FOR AGENDA

EBD/97/110

October 3, 1997

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Pakistan—Enhanced Structural Adjustment Facility—
Policy Framework Paper, 1997/98-1999/2000**

Attached for consideration by the Executive Directors is the policy framework paper for Pakistan for the period 1997/98-1999/2000. This subject, together with the staff report for the 1997 Article IV consultation with Pakistan and Pakistan's request for arrangements under the Enhanced Structural Adjustment Facility and the Extended Fund Facility (EBS/97/185, 10/3/97), will be brought to the agenda for discussion on a date tobe announced.

Mr. Furtado (ext. 38423) or Mrs. Moalla-Fetini (ext. 34987) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Unless the Documents Preparation Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the Asian Development Bank (AsDB), the European Investment Bank (EIB), the Food and Agriculture Organization (FAO), the Islamic Development Bank (IsDB), the United Nations Development Programme (UNDP), and the World Food Programme (WFP), following its consideration by the Executive Board.

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Department Heads

INTERNATIONAL MONETARY FUND

PAKISTAN

Enhanced Structural Adjustment Facility
Policy Framework Paper, 1997/98–1999/2000

Prepared by the Pakistan Authorities in Collaboration with
the Staffs of the Fund and the World Bank

July 1997

I. INTRODUCTION

1. In recent years, Pakistan has made several attempts to address its macroeconomic imbalances and deep-rooted structural problems. However, slippages in policy implementation, and inconsistencies in the sequencing of certain components of adjustment and reform muted the supply response, led to policy reversals, and worsened the fiscal and external positions, bringing the economy to the verge of foreign exchange crises in 1995 and 1996. The cost to Pakistan has been very high in terms of lower growth and employment, chronic double-digit inflation, weak exports, and reduced policy credibility and access to low cost foreign financing.

2. Immediately after taking office in February 1997, the present government initiated a far-reaching program of structural reforms and stabilization measures to re-invigorate growth, reduce inflation, strengthen the balance of payments, and improve Pakistan's competitiveness in the new global environment. Taxation reforms directed at promoting economic revival have been the key components of the program. An agricultural incentive package has been put in place to enhance agricultural production and productivity. Agricultural income has been brought into the tax net. The State Bank of Pakistan has been given greater autonomy to formulate monetary policy and has been made the sole supervisory and regulatory authority over banks and financial institutions. The financial system has been strengthened through improvements in management and measures have been taken to develop the capital market. Governance issues are being addressed through an accountability mechanism, restructuring of government departments and public enterprises, and introduction of merit and professional criteria for senior level appointments.

3. To consolidate and expand these initiatives, the authorities have formulated an ambitious three-year economic program for the period July 1, 1997–June 30, 2000, in consultation with the staffs of the IMF and the World Bank. In support of this program, the government intends to request financial assistance under the Fund's Enhanced Structural Adjustment Facility (ESAF) combined with use of Fund resources under the Extended Fund Facility (EFF), as well as financial support from the World Bank, the Asian Development Bank, and bilateral donors.

II. Current Macroeconomic and Structural Challenges

A. Macroeconomic Performance

4. Pakistan's macroeconomic performance in the mid-1990s has been marked by unsatisfactory growth and persistently large fiscal imbalances. Economic growth over the past five years has averaged 4 percent per year, significantly slower than in past decades and not fast enough to significantly raise living standards for a population growing at an annual rate of about 3 percent. The economy remains too dependent on agricultural output which is affected by the vagaries of weather and plant disease. Growth in the industrial sector has been weak in recent years, with large-scale manufacturing contracting in 1996/97, reflecting mainly difficulties faced by the textile industry as a result of lagging competitiveness, inadequate investment, and the impact of several poor cotton crops.

5. Sluggish economic activity has contributed to setbacks in the conduct of fiscal policy. The budget deficit has fluctuated around 6 percent of GDP since 1993/94 despite repeated attempts at further reduction. The tax to GDP ratio has remained flat over the last three years, despite several revenue measures introduced in the successive budgets as well as post-budget measures, as these efforts have been diffused by distortions in the tax system and poor administration and enforcement. Non-tax revenues have declined in relation to GDP reflecting a worsening of the financial position of public enterprises and correspondingly lower transfers of profits to the budget. Thus, just to keep the budget deficit from rising above a high level, there has been a need to compress development expenditure and the nonwage component of operations and maintenance outlays.

6. The size of Pakistan's budget deficit and the manner in which it has been financed have had pervasive effects throughout the economy. In particular, bank borrowing for budgetary support increased sharply over the last three years, contributing to excessive domestic credit expansion and restricting credit availability to the private sector, with adverse effects on private investment and growth. The increasing need to supplement bank budgetary support with domestic nonbank borrowing has compelled the government to offer high rates of return on nonmarketable government debt instruments, leading to segmentation of the credit market and to a curtailment in the financial intermediation role of the banking sector. This, together with the large liquidity overhang from injections of high-powered money to finance budget deficits, has weakened banks' finances, limited the effectiveness of monetary policy, and slowed progress toward indirect methods of monetary control.

7. The monetary impact of high levels of bank borrowing to finance the budget deficit has been compounded by heavy bank borrowing by public sector enterprises. The associated high domestic credit expansion during 1994/95–1996/97 (by an average of 13.6 percent annually) has fed a spiral of double-digit inflation, declining demand for real rupee balances, and nominal depreciation of the rupee (by a cumulative 32 percent over the same period) to counteract real exchange rate appreciation. The further weakening of the already negative real deposit rates, together with a loss of confidence in the domestic currency, has encouraged a

movement into foreign currency deposits, whose rupee equivalent grew at an average annual rate of 35 percent over the last three years, compared to only 10 percent for rupee deposits.

8. Fiscal imbalances and associated monetary injections contributed to a sharp deterioration in the external current account in 1995/96, which was only marginally reversed in 1996/97. This reflected mainly sluggish exports, a surge in imports, and rising interest payments. Given the absence of a commensurate strengthening in medium- and long-term capital inflows, the enlarged current account deficit has led to depletion of gross official reserves, which fell from a peak of US$3.2 billion in September 1994 to US$1.2 billion (equivalent to about 4.3 weeks of imports) in June 1997. The vulnerability of the external position has been further increased by a trend in recent years toward greater reliance on foreign currency deposits and short-term external borrowing.

B. Key Structural Issues

9. Economic growth in Pakistan has been hindered by structural impediments to investment, savings, and gains in productivity. Investment, both public and private, in physical as well as in human capital, is very low. Fixed capital formation, at around 18 percent of GDP, is among the lowest in low-income countries. Public investment, hindered by serious structural problems in the budget, has declined to a historically low level of 3 percent of GDP in 1996–97, with an adverse impact on basic infrastructure. Public spending on human resource development has been constrained at less than 3.5 percent of GDP, preventing any significant improvement in Pakistan's social indicators, which thus remain among the least favorable in the developing world. Capital formation in the private sector has been limited by low domestic savings, inefficiencies in financial intermediation, and the fact that a substantial part of the private sector's savings are channeled to finance government expenditure. Also, macroeconomic instability, the lack of an appropriate institutional environment, and governance problems have limited Pakistan's ability to mobilize foreign savings. Moreover, inefficient public enterprises in key input and infrastructural sectors, a weak banking sector, price distortions, and high trade barriers prevent significant gains in productivity.

10. Pakistan's serious budgetary problems stem from both the poor performance of the tax system and the low productivity of public expenditure. In recent years the tax to GDP ratio has been flat in the range of 13–14 percent of GDP. This is the result of an overly complex tax regime (with many tax exemptions and concessions); a narrow tax base (with over reliance on taxation of imports); an inequitable tax burden (concentrated on large firms and salaried individuals); a weak tax administration; and widespread tax evasion and the growth of a tax-free informal sector in the economy. The expenditure side is marked by rigidities stemming from heavy interest payments (25 percent of total expenditure or over 40 percent of total tax collection) and defense outlays. Also, the overall effectiveness of government expenditure is low owing to the excessive size, low pay, and poor management and inadequate skill base of the civil service. The budgetary problems are compounded by serious financial imbalances in Pakistan's large number of public enterprises, including those in the energy, power, and rail

sectors. In recent years, the performance of these enterprises has been marked by operational inefficiencies, large line losses, and unsustainable expenditure levels.

11. Until recently, restrictions on the lending regime (to maintain a captive market for government securities and implement special credit schemes) and a deterioration in governance and credit discipline (especially in the state-owned banks, which account for over 60 percent of total bank assets) have seriously undermined the soundness of the banking sector. The stock of nonperforming loans is in the range of 15–20 percent of the total outstanding bank credit. The adverse impact on bank profitability of the large stock of nonperforming loans has been compounded by the effects of high liquidity requirements (geared at channeling resources to finance the budget), mandatory and concessional credit schemes, overstaffing, and the excessive number of branches. These factors are at the root of the inordinately high spreads between lending and deposit rates and associated efficiency losses in financial intermediation.

12. In view of the difficulties in mobilizing adequate financing for the widening current account deficit, Pakistan has accumulated a large stock of short-term external liabilities in the form of nonresidents' foreign currency deposits. This, combined with increasing holdings of residents, has raised the total stock of foreign currency deposits to US$9.8 billion as of end–June 1997 (about 50 percent of the deposit base and eight times the level of gross reserves), giving rise to significant risks and rigidities. In particular, given the forward cover scheme under which the SBP provides exchange rate guarantees for these deposits, any exchange rate movement in excess of the fee charged for the cover gives rise to quasi-fiscal foreign exchange losses. This has been the case in the last two years, when such losses amounted to an annual average of 0.8 percent of GDP, posing a major constraint on the budget and on exchange rate policy.

13. These structural problems were compounded by serious governance issues. These had numerous aspects, affecting routine public sector decision making (e.g., recruitment, transfers, and promotion of civil servants and other public employees), the effectiveness and capacity of many public institutions, and law enforcement and timely dispensation of justice. Governance problems have contributed importantly to tax evasion, widespread granting of tax exemptions and concessions, loan defaults, and arrears in payments of utility bills. More generally, they weaken macroeconomic management, reduce the effectiveness of public expenditure and the tax collection machinery, and hold back and distort the development of the private sector.

III. The Medium-Term Policy Framework

14. The authorities are aware of the need for major policy changes to address the macro-economic situation and Pakistan's longer-term development issues, without which the expected growth of population would prevent any improvement in Pakistan's poor social indicators and would lead to rapid environmental degradation. Past experience has shown that short-term stabilization measures which are not rooted in structural reforms are easily dissipated. Thus, the strategy is to put in place a sustainable and consistent set of polices to

unlock the economy from the low-investment, low-growth, and high-inflation path of recent years. Building on initiatives undertaken in recent months, these policies will encompass critical reforms of the tax system, the public sector, the financial system, the foreign exchange market, and the regulatory regime for large-scale privatization that are critical for sustaining the stabilization effort and eliciting a strong supply response in the economy. Concurrently with the structural policies of most immediate macroeconomic impact, the government will be implementing policies directed at developing Pakistan's human capital, raising productivity in key sectors, and protecting the environment.

A. Macroeconomic Policies

15. The macroeconomic objectives for the three-year program period (1997/98–1999/2000) are: to raise the growth rate of real GDP to the 5–6 percent range; (ii) to progressively reduce annual inflation to about 7 percent; and (iii) to reduce the external current account deficit (excluding official transfers) to the range of 4.0–4.5 percent of GDP.[1] The targeted improvement in growth performance would result from an increase in domestic investment from about 18 percent of GDP in 1996/97–1997/98 to 19 ½ percent by 1999/2000 and from gains in total factor productivity—a key objective of the structural reform package. Specifically, these gains would result from investments in education and health, further deregulation of agricultural output and input markets, improvements in the irrigation system, financial deepening, privatization, lower protection of inefficient public and private industries through trade liberalization, and removal of energy supply constraints and other infrastructure bottlenecks. The targeted reduction in inflation and strengthening of the external reserve position would require that national savings increase from about 12 percent of GDP in 1996/97 to about 15 percent by 1999/2000. About two-thirds of this increase in national savings is projected to originate from higher budgetary savings.

16. The strengthening in budgetary savings would result from an increase in revenue to 16.8 percent of GDP by 1999/2000 (from 15.3 percent in 1996/97) and a reduction of current expenditure to 17.2 percent of GDP (from 18.1 percent in 1996/97). Tax revenue would increase in the areas of the GST and direct taxes, which would more than offset lower customs revenues due to tariff reform. This would reflect further horizontal expansion of the GST and its extension to the trade sector; expansion of the base of direct taxes, including to agriculture; and major improvements in tax administration and tax compliance. Nontax revenues would also increase, reflecting the strengthened financial position of public enterprises. On the expenditure side, the envisaged decline in current outlays would follow from restructuring of government ministries/divisions and attached departments and autonomous bodies, reform of the civil service designed to enhance the productivity of government employment, and better planning and monitoring of budgetary expenditure, particularly non-productive current expenditure. Enhanced budgetary savings would allow for a reduction in the overall budget deficit to 4.0 percent of GDP by the third year of the

[1]Key economic and financial indicators are presented in Table 1.

program. This fiscal path would enable the ratio of public debt to GDP to drop to 65 percent by 1999/2000 (from 76 percent in 1996/97).

17. The strengthening of the budgetary accounts would be supported by improvements in the operating position of the key public enterprises which dominate the production and distribution of public utilities. Under existing tariff structures and levels of internal efficiency, and with an unchanged ratio of capital expenditure to GDP, the overall deficit of these enterprises would have widened to 2.6 percent of GDP in 1997/98 (from an estimated 2.1 percent in 1996/97). A set of measures amounting to 0.8 percent of GDP is being implemented which will provide for a reduction in their overall deficit by 0.3 percent of GDP in 1997/98 (to 1.8 percent of GDP), to be followed by further gains over the medium term as they are restructured and privatized.

18. Declining inflation, restructuring of the banking system, and the associated strengthening of confidence should raise the demand for money and lead to a gradual recovery in the ratio of domestic liquidity to GDP to its 1992/93–1993/94 level. Containment of credit to the government would create room for credit to the private sector to expand somewhat faster than the growth in nominal GDP. In the context of an improved environment for monetary policy, the SBP will intensify its reliance on open market operations to control the expansion of domestic liquidity. As regards rates of return, the efficiency gains associated with the restructuring and privatization of financial institutions are likely to be reflected in a narrowing of the spread between deposit and lending rates. This, together with a declining borrowing requirement of the government, would contribute to a simultaneous moderation of real lending rates and enhancement of real deposit rates over the program period.

19. The above described fiscal and monetary policies, and the structural and sectoral policies discussed below, should substantially strengthen Pakistan's external position. The favorable impact of the structural policies will be associated with elimination of anti-export biases in the tariff system; rationalization and simplification of the existing duty drawback scheme; containment of local costs induced by reforms in the financial and public enterprise sectors; and the planned modernization of transport infrastructure, including ports. These policies will be supported by an active exchange rate policy directed at achieving competitiveness of the tradeable goods sector. In addition, the generally more favorable business climate will encourage the build-up and modernization of productive capacity, especially in the manufacturing sector. Annual export growth is projected to average 9 percent in U.S. dollar terms during the program period, driven by an expected recovery of traditional exports such as raw cotton, cotton yarn, and textile products and a rapid expansion of non-traditional exports. By contrast, import growth will be contained in the first year of the program, in spite of the reduction in effective protection in the economy, as buoyant imports by the private sector will be offset by a strong adjustment in the volume of imports that are controlled by the public sector. Following this correction, imports are projected to grow broadly in line with real GDP growth. As a result, the current account deficit (before official transfers) is projected to decline to 5.1 percent of GDP in 1997/98 (from 6.4 percent in 1996/97), and to 4.2 percent of GDP by 1999/2000.

B. Structural Policies

20. The structural policy agenda includes, inter alia, actions to broaden the base of domestic taxes; further liberalize the trade regime; revamp tax administration; raise the productivity of government expenditure; strengthen and privatize public enterprises and state-owned banks; improve financial intermediation; and develop an interbank foreign exchange market with a view to exiting from the forward cover scheme for foreign currency deposits and moving to a more market-determined exchange rate.

Fiscal reforms

Tax reform

21. The thrust of the tax reform program is to promote a more equitable distribution of the tax burden and greater documentation of the economy. The salient features of the reforms are reductions in tax rates and a broadening of the tax base to include hitherto untaxed income and undertaxed sectors, supported by improvements in tax administration. These actions are being taken in the context of a new revenue sharing arrangement under the 1997 National Finance Commission Award between the federal government and the provinces, which has incorporated all federally collected taxes into the divisible pool and established a uniform sharing ratio across taxes. The new arrangement has removed the strong disincentive to tax reform which was associated with the allocation of most import taxes to the federal government and the bulk of revenues from domestic taxes to the provinces. Removal of this major structural distortion has provided an environment which is conducive to progress with reforms at both the federal and provincial levels. As a result, provinces will be able to reduce their dependence on nonmandatory grants and loans from the federal government and, with a strengthened own–resource mobilization effort, will be able to better forecast and protect their priority expenditures on basic social services.

22. Significant progress has been made over the last two years in reforming the General Sales Tax (GST) into a modern, broadly-based value-added tax. Important amendments to the 1990 GST Act were introduced in June 1996, expanding the horizontal coverage at the manufacturing and import stages, removing excise-type features, and establishing a turnover threshold for registration. This was followed by major improvements in the 1997/98 budget, including compulsory registration of importers, wholesalers, and distributors, and abolition of replacement invoices; effective extension of the GST to two major sectors of the economy, namely textiles and steel; improvement in refund procedures; and strengthening of the legal provisions to deal with delinquent tax payers, curb tax fraud, and minimize evasion. Also, following a simplification in March 1997, the GST rates were unified into a single standard rate of 12.5 percent in the 1997/98 budget. Building on these achievements, the next steps in GST reform will involve: (i) removing the exemptions for sugar and edible oils by end-June 1998; (ii) as a transitional step for the extension of the GST to the retail stage, introducing a 3 percent turnover tax on traders in January 1998, with an option to pay the standard GST; (iii) phasing out the turnover tax and extending the standard GST to the retail stage by

June 1999 for outlets beyond a minimum turnover threshold; and (iv) considering reducing the coverage of remaining exempted goods with the 1998/99 and 1999/2000 budgets. In this regard, the exemption for fertilizers will be reviewed in the broader context of the government's policy for the agricultural sector; and that for electricity will be reviewed in the context of a rationalization of the tax incidence on this key commodity and associated legal implications. Moreover, the recent changes in refund policy and the related exemption for capital goods will be assessed following an initial implementation stage.

23. Steps aimed at expanding the base of the **income tax** have already been taken with effect from July 1, 1997. The concept of taxable income has been redefined to include perquisites in cash and in kind, and certain deductions have been reduced. With regard to the rate structure, personal income tax rates have been reduced to 5, 10, 15, and 20 percent (from 10, 20, 30, and 35 percent, respectively) while the rates of corporate tax have been reduced to 30 percent for public limited liability companies (from 33 percent); to 35 percent for private limited liability companies (from 43 percent); and to 55 percent for banks (from 58 percent). These changes will take effect with the assessments beginning from July 1, 1998. The government will undertake a comprehensive review of the income tax system with a view to specifying steps aimed at imparting simplification and neutrality. The recommendations emanating from this review, which the government expects to complete by March 1998, and for which it intends to request technical assistance from the Fiscal Affairs Department of the Fund, would be implemented with the 1998/99–1999/2000 budgets.

24. The government is fully committed to initiating implementation of a meaningful **agricultural income taxation**. The recent enactment of land–based taxes by all four provinces represents a breakthrough in the tax policy area. The imposition of this tax will meet the dual objectives of promoting equitable sharing of the tax burden across different sectors as well as tapping a potentially significant additional source of revenues for the provinces. Initially, the provincial governments have opted for a presumptive land-based tax, with exemption limits based on farm size, and variation in rates by irrigation status and coverage of types of farm land across the four provinces; the land revenue will continue to be collected along with this new tax. As the first step, the provinces will strengthen the collection mechanisms and ensure achievement of the 1997/98 budgeted revenue target of PRs 2.1 billion. As a second step, provinces will harmonize the tax rates and coverage to those prevailing in the province of Punjab by end-June 1998. As a third step, tax rates and exemptions will be adjusted by end-June 1999 to achieve a major improvement in revenues in 1999/2000. The federal and provincial governments, with technical assistance from World Bank, will initiate in 1997/98 a study on various options for moving from the land-based tax toward an agricultural income tax over the medium-term. The study will be completed by June 1998. Based on the recommendations of the study, provinces will decide on an appropriate form of agricultural income taxation by December 1999 and will develop in 1999/2000 an action plan for phased implementation of the new system, which would lead to a substantial increase in revenues and give farmers the option of filing regular income tax returns. Simultaneously, the domestic output prices (especially wheat) in the agricultural sector will be

set at border prices to ensure a reversal of the deterioration of terms of trade of the agriculture that has taken place in the past, and credit availability to agriculture will be enhanced.

Reform of tax administration

25. Major efforts are being initiated and will be intensified over the next three years to improve tax administration in support of the above policies regarding the GST and the income tax. In this context, the Central Board of Revenue will be strengthened through incentives to ensure continuity in recruitment, and will be provided with appropriate resources to acquire and maintain suitable facilities, equipment, and supplies.

- With regard to the GST: (i) a **registration enforcement program** is being implemented; the target is to reduce the number of non-filers from 30 percent currently to 15 percent by July 1998, and to 10 percent by July 1999; and (ii) an **audit program** covering all activities and categories of taxpayers will cover 10–15 percent of the GST payers in 1997/98, and 20–25 percent in 1998/99 and subsequent fiscal years. For this purpose, the audit capacity of the GST department is being expanded; the possibility of outsourcing GST auditing work is also being considered.

- With regard to income tax, a **Tax Audit and Investigation Unit** will be established by December 1997 to audit large taxpayers from whom serious under reporting has been detected and fraud is suspected.

- To promote integration of the tax system, an **information exchange program** encompassing the income tax, GST, and customs administrations is being developed.

Tariff reform

26. **Tariff reform** constitutes one of the cornerstones of the structural reform agenda and builds on the significant progress Pakistan has made in liberalizing its trade regime in recent years. This has included phasing out all quantitative restrictions on exports and most restrictions on imports, elimination of export taxes, and reduction in tariffs and their dispersion. Building on this progress, the ongoing tariff reform seeks to provide further incentives for a reallocation of resources toward efficient industries where Pakistan has a comparative advantage, remove the remaining anti-export bias, and raise consumer welfare. Moreover, the government envisages a phasing out, during the course of the program, of the remaining quantitative restrictions which cannot be justified on health, safety, social, national security, religious, or environmental grounds

27. The tariff reform will be oriented toward further lowering and rationalizing the rate structure as well as merging the remaining concessional rates with the statutory regime, with the exception of those relating to international commitments, exports, deletion programs, or which are time-bound. An important and bold step toward these objectives was taken in

March 1997, when the maximum tariff was brought down to 45 percent (from 65 percent), the number of slabs was reduced from 14 to six (zero, 10, 15, 25, 35, and 45 percent), and the 10 percent regulatory duty that had been introduced in October 1995 was eliminated, except for a few items. Following a review of the performance of customs duties and of the evolution of imports, the maximum tariff rate will be lowered to 30–35 percent by June 1999, with a simultaneous reduction in the number of slabs to four or five; in this context, the possibility of an intermediate tariff reform step in June 1998 will be considered.

Expenditure reforms

28. Expenditure policy will emphasize greater effectiveness and developmental impact. In line with this policy, the government implemented measures to contain the level of expenditures and rationalized its investment program in the course of 1996/97, and made considerable progress in the context of the 1997/98 budget in reducing spending on lower-priority activities. Expenditures on defense, civil administration, and subsidies have been contained in nominal terms, while nonpriority expenditures of the development budget have been sharply reduced. Building on this momentum, the government will undertake efforts to further contain expenditure and improve its composition. Specifically, it will seek to: (i) rationalize spending on personnel; (ii) reallocate budgetary resources toward high-priority uses such as essential nonwage O&M and high–return development projects; and (iii) provide adequate budgetary allocations for basic social services, in particular for the Social Action Program. These objectives will be pursued by rationalizing employment; restructuring ministries and attached departments, reforming the civil service; and better planning and monitoring of budgetary expenditures. In this context, the following actions will be taken:

- Building on the progress already achieved by the government in rationalizing the number of Federal ministries and divisions in early 1997, and based on a review of ministries/divisions, attached departments, and autonomous bodies recently completed, the government will prepare, by June 1998, an operational plan for restructuring these entities and will implement it in a phased manner. In order to further contain establishment costs and shift resources to essential nonwage O&M expenditures, existing government hiring freezes at federal level will be maintained (with the exception of the SAP sectors and development projects and, when needed, to augment essential skills), and provinces will be encouraged to introduce similar policies.

- The government will prepare a study on civil service reform by December 1998, leading to the preparation, by June 1999, of an action plan on the basis of which initial steps will be taken during 1999/2000 to enhance the skills base and rationalize management, terms and conditions of service, and the pension system.

- In order to develop a consistent and realistic medium-term resource framework, facilitate matching public expenditure allocations to strategic priorities, enhance the predictability of allocations, and harden the budget constraints of line agencies and thereby increase their incentives for efficient and effective use of funds, a medium-term expenditure framework will be developed by March 1998 for use in preparing future budgets, starting with the 1998/99 budget. This will involve, inter alia, establishing strategic objectives and priorities; developing sectoral expenditure strategies (based on reconsideration of the appropriate role of government in each sector) and corresponding sectoral resource envelopes to facilitate programming of government activities at the sector level; and closer integration between the recurrent budget and the Public Sector Development Program (PSDP) on a sectoral basis.

- A multiyear development plan, subject to annual review, will be finalized by June 1998, and updated in each year thereafter, to identify the new "throw-forward" of the ongoing projects to ensure that the consequences of projects for PSDP expenditures in subsequent years, as well as recurrent cost implications, are fully taken into account.

- In the context of PIFRA (the Improvement to Financial Reporting and Auditing Project), an action plan will be developed by June 1998, and implemented during 1998/99–1999/2000, to improve the quality and timeliness of information flows relating to public expenditures at both federal and provincial levels, including employment and establishment costs, PSDP implementation, economic classification of expenditures on a uniform format, timely availability of final audited accounts, and a review of accounting definitions.

- A database and management information systems will be developed for the purpose of monitoring performance of the public enterprises.

29. As regards the PSDP, the authorities will continue and intensify their efforts to better prioritize, manage, and implement the Federal PSDP and will encourage the provinces to make similar efforts. The large cutback in the PSDP in November 1996 was well-prioritized, and subsequently further progress has been made in eliminating low-priority and poorly-performing projects, and in drastically reducing the number of new projects and the "throw-forward" of future liabilities to complete projects under implementation. In the context of the 1997/98 budget, the government decided not to start major new public investment projects or development initiatives. The Planning Commission is shifting its focus toward strengthening monitoring and evaluation of the PSDP. The government recognizes the need to restore public investment in core areas of public sector responsibility to more adequate levels, and, in this context, priority will be given to adequately funding ongoing projects near completion and those that can reap economic benefits relatively quickly. Concerning the Core Development Program (CDP), the government considers that this has been a useful device for effective prioritization of the PSDP and is developing a list of high-priority projects and programs to comprise the CDP for 1997/98—an exercise which will be repeated each year—in consultation with the World Bank and other donor agencies. The funding allocations for these projects/programs will be determined in consultation with the World Bank, and the CDP will be protected from fiscal cutbacks that may become necessary during the course of each year.

Public enterprise reform

30. The government has constituted committees that have reviewed the performance of the seven major public enterprises[2] and formulated remedial measures for improving their financial situation and preparing them for privatization. The measures recommended include appointment of top managements and a restructuring aimed at an overall improvement in the operations of these enterprises, involving generation of internal efficiencies (including reduction in line losses for power utilities), expenditure containment, rationalization of tariff structures, and stepped-up efforts to collect overdue receivables and to settle the arrears among the enterprises and the government. Performance improvement arrangements will be introduced by December 1997 between the government and WAPDA. These policies, combined with the development and implementation of a strategy to rationalize employment, are expected to set the stage for privatization of several of the key public enterprises.

Financial sector and capital market reforms

31. Considerable progress has been made in recent years in the use of market-based instruments for monetary control. Building on the introduction of an auction system for government securities, the SBP has been managing domestic liquidity, to a large extent, by intervening in the secondary market through open market operations. For a period following the elimination of absolute credit ceilings, the limits for credit expansion by the commercial banks were determined through a credit-to-deposit ratio mechanism which has also been abolished. Ceilings on lending rates have been eliminated and the scope of mandatory and concessional credits schemes substantially curtailed. In a recent move, the statutory liquidity ratio for commercial banks and nonbank financial institutions was lowered, respectively, to 20 percent and 14 percent (from 25 percent and 19 percent).

32. The monetary reform agenda will target further financial liberalization and greater reliance on market–based instruments of monetary control. Consistent with this approach, the following actions will be taken to enhance the enabling institutional environment for market-based monetary control: (i) with immediate effect, the authorities will initiate a reform of the primary dealer system for government securities; (ii) treasury bills covering a range of maturities (three months, six months, and one year) will be introduced in steps during 1997/98; and (iii) the existing six–month federal bonds will be eliminated as they are not well suited for trading in the secondary market. Within this improved environment, the operational procedures for open market operations will be refined with a view to, inter alia, reducing short-term interest rate volatility in the interbank market. This would involve, inter alia, introducing two-way open market operations and a deposit facility at the SBP to absorb

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[2]Pakistan Railways, the Water and Power Development Authority (WAPDA), the Karachi Electricity Supply Corporation (KESC), Sui Northern Gas Pipelines Ltd., Sui Southern Gas Company, the Pakistan Telecommunications Corporation Ltd., and the Oil and Gas Development Corporation.

surplus overnight funds; the SBP has already changed the reserve requirement from daily to a weekly average basis. Also, public debt management will be improved with a view to channeling an increasing share of financial savings into marketable debt instruments in order to broaden the market for government securities and to ensure comparable and market-related terms on the various debt instruments.

33. The government views the weaknesses of the financial system as a major factor behind the slowdown in the real growth of the economy, the decline in domestic savings, and the emergence of unsustainable macroeconomic imbalances. Accordingly, it has endorsed and is fully implementing legal and regulatory/supervisory reforms in this area. Specifically: (i) the ordinances to strengthen the authority and autonomy of the SBP, insulate the state-owned banks and development finance institutions from political interference, facilitate loan recovery, and unify the banking court system have been enacted into law; (ii) banking regulations are being upgraded and the SBP's supervision capacity is being strengthened; and (iii) the managements of the state-owned banks and development finance institutions have been professionalized and action plans to reduce operating losses, principally through appropriate downsizing, are being prepared and implemented under the direction of the SBP.

34. Regarding further financial sector reform, the basic strategy is to insulate the banking system from outside interference in order to provide proper governance and impose financial discipline. The reform will be based on a three-pronged approach: (i) privatization of banks and development finance institutions; (ii) enhancement of the ability of the SBP to supervise banks and effectively enforce regulations; and (iii) improvement of the legal environment for loan recovery and enforcement of financial contracts. The privatization plan calls for: (i) divestiture of the government's remaining ownership interests in the Muslim Commercial Bank, Allied Bank Limited, Pakistan Industrial Credit and Investment Corporation, and Bankers' Equity Limited; the exact timing of completion of this divestiture will be determine by the government's banking sector reform program, supported by the World Bank; (ii) privatization of Habib Bank Limited (HBL), United Bank Limited (UBL), National Bank of Pakistan (NBP), National Development Finance Corporation (NDFC), Industrial Development Bank of Pakistan (IDBP);[3] and (iii) replacement of the bad assets (net of capital and reserves) of these institutions by government securities at the time of their privatization. In addition, with technical assistance from the ADB, the government is studying possible privatization of two mutual funds (Investment Corporation of Pakistan and National Investment Trust), as well as an insurance company (State Life Insurance Corporation).

35. In order to enhance the regulatory and supervisory system, and to improve the legal environment and strengthen judicial institutions for loan recovery, the following steps will be taken: (i) the prudential regulations on capital adequacy, loan classification and provisioning, loan concentration and exposure limits, and accounting and auditing standards will be made consistent with international norms starting by December 1997 (compliance by all banks and

[3]The timetable for these actions is specified in the policy matrix (Appendix I).

nonbank financial institutions with the new capital adequacy standards will be phased in starting by December 1997 and ending by June 2000); (ii) an early warning system and on-site and off-site supervision mechanisms, which have already been initiated, will be fully operational by January 1998; (iii) a deposit insurance scheme will be in place by January 1999 which will provide a minimum level of protection for depositors and would be funded through assessment on banks; (iv) the number of banking courts will be increased and their operations will be fully funded by December 1997 to enforce the recently enacted recovery law; and (v) a centralized system of registering bank securities will be operational by January 1999.

Capital market reform

36. The growth in the equities market in Pakistan following the start of the privatization program and the encouragement of private investment in the energy and infrastructure sectors has attracted international attention. However, the equities market remains underdeveloped and the market for commercial paper and the corporate bond market are practically nonexistent. This has hindered private sector development and prevented a faster pace of economic growth.

37. The government, with the assistance of the Asian Development Bank, has developed a comprehensive program to accelerate the development of **capital markets** in Pakistan. The key objectives of the program are to augment mobilization of long-term financial resources and improve the efficiency of their allocation through a diversified and competitive capital market in order to encourage broad-based participation of issuers and investors. To achieve these objectives, the government has recently rationalized the tax treatment of public and private mutual funds, and will implement the following reforms:[4] (i) *elimination of market distortions*: removing the existing tax discrimination against private corporate debt; and lowering restrictions on investments by institutional investors; (ii) *strengthening of market regulation and supervision*: restructuring the Corporate Law Authority (CLA) into an independent and autonomous Securities Exchange and Corporate Commission of Pakistan (SECC) which will oversee and regulate the securities markets and corporate affairs; amending the securities and company laws; strengthening self-regulation of stock exchanges; and restructuring governing boards of stock exchanges; (iii) *modernization and upgrading securities market infrastructure*: reforming stock exchanges to improve corporate governance; enhancing integration of markets through operationalization of harmonized and automated trading and developing electronic linkages among stock exchanges; and developing centralized clearing, settlement and depository systems; and (iv) *improvement of investment alternatives and efficiency of market participants*: promoting the development of the corporate debt market and the mutual fund industry, and improving the regulatory framework for the industry; introducing money market and fixed income funds; reforming and consolidating the leasing industry by strengthening its regulatory and legal frameworks; and promoting contractual savings through reforms of the insurance and pension provident fund industries.

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[4]The timetable for these reforms is specified in the policy matrix (Appendix I).

Exchange market and exchange system reforms

38. Pakistan made significant progress in liberalizing its exchange system during the first half of this decade—a process which culminated in full current account convertibility of the rupee and acceptance of the obligations under Article VIII of the Fund's Articles of Agreement in July 1994. However, the pace of reform has been slowed by the difficult external position and the deterioration in the performance of major financial institutions. The progressive alleviation of these constraints will allow important steps during the period of the program, leading to a gradual withdrawal of the SBP from its current central role in the foreign exchange market and the development of an interbank foreign exchange market. This will allow the SBP's gradual exit from provision of forward cover for foreign currency deposits.

39. The strategy for promoting the development of the interbank foreign exchange market and exiting from the forward cover scheme involves the following elements: (i) authorizing banks to provide forward cover for non-trade transactions (by end-September 1997); and to increase the term of forward cover for trade transactions to one year (by end-December 1997); (ii) increasing banks' nostro account limits by at least 15 percent by March 1998;[5] (iii) issuing, by March 1998, a two year marketable foreign currency bond, with a fixed coupon, to be available to both resident and nonresidents, while allowing banks to cover a portion of their foreign currency deposit liabilities by investing in the new foreign currency bond; (iv) widening the buy/sell margin for SBP operations; (v) phasing out the surrender requirement for export earnings during the program period while maintaining the repatriation requirement; (vi) ending the practice of fixing daily buy/sell spot market prices at which banks are required to transact with customers; and (vii) permitting an opening, according to a phased schedule, for the uncovered foreign exchange position of banks. During the program period, the SBP will progressively raise the forward cover fee to encourage the development of private forward cover and reduce its own role in this activity.

Private sector development

Privatization

40. Under Pakistan's privatization program, started in 1990, considerable progress has been achieved in the sale of industrial and financial sector assets. Eighty-six industrial units, two commercial banks and one development bank, the Kot Addu Power Plant, and minority shareholdings in Pakistan International Airlines (PIA) and the Pakistan Telecommunications Corporation (PTC) have been sold to the private sector. The government views further privatization as essential for raising the productivity of the economy and improving governance. To strengthen the regulatory framework, an essential condition for moving to a larger scale of privatization, the government will work to strengthen the core infrastructure

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[5]Nostro accounts are banks' clearing accounts with foreign banks in foreign currencies.

regulatory bodies to ensure that they are credible, effective, and independent institutions. This will help establish tariffs in these sectors that are fair to consumers and attractive to investors. Moreover, to improve the marketability of transactions, the government is working on a plan to deal with labor impediments to privatization which will involve full consultation with affected parties.

41. The government has established ambitious privatization targets for the next three years. By June 1998, the Sui Northern Gas Pipelines Ltd. and Sui Southern Gas Company will be brought to the point of sale. In the industrial sector, 18 additional industrial units will have been sold, including fertilizer and vegetable oil facilities and a heavy electrical complex. Within the same time period, an effective regulatory regime will be put in place for the utility sector. By June 1999, the government will have divested a total of 46 mainly industrial units; and the Karachi Electricity Supply Corporation and the Faisalabad Area Electricity Board will have been brought to the point of sale. In addition, the government will either put in place private management or pursue privatization of five other area electricity boards. The government is reviewing the timing of the privatization of other public sector power generating plants in light of sectoral developments, including the Jamshoro Electric Power Plant; the Guddu, Muzaffargarh, Multan, and Faisalabad thermal plants. The Pakistan National Shipping Corporation and the National Tanker Company will be brought to the point of sale by June 1999. Finally, by June 2000, Pakistan Railways, Oil and Gas Development Corporation, and PTC will be brought to the point of sale.

Export Promotion

42. In addition to ensuring a competitive exchange rate and further lowering import duties to reduce anti-export biases, the authorities are developing a targeted export promotion strategy. The main elements of such a strategy are institutional development and administrative streamlining. Specifically, the following reforms will be implemented: strengthening of the unit for computation of duty drawback rates; expansion of the number of specific drawback rates; allowing exporters to claim drawbacks on the basis of taxes and duties actually paid; integration of the duty drawback and sales tax refunds in one window to avoid unnecessary transactions; and firm enforcement of standards on timing of repayments. Pakistan has two schemes that permit exporters to hold tax and duties on imported inputs in suspense until the associated exports have taken place (temporary importation and bonded manufacturing); a key element of the program is to simplify the eligibility and operating requirements for such schemes to encourage their use.

C. Social Policies

Social action program

43. The Social Action Program (SAP) was launched in 1992 to expand and improve the very weak social services in elementary education, primary health, population welfare, and rural water supply and sanitation. While the SAP focuses mainly on expanding provisions and

improving delivery of basic social services by the government, it also strives to strengthen nongovernmental organizations and private sector involvement. The second phase of the SAP will emphasize, in addition to access to services and budgetary allocations, an improvement in the quality of the basic services, particularly education, and maximization of the impact of expenditures at the facility level. Public expenditures on social sectors under the second phase of SAP are projected to rise from an annual average of 2 percent of GDP over the last three years to at least 2.4 percent of GDP a year during the program period (with federal and provincial governments' contribution at least in the range of 1.8 percent to 1.9 percent of GDP per year and donors' contribution in the range of 0.5 to 0.6 percent of GDP per year). The SAP program and its related sub-programs—which will be protected from budgetary cutbacks—will be agreed upon on an annual basis by the government, the World Bank, and other participating donors. To monitor effectiveness, the government will conduct an annual Integrated Household Survey (PIHS) as a basis for the evaluation of sectoral outcomes, and it will also conduct an annual assessment of the impact and effectiveness of the SAP reform agenda with the support of commissioned studies.

- In the **education** sector, the strategy to provide effective learning opportunities to all children through elementary education level would focus on enhancing the quality of education services through improvements in the teaching environment and in text-books and materials, and greater access to educational opportunities, particularly for girls. The provincial governments will develop and implement a teacher redeployment plan with the objective of reducing the inequality of teacher-student ratios within each province/federal area; and achieving efficiency gains and reductions in unit costs. To facilitate school-level improvement, management and supervision will be strengthened and appropriate incentives for a greater community, NGO, and private sector participation will be provided.

- In the **health** area, the focus will be on strengthening of basic health care services at the community level. A prioritized package of primary health care services has been developed and is being strengthened for implementation; the school health services program will be reviewed and reformed; provision of family planning services with female staff to all health facilities will be expanded; the Tuberculosis Program, and the Nutrition Program will be strengthened; and the Immunization Program will be broadened.

- In the **population** area, management and effectiveness of the program will be improved; budgetary allocations for the Population Welfare Program will be increased significantly in real terms; and the private sector and NGO's roles in provision of family planning services facilitated and expanded. The coverage of health and sanitation education will be expanded to rural communities in order to disseminate knowledge and best practices, and to generate demand for sanitation services.

Social safety nets

44. A multifaceted strategy will be undertaken by the government to minimize potential social costs of reforms in short-run and strengthen the social safety net. First, by insulating SAP and high-priority public investments from expenditure cutbacks, the government expects to maintain the level of basic social services provided to the poor. Second, as part of the second phase of the SAP program, the government is strengthening the Participatory Development Program to support NGOs and the private sector in the management and delivery of basic social services. Third, the government has established the Pakistan Poverty Alleviation Fund to mobilize and assist poor communities in developing income-generating activities through human resource development and micro-credit programs. Fourth, the government has carried out a review of existing public sector safety nets (i.e., Zakat and Ushr, Bait-ul-Mal), based on which it will ensure more adequate and better targeting of the most vulnerable groups among the poor. Fifth, the government will seek technical and financial assistance from the donor community to finance severance packages for compensation and retraining of workers affected by the restructuring exercise.

D. Sectoral and Environmental Policies

45. Pakistan's **agriculture**—which needs to grow at a steady rate on the order of at least 4 percent per year in order for Pakistan to achieve its growth and anti-poverty objectives, and to alleviate external imbalances—suffers from exhaustion of past sources of productivity growth, worsening degradation of agricultural land, deteriorating and poorly-managed irrigation infrastructure, inadequate research and extension services, and distortions in the prices of inputs and outputs as well as imperfections in the land market. On the input side, subsidies remain at the provincial level for fertilizers (phosphate and potash). On the output side, the price of wheat has been kept below world levels through subsidized release price of imported wheat although this subsidy was significantly reduced in 1996/97. In addition, concerning environmental degradation, the irrigated land is seriously affected by waterlogging and soil salinity, which have resulted in a significant loss in the output of major crops.

46. In addressing these issues, the government's strategy is to limit the role of the public sector, shift management responsibility to the private sector, strengthen local capacity, remove policy distortions in factor and output markets, and assist in natural resource management and environmental protection. In the context of National Drainage Project (NDP), management of the irrigation and drainage system will be decentralized in early 1997/98 by transferring it from the provincial irrigation departments to autonomous Provincial Irrigation and Drainage Authorities (PIDAS), with a firm commitment to phase out subsidies for O&M costs over the program period. WAPDA's Water Wing will be restructured and reoriented to focus on basin-wide water resource management. Key reforms will be implemented during the program in the pricing and trade policy areas: the government control over imports of fertilizers, the subsidy on wheat imports, and the remaining restrictions on imports and exports of agricultural commodities will be phased out. Concurrently, the government will explore the possibility of

taking measures to address the land market distortions by reforming the land titling and registration process through improvements and computerization of land records.

47. Over the last few years, Pakistan has made significant progress in pursuing a comprehensive reform program in the **energy sector** to create a competitive market structure. The government has been pursuing a two-pronged approach consisting of encouraging private sector participation in new energy supply facilities, while initiating the restructuring and partial privatization of the power and gas utilities. This approach, accompanied by the introduction of pricing reforms and the establishment of a transparent regulatory framework, will provide the foundations for the development of a competitive market structure in the energy sector over the medium term. While this strategy has succeeded in attracting private investment and expertise for thermal power plants and gas exploration projects, the restructuring program of the energy utilities has lagged behind and an effective and independent regulatory framework has not yet been established. Thus, consumers have not yet fully benefited from the efficiency gains associated with private sector involvement. Pricing reforms for natural gas and electricity aimed at reducing cross-subsidies and adjusting average tariffs to fully reflect changes in the costs have been implemented at a slower pace than originally envisaged, resulting in deterioration of the financial position of the utilities, already weakened by overstaffing, and increasing levels of cross arrears between the utilities and the government.

48. The government is now addressing these issues by taking important steps to revive the reform program in order to achieve significant efficiency improvements in the medium term. The government is initiating a comprehensive review of its Energy Policy, with technical assistance from the World Bank, in the context of which it will prepare a new policy for new investments in the energy sector. The energy utilities are beginning to address the overstaffing as well as the cross-arrears issues. Recently, in the power sector, the government has decided to raise tariffs in the Federally Administered Tribal Areas and to convert the flat rates for the agricultural tubewells into metered charges. Over the medium term, the reform agenda for the sector would focus on: (i) accelerating the restructuring and privatization program of the power and gas utilities, which also requires establishment of an effective regulatory regime; (ii) adopting more appropriate pricing policies; and (iii) continuing to increase private sector participation in new energy supply facilities under revised mechanisms and incentives.

- In the **power sector**, the government will corporatize and commercialize WAPDA by December 1998.[6] Moreover, as noted, performance improvement arrangements will be introduced between the government and WAPDA by December 1997. Cross-subsidies will be gradually reduced and the average tariff level increased to reflect the costs. The National Electric Power Regulatory Authority (NEPRA) will be made fully operational by June 1998. As regards private power projects, the government will introduce a competitive solicitation mechanism in order to improve transparency in sanctioning new private projects while taking advantage of the better terms offered under a

[6]Privatization of the power utilities is discussed in paragraph 41.

competitive solicitation process. The tax exemptions for new private power projects will be reconsidered during 1997/98.

- In the **petroleum sector**, the government will consider restructuring and privatization of Pakistan State Oil Ltd., the largest oil marketing company. Following a suspension dictated by revenue considerations, the **automatic petroleum pricing mechanism** will be reinstated by December 1997 under a revised formula.

- In the **gas sector**, two major gas distribution companies will be brought to the point of sale in 1997/98 (see paragraph 41), while the government is considering restructuring the Oil and Gas Development Corporation (OGDC) (the state-owned hydrocarbon exploration and production company) to separate its technical services from its exploration and production functions with a view to its subsequent privatization during the program period. Natural gas consumer tariffs will be adjusted according to the variation in the domestic price of fuel oil and the prescribed price of gas will be adjusted to achieve a rate of return on assets as agreed with the World Bank. The Gas Regulatory Authority will be made fully operational by June 1998.

49. Pakistan's growth and export potential depend importantly on the modernization of its outmoded **transportation** systems. The country's traditional freight distribution systems impose substantial economic costs for the industrial and trading sectors of the economy. To substantially improve the transport system, actions will be taken over the next three years to upgrade and expand the country's highways, railways, and ports.

- As regards **highways**, this includes adoption of an institutional framework to encourage greater private sector investment and establishment of an adequate source of funding for road maintenance at the federal level by the National Highway Authority, based primarily on enhanced road user charges. Provincial governments will be encouraged to do the same.

- With respect to **railways**, important institutional changes will be implemented with a view to reducing inefficiencies and preparing the ground for privatization. In this context, the Railway Board will be separated from the Ministry and reconstituted by December 1997 to include private sector members. By June 1998, the government will establish the Railway Restructuring Authority to handle redundant labor and the reconstituted Railway Board will have taken measures to facilitate privatization process (including identifying surplus labor and transferring it to the Railway Restructuring Authority; and divesting ancillary services). Within the same timeframe (June 1998), a Railway Regulatory Authority will be established. The privatization of core assets and sale of surplus railway land are envisaged for 1999–2000.

- As regards **port facilities**, the development of an efficient, cost-competitive port in Karachi requires an agenda to permit a change to a landlord port through dealing with management issues, rationalization of operations, elimination of restrictions on working practices, and establishment of an environment for increased private sector participation.

50. Improving Pakistan's **water supply and sewerage system** is a high priority. Subsidies and inefficient service delivery systems have limited the expansion of these services and have not provided significant benefits to the poor—most have limited access to piped water systems and usually buy from private vendors at high prices. The sewerage systems are almost nonexistent with the result that poor sanitation is of growing concern. Given the need for large investments in water and wastewater services, and the generally poor performance of existing services, the government is considering the concession model—combining both water supply and sewerage—to be adopted for Lahore and Karachi in line with the best international practice (including an appropriate regulatory framework). During the program period, the government will issue a policy statement encouraging private sector participation in urban water and wastewater services; it will also prepare the regulations to encourage foreign investment in the sector.

51. One of the most pressing priorities for sustainable development in Pakistan is the strengthening of institutional and regulatory framework for improved enforcement of **environmental protection**. Specific areas of concern include the inability of provincial Environmental Protection Agencies to design strategies/action plans for the enforcement of National Environmental Quality Standards and other provisions of the Environmental Protection Ordinance; and the absence of a pollution control scheme at the national level. Against this background, the following steps will be taken over the program period:[7] (i) enactment of the environmental protection law by the National Assembly by September 1997; (ii) development of provincial capabilities for enforcement; (iii) implementation of mass awareness programs; (iv) development of a comprehensive and well-prioritized pollution control and environmental impact assessment enforcement system by March 1998; and (v) targeting of the industrial sector for compliance with sound pollution control strategies.

E. Governance

52. Governance has emerged as an increasingly important policy issue for Pakistan. In recent years, worsening problems in this area have had a major impact on macroeconomic performance and have hindered the effectiveness and sustainability of reforms. Specifically, weak governance has reduced tax collection and undermined tax administration, opened the way for massive waste in public enterprises, and contributed to build up of the nonperforming loan portfolio of the banking system.

53. In the context of governance, strong actions have already been taken to strengthen and expedite the accountability process. The abolition of block budgetary allocations at the federal

[7] The exact timing of measures is provided in the policy matrix (Appendix I).

and provincial levels; and the termination of quotas for public sector employment, plots of land, access to educational institutions, etc., also constitute important steps in improving governance. Tax reforms have been introduced to promote documentation and reduce the scope for discretion by tax officials. Also, it is expected that important benefits will accrue from the planned restructuring of the government and the envisaged reform of the civil service. Key elements of the government's medium-term program include: (i) ensuring effective law and order; (ii) strengthening transparent and competitive procurement practices to promote competition; (iii) promoting greater accountability of public service providers to the beneficiaries and communities by involving NGOs and encouraging community participation; (iv) enhancing the efficiency of the civil service; and (v) strengthening the legal and judicial system.

IV. External Financing Requirements

54. Total external financing requirements for the program are estimated at US$24.3 billion over the 1997/98–1999/2000, averaging the equivalent of 11.5 percent of GDP (Table 2). Due to the strength of the structural measures, significant medium-term private inflows are expected—excluding the potential sales of public enterprises to foreign investors—in an amount of US$7.1 billion. Nevertheless, the financing of the public sector operations and the targeted buildup of gross official reserves (by US$2.1 billion) are projected to give rise to large residual financing gaps in the period ahead. These gaps will be covered by official project loans amounting to US$5.4 billion (of which US$5.1 billion are already committed) and grants (about US$500 million), which are linked to the public sector investment program; and trade credits amounting to US$1.5 billion which will cover government-sponsored food imports. In addition, the government expects to mobilize US$5.7 billion of medium-term and short term commercial loans. The residual financing needs are estimated at US$3.8 billion over 1997/98–1999/2000. They would be covered by expected financing over the program period from the Fund (US$1.6 billion), the World Bank (US$600 million), the Asian Development Bank (US$500 million), JEXIM Bank (US$500 million), and OECF (US$600 million).

V. Technical Assistance Requirements

55. The Pakistan authorities expect to benefit from substantial technical assistance during the three-year period corresponding to the above-described program. Technical assistance from the IMF will be requested for: (i) undertaking a comprehensive review of the income tax system; (ii) improving tax administration; (iii) developing a data base for monitoring public enterprises; (iv) reforming the primary dealer system for government securities and implementing exchange market reforms; (v) improving the compilation of/reporting requirements for the monetary statistics; and (vi) addressing remaining deficiencies in the economic data base of Pakistan, particularly in the area of national accounts. Technical assistance from the World Bank would focus on: (i) studying the various options for improving the agricultural income tax; (ii) developing operational plans to improve the quality and timeliness of information flows relating to public expenditure; (iii) preparing a program of civil service reform; (iv) developing safety net programs to address the effects of restructuring in the public

sector; (v) developing management information systems for public enterprises; (vi) strengthening banking regulation and supervision; (vii) implementing the privatization program, including as regards financial institutions; (viii) strengthening the regulatory bodies for core infrastructure; and (ix) improving the institutional support for exporters. Technical assistance from the ADB would be directed at: (i) reforming pension and provident funds; (ii) reforming the insurance industry; and (iii) restructuring the public sector mutual funds.

Attachments:
Table 1: Pakistan—Key Economic Indicators, 1993/94–1999/2000
Table 2: Pakistan—External Financing Requirements and Sources, 1996/97–1999/2000
Appendix I: Pakistan—Policy Matrix, 1997/98–1999/2000
Appendix II: Pakistan—Income and Social Indicators

Table 1. Pakistan: Key Economic Indicators, 1993/94–1999/2000

	1993/94	1994/95	1995/96	Prel. 1996/97	Prog. 1997/98	Prog. 1998/99	Prog. 1999/2000
	(In percentage change)						
Output and prices							
Real GDP at factor cost	4.5	5.2	4.6	3.1	5.5	5.8	6.0
GDP deflator at factor cost	12.6	13.6	10.9	11.3	11.0	9.5	7.0
Consumer price index (annual average)	11.3	13.0	10.8	11.8	10.5	9.0	7.0
Consumer price index (end-of-period)	11.8	12.1	10.3	12.5	9.0	7.5	7.0
Nominal GDP at market prices	17.2	19.7	15.4	15.3	17.1	15.9	13.4
	(In percent of GDP)						
Investment and savings							
Total investment	19.4	18.4	18.6	18.2	17.8	18.8	19.4
Public	7.7	6.9	7.0	5.6	4.9	5.2	5.5
Private	11.7	11.5	11.6	12.6	12.8	13.0	13.3
Gross national savings	15.8	14.5	11.8	11.8	12.6	14.0	15.2
Public	0.1	0.3	-1.1	-2.0	-1.2	-0.4	0.4
Private	15.7	14.2	12.9	13.9	13.8	14.4	14.8
Savings/Investment balances	-3.6	-3.9	-6.8	-6.4	-5.1	-4.8	-4.2
Public	-7.6	-6.6	-8.1	-7.6	-6.2	-5.6	-5.1
Private	4.0	2.7	1.3	1.2	1.0	1.4	1.5
Budgetary operations							
Budgetary revenue	17.2	17.0	17.0	15.3	15.7	16.4	16.8
Budgetary expenditure	23.2	22.6	23.8	21.5	20.8	20.9	20.8
Budgetary balance	-6.0	-5.6	-6.9	-6.1	-5.0	-4.5	-4.0
Domestic debt	45.2	42.9	42.3	41.4	39.3	38.9	37.0
	(Changes in beginning-of-period domestic liquidity)						
Monetary sector							
Net foreign assets	5.6	3.8	-4.7	-3.6	1.3	2.5	2.7
Net domestic assets	12.4	13.4	18.5	14.4	14.4	13.2	11.9
Domestic liquidity	18.0	17.2	13.8	10.8	15.7	15.6	14.6
	(In percent of GDP)						
External sector							
Exports	12.9	13.2	13.3	12.7	13.5	14.2	14.4
Imports	16.6	16.8	18.5	17.7	17.1	17.2	16.7
Current account excluding official transfers	-3.6	-3.9	-6.8	-6.4	-5.1	-4.8	-4.2
Current account including official transfers	-3.0	-3.4	-6.5	-6.0	-4.9	-4.5	-4.0
External public debt 1/	48.2	44.5	42.5	43.8	45.3	46.7	46.2
	(In millions of U.S. dollars)						
Current account, excluding official transfers	-1,904	-2,413	-4,409	-4,092	-3,418	-3,328	-3,148
Current account balance	-1,590	-2,101	-4,195	-3,837	-3,283	-3,140	-2,960
Gross reserves 2/	2,302	2,741	2,053	1,238	1,673	2,483	3,383
Gross reserves 2/ (in weeks of imports)	12.6	12.7	8.2	5.2	7.0	10.0	13.0
External debt service ratio 3/	22.6	22.0	24.7	27.9	24.9	24.0	23.8

Source: Data provided by the Pakistan authorities; and Fund staff estimates and projections.
1/ Excludes foreign currency deposit liabilities.
2/ Excluding gold.
3/ Medium- and long-term debt service in percent of exports of goods and services and receipts of private transfers.

Table 2. Pakistan: External Financing Requirements and Sources, 1996/97–1999/00

(In millions of U.S. dollars)

	1996/97 Prel.	1997/98 Prog.	1998/99 Prog.	1999/00 Prog.	1997/98–1999/00 Prog.
Current account balance excluding official transfers	-4,092	-3,418	-3,326	-3,147	-9,892
Trade balance	-3,223	-2,365	-2,073	-1,663	-6,100
Exports, f.o.b.	8,195	9,004	9,844	10,796	29,644
Imports, f.o.b.	-11,418	-11,368	-11,917	-12,458	-35,743
Service balance	-3,820	-3,649	-3,853	-4,076	-11,578
Private transfers	2,951	2,596	2,599	2,592	7,786
Amortization	-4,723	-3,955	-3,575	-3,967	-11,497
Repayments to IMF	-317	-241	-208	-287	-735
Change in gross official reserves (increase -)	850	-435	-810	-900	-2,145
Total financing requirements	**-8,283**	**-8,049**	**-7,919**	**-8,301**	**-24,269**
Official transfers	255	135	188	188	511
Medium- and long-term capital	5,185	6,043	6,513	6,786	19,342
Public and publicly guaranteed	3,456	3,928	4,134	4,158	12,221
Project and nonproject aid	2,304	2,882	3,079	3,133	9,095
Project loans	1,780	1,494	1,932	1,964	5,389
Food loans	524	489	498	519	1,506
Program loans	0	900	650	650	2,200
Multilateral creditors	0	450	325	325	1,100
Bilateral creditor	0	450	325	325	1,100
Other public and publicly guaranteed 1/	1,152	1,046	1,055	1,025	3,126
Private sector	1,729	2,115	2,379	2,628	7,122
Short-term capital inflows	2,691	1,435	674	674	2,783
Public sector 1/	1,287	1,285	674	674	2,633
Private sector	1,404	150	0	0	150
IMF	152	435	544	653	1,632
Total identified financing	**8,283**	**8,049**	**7,919**	**8,301**	**24,269**
Financing gap	**0**	**0**	**0**	**0**	**0**

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

1/ Includes borrowing from commercial banks and the Islamic Development Bank.

Pakistan: Policy Matrix, 1997/98–1999/2000

Policy Area	Objectives and Targets	Actions	Implementation	TA Requirements
1. **Tax reform**	Improve resource mobilization, rationalize the tax system, broaden the tax base, promote a more equitable distribution of the tax burden, and improve tax administration.			
a. GST		• Unifying the GST rates (10, 18, and 23 percent) into a single standard rate of 12.5 percent; compulsory registration of importers, wholesalers, and distributors, and abolition of replacement invoices; extension of the GST to textiles and steel; improved refund procedures; strengthening of the legal provisions to deal with delinquent tax payers.	1997/98 (completed)	
		• Assessing the recent changes in refund policy and the related exemption for capital goods following an initial implementation stage.	1997/98	
		• Introducing a 3 percent turnover tax on traders with an option to pay the standard GST.	January 1998	
		• Extending the GST to sugar and edible oils.	1998/99 budget	
		• Extending the GST to the retail stage for outlets beyond a minimum turnover threshold.	By June 1999	
		• Considering removal of exemptions (including the exemptions for fertilizers and electricity).	1998/99–1999/2000	
b. Personal and corporate income taxes		• Reforming the income tax through expansion of the base and introduction of obligatory filing.	1997/98 (completed)	
		• Comprehensive review of the income tax system.	By March 1998	FAD TA mission on income tax system

Pakistan: Policy Matrix, 1997/98–1999/2000 (continued)

Policy Area	Objectives and Targets	Actions	Implementation	TA Requirements
		• Implementing changes in the income tax system taking into account recommendations emanating from the above–mentioned review.	1998/99–1999/2000	
c. Agricultural income tax	Promote equitable sharing of the tax burden across different sectors as well as tapping a potentially significant additional source of revenue for the provinces.	• Implementing the existing land tax in all four provinces, with exemption limits based on farm size, and variation in rates by irrigation status and coverage of types of farm land.	1997/98 (completed)	
		• Strengthening the collection mechanisms to ensure achievement of the budgeted revenue target of PRs 2.1 billion.	1997/98	
		• Conducting a study, with technical assistance from the World Bank, on various options for improving the agricultural income tax.	By June 1998	World Bank TA
		• Harmonizing the tax rates and coverage to those prevailing in the province of Punjab.	1998/99 budgets	
		• Adjusting tax rates and exemptions to achieve a major improvement in revenue.	1999/2000 budgets	
		• Decisions on an appropriate agricultural income tax system.	By December 1999	
		• Developing an action plan for the implementation of the new system.	1999/2000	
2. Reform of tax administration	Improve tax administration in support of the above policies regarding the GST and the income tax.	• Strengthening the Central Board of Revenue through incentives to ensure continuity in recruitment, proper training, and provision of appropriate resources to acquire and maintain suitable facilities, equipment, and supplies.	During the program period	FAD Resident experts.
a. GST		• Implementing a registration enforcement program.	During the program period	

Pakistan: Policy Matrix, 1997/98–1999/2000 (continued)

Policy Area	Objectives and Targets	Actions	Implementation	TA Requirements
		• Implementing an audit program covering: 10–15 percent of tax payers. 20–25 percent of tax payers.	 By June 1998 By June 1999	FAD follow-up TA mission on tax administration
b. Income tax		• Establishing a Tax Audit and Investigation Unit to audit large tax payers.	By December 1997	
		• Establishing an information exchange program encompassing the income tax, GST, and customs administrations to promote integration of the tax system.	1997/98	
3. Trade reform				
a. Statutory tariffs	Further lowering and rationalizing the rate structure, as well as merging the remaining concessional rates with the statutory regime.	• Lowering the maximum tariff rate to 30–35 percent.	By June 1999	
		• Reducing the number of slabs to four or five.	By June 1999	
		• Merging the remaining concessional rates with the statutory regime as specified in paragraph 27 of the PFP.	By June 1999	
b. Quantitative restrictions	Further liberalize the trade regime.	• Developing a plan and timetable to phase out remaining quantitative restrictions on imports as specified in paragraph 26 of the PFP.	By March 1998 (Plan) During the program period (implementation)	
4. Expenditure reform	Improve composition, prioritization, and quality of public expenditure through structural adjustments, improved decision-making, and better management.			
	Alleviate crowding out of essential nonwage O&M by the public sector wage bill.	• Introducing hiring freezes at the federal level and encouraging provincial governments to do the same (except for the SAP sectors and development projects and, on an exceptional basis, to provide essential skills), and ensuring that these freezes apply to nonregular as well as regular employees.	During the program period	

Pakistan: Policy Matrix, 1997/98–1999/2000 (continued)

Policy Area	Objectives and Targets	Actions	Implementation	TA Requirements
	Improve the prioritization and quality of public investment.	• Identifying, in consultation with the World Bank, a core development program within the PSDP for which funding allocations would be protected against budgetary cutbacks.	Each program year	
	Strengthen medium-term perspective of public expenditure decision making.	• Preparing multi-year development plans to ensure that the consequences of new and ongoing projects for PSDP and other budgetary expenditures in subsequent years are taken into account.	During the program period	
		• Developing a medium-term expenditure framework to set strategic priorities for use in preparation of annual budgets.	During the program period	
		• As part of the PIFRA project, developing operational plans and TORs to improve the quality and timeliness of information flows relating to public expenditures.	1998/99	World Bank TA
		• Preparing operational plans for restructuring government ministries and divisions, attached departments, and autonomous bodies. Implementing operational plans in a phased manner.	June 1998 (plans); 1998/99–1999/2000 (implementation)	
		• Preparing a program of civil service reform within a medium-term time horizon as specified in para. 28 of the PFP.	December 1998 (study); June 1999 (Specification of Program)	World Bank TA
		• Implementing the initial phase of the civil service reform program.	1999/2000	

Pakistan: Policy Matrix, 1997/98–1999/2000 (continued)

Policy Area	Objectives and Targets	Actions	Implementation	TA Requirements
5. Public enterprises reform	Strengthen financial position while working on action plans for privatization.	• Developing action plans for restructuring of the seven major public enterprises. Implementing plans in a phased manner.	1997/98 (plans) 1998/99–1999/2000 (implementation)	
		• Generating internal efficiencies, containing expenditures, collecting overdue receivables, and rationalizing tariff structures.	During the program period	
		• Developing database and MIS for monitoring PEs.	During the program period	IMF/World Bank TA
6. Financial sector and capital market reforms				
a. Monetary reform	Enhancing the enabling institutional environment for market-based monetary control.	• Initiating the reform of the primary dealer system for government securities.	By July 1997	MAE TA
		• Introducing treasury bills covering a range of maturities (three months, six months, and one year).	By June 1998	
		• Eliminating the existing six-month federal bonds.	By June 1998	
b. Privatization of banking institutions	Restore good governance, enhance financial discipline, and increase efficiency in the banking institutions.	• Fully implementing actions to privatize banks and nonbank financial institutions: (a) rationalizing staffing and branches before privatization; and (b) replacing bad assets (net of capital and reserves) by government securities at the time of privatization.	During the program period	World Bank TA
		• Completing divestiture of the government's remaining ownership interests in the Muslim Commercial Bank, Allied Bank Limited, Pakistan Industrial Credit and Investment Corporation, and Bankers' Equity Limited.	By March 1998	
		• Bringing National Development Finance Corporation to the point of sale.	By June 1998	

Pakistan: Policy Matrix, 1997/98–1999/2000 (continued)

Policy Area	Objectives and Targets	Actions	Implementation	TA Requirements
		• Bringing United Bank Limited to the point of sale.	By June 1998	
		• Bringing Industrial Development Bank of Pakistan to the point of sale.	By December 1998	
		• Bringing Habib Bank Limited to the point of sale.	By June 1999	
		• National Bank of Pakistan to the point of sale.	By December 1999	
c. Regulation and supervision of financial institutions	Enhance the SBP's supervisory and regulatory capacity.	• Making all prudential regulations on capital adequacy, loan classification and provisioning, loan concentration and exposure limits, and accounting and auditing standards consistent with international norms.	By December 1997	World Bank TA
		• Enforcing compliance by banks and nonbank financial institutions with the new capital adequacy standards.	During the program period	
		• Making the early warning system and on-site examination mechanism fully operational.	By January 1998	
		• Introducing a deposit insurance scheme.	By January 1999	
d. Legal and judicial reforms	Improve the legal environment for loan recovery and facilitate the enforcement of financial contracts.	• Securing legislative approval of the following ordinances: – Banks (Nationalization—Fourth Amendment) Ordinance 1996. – Banks (Nationalization—Amendment) Ordinance 1997. – Banking Companies (Amendment) Ordinance 1997. – State Bank of Pakistan (Amendment) Ordinance 1997. – Central Depositories Ordinance 1997.	By June 1997 (completed)	
		• Adopting a new Bank Loan Recovery Law.	By June 1997 (completed)	
		• Increasing the number of banking courts and providing adequate resources for their operations.	By December 1997	
		• Establishing a centralized system for registering bank securities.	By January 1999	

Pakistan: Policy Matrix, 1997/98–1999/2000 (continued)

Policy Area	Objectives and Targets	Actions	Implementation	TA Requirements
e. Capital market reform	Augment mobilization of long-term financial resources and improve the efficiency of its allocation through a diversified and competitive capital market in order to encourage broad based participation of issuers and investors.			TA from ADB (on insurance, pension, and restructuring of public sector mutual funds)
		• Eliminating market distortions:		
		– Rationalization of tax treatment of public and private mutual funds.	By June 1997 (completed)	
		– Removal of the existing tax discrimination against private corporate debt.	By September 1997	
		– Lowering restrictions on investments by institutional investors.	By June 1999	
		• Strengthening market regulation and supervision:		
		– Improving stock exchanges' corporate governance by restructuring their Governing Board and inducting independent chief executive officer	By September 1997	
		– Restructuring the Corporate Law Authority to establish an independent Securities Exchange and Corporate Commission of Pakistan	By June 1998	
		– Strengthening self–regulation of stock exchanges	By June 1999	
		– Strengthening self–regulation of financial industries	By June 1999	
		• Modernizing and upgrading of securities market infrastructure:		
		– Integration of markets through operationalization of harmonized and automated trading, development of electronic linkages among exchanges, and development of a centralized clearing, settlement, and depository system.	By December 1999	
		• Improving investment alternatives and efficiency of market participants:		
		– Development of corporate debt market.	By June 1999	

Pakistan: Policy Matrix, 1997/98–1999/2000 (continued)

Policy Area	Objectives and Targets	Actions	Implementation	TA Requirements
		– Development of the mutual fund industry, improvements in regulatory framework, and introduction of money market and fixed-income funds.	By June 1999	
7. Exchange market and exchange system reforms	Liberalize the foreign exchange market so as to increase market determination of the exchange rate and promote the development of private forward cover.			MAE follow-up mission
		• Authorizing banks to provide forward cover for allowable capital account transactions.	By September 1997	
		• Authorizing banks to increase the term of forward cover for trade transactions to up to one year.	By December 1997	
		• Increasing the nostro account limits by at least 15 percent.	By March 1998	
		• Issuing a two-year marketable foreign currency bond, with a fixed coupon, to be available to both resident and nonresidents.	By March 1998	
		• Agreement on a timetable for phasing out the surrender requirement for export earnings by June 2000.	By March 1998	
		• Agreement on a timetable for ending the practice of fixing daily buy/sell spot market prices for banks and widening the buy/sell margin for SBP operations.	By March 1998	
		• Agreement on a timetable for increasing banks' uncovered position limits for foreign exchange.	By March 1998	
		• Adjusting the forward cover fee so as to encourage the development of forward cover in the interbank foreign exchange market, and gradually phase out the SBP's role in this activity.	During the program period	

Pakistan: Policy Matrix, 1997/98–1999/2000 (continued)

Policy Area	Objectives and Targets	Actions	Implementation	TA Requirements
8. Privatization	Raise productivity, improve governance, and increase the role of private sector in the economy to enhance efficiency and competition.	• Strengthening the regulatory bodies for core infrastructure.	During the program period.	World Bank TA
		– Strengthening the National Electric Power Regulatory Authority.	By June 1998	World Bank TA
		– Making the Pakistan Telecommunications Authority fully operational.	By June 1998	World Bank TA
		– Establishing the Gas Regulatory Authority.	By June 1998	World Bank TA
		• Bringing Sui Northern Gas Pipelines Ltd. and the Sui Southern Gas Company to the point of sale.	By June 1998	
		• Selling at least 18 industrial units.	By June 1998	
		• Selling/divesting a cummulative total of at least 46 industrial units—including fertilizer, cement, and vegetable oil facilities—and a heavy electrical complex.	By June 1999	
		• Bringing Pakistan National Shipping Corporation and National Tanker Company to the point of sale.	By June 1999	
		• Bringing Karachi Electricity Supply Corporation and Faisalabad Area Electricity Board to the point of sale.	By June 1999	
		• Bringing Pakistan Railways, Oil and Gas Development Corporation, and Pakistan Telecommunications Corporation to the point of sale.	By June 2000	
9. Social policies	Improve Pakistan's social indicators through expanded delivery and better quality of basic social services.	• Raising annual expenditures on the SAP to achieve a ratio to GDP of at least 2.4 percent, with government contribution of at least in the range of 1.8 to 1.9 percent of GDP and donors' contribution in the range of 0.5–0.6 percent of GDP.	During the program period.	

Pakistan: Policy Matrix, 1997/98–1999/2000 (continued)

Policy Area	Objectives and Targets	Actions	Implementation	TA Requirements
		• Increasing nonsalary budgetary expenditure for SAP education and health subprograms by at least 10 percent per annum in real terms.	During the program period.	
		• Protecting SAP allocations from budgetary cuts.	During the program period.	
		• Implementing satisfactorily the SAP as agreed in the operational plans of the sub-programs based on periodic reviews by the supporting donors led by the World Bank.	During the program period.	
		• Conducting annual assessments of the impact and effectiveness of SAP, based on the annual Integrated Household Survey (PIHS).	During the program period.	
	Ease adjustment burden on the poor and promote improvements in living standards of poor communities.	• Operationalizing the Pakistan Poverty Alleviation Fund to assist poor communities in developing small-scale infrastructure and income-generating activities through micro-credits and human resource development.	1997/98	
	Ensure fair treatment of those affected by public sector restructuring.	• Developing and implementing safety net programs for public sector employees affected by restructuring.	Development of programs (1997/98). Phased implementation (1998/99–1999/2000)	World Bank TA
10. Sectoral policies				
a. Agriculture	Increase productivity and income generation.	• Phasing out gradually wheat and fertilizer subsidies, and removing remaining controls on international trade in agricultural commodities as specified in paragraph 46 of the PFP.	During the program period.	
		• Decentralizing management of the irrigation and drainage system to autonomous PIDAS, and phasing out subsidies for operation and maintenance costs of the irrigation system.	During the program period.	

Pakistan: Policy Matrix, 1997/98–1999/2000 (continued)

Policy Area	Objectives and Targets	Actions	Implementation	TA Requirements
		• Improving the functioning of the agricultural credit market by gradually phasing out credit subsidies and directed credit, and promoting development of more effective, market-based credit institutions for agriculture.	During the program period.	
		• Restructuring WAPDA's water wing and reorienting its focus toward basin-wide water resource management.	By July 1999	
b. Export promotion	Improve institutional environment for sustained rapid export growth and diversification.	• Improving the duty drawback mechanism by strengthening the capacity of the existing special cell for computing duty drawback rates. Integrating the duty drawback system with the sales tax refund process by creating an exporter tax window; and streamlining procedures and enforcing standards on timing of repayments.	During the program period.	
		• Expanding and simplifying eligibility criteria for access to suspense schemes (temporary importation and bonded manufacturing); establishing a computer-based system for monitoring transactions under suspense to control potential leakages.	During the program period.	
		• Developing a plan to improve institutional support and streamline administrative processes for exporters.	By June 1998	World Bank TA on institutional support needs and options
c. Energy	To raise efficiency by rationalizing the public sector utilities and promoting a greater role for the private sector.	• Developing a program for rationalization of public sector energy utilities.	By December 1997	
		• Introducing performance improvement arrangements between the government and WAPDA.	By December 1997	
	Impart flexibility to petroleum pricing and protect budgetary revenue from petroleum taxation.	• Reinstating automatic petroleum pricing mechanism.	December 1997	
		• Implementing automatic petroleum mechanism under revised formula.	During the program period	

Pakistan: Policy Matrix, 1997/98–1999/2000 (continued)

Policy Area	Objectives and Targets	Actions	Implementation	TA Requirements
		• Separating the technical services from the exploration and production functions in OGDC.	1997/98	
		• Introducing a competitive solicitation mechanism for new private power projects and reconsidering their tax exempt status.	1997/98	
		• Corporitizing and commercializing WAPDA.	By December 1998	
		• Adjusting and rationalizing WAPDA electricity tariffs as required to achieve agreed targets with the World Bank for self-financing of WAPDA's agreed investment program and debt service to revenue ratio.	During the program period	
		• Adjusting prescribed gas tariffs as required to achieve rate of return on assets target for SNGPL as agreed with the World Bank and adjusting gas consumer prices according to the variation in the domestic price of fuel oil.	During the program period	
		• Settling cross-arrears among energy utilities and the government.	Each program year	
d. Transportation	Promote development of an efficient transport sector in support of sustained rapid economic growth.			
(i) Highways		• Adopting a Highway Private Sector Policy and institutional framework to encourage private sector investment.	By December 1997	
		• Establishing an adequate source of funding for road maintenance at the federal level by the National Hightway Authority based primarily on enhanced road user charges. Encouraging the provincial governments to do the same.	By June 1999	

Pakistan: Policy Matrix, 1997/98–1999/2000 (concluded)

Policy Area	Objectives and Targets	Actions	Implementation	TA Requirements
(ii) Railways		• Separating the Railway Board from the Ministry of Railways and reconstituting the Board to include private sector members for facilitating the privatization process.	By December 1997	
		• Establishing a Railway Restructuring Authority and a Railway Regulatory Authority.	1998	
		• Privatizing railway core activities and noncore assets.	1999/2000	
e. Environment	Improve legal framework for environmental protection and strengthen enforcement.	• Enacting the Environmental Protection Law.	By September 1997	
		• Developing an action plan for the finalization and promulgation of National Environmental Quality Standards and their implementation at the national and provincial levels.	1997/98	
		• Developing a comprehensive pollution control scheme for existing and proposed industry.	By March 1998	

Pakistan: Income and Social Indicators

	1970–75	1980–85	1990–95	Prel. 1996/97
Population				
Population (in millions) 1/	71.0	96.2	129.9	135.8
Population growth rate (in percent) 2/	3.2	3.1	2.8	2.8
Urban population (in percent of population)	26.4	29.8	34.7	...
Total fertility rate (in percent)	7.0	7.0	5.2	...
Poverty				
Rural poverty line	...	296 3/	296 3/	...
National headcount index (percent of population)	...	...	34.0	...
Urban headcount index	...	38.0	28.0	...
Rural headcount index	...	49.0	36.9	...
Income				
U.S. dollar GNP per capita	150	360	460	480
Income/consumption distribution				
Share of income or consumption (in percent)				...
Lowest quintile	8.0	...	8.4	
Highest quintile	41.8	...	39.7	...
Social indicators				
Share of public expenditure (percent of GDP)				
Health	0.3	0.5	0.8	0.9
Education	1.4	1.7	2.0	2.1
Social security and welfare	...	0.1	0.1	0.1
Net primary school enrollment rate (percent of age group) 4/				
Total			56	60
Male			67	70
Female			44	49
Access to safe water (percent of population)				
Total	25.0	44.0	60.0	...
Urban	75.0	84.0	85.0	...
Rural	5.0	28.0	47.0	55.0
Immunization rate (percent under 12 months)				
Measles	...	23	53	72
DPT	...	30	55	77
Child malnutrition rate (in percent under 5 years)	...	...	40	...
Life expectancy at birth (years)				
Total	51	56	63	...
Male	51	56	62	...
Female	51	57	64	...
Mortality				
Infant mortality rate (per 1,000 live births)	140	120	90	...
Under 5 mortality rate (per 1,000 live births)	...	...	127	...
Adult (15-59) mortality rate (per 1,000 population)				
Male (per 1,000 population)			208	...
Female (per 1,000 population)			228	...
Maternal mortality rate (per 100,000 live births)	...	600	500	...

Sources: Data provided by the authorities; World Bank, World Development Indicators, February 1997; and Fund and World Bank staff estimates and projections.

1/ Mid-year population estimates.
2/ Annual averages.
3/ Poverty line of PRs 296 per capita per month in 1991/92 rural prices.
4/ 1990–95 figures refer to 1994.