
- (ii) the second disbursement, in an amount equivalent to SDR 86.14 million, will be available on or after March 20, 2002, at the request of Pakistan and subject to paragraph 2 below; and

^{*} See EBS/01/197, Sup. 1 (12/3/01).

- (iii) the third disbursement, in an amount equivalent to SDR 86.14 million, will be available on or after June 20, 2002, at the request of Pakistan and subject to paragraph 2 below; and
- (iv) the fourth disbursement, in an amount equivalent to SDR 86.14 million, will be made available on or after September 20, 2002, at the request of Pakistan and subject to paragraph 2 below.

(d) The right of Pakistan to request disbursements during the second and third years of this arrangement shall be subject to such phasing and conditions as shall be determined. The phasing of, and conditions for, disbursements during the second year of this arrangement shall be determined in the context of a review of Pakistan's program with the Trustee the timing of which shall be established at the first review contemplated in paragraph 2 (c) of this arrangement.

2. Pakistan will not request:

I. the second, third, and fourth disbursements specified in paragraph 1(c)(ii), 1(c)(iii), and 1(c)(iv) above:

(a) If the Managing Director of the Trustee finds that, with respect to the second disbursement, the data as of December 31, 2001, with respect to the third disbursement, the data as of March 31, 2002, and with respect to the fourth disbursement, the data as of June 30, 2002, indicate that:

- (i) the floor on net foreign assets of the State Bank of Pakistan, or
- (ii) the ceiling on the net domestic assets of the State Bank of Pakistan, or
- (iii) the ceiling on the overall budget deficit, or
- (iv) the ceiling on net government bank borrowing, or
- (v) the floor on the revenue of the Central Board of Revenue, or
- (vi) the ceiling on net credit to public sector enterprises, or
- (vii) the ceiling on the accumulation of budgetary arrears to Water and Power Development Authority by list of priority connections, or

- (viii) the ceiling on contracting or guaranteeing by the government or the State Bank of Pakistan of new non-concessional external debt with a maturity of less than one year, or
- (ix) the ceiling on contracting or guaranteeing by the government or the State Bank of Pakistan of new non-concessional external debt with a maturity of more than one year, or
- (x) the sub-ceiling on contracting or guaranteeing by the government or the State Bank of Pakistan of new non-concessional external debt with a maturity of one to five years, or
- (xi) the ceiling on the State Bank of Pakistan's foreign exchange reserves held with foreign branches of domestic banks, or the sub-ceiling on the State Bank of Pakistan's foreign exchange reserves, other than current accounts, held with foreign branches of domestic banks, or
- (xii) the ceiling on the contracting of foreign currency swap and forward sales,

referred to, with respect to the second and third disbursement, in Table 1 of the Memorandum and further specified in the Technical Memorandum, was not observed. The ceilings and floors for the performance criteria set out in this sub-paragraph for the fourth disbursement shall be determined in the context of the first review under the arrangement referred to in paragraph 2(c) below; or

(b) If the Managing Director of the Trustee finds:

- (i) with respect to the second disbursement, that Pakistan has not carried out its intentions with respect to the implementation of a new organizational set-up for Central Board of Revenue headquarters by February 28, 2002, as specified in paragraph 21 and Table 2 of the Memorandum, or
- (ii) with respect to the third disbursement, that Pakistan has not carried out its intentions with respect to the application of the standard GST penalty regime to retailers and the elimination of GST exemptions for all fertilizer wholesale and retail trade by March 31, 2002, as specified in Table 2 of the Memorandum, or
- (iii) with respect to the third disbursement, that Pakistan has not carried out its intentions with respect to the adoption of a timetable for the phasing out during the program period of the

GST subsidy on electricity and of GST exemptions for edible oil, vegetable ghee, and pharmaceuticals (with the exception of life-saving drugs) by March 31, 2002, as specified in Table 2 of the Memorandum, or

- (iv) with respect to the fourth disbursement, that Pakistan has not carried out its intentions with respect to the bringing of Karachi Electricity Supply Corporation to the point of sale, by July 31, 2002, as specified in paragraph 23 and Table 2 of the Memorandum, or
- (v) with respect to the fourth disbursement, that Pakistan has not carried out its intentions with respect to the starting of the operations of a Large Taxpayer Unit, integrating all domestic tax operations, by July 1, 2002, as specified in Table 2 of the Memorandum; or
- (vi) with respect to the fourth disbursement, that Pakistan has not carried out its intentions with respect to the implementation of the income tax reform package effective for income earned from July 1, 2002, by July 1, 2002, as specified in Table 2 of the Memorandum; or
- (vii) with respect to the fourth disbursement, that Pakistan has not carried out its intentions with respect to the implementation of the universal self-assessment effective for all income earned from July 1, 2002, by July 1, 2002, as specified in Table 2 of the Memorandum; or
- (viii) with respect to the fourth disbursement, that Pakistan has not carried out its intentions with respect to the issuance of the circular allowing banks to purchase from August 1, 2002 foreign exchange from money changers at freely negotiated rates by August 1, 2002, as specified in Table 2 of the Memorandum; or

(c) Until the Trustee has determined, with regard to the second disbursement, that the first review of Pakistan's program scheduled for completion on March 31, 2002 and referred to in paragraph 2 of the Letter has been completed and, with regard to the third and fourth disbursements, that the second and third reviews of Pakistan's program, the timing of which will be determined at the first review referred to in paragraph 3 of the Letter, has been completed.

II. any disbursement under this arrangement,

(a) if, at any time during this arrangement, Pakistan accumulates any new external payment arrears as specified in Table 1 of the Memorandum, or

(b) if, at any time during this arrangement, Pakistan fails to carry out its intentions with respect to: (i) the non granting of new exemptions or special privileges regarding income tax, custom duties, or GST, (ii) the non imposition of new regulatory import duties (with the exception of anti-dumping measures), and (iii) the lapsing of all time bound exemptions and regulatory import duties without extension, with the exception of existing contracts and exemptions based on international commitments; or

(c) if Pakistan has:

- (i) imposed or intensified restrictions on payments and transfers for current international transactions, or
- (ii) introduced or modified multiple currency practices, or
- (iii) concluded bilateral payments agreements that are inconsistent with Article VIII, or
- (iv) imposed or intensified import restrictions for balance of payments reasons.

When Pakistan is prevented from requesting disbursements under this arrangement because of this paragraph 2, such disbursements may be made available only after consultation has taken place between the Trustee and Pakistan and understandings have been reached regarding the circumstances in which Pakistan may request the disbursements.

3. In accordance with paragraph 2 of the Letter, Pakistan will provide the Trustee with such information as the Trustee requests in connection with the progress of Pakistan in implementing the policies and reaching the objectives of the program supported by this arrangement.

4. In accordance with paragraph 3 of the Letter, during the period of this arrangement, Pakistan shall consult with the Trustee on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director of the Trustee requests such a consultation. Moreover, after the period of this arrangement and while Pakistan has outstanding financial obligations to the Trustee arising from loan disbursements under this arrangement, Pakistan will consult with the Trustee from time to time, at the initiative of the Government or whenever the Managing Director of the Trustee requests consultation on Pakistan's economic and financial policies. These consultations may include correspondence and visits of officials of the Trustee to Pakistan or of representatives of Pakistan to the Trustee.