FOR AGENDA

EBS/08/127
Supplement 2

CONFIDENTIAL

November 20, 2008

To: Members of the Executive Board

From: The Secretary

Subject: **Pakistan—Assessment of the Risks to the Fund and the Fund's Liquidity Position**

The attached note, which assesses the risks to the Fund arising from the proposed Stand-By Arrangement for Pakistan and its effects on the Fund's liquidity position, is being issued as a supplement to the paper on Pakistan's request for a Stand-By Arrangement (EBS/08/127, 11/20/08), which is tentatively scheduled for discussion on **Monday, November 24, 2008**. At the time of circulation of this paper to the Board, the Secretary's Department has received a communication from the authorities of Pakistan indicating that they consent to the Fund's publication of this paper.

Questions may be referred to Ms. Bassett, FIN (ext. 34621) and Mr. McGrew, SPR (ext. 38531).

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

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Department Heads

INTERNATIONAL MONETARY FUND

Pakistan—Assessment of the Risks to the Fund and the Fund's Liquidity Position

Prepared by the Finance and Strategy, Policy, and Review Departments

In consultation with other Departments

Approved by Andrew Tweedie and Adnan Mazarei

November 20, 2008

1. **This note assesses the risks to the Fund arising from the proposed Stand-By Arrangement (SBA) for Pakistan and its effects on the Fund's liquidity, in accordance with the policy on exceptional access.**[1] The authorities are requesting a 23-month SBA with access of SDR 5.17 billion (500 percent of quota). A front-loading of SDR 2.07 billion (200 percent of quota) would be made available upon approval of the arrangement; this would be followed by two quarterly purchases of SDR 568.5 million each, and four quarterly purchases of SDR 434.2 million each. The last purchase of SDR 227.4 million is scheduled to take place in September 2010 (Table 1).

Table 1. Pakistan: Proposed SBA—Access and Phasing

		Purchases		
			Percent of quota	
Availability	Date 1/	SDR mn	Annual	Cumulative
2008	November (Approval)	2,067.400	200	200
2009	March	568.535	55	255
	June	568.535	55	310
	September	434.154	42	352
	December	434.154	42	394
2010	March	434.154	42	436
	June	434.154	42	478
	September	227.414	22	500
	Total	5,168.500	500	500

Source: Finance Department.

1/ Starting from March 2009, purchases will depend on the completion of a review.

[1] See *The Acting Chair's Summing Up of the Review of Access Policy Under the Credit Tranches and the Extended Fund Facility, and Access Policy in Capital Account Crises—Modifications to the Supplemental Reserve Facility and Follow-Up Issues Related to Exceptional Access Policy* (BUFF/03/28, 3/5/03).

I. Background

2. **Pakistan has been one of the most prolonged users of Fund resources.** [2] Until the late 1970s, Fund arrangements for Pakistan were infrequent and mostly short term in nature. However, as growth faltered in the 1980s, and persistent fiscal and external imbalances produced an unsustainable debt burden, Pakistan became more heavily dependent on Fund financial support. Total Fund credit to Pakistan reached a peak of about SDR 1.5 billion following its 1980 EFF,[3] fell to less than SDR 0.5 billion in 1988, and increased gradually thereafter as Pakistan received financial assistance under nine different arrangements from the Fund between 1988–2001 (4 SBAs, 2 EFFs, 3 ESAF/PRGFs—see Table 2). Pakistan's last Fund arrangement was a PRGF arrangement in an amount equivalent to over SDR 1 billion, which was completed in 2004. As a result, the bulk of Pakistan's current outstanding obligations to the Fund are to the PRGF Trust (Figure 1).

3. **All but the last two Fund arrangements for Pakistan were undermined by severe policy slippages**. From 1988 to 1999, Fund arrangements were either extended to accommodate delays in the completion of reviews, or cancelled and replaced by new arrangements that partially accommodated deviations from the targets set in previous programs. In contrast, both the programs supported under the 2000 SBA and the follow-up 2001 PRGF arrangement were completed successfully without requiring extensions of the arrangements. At the 2005 Board discussion of Pakistan's ex post assessment, Directors highlighted the dramatic change in ownership of economic policies in Pakistan compared to the earlier period, and emphasized that steadfast implementation of sound policies and broad-based structural reforms were mainly responsible for Pakistan's economic recovery.[4]

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[2] See *Pakistan*: *Ex Post Assessment of Longer-Term Program Engagement* (SM/05/367, 10/7/05).

[3] This amount also includes borrowing under the Oil Facility, CFF, and Trust Fund loans.

[4] See *The Acting Chair's Summing Up, Pakistan—2005 Article IV Consultation, the Ex Post Assessment of Longer-Term Program Engagement, and the Report on Noncomplying Disbursements and Recommendation for Waiver of Nonobservance of Performance Criterion* (BUFF/05/180, 11/7/05).

Table 2. Pakistan: IMF Financial Arrangements, Purchases and Repurchases, 1973–2015

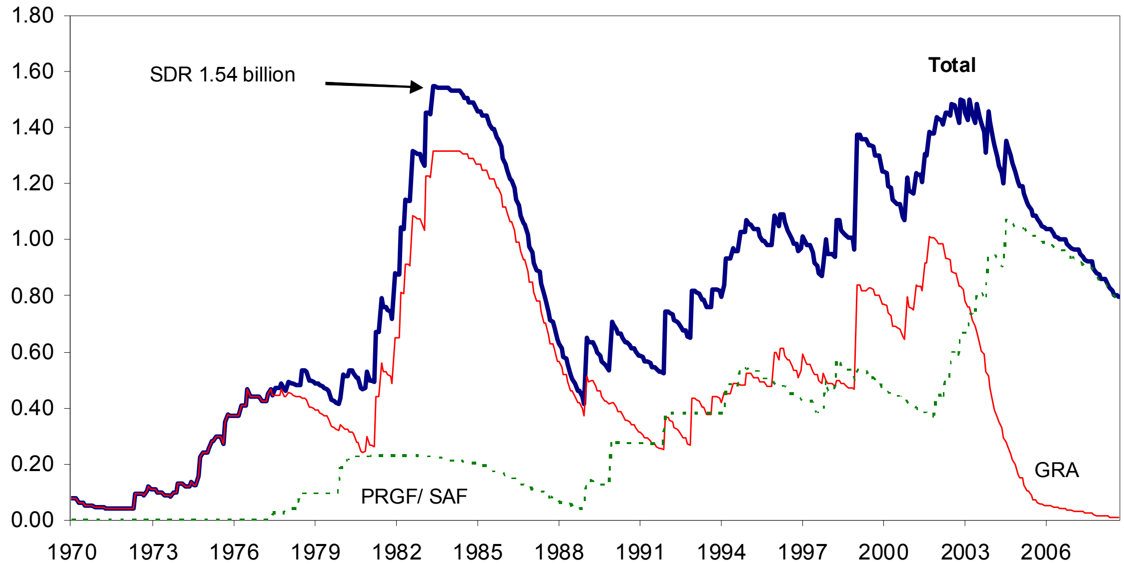
(in millions of SDRs)

Year	Type of Arrangement	Date of Arrangement	Date of Expiration or Cancellation	Amount Approved	Amount Drawn	Purchases and Disbursements 2/ 3/	Repurchases and Repayments 2/ 3/	Fund Exposure 1/ GRA 2/	Fund Exposure 1/ PRGF 3/	Fund Exposure 1/ Total 2/ 3/
1973	SBA	11-Aug-1973	10-Aug-1974	75.0	75.0	60.0	40.9	129.8	--	129.8
1974	SBA	11-Nov-1974	10-Nov-1975	75.0	75.0	129.9	20.9	238.9	--	238.9
1975						161.4	25.9	374.4	--	374.4
1976						107.2	42.0	439.6	--	439.6
1977	SBA	09-Mar-1977	08-Mar-1978	80.0	80.0	92.1	68.9	437.6	25.1	462.8
1978						112.3	84.3	395.1	97.4	492.5
1979						21.2	80.7	337.4	97.4	434.8
1980	EFF	24-Nov-1980	23-Nov-1983	1,268.0	1,079.0	236.4	107.0	299.7	228.8	528.5
1981						483.8	132.6	650.0	229.7	879.7
1982						455.2	48.7	1,056.5	229.7	1,286.2
1983						285.0	30.9	1,317.2	223.1	1,540.3
1984						–	71.1	1,265.6	203.6	1,469.2
1985						–	180.7	1,116.4	172.1	1,288.5
1986						–	315.3	846.9	126.4	973.2
1987						–	326.0	566.6	80.6	647.2
1988	SBA	28-Dec-1988	30-Nov-1990	273.2	194.5	–	235.8	370.0	41.4	411.4
	SAF	28-Dec-1988	27-Dec-1991	382.4	382.4					
1989						467.6	169.4	421.4	288.3	709.7
1990						–	122.4	313.2	274.0	587.3
1991						231.7	72.5	364.0	382.4	746.4
1992						189.6	116.1	437.5	382.4	819.9
1993	SBA	16-Sep-1993	22-Feb-1994	265.4	88.0	88.0	91.4	434.1	382.4	816.5
1994	ESAF	22-Feb-1994	13-Dec-1995	606.6	172.2	295.4	45.1	523.2	543.7	1,066.8
	EFF	22-Feb-1994	13-Dec-1995	379.1	123.2					
1995	SBA	13-Dec-1995	30-Sep-1997	562.6	294.7	134.0	115.8	595.9	489.1	1,085.0
1996						107.2	221.6	536.1	434.4	970.5
1997	PRGF	20-Oct-1997	19-Oct-2000	682.4	265.4	205.2	226.2	488.8	460.7	949.5
	EFF	20-Oct-1997	19-Oct-2000	454.9	113.7					
1998						132.7	116.2	468.0	498.0	966.0
1999						447.5	172.3	770.0	471.2	1,241.2
2000	SBA	29-Nov-2000	30-Sep-2001	465.0	465.0	150.0	217.5	758.8	414.9	1,173.7
2001	PRGF	06-Dec-2001	05-Dec-2004	1,033.7	861.4	401.2	137.1	993.0	444.7	1,437.8
2002						258.4	201.8	825.6	668.7	1,494.4
2003						344.6	420.3	473.9	944.7	1,418.6
2004						172.3	383.0	164.5	1,043.4	1,207.9
2005						–	163.9	53.7	990.3	1,044.0
2006						–	72.0	34.8	937.2	972.0
2007						–	97.9	15.8	858.3	874.1
2008 4/						–	87.2	7.9	779.1	787.0
2008 5/ 6/	*SBA*	*24-Nov-2008*		*5,168.5*		*2,067.4*	*116.2*	*2,072.1*	*753.2*	*2,825.4*
2009 6/						*2,005.4*	*146.4*	*4,072.8*	*611.6*	*4,684.4*
2010 6/						*1,095.7*	*172.3*	*5,168.5*	*439.3*	*5,607.8*
2011 6/						--	*172.3*	*5,168.5*	*267.0*	*5,435.5*
2012 6/						--	*1,589.7*	*3,725.2*	*120.6*	*3,845.8*
2013 6/						--	*2,422.3*	*1,389.0*	*34.5*	*1,423.5*
2014 6/						--	*1,175.4*	*248.1*	*0.0*	*248.1*
2015 6/						--	*248.1*	*0.0*	*0.0*	*0.0*

Source: Finance Department.

1/ As of end-December, unless otherwise indicated.
2/ Includes purchases under the Oil Facility (1974-76), CFF (1976-77, 1982, 1991, 1999), first credit tranche purchases (1981), and Emergency Assistance (1992). These purchases are not listed separately under the arrangements heading.
3/ Includes Trust Fund loans(1977-81), SAF loans(1988-91), and ESAF loans(1994). Loans under the Trust Fund were not made under a formal arrangement.
4/ As of end-October.
5/ Projected as of end-December.
6/ Figures under the proposed program in italics. Assumes repurchases on an obligations basis.

Figure 1. Pakistan: IMF Credit Outstanding, 1970–2008
(In billions of SDRs)



Source: IFS, Finance Department

4. **The large and sustained decline in the external debt-to-GDP ratio was one of Pakistan's most remarkable macroeconomic achievements of recent years.** By end-June 2008 (the end of fiscal year 2007/08), Pakistan's external debt-to-GDP ratio was 26½ percent, down from 45 percent in 2001/02 (Table 3). This level of external debt is significantly lower than those of countries that have had exceptional access arrangements from the Fund in recent years (Table 4).[5] The composition of Pakistan's external debt is also different from most recent exceptional access cases. Public and publicly guaranteed debt accounts for more than 90 percent of total external debt and over 90 percent of public external debt is owed to bilateral and multilateral creditors (Figure 2). As a result, external debt service is low and the implicit interest rate on external debt is about 2½–3 percent.

[5] The recent exceptional access cases used as comparators in this paper are those approved since this policy was put in place. The 2008 extended arrangement for Liberia also involved exceptional access. However, Liberia is excluded since this arrangement was different from other exceptional access cases in that exceptional access was granted in the context of Liberia's clearance of arrears to the Fund.

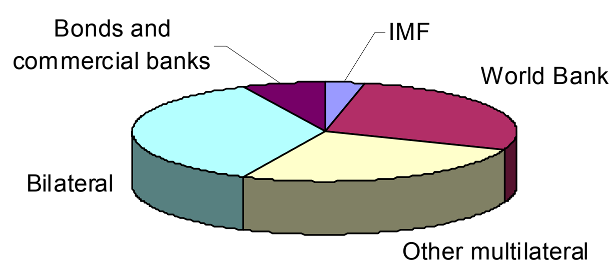
Table 3. Pakistan: Total External Debt, 2005/06–2008/09 1/

		2005/06	2006/07	2007/08	2008/09
		(In billions of U.S. dollars)			
Total External Debt		35.7	38.7	44.5	51.3
of which:	Public	34.1	36.7	41.6	48.1
	Multilateral	18.0	20.1	22.9	30.0
	IMF	1.5	1.4	1.3	5.8
	Other Multilateral 2/	16.5	18.7	21.6	24.2
	Bilateral & Commercial	16.0	16.6	18.7	18.1
	Private	1.6	2.0	2.9	3.2
		(In percent of GDP)			
Total External Debt		28.0	26.9	26.5	31.4
of which:	Public	26.7	25.5	24.8	29.5
	Multilateral	14.1	14.0	13.7	18.4
	IMF	1.2	1.0	0.8	3.5
	Other Multilateral 2/	13.0	13.0	12.9	14.8
	Bilateral & Commercial	12.6	11.5	11.1	11.1
	Private	1.2	1.4	1.7	1.9

Sources: Pakistani authorities and IMF staff estimates.

1/ Fiscal year ending June 30. Figures for 2008/09 are staff projections for end-June 2009.
2/ Includes the World Bank, the Asian Development Bank, and the Islamic Development Bank.

Figure 2. Pakistan: Total External Public Debt by Creditor, end-June 2008



Sources: Pakistani authorities and IMF staff estimates.

Table 4. Debt Ratios in Recent Exceptional Access Cases 1/
(in percent of GDP)

	Total External Debt	Public External Debt	Debt to IMF
A. Earlier arrangements, 2003-05:			
Argentina (2003)	129.0	82.5	12.2
Brazil (2003)	38.6	21.5	5.1
Turkey (2005)	35.0	17.8	3.0
Uruguay (2005)	82.0	60.8	13.8
B. Newly approved arrangements (2008):			
Georgia 2/	34.6	21.0	2.8
Hungary 3/	106.4	37.6	4.2
Iceland 4/	165.0	99.9	5.1
Ukraine 5/	54.3	10.4	2.5
Pakistan (2008/09) 6/	*31.4*	*29.5*	*3.5*

Sources: Board documents and IMF staff estimates.

1/ Ratios for the year indicated in parenthesis. Year in parenthesis corresponds to the year of approval of the last IMF arrangement with each country.
2/ Projected to end-2008, including PRGF resources.
3/ End-2008 projection, see EBS/08/119, Sup. 1 (11/04/08).
4/ End-2008 projection, see EBS/08/124, Sup. 1 (11/17/08).
5/ End-2008 projection, see EBS/08/114, Sup. 2 (11/03/08).
6/ Projection for end-June 2009, including outstanding PRGF loans.

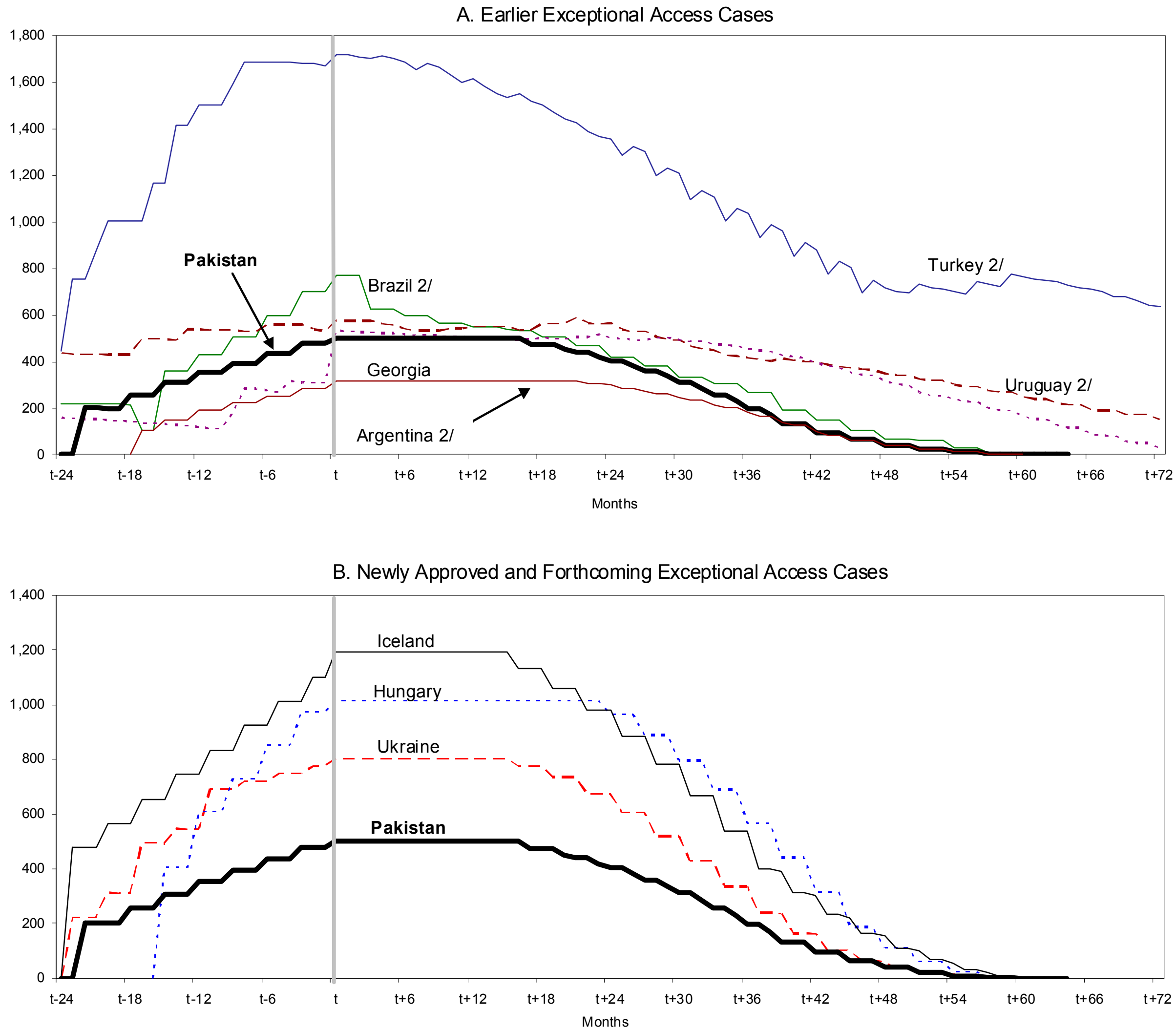
II. The New SBA—Risks and Impact on the Fund's Finances

A. Risks to the Fund

5. **Access under the proposed arrangement would far exceed that in previous arrangements for Pakistan, and would surpass both the annual and cumulative limits.** If all purchases are made as scheduled, Pakistan's total outstanding use of GRA resources would rise to slightly over 200 percent of quota with the first drawing and peak at 500 percent in September 2010, remaining at this level through January 2012. In terms of SDRs, this access would be more than 3½ times higher than Pakistan's previous peak of Fund credit outstanding. In terms of quota, this peak exposure would be comparable to that of recent exceptional access cases, but lower than the peak exposure of Hungary, Iceland and Ukraine (Figure 3).[6]

[6] Currency holdings resulting from the scheduled purchases under the proposed SBA would be subject to level-based surcharges of 100 basis points over the basic rate of charge (adjusted for burdensharing) on GRA credit outstanding exceeding 200 of quota from the time of the first purchase through July 2013 and to surcharges of 200 basis points on the credit outstanding exceeding 300 percent of quota starting in May 2009 through April 2013.

Figure 3. Fund Credit Outstanding in the GRA Around Peak Borrowing 1/
(In percent of quota)



Source: IFS, Finance Department, and IMF staff estimates.

1/ Peak borrowing is defined as the highest level of credit outstanding for a member, in percent of quota. Month t represents the month of the highest historical credit outstanding (in percent of quota). For Argentina, t is September 2001; for Brazil, September 2003; for Turkey, April 2003; and for Uruguay, August 2004. For Georgia, t would be reached in October 2010. For the countries in Panel B, t would be reached in February 2010 in the cases of Hungary, October 2010 in the cases of Iceland and Ukraine, and September 2010 in the case of Pakistan. For comparability, projected repurchases are assumed to be on an obligations basis.

2/ Projected repurchases (on an obligation basis) as of May 2005. Schedules do not show large early repurchases made by Argentina, Brazil, and Uruguay in 2005-06.

6. **If the proposed SBA is fully disbursed, GRA credit outstanding to Pakistan will exceed 4 percent of GDP by June 2010** (Table 6).[7] Upon approval of the arrangement, and drawing of the first purchase, Pakistan would become the fourth largest exposure in the GRA (Table 5).

7. **Under the proposed SBA, Pakistan's debt to the Fund as a share of its public external debt would increase significantly.** Pakistan's outstanding use of Fund GRA resources would account for about 14 percent of public external debt by 2009/10, compared to close to zero at present.[8] Pakistan's projected repayments to the Fund would rise from about 5 percent of public external debt service in 2008/09 to nearly 30 percent in 2011/12 and about 45 percent in 2012/13.[9] In terms of exports of goods and services, Pakistan's external debt service to the GRA would amount to about 3 percent in 2011/12 and nearly 8 percent in 2012/13, similar to the ratios projected for the recently approved arrangements for Iceland and Ukraine.

B. Impact on the Fund's Liquidity Position and Risk Exposure

8. **The proposed arrangement for Pakistan would reduce Fund liquidity by about 5 percent (Table 6).**[10] Commitments under the proposed arrangement would reduce the one-year forward commitment capacity (FCC) by SDR 5.2 billion—from an estimated level of SDR 104.8 billion at the time of program approval.[11]

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[7] Economic data for Pakistan is on a fiscal year basis, which runs from July 1 to June 30; references for fiscal years are for the calendar year in which they end (FY10 refers to FY 2009/10). Indicators of capacity to repay shown in Table 6 are therefore calculated on a fiscal year basis.

[8] The debt to the Fund of 1.4 percent of GDP reported in Table 3 corresponds, primarily, to debt to the PRGF Trust.

[9] The figures on debt service used in this report correspond to the schedule on an obligations basis, in line with the guidelines stipulated in *Review of Fund Facilities—Proposed Decisions and Implementation Guidelines* (EBS/00/216, 11/3/00). Under the obligations schedule, the first repurchase should take place in February 2012, 3¼ years after the first purchase under the arrangement. Under the policy on time-based repurchase expectations, there is an expectation that repurchases of holdings resulting from the purchases in the credit tranches and the EFF, including under exceptional access, will adhere to the expectations schedule, and an extension from the expectations to the obligations schedule would require a decision by the Executive Board.

[10] The FCC is the principal measure of Fund liquidity. The (one-year) FCC indicates the amount of GRA resources available for new financing over the next 12 months. See *The Fund's Liquidity Position—Review and Outlook* (EBS/02/177, 10/14/02);(BUFF/02/179, 11/4/02); and BUFF(02/68, 5/15/02). Following the creation of the Short-term Liquidity Facility (SLF), the calculation of the FCC will exclude the repurchases falling due under the SLF—See *A New Facility for Market Access Countries—The Short-Term Liquidity Facility—Proposed Decision* (SM/08/324, Supplement 1, 10/27/08).

[11] The FCC at the time of approval is assumed to be equal to its level as of November 6 minus the first purchase under the SBA for Iceland.

Table 5. Fund GRA Exposure 1/

	SDR Millions	In Percent of Quota	GDP 3/	Total GRA Credit: As of end-Oct. 2008	Total GRA Credit: After approval of arrangements in panel B 4/
A. Top five borrowers as of end-October 2008: 1/					
Turkey	5,742.5	482.0	1.2	77.9	33.4
Liberia	342.8	265.3	59.4	4.6	2.0
Dominican Republic	331.6	151.5	1.2	4.5	1.9
Sudan	220.9	130.2	0.6	3.0	1.3
Georgia	161.7	107.6	2.0	2.2	0.9
B. Proposed and newly approved exceptional access arrangements:					
Iceland 2/	560.0	476.2	5.1	…	3.3
Hungary 2/	4,215.0	405.9	4.2	…	24.5
Ukraine 2/	3,068.5	223.7	2.6	0.9	17.8
Pakistan 2/	2,075.3	200.8	2.9	0.1	12.1

Sources: Finance Department and IMF staff estimates.

1/ Fund credit outstanding as of October 31, 2008.

2/ Fund credit outstanding after the first purchases of the proposed SBA for Pakistan and the recently approved SBAs for Ukraine (EBS/08/114), Hungary (EBS/08/119), and Iceland(EBS/08/124). For Ukraine and Pakistan, it includes credit outstanding as of end-October 2008.

3/ Staff projections to end-2008 for all countries except Pakistan, where projections are for end-June 2009.

4/ Numerator is Fund credit outstanding as of end-October 2008 for countries in panel A, and Fund credit outstanding as of end-October 2008 plus the first purchases under the proposed and newly approved SBAs for countries in panel B. Denominator is the sum of total Fund GRA credit outstanding as of end-October 2008 and the first purchases of the proposed and newly approved arrangements in panel B.

9. **After the first drawing, Fund GRA credit to Pakistan as a share of total Fund credit from the GRA would be about 12 percent.** This share takes into account the initial purchase under the recently approved arrangements for Ukraine, Hungary, and Iceland. Concentration of Fund credit among the top five borrowers would decrease somewhat, but remain above 90 percent.

10. **Potential GRA exposure to Pakistan would be substantial in relation to the Fund's precautionary balances (the general and special reserves and the SCA-1).** Outstanding GRA credit to Pakistan following the first purchase would be equivalent to 30 percent of the Fund's current stock of precautionary balances.

Table 6. Pakistan—Impact on GRA Finances

(in millions of SDRs, at end of period unless otherwise noted)

	2008	2009	2010	2011	2012	2013	2014	2015
Exposure								
Fund GRA credit outstanding to Pakistan 1/	2,072.1	4,072.8	5,168.5	5,168.5	3,725.2	1,389.0	248.1	0.0
Fund GRA credit outstanding to Pakistan (percent of quota) 1/	200.5	394.0	500.0	500.0	360.4	134.4	24.0	0.0
Fund GRA credit outstanding to Pakistan (percent of total GRA credit outstanding) 2/	12.1	…	…	…	…	…	…	…
Fund GRA credit outstanding to five largest debtors (percent of total GRA credit outstanding) 2/	91.0	…	…	…	…	…	…	…
Liquidity								
One-year Forward Commitment Capacity (FCC) 3/	104,836.4	…	…	…	…	…	…	…
Pakistan's impact on FCC 4/	(5,168.5)	…	…	…	…	…	…	…
Prudential measures								
Fund GRA credit outstanding to Pakistan (percent of current precautionary balances) 5/	29.9	…	…	…	…	…	…	…
Debt and Debt Service Ratios 6/								
Pakistan's GRA credit outstanding (percent of total public external debt) 7/	0.0	9.9	13.7	13.7	11.7	6.7	1.7	0.1
Pakistan's GRA credit outstanding (percent of GDP) 7/	0.0	2.9	4.3	4.2	3.4	1.8	0.4	0.0
Pakistan's GRA credit outstanding (percent of gross international reserves) 7/	0.2	55.3	64.9	62.4	50.3	27.1	6.3	0.2
Pakistan's GRA debt service to the Fund (percent of exports of goods and services) 7/	0.1	0.3	0.6	0.9	3.2	7.7	6.8	2.1
Pakistan's GRA debt service to the Fund (percent of public external debt service) 7/	0.8	1.6	3.9	6.6	22.6	43.1	43.1	19.1
Pakistan's total debt to the Fund (percent of total public external debt) 7/ 8/	3.2	12.0	15.2	14.6	12.2	6.9	1.8	0.1
Pakistan's total debt service to the Fund (percent of total public external debt service) 7/ 8/	5.2	5.8	8.7	12.8	27.4	45.6	44.2	19.6
Memorandum items								
Fund's precautionary balances 5/	6,938.6	…	…	…	…	…	…	…
Fund's residual burden sharing capacity 9/	80.0	…	…	…	…	…	…	…
Projected payment of charges to the Fund on GRA credit outstanding	10.3	87.0	165.3	191.8	173.7	97.3	28.6	4.1
Projected debt service payments to the Fund on GRA credit outstanding	13.5	91.7	165.3	191.8	1,617.0	2,433.4	1,169.5	252.1

Sources: Pakistani authorities, Finance Department, World Economic Outlook, and IMF staff estimates.

1/ Repurchases follow the obligations schedule.

2/ Reflects Fund GRA credit outstanding as of October 31, 2008, plus first purchases by Pakistan, Iceland (EBS/08/124), Ukraine (EBS/08/114), and Hungary (EBS/08/119).

3/ As of November 6, 2008 less the total commitments under the program for Iceland. The Forward Commitment Capacity is a measure of the resources available for new financial commitments in the coming year, equal to usable resources plus repurchases one-year forward minus the prudential balance.

4/ A single country's negative impact on the FCC is defined as the country's sum of Fund credit and undrawn commitments minus repurchases one-year forward.

5/ As of end-April 2008.

6/ Staff projections for total external public debt, GDP, gross international reserves, and exports of goods and services, as used in the staff report that requests the proposed SBA.

7/ Pakistan's fiscal year ends on June 30. All ratios are expressed as shares of the end-June projection of the corresponding years.

8/ Total debt to the Fund comprises balances outstanding on GRA credit and PRGF loans.

9/ Estimated based on end-October data and taking into account the first purchase of Iceland (EBS/08/124), Ukraine (EBS/08/114), and Hungary (EBS/08/119). Burden-sharing capacity is calculated based on the floor for remuneration at 85 percent of the SDR interest rate. Residual burden-sharing capacity is equal to the total burden-sharing capacity minus the portion being utilized to offset deferred charges and takes into account the loss in capacity due to nonpayment of burden sharing adjustments by members in arrears.

11. **Were Pakistan to incur arrears on the charges accruing to its GRA obligations, the Fund's burden sharing mechanism would be put under significant strain.**[12] Charges on the new GRA obligations will be about SDR 87 million over the next year. This would exceed the Fund's estimated residual burden-sharing capacity, taking into account the newly approved arrangements (see Table 6). However, the impact on the Fund's burden sharing capacity of potential arrears from this arrangement would be expected to decline if there is a sustained pick up in lending.

III. Assessment

12. **The proposed arrangement for Pakistan entails considerable financial risks for the Fund.** The proposed level of access is large in terms of most relevant metrics, including the size of Pakistan's economy and its debt servicing capacity and is more than 3½ times higher than the previous peak Fund exposure to Pakistan.

13. **Continued portfolio outflows, insufficient financial support from donors and other creditors, and weak policy implementation are major downside risks to the program.** Pakistan's large external imbalances and weak reserves position leave little room for accommodating additional delays in adopting measures to restrain demand or for absorbing new external shocks. Moreover, a difficult security situation in the context of global financial turmoil suggests that the risks of a balance of payments crisis, despite the Fund's financial support, cannot be ruled out.

14. **The above risks may adversely affect Pakistan's capacity to repay the Fund.** The proposed access is significant in terms of both the Fund's resources and the debt service burden it generates in a very challenging economic and security environment. A sustained and forceful implementation of the program, and a prompt response to changes in underlying conditions and deviations from program assumptions are essential to mitigating these risks and safeguarding Fund resources.

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[12] Under the burden-sharing mechanism, the financial consequences for the Fund that stem from the existence of overdue financial obligations are shared between creditors and debtors through a decrease in the rate of remuneration and an increase in the rate of charge, respectively. The mechanism is used to accumulate precautionary balances in the special contingent account (SCA-1) and to compensate the Fund for a loss in income when debtors do not pay charges. The Executive Board has set a floor for remuneration at 85 percent of the SDR interest rate. No corresponding ceiling applies to the rate of charge. The adjustment for the SCA-1 was suspended, effective November 1, 2006, by the Executive Board (Decision No. 13858-(07/1), adopted January 3, 2007).