FOR AGENDA



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November 15, 1988

To: Members of the Executive Board

From: The Secretary

Subject: Pakistan - Structural Adjustment Facility - Policy Framework Paper, 1988/89-1990/91

Attached for consideration by the Executive Directors is the policy framework paper under the structural adjustment facility for Pakistan which, together with the staff report for the 1988 Article IV consultation with Pakistan and its requests for arrangements under the structural adjustment facility and for a stand-by arrangement (to be circulated later), will be brought to the agenda for discussion on a date to be announced.

Mr. Knight (ext. 7474) or Mr. Maciejewski (ext. 7112) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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Department Heads

INTERNATIONAL MONETARY FUND

PAKISTAN

# Structural Adjustment Facility - Policy Framework Paper, 1988/89-1990/91

Prepared by the Pakistan authorities

(In collaboration with the staffs of the Fund and the World Bank)

November 15, 1988

## I. Economic Background and Adjustment Issues

1. In recent years, Pakistan's economic growth has been buoyant, inflation has generally been moderate, and external debt servicing difficulties have been avoided. Wheat output and domestic crude oil production have also risen substantially. With cotton production at record high levels in 1985/86-1986/87, there were substantial increases in cotton-based exports. These impressive gains have been achieved through the continuing implementation of policies to enhance producer price incentives. In addition, since late 1985/86 the Government has taken initiatives aimed at fostering trade and price deregulation in a number of important economic sectors such as edible oils and wheat. Nevertheless, economic performance continues to be inhibited by three key structural weaknesses: vulnerability of the external current account, large fiscal imbalances, and some distortions in domestic costs and prices. The Government believes that these structural problems, if left uncorrected, would jeopardize the prospects for sustaining high growth, low inflation, and external payments viability in the future.

### Developments in recent years

2. In the three years to fiscal 1986/87 GDP growth averaged nearly 7 percent annually, reflecting generally strong performance by the agricultural sector and continued brisk expansion in manufacturing output. Pakistan also benefited from relatively low rates of inflation at home and abroad. However, the fiscal position weakened considerably and the balance of payments remained vulnerable. The overall fiscal deficit rose to about 8 percent of GDP on average in 1984/85-1986/87 (compared with 6 percent on average in the preceding three years), owing to an increasing share of government expenditures in GDP and only limited gains in the comparable budget revenue ratio. Mounting fiscal deficits have led to increased public sector domestic borrowing, as well as larger recourse to external financing. This development has entailed a rapid accumulation of domestic and external debt and rising debt service obligations. In addition, overruns in credit to the nongovernment sectors have contributed to high levels of private domestic absorption.

3. Following a substantial weakening in 1984/85, when the overall external payments deficit was financed by a 60 percent fall in gross official reserves, both the external current account and the overall balance of payments strengthened during 1985/86-1986/87. Over these two years, the country's export performance, particularly in cotton-based products, improved markedly. These receipts, along with lower world prices for petroleum and other major imported commodities, temporarily reduced the ratio of the external current account deficit to GNP to 2 percent in 1986/87, from 5 percent in 1984/85. Since 1986/87, however, it has been necessary for the Government to undertake indirect forms of official short-term external borrowing to bolster the official reserve position.

4. In 1987/88 real growth and agricultural expansion were strong, but Pakistan's fiscal position remained weak, the inflation rate rose, and the external current account deficit widened. In spite of the revenue gain from high cotton export duties, the overall fiscal deficit continued to be in the range of 8-9 percent of GDP. There were persistent structural weaknesses in the revenue system and difficulties in restraining government expenditure. As a result, it was necessary to continue the high level of public sector borrowing from external sources and domestic nonbank private savers and to continue to rely on domestic banks to cover the financing gap. In the external sector, good agricultural performance, higher cotton production and prices, and sustained growth of cotton textile sales further enhanced export receipts. However, import values rose rapidly, reflecting increases in the world prices of certain imported commodities, unfavorable fiscal trends, and generally accommodative domestic credit conditions. As a result of these developments and a continuing erosion in workers' remittance inflows, the external current account deficit rose to nearly 4 percent of GNP in 1987/88. As a result, despite a substantial increase in net capital inflows owing in part to an acceleration in aid disbursements, the overall balance of payments position recorded a small deficit in 1987/88. At end-September 1988, gross official foreign exchange reserves declined further to less than two and a half weeks' imports, a level substantially less than that of the external short-term liabilities of the banking system.

Adjustment issues

a. External current account

5. The external current account deficit averaged 3.5 percent of GNP during 1984/85-1986/87. The financing of these deficits and the need to maintain gross official reserves at adequate levels entailed recourse to external borrowing on commercial terms. As a result, there was a

significant increase in the external debt service ratio, 1/ to about 31 percent of current receipts in 1986/87. With the present low level of gross official reserves and the high debt service ratio, a continuation of current account deficits of this magnitude is not sustainable. In view of the external sector's vulnerability to exogenous shocks that could quickly lead to serious debt servicing difficulties, future recourse to substantially higher levels of external commercial bank borrowing to sustain a high current account deficit or to bolster gross official reserves would be imprudent. Given the prospective availability and terms of external financing, measures must be taken to ensure that the current account deficit is maintained at a level consistent with reducing the debt service ratio to a level that is sustainable over the longer term.

6. Owing to the protracted nature of the structural weaknesses in the balance of payments, a sustainable external position will not be easy to maintain without the early implementation of wide-ranging policy reforms. The serious weaknesses include a large trade deficit; an excessive dependence on cotton-based exports whose future expansion is vulnerable to world commodity price movements and protectionist measures in industrial countries; the failure to expand the narrow base of nontraditional exports; the trend decline in workers' remittances; and trade controls.

b. Fiscal imbalances

7. The fiscal performance in recent years has exacerbated weaknesses in the structure of the balance of payments. If large and growing overall fiscal deficits were allowed to persist, they would continue to absorb domestic and foreign savings, lead to increased domestic financial instability and possible crowding out of private sector investment, and add to potential difficulties in servicing both domestic and external debt. There is therefore an urgent need to lower the fiscal deficit. For the improvement in the fiscal position to be sustainable, however, it is crucial for major structural weaknesses in the fiscal system to be corrected; these include the narrow and inequitable tax base and the low elasticity of the tax system. It will also be essential to strengthen expenditure control measures. Such a fiscal adjustment is necessary to improve national savings performance and to permit adequate levels of investment in key sectors, so that

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1/ The definition used here includes debt service paid in foreign and domestic currency on medium- and long-term nonconcessional loans, on public and publicly guaranteed commercial loans with a maturity of more than one year, on use of Fund credit, and on deposits of foreign monetary authorities; and interest on foreign currency deposits, on foreign exchange bearer certificates, on public and publicly guaranteed commercial loans with a maturity of up to one year, and on compensatory short-term bororowing secured by cotton and rice stocks.

satisfactory growth performance can be maintained in the future. It will also help to minimize the danger of a buildup of inflationary pressures.

c. Pricing and regulatory policies

8. The measures to achieve the fiscal and external current account objectives must be reinforced by actions to reduce major distortions in the structure of costs and prices resulting from excessive regulation and trade controls. Moreover, measures will be needed to encourage private investment. The appropriate policy response will include tax and tariff reforms and trade liberalization, which will help to correct price distortions in the domestic economy, thereby enhancing productivity in a competitive environment. In order to reduce the serious existing impediments to efficient resource allocation and to foster productivity growth it will also be necessary to dismantle regulatory procedures such as investment sanctioning, and to adjust major input and output prices regularly, particularly in the agriculture, energy, and transport sectors.

## II. The Medium-Term Structural Adjustment Program: 1988/89-1990/91

### Objectives and policy priorities

9. It is the Government's intention to address the major macroeconomic imbalances and structural problems of the economy by means of a medium-term adjustment and structural reform program designed to sustain strong economic growth while ensuring domestic and external financial stability. This comprehensive package of measures is being implemented over a period of three fiscal years beginning in July 1988. The program will concentrate on several key policy areas that are critical to the achievement of the macroeconomic objectives; it will also initiate wide-ranging reforms in other sectors that will be important in improving the efficiency and growth potential of the economy in the period after 1990/91. The priority structural measures to be achieved by 1990/91 include major fiscal reforms to broaden the tax base, a comprehensive program of trade liberalization, and deregulation of important costs and prices throughout the economy. In the external sector, the program will aim at ensuring a sustainable current account deficit while substantially increasing the level of gross official reserves. It is hoped that the adjustment program outlined here will establish a macroeconomic and financial environment conducive to mobilizing increased foreign assistance for Pakistan's longer-term development efforts. This current account and the strengthening of reserves will be substantially financed without undue recourse to

borrowing on commercial terms 1/ in order to bring about a lowering in the debt service ratio. The program will require continued high levels of aid disbursements. In addition, during the program period, there will also be exceptional external financing needs, largely to meet the objective of rapidly rebuilding external reserves to a less vulnerable level. The program aims at ensuring that Pakistan will avoid recourse to exceptional financing after 1990/91, while attracting continued high levels of aid disbursements.

10. In the real sector, the Government will implement measures to expand both public and private fixed capital formation and will accelerate progress in reallocating its development outlays toward priority areas. Measures will also be implemented to augment total domestic savings, thereby limiting the rise in foreign indebtedness. The Government will renew its efforts toward reducing cost and price distortions. Such efforts--in conjunction with a flexible exchange rate policy--will provide incentives to efficient domestic producers and exporters in agriculture and industry. They will also help to reduce the need for implicit subsidies, thereby releasing resources to maintain public investment while contributing to significant reductions in the overall fiscal deficit. The Government believes that further reductions in the degree of direct and indirect regulation of prices, investment decisions, and domestic trade will yield a number of benefits and encourage private investment, particularly in the manufacturing and energy sectors. Further deregulation efforts will therefore be implemented in these areas. Combined with important initiatives in the area of trade policy reform (see below), these measures will reinforce the objective of sustaining real growth, with increased reliance on the private sector to carry the growth momentum of the economy and improved export performance. Continued efforts to enhance efficiency and profitability in the public enterprise sector will also contribute to these objectives.

11. In the area of public finance, consistent with the program's objectives, the Government will implement measures sufficient to ensure a reduction in the overall fiscal deficit to 6.5 percent of GDP in fiscal year 1988/89 (compared with an estimated average ratio of around 8.1 percent in the last two fiscal years) and further to 4.8 percent of GDP in fiscal year 1990/91, while protecting government development spending at a level of around 7 percent of GDP. To achieve these objectives, a series of major reforms will be implemented to improve revenue performance and to rationalize expenditures. Moreover, starting in 1988/89, the Government has initiated, inter alia, measures aimed at improving public debt management and reducing the servicing cost in real terms of domestic public debt (see below).

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1/ Including, inter alia, deposits from nonresident commercial banks, foreign exchange bearer certificates, and other forms of short-term borrowing.

12. On the revenue side, beginning with 1988/89 budget, the Government has begun to carry out a substantial reform of the tax system, which is designed to broaden the domestic tax base and make the tax system more equitable over the medium term, thereby increasing significantly both its yield and its elasticity, and reducing the present excessive reliance of budgetary revenues on international trade taxes. Owing to the pressing need to improve revenue performance, the budget for 1988/89 emphasizes a strengthening of revenues and includes a significant increase in the rates of tax on excisable products, the introduction of an improved mechanism for adjusting specific excise rates, the inclusion of additional domestic products in the consumption tax base, the application of the general rate of sales tax to products previously taxed at lower rates, as well as improvements in administration and changes in the structure of the income tax that enhance its vertical equity. These measures represent the first stage of a comprehensive program of reform of the tax system. In particular, the Government is committed to the implementation of a broad-based general sales tax by July 1, 1990. To this end, it has already established a timetable for the preparatory work for the implementation of this tax that will be carried out in the next 18 months. In the 1989/90 budget, the Government will take action to broaden the base of the existing sales tax on domestically produced products by greatly reducing the number of exemptions, and will also extend the present system of excises to some other services such as travel and advertising, in addition to telephone and telegraph. The base of the general sales tax will comprise these and other goods and services. The Government will also reinforce the measures taken in the 1988/89 budget to strengthen the administration of the income and profits tax and to broaden its base. The yield of nontax revenue sources will be increased gradually by raising user charges for government services. With these measures, total revenue (including the surplus of autonomous bodies) as a proportion of GDP is targeted to rise to 20 percent by 1990/91, from 17.5 percent on average over 1986/87-1987/88.

13. Since the scope of the public expenditure program is affected by resource constraints, the successful implementation of the revenue measures will influence government spending significantly. The targeted deficit for 1988/89 requires that total expenditure decline in relation to GDP in spite of the increase in total revenue that results from the revenue measures outlined in paragraph 12. In particular, the growth of current expenditure, excluding interest payments, will be constrained. The Government has recently taken measures to improve its control over both its own spending and that of the provinces, and these measures will be reinforced in the next two years. In particular, the provinces will be obliged to take the responsibility for expenditure overruns, and will be encouraged to rely more on their own revenue sources, which up until now have been of minor importance. In spite of the restraint exercised on total expenditure, the streamlining of investment projects will allow increases in development expenditure conducive to growth, especially expenditure on operations and capital maintenance in the priority and social sectors. The Government intends to assess the contribution of

development outlays to growth and to establish priorities regarding size, and inter- and intra-sectoral allocations. However, enhanced revenue performance, together with rationalization of the expenditure program, is expected to enable the Government to maintain and, in future years, gradually increase development spending over the adjustment period in line with the program's broader objectives. Total expenditure as a proportion of GDP is targeted to decline to under 25 percent in 1990/91, from 26 percent on average during 1986/87-1987/88.

14. It is recognized that if buoyant growth is to take place without increased recourse to external borrowing, policies will be needed to stimulate the level of domestic savings. The fiscal adjustments described in the preceding paragraphs will serve to increase the overall domestic savings rate. However, owing to the private sector's increased tax liability and the need to limit government current spending in the first year or two of the adjustment program, the private sector savings rate is not expected to remain at the unusually high level recorded in 1986/87-1987/88, especially in the first year of adjustment. The macroeconomic and structural measures included in this program are expected to result in somewhat higher private sector savings rates over the longer term, relative to the average rates achieved over 1980/81-1985/86. Although the need to allocate investment to replacing obsolescent infrastructure will make it difficult to achieve average annual GDP growth rates in excess of 5.5 percent during the three-year adjustment period to 1990/91, improved private savings performance will raise the potential for achieving average GDP growth rates somewhat above 5.5 percent after the program is completed.

15. The Government recognizes that cautious domestic credit policies will be needed to avoid inflationary pressures and achieve the targeted improvements in external sector performance. In view of recent price experience, the goal is to contain the inflation rate to 10 percent in 1988/89, and to gradually bring it down to about 6 percent in 1989/90-1990/91, while allowing for the effects of exchange rate developments and price deregulation. The annual credit plans will ensure that monetary expansion is kept in line with nominal GDP growth at the targeted inflation rate. The Government's net recourse to bank borrowing will be limited to levels consistent with sound demand management. Credit for commodity operations and to the public enterprises will be monitored carefully. During the program period, appropriate annual targets for the growth of credit to the nongovernment sectors will be set so that the envisioned gains in real private investment and production can be realized. Within the target, mandatory provisions for commercial bank lending to agriculture for fixed investment, to industry, to small businesses and industries, and for tobacco marketing (excluding special credit programs from foreign lending institutions) will not exceed, as a proportion of the annual target, the levels fixed in the credit budget for 1988/89. As the fiscal position improves, the Government will take steps to use market mechanisms more intensively to allocate available credit, thereby reducing reliance on credit allocation plans. In this regard, it is

expected that the present flexibility will continue to be permitted in the cost of borrowing and in rates of return on deposits under the Islamic financial system. In particular, the maximum ceiling on rates of return on non-investment financing by commercial banks will not be lowered from the present level of 20 percent. This approach will enhance the efficiency of credit allocation and will eventually contribute to the objective of increasing private savings and investment rates.

16. The Government's objectives in the external sector are to achieve a viable overall balance of payments position, defined as an external current account deficit that can be financed largely by net aid disbursements while maintaining adequate reserves, and significantly reducing restrictions on trade and payments. In addition to reducing the external current account deficit to a sustainable level of about 2.5 percent of GNP by 1990/91, from nearly 4 percent in 1987/88 and compared with an average rate of 3.5 percent of GNP over 1984/85-1986/87, the program envisages a substantial strengthening of the structure of the current account and of the debt service profile. In particular, the Government aims at diversifying the export base, thereby reducing reliance on workers' remittances and rice and cotton-based exports. Comprehensive tariff and trade policy reform and industrial deregulation (see below) will be crucial elements in achieving these improvements.

17. A continuation of the flexible exchange rate policy pursued in recent years will also be essential to achieving the Government's external sector goals. The specific objectives of exchange rate management will be to foster the international competitiveness of nontraditional exports; to help ensure a stable evolution of the current account, particularly in the context of the intended trade liberalization; and to strengthen the external reserves position. In particular, to help reduce the vulnerability of Pakistan's external reserve position, the Government aims at restoring gross official foreign exchange reserves to seven weeks of imports by the end of the program period (from less than three and a half weeks at end-June 1988), while limiting recourse to short-term commercial borrowing.

18. The Government intends to pursue a cautious external borrowing policy with the objective of ensuring that service payments on external debt decline from about 31 percent of current receipts on average over 1986/87-1987/88 to less than 25 percent by 1990/91, which will be sustainable over the longer term. Although a large portion of official external debt is on relatively concessional terms, in recent years there has been an expansion in official short-term borrowing on commercial terms. The Government will henceforth gradually reduce the stock of short-term loans on commercial terms (apart from normal import-related trade credits) to more manageable levels, either directly or via other public sector entities or the domestic banking system, and will ensure that recourse to medium-term credits on commercial terms is kept within

predetermined levels. This will limit the external sector's vulnerability to changes in market interest rates.

Public sector development program

19. Although Pakistan has been able to achieve rapid growth in recent years, the weak financial position of the Government has constrained the public investment program as well as expenditure on operations and maintenance in key sectors, particularly power, irrigation, transportation, education, and health. As a result, infrastructural and human resource development has been hampered. In response, the Government has not only increased outlays on priority sectors in the context of the Sixth Plan and the Seventh Plan, but has also attempted to improve the balance between expenditures on operations and maintenance and on capital investment. Accordingly, the Government intends to intensify its efforts in this area in the context of the Seventh Plan (1988/89-1992/93). These efforts have involved a closer examination in the context of the 1988/89 budget preparation of how the overall size and allocation procedures of the development budget contribute to growth. Over the three fiscal years 1988/89-1990/91, the Government intends to pursue policies directed at raising gross domestic investment to 19 percent of GDP by 1990/91 from 16.5 percent on average over 1986/87-1987/88, while maintaining or increasing the share of private sector in total investment from the current level of around 60 percent.

Priorities among sectoral policies

20. The Government's basic development objective is to alleviate poverty and to raise the living standard of Pakistan's population. Therefore, priority will be placed on education and health services that are the basic ingredients for equal participation in economic life and for human resource development. Priority will also be given to alleviating bottlenecks in the economic infrastructure. However, in view of the macroeconomic limits on the resources that can be allocated to the public sector over the next three years, these priority investments will need to be complemented by increased private sector investments. Moreover, to move the economy to a more efficient growth path, the Government believes that the growth pattern of both agriculture and industry will have to change. In particular, major efforts to raise productivity growth will have to be undertaken.

Human resources

21. The most important resource for the development of Pakistan is its people. Therefore, in the investment program greater priority will be given to health, education, and related sectors, consistent with the objectives of the Seventh Plan. Actions in these sectors are to provide better service to a larger share of the population, and at the same time contribute to slowing rapid population growth so that individual living standards may be raised. These actions are expected to help achieve an adequate level and quality of basic health care and a higher literacy

rate among the population, with equitable provision of education for both men and women, and in both rural and urban areas. Furthermore, recurrent expenditures would also be raised to achieve higher operational efficiency, appropriate staffing, and adequate supplies of materials. The Government intends to implement this program with appropriate balance between quantity and quality of service, while addressing the need for increased resource mobilization for the social sectors through the reform of provincial and local taxes and the introduction of user charges where appropriate.

Infrastructure

22. There has been a substantial deterioration in physical and social infrastructure in recent years, which is no longer adequate to support further strong growth and has been a constraint on productivity improvement in the economy. The Government intends to reverse this deteriorating trend through selective investments at the provincial level, including shelter-related services for meeting basic needs, accompanied by improvements in cost recovery and resource mobilization. To achieve this objective, tariffs for key urban services, particularly water and sewerage, will be adjusted to more realistic levels; programs will be initiated to improve local tax administration, and plans to raise the operational efficiency of urban and rural services, including training programs for local government staff, provincial project monitoring systems, and modern accounting systems and practices will be implemented.

23. The transportation network needs improvement. Private sector road transport has long replaced the railway as the dominant mode. However, poor road conditions due to inadequate maintenance and rehabilitation, together with the use of undersized trucks for long-distance haulage, have unnecessarily raised road transport costs. Moreover, the railway has been slow to adjust to competition, and its losses have been a growing burden on the federal budget. In the port system, mechanization is needed to handle the growth in trade and commercial traffic. To alleviate problems in road transport the Government intends to allow imports of a larger range of truck types and sizes, and has already deregulated private bus fares. Highway sector planning would be improved and modern methods of construction, maintenance, and rehabilitation introduced. The Government will also implement a restructuring program for the Pakistan Railways, to reduce losses and increase its ability to compete with road traffic. Improved cargo handling would be adopted for ports. These initiatives will be accompanied by adjustments in taxes, fees, and user charges to raise efficiency.

Energy

24. With a large untapped potential in hydropower and substantial proven reserves of oil and natural gas, Pakistan has good prospects for realizing a sustained increase in domestic energy output provided appropriate policies are followed. The development of domestic energy resources, however, has not kept up with increases in demand. To resolve this problem, a five-year investment program based on least-cost principles has been developed for the Seventh Plan. The Government will ensure that this program will be implemented fully while encouraging private sector participation. A framework for allowing private power generation and sales to the national grid is under preparation and is expected to be implemented in the first half of 1988/89. Moreover, a program to attract foreign private investment in joint ventures in oil and gas is under implementation, and a new producer price formula for gas was introduced in September 1985 to provide incentives to the private sector to undertake exploration and development of natural gas. To promote more rapid development of domestic coal resources, a program to restructure Pakistan Mineral Development Corporation will be implemented beginning in 1989/90, while a framework to encourage more private sector participation will also be adopted.

25. The energy sector development strategy aims at resource mobilization for energy investment, efficient substitution of domestic energy for imported products, and the management of energy demand through appropriate pricing policies. In this regard, the Government will pursue its efforts to rationalize energy prices, to ensure that all sources of tradable energy are priced at least at equivalent border prices plus the cost of inland handling, and that all nontradable sources are priced at least at the economic cost of supply. Regarding the petroleum subsector, the Government will intensify efforts to phase out cost-plus arrangements and to encourage refineries to produce an appropriate mix at least cost and to promote new investments in refining capacity; and both input and output prices will be linked to world prices in some appropriate manner. Given conservation and fiscal requirements, the Government intends to pass through to domestic consumers increases in the costs of domestic and imported petroleum beyond the average cost assumed for the 1988/89 budget as well as the effects of the depreciation of the rupee. If declines in world prices appear to be more than temporary in nature, the Government will review the pricing structure of petroleum products. Similarly, gas prices, which are now above the international fuel oil equivalent per BTU (compared with a target of two thirds of fuel oil parity which the Government had set for 1987/88), will be maintained at full oil parity or above. With a view to maintaining better balance between gas demand and supply, the recommendations of the recently completed study of the potential for seasonal pricing for gas will be reviewed with the World Bank.

26. To provide better incentives for private sector exploration, a new producer pricing formula for natural gas, introduced in 1985, also links the price of gas from new private concessions to two thirds of fuel oil parity less a discount to be negotiated field by field based on local conditions. The Government will continue to review producer prices for natural gas to reflect changes in world oil prices. Regarding electricity, the Government will continue to require that WAPDA tariffs, which were raised by 16 percent on average in 1988/89, be adjusted at the outset of each fiscal year to assure the self-financing of 40 percent of an agreed core investment program, a target which will lead to tariff increases substantially above the expected rate of inflation. In addition, a load research and management study, designed to provide detailed information on the pattern of energy consumption by various consumer categories, may provide a basis for considering a restructuring of tariffs on a peak and off-peak and costs-of-supply basis.

Agriculture

27. The main objective in the agricultural sector is to achieve strong growth of output by shifting the growth pattern from extensive to intensive land use and by enhancing productivity performance through adequate funding of investment and appropriate price incentives to farmers. In line with the medium-term program set out in the Seventh Plan, the Government will accord priority to ensuring that the program to develop an efficient irrigation and drainage sector is adequately funded. In addition, beginning in 1988/89 the Government will enhance its efforts to privatize tubewells in fresh groundwater areas.

28. The Government will also review procurement and support prices for key crops (wheat, rice, cotton, sugarcane, and oilseeds) to ensure that they are in line with the levels and trends in international prices and to provide appropriate incentives for farmers. Price adjustments will be made at the beginning of each crop year. In addition, because marketing costs of public sector agencies in the rice and cotton export trade strongly influence the support prices that the Government can pay farmers while keeping these agencies profitable, their costs need to be reviewed and remedies introduced where necessary. To this end, the Government will continue to promote private sector participation in rice and cotton exports. The Government has already initiated a deregulation of the edible oils subsector with a view to encouraging the production of nontraditional oilseeds; a plan of action for developing the sector will be drawn up and implemented beginning in 1988/89. With respect to input pricing, the Government has already initiated steps to remove direct price and distribution controls on nitrogenous fertilizers and to increase the prices of the major phosphatic fertilizers. The economic subsidy on all phosphatic fertilizers will be removed by October 1991 and that on potash fertilizers will be reduced each year with the objective of eliminating it by October 1995. These targets have involved substantial price adjustments in 1988/89 (15 percent for DAP, 10-20 percent for the others) and will require further price adjustments

in subsequent years. These steps will be accompanied by a program to ensure that the economic and the cash budgetary subsidies on nitrogenous fertilizers will not re-emerge. In addition, the ongoing privatization of the distribution of imported fertilizers will be accelerated, with a view to reaching the target of 80 percent set for private sector participation by 1990/91. With respect to surface irrigation and subsurface saline drainage systems, the Government is committed to full recovery of operations and maintenance costs in the Sind and Punjab provinces. In this context, the Government will review and improve methods of water charge assessment and collection on the basis of an implementation plan to be completed by July 1, 1989. Any recovery shortfalls after July 1, 1992 will be covered by adjusting water charges.

Industry, trade, and finance

29. The manufacturing sector has become more diversified in recent years, and the Government has already taken a number of steps to continue this trend. Despite the progress, a number of issues must be addressed to provide an improved framework for encouraging the growth of efficient industry, facilitating the realization of innovation and technological progress and thereby enhancing productivity and a sustained expansion of manufactured exports. To this end, the Government will continue progress in deregulation of government controls on investment and prices, divestiture of government ownership in public enterprises, greater exposure to international competition through the implementation of comprehensive trade reform measures, and financial sector reforms.

a. Industrial policy

30. In setting sectoral policies for industry, the Government has long recognized that appropriate sequencing is critical to assuring the benefits of supply response in the medium term. The Government has already embarked on the first step of that sequence in deregulating business decisions, and is committed to early completion of other regulatory reforms recommended by the Deregulation Commission. The Government will not expand the list of specified industries (those requiring sanctions regardless of project size) and will adjust annually the present investment sanctioning limit of PRs 700 million in line with the inflation rate. Industrial location policies will be re-examined, and will be replaced over the three-year period by a regime that allocates infrastructure services by prices reflecting economic costs.

31. As regards industrial policy, in line with the Disinvestment Committee's recommendations, the Government intends to divest the shares of the companies already identified for equity participation by the private sector. Under separate arrangements, companies scheduled for full divestiture will be sold to the private sector. At the same time, a corporate rationalization/restructuring program will be developed to

enhance efficiency in remaining public enterprises. Financial and management autonomy and accountability will be instituted, and corporate investment and financial planning will be improved in these enterprises.

b. Trade policy

32. The Government has undertaken a comprehensive trade policy reform. With the "New Trade Policy" of June 1987, measures for export promotion were instituted to help move exporters to free trade status in production. The trade reform, which is viewed as a primary instrument of Pakistan's structural adjustment effort, will continue to enhance the incentives framework for exports. It also involves a comprehensive import policy reform in order to reduce the level and dispersion of protection accorded to different activities. The trade reform will take place in the context of appropriate fiscal, monetary, and exchange rate policies.

33. Further liberalization of the export system is being implemented during the 1988/89-1990/91 period. In particular, on July 1, 1988, in the context of the 1988/89 Export Policy Order, the Government removed a few items from the list of essential commodities for which exports are banned, as well as the list of commodities that are presently exportable only through public sector agencies. Private sector participation in cotton and rice exports has also been liberalized further.

34. The Government is implementing a major import policy reform over the three years 1988/89-1990/91. Effective July 1, 1988, with the 1988/89 budget and Import Policy Order, a significant number of existing nontariff barriers were replaced by tariffs, the maximum tariff duty levied on imports (other than large automobiles and alcoholic beverages and items subject to specific short-term antidumping duties) was reduced from 150 percent to 125 percent and the first phase of the rationalization of the tariff structure was implemented. Specifically, 162 categories were removed from the negative list and 51 categories were dropped from the restricted list. To improve the transparency of the trade regime, the restricted lists of items importable by public enterprises, by industrial consumers, under specific conditions, and from specified sources, as well as those subject to quantitative restrictions have been merged into a single restricted list. In addition, the licensing system has been simplified and liberalized by a 20 percent increase in all value ceilings on imports of machinery and millwork against cash licenses, and by a doubling of the ceiling on imports by actual users. Subsequently, in connection with the 1989/90 and 1990/91 budgets and IPOs, 140 additional categories of the remaining items on the negative list (using the classification of the 1987/88 IPO) will be liberalized and the restricted list will be further reduced and rationalized. Moreover, the average level and dispersion of tariff rates will be reduced, with a view to achieving a tariff range of zero to 100 percent by July 1, 1990. The tariff structure will be further rationalized and lowered in future years. In addition, all tariff exemptions--except duty drawbacks for exporters, newly established

exemptions for imports of capital equipment and machinery by key industries and industries established in backward areas, and reasonable baggage allowances--will be phased out during 1989/90-1990/91. Finally, all value ceilings on imports of machinery and millwork against cash licenses and the limits on imports by actual users will be increased significantly in real terms on July 1, 1989.

c. Financial sector reform

35. With a view to reinforcing the industrial and trade policies described above, the Government will also implement major financial sector reforms. To this effect, a comprehensive program will be initiated in four areas: (i) domestic debt management; (ii) monetary and credit management; (iii) supervision and regulation of the financial institutions; and (iv) improved efficiency and profitability of the banking system. A detailed set of measures for 1988/89 and 1989/90 has been agreed in principle. The Government also intends to implement measures aimed at improving the present structure of rates of return and borrowing costs (including on public debt), strengthening the legal framework for debt recovery, establishing autonomy and accountability of government-owned financial institutions, particularly the nationalized commercial banks, improving competition by allowing the establishment of private investment banks, and strengthening and unifying banking supervision and regulation. It also plans to improve regulation and supervision affecting capital markets, promote private venture capital firms, eliminate official setting of share prices, and establish a credit information bureau within the State Bank of Pakistan.

## III. The Social Impact

36. In recognition of the fact that economic growth has not benefited all socio-economic groups equally, the Government has introduced policies designed specifically to benefit poorer sections of society. The main policy instrument is the spread of public services, particularly education and health, to all segments of society. Other measures include employment creation and safety net programs for the most vulnerable groups. Protection of these programs during the adjustment program will be ensured to the full extent possible within the limits imposed by the paramount objective of reducing the overall fiscal deficit at the outset of the program.

37. With major structural changes taking place in the economy, it is likely that some socio-economic groups will be adversely affected. With adequate care and attention, poorer socio-economic groups can be protected in the short run and, over time, their position should be improved by extended coverage of public services and better targeting of subsidies. The brunt of the adjustment effort is likely to fall on middle- and upper-income groups, but with appropriate phasing of the reforms, the severity of the impact can be contained. It is expected that increased public resource mobilization involving additional

taxation and user charges for certain public services and infrastructure should fall on groups most able to bear them. Those currently enjoying high incomes as a result of protected positions may be adversely affected by the opening up of the economy but consumers at large should benefit.

38. The outward oriented development strategy underlying the program is expected to encourage more investment in industries that can compete in world markets, to induce faster productivity growth in both rural and urban areas, and consequently to foster employment growth. As in the past, the distributional consequences of future economic growth will not necessarily benefit the poor more than other groups, but the adjustment program will establish the basis for sustained growth of investment in public services over the medium term and this should result in improved physical and economic well-being of the poorer socio-economic groups.

## IV. External Financing Requirements, 1988/89-1990/91

39. The effective implementation of Pakistan's macroeconomic and structural adjustment policies is expected to strengthen its external payments position. In particular, as a result of the correction of the structural weaknesses, the external current account deficit will be kept at levels that can be financed without compromising improvements in the external debt service profile and the gross official reserves position. As indicated in Section II, over the three-year adjustment period, the external current account deficit (excluding official grants) is targeted to decline from nearly 4 percent of GNP in percent of GNP in 1990/91, which would result in a cumulative financing requirement for current transactions of US$3.7 billion over 1988/89-1990/91. In addition, debt amortization payments, repurchases from the Fund, and the targeted improvement in reserves together are estimated to amount to US$4.4 billion.

40. Pakistan expects to continue to receive substantial amounts of foreign assistance on relatively concessional terms over the next several years from traditional multilateral and bilateral creditors, mainly in the form of project, food, and commodity aid. Disbursements of already committed official grants and project- and nonproject-related medium- and long-term loans from bilateral and multilateral creditors are projected to total about US$3.1 billion during 1988/89-1990/91 and therefore constitute the largest share of Pakistan's external financing requirements. Within this total it is estimated that World Bank disbursements, taking into account operations already approved in the form of project and program loans but excluding fast disbursing sector loans, will amount to about US$0.9 billion, including US$0.3 billion in 1988/89. A modest level of disbursements from commercial banks and other institutions on commercial terms, together with net short-term and private capital inflows, would contribute an additional US$1.3 billion. There would therefore remain additional financing requirements totaling US$2.1 billion over the period, although these are projected to

decline from about US$0.8 billion in 1988/89 to US$0.7 billion in 1989/90 and further to US$0.5 billion in 1990/91. It is our expectation that these additional financing requirements could be covered in large part by disbursements from new commitments, including World Bank and Asian Development Bank sector loans, which would be important elements of their lending programs over the three-year program period, and from Fund resources. Fund resources could contribute US$0.8 billion, while new commitments of World Bank and Asian Development Bank sectoral lending could contribute approximately US$0.5 billion and US$0.4 billion, respectively. In 1988/89 additional financial requirements of US$0.8 billion are expected to be met by use of Fund resources, including disbursements of US$143 million under the Structural Adjustment Facility, US$75 million from World Bank sector loans, US$100 million from the Asian Development Bank sector loans, and the remainder of US$200 million in the form of financial assistance from other donors. After completion of the program in 1990/91, it is expected that the external current account deficit will be kept at the sustainable level of 2.5 percent of GNP, without recourse to extensive exchange and trade restrictions. In addition, there will be no need for further substantial increases in gross official reserves, or for exceptional financing.

Table 1. Pakistan: Key Indicators, 1980/81-1990/91

(In percent, unless otherwise indicated)

| | Actuals | | | Prov. Actuals | Official Est. | Program Projections | | |
|---|---|---|---|---|---|---|---|---|
| | 1980/81 | 1984/85 | 1985/86 | 1986/87 | 1987/88 | 1988/89 | 1989/90 | 1990/91 |
| GDP growth rate (1959/60 market prices) | 7.6 | 8.2 | 7.8 | 5.4 | 5.3 | 5.2 | 5.5 | 5.5 |
| Real consumption/capita growth rate | 3.5 | 5.6 | 6.2 | 0.2 | 2.3 | 1.1 | -0.8 | 0.8 |
| Debt service (million US$) | 888 1/ | 1,273 | 1,831 | 2,137 | 2,247 | 2,276 | 2,337 | 2,253 |
| Debt service/current receipts | 14.7 1/ | 20.9 | 27.2 | 30.2 | 29.7 | 28.2 | 26.8 | 23.8 |
| Debt service/GDP | 3.1 1/ | 4.0 | 5.4 | 6.0 | 5.8 | 5.6 | 5.4 | 4.8 |
| Gross investment/GDP | 17.1 | 16.7 | 16.4 | 17.0 | 16.4 | 16.2 | 17.9 | 18.9 |
| Domestic savings/GDP | 6.3 | 4.7 | 7.0 | 10.5 | 9.2 | 10.1 | 13.0 | 14.4 |
| National savings/GDP | 13.4 | 11.4 | 12.8 | 15.0 | 12.3 | 12.8 | 15.2 | 16.4 |
| Marginal national savings rate | -- | -3.2 | 23.2 | 37.3 | -9.4 | 15.9 | 34.3 | 26.0 |
| Government investment/GDP 2/ | 10.4 | 6.5 | 6.8 | 5.8 | 7.0 | 6.4 | 7.2 | 7.4 |
| Government savings/GDP 3/ | 4.2 | -1.1 | -0.8 | -1.9 | -1.6 | -- | 1.8 | 2.7 |
| Private investment/GDP | 6.7 | 10.1 | 9.6 | 11.2 | 9.3 | 9.8 | 10.8 | 11.5 |
| Private savings/GDP | 9.7 | 12.5 | 13.6 | 16.8 | 13.9 | 12.8 | 13.2 | 13.3 |
| Ratio of government/private investment | 155.5 | 64.4 | 71.1 | 51.3 | 75.2 | 65.4 | 66.2 | 64.1 |
| Government revenues/GDP 4/ | 17.3 | 16.6 | 16.9 | 17.4 | 17.6 | 18.5 | 19.5 | 20.0 |
| Government expenditures/GDP 4/ | 22.5 | 24.2 | 24.6 | 25.2 | 26.2 | 25.0 | 25.0 | 24.8 |
| Overall fiscal deficit/GDP 4/ | -5.2 | -7.6 | -7.6 | -7.7 | -8.6 | -6.5 | -5.5 | -4.8 |
| Export f.o.b. (growth rate) | 19.5 | -7.9 | 19.7 | 18.9 | 24.1 | 13.4 | 11.7 | 12.1 |
| Exports/GDP | 9.9 | 7.8 | 8.7 | 9.9 | 11.1 | 11.4 | 12.7 | 13.2 |
| Import f.o.b. (growth rate) | 14.5 | 0.3 | -0.4 | -3.2 | 18.8 | 2.9 | 3.6 | 8.0 |
| Imports/GDP | 19.6 | 19.1 | 17.6 | 16.4 | 17.6 | 17.4 | 17.0 | 17.0 |
| Current account (million US$) | -991 | -1,680 | -1,236 | -719 | -1,594 | -1,374 | -1,195 | -1,196 |
| Current account/GDP | -3.5 | -5.2 | -3.6 | -2.0 | -4.1 | -3.4 | -2.8 | -2.6 |
| Consumer price index | 12.4 | 6.1 | 4.6 | 3.8 | 6.3 | ... | ... | ... |
| Real effective exchange rate 5/ | 4.4 | -- | -14.6 | -15.9 | -7.1 | ... | ... | ... |

Sources: Pakistan authorities; and program projections.

1/ Actual payments (scheduled debt service payments totaled US$1,041 million before rescheduling).
2/ Government investment is defined as budgetary development expenditures.
3/ Budgetary current revenues plus surplus of autonomous bodies less current expenditures.
4/ Includes autonomous bodies.
5/ A minus sign indicates a depreciation.

Table 2. Pakistan: External Financing Requirements, 1988/89-1990-91

(In millions of U.S. dollars)

| | 1988/89 | 1989/90 | 1990/91 | Total |
|---|---|---|---|---|
| Current account | 1,371 | 1,142 | 1,198 | 3,711 |
| Amortization 1/ | 1,046 | 1,032 | 931 | 3,009 |
| Change in reserves | 263 | 372 | 214 | 849 |
| IMF repurchases | 224 | 165 | 113 | 502 |
| Total financing requirements | 2,904 | 2,711 | 2,456 | 8,072 |
| Grants | 598 | 531 | 493 | 1,622 |
| Private and short-term 2/ | 434 | 439 | 429 | 1,302 |
| Disbursements: Existing commitments | 1,099 | 1,006 | 987 | 3,093 |
| Of which: | | | | |
| Bilateral creditors | (431) | (...) | (...) | (1,223) |
| World Bank | (345) | (...) | (...) | (932) |
| Asian Development Bank | (242) | (...) | (...) | (722) |
| IMF purchases | (--) | (--) | (--) | (--) |
| Disbursements: Expected new commitments | 773 | 735 | 547 | 2,055 |
| Of which: | | | | |
| Bilateral creditors | (200) | (...) | (...) | (300) |
| World Bank | (75) | (...) | (...) | (542) |
| Asian Development Bank | (100) | (...) | (...) | (400) |
| IMF purchases: SBA | (255) | (103) | (...) | (358) |
| IMF purchases: SAF | (143) | (215) | (97) | (455) |
| Identified financing | 2,904 | 2,711 | 2,456 | 8,072 |
| Financing gap | -- | -- | -- | -- |

Sources: Pakistan authorities; and program projections.

1/ Includes repayment of Trust Fund loans.
2/ Includes borrowing from commercial banks and import trade credit provided by the Islamic Development Bank.

Pakistan: Summary and Time Frame for Structural Adjustment Policies, 1988/89-1990/91

| Policy Areas | Objectives and Targets | Strategies and Measures | Timing of Measures |
|---|---|---|---|
| I. Fiscal Policy | | | |
| a. Overall Deficit | Achieve a reduction in the overall fiscal deficit/GDP ratio to 4.8 percent by the end of the program period; reduce budget's dependence on private savings and domestic bank borrowing. | Major improvements in overall revenue performance and tight control of expenditure growth. | 1988/89-1990/91 |
| b. Revenue | Foster domestic resource mobilization in order to achieve a sustainable level of development and essential current expenditures aimed at maintaining high economic growth in the context of economic and financial stability. Achieve an increase in the revenue/GDP ratio to about 20 percent by the end of the program period. | Begin to implement a tax reform directed at expanding the tax base and at increasing tax elasticity; continue the strengthening of tax administration. | By July 1, 1988 |
| | | Extension of sales tax on about 22 percent of domestic industrial production. | By July 1, 1988 |
| | | Extension of sales tax on 30 percent of domestic industrial production. | By July 1, 1989 |
| | | Increases in telephone charges. | October 1, 1988 |
| | | Extension of ad valorem excise on certain services such as travel and advertising. | By July 1, 1989 |
| | | Annual revision in those excises which are at specific rates so that there is revenue elasticity. | 1989/90-1990/91 |
| | | Initiate a program of action to prepare for the introduction of a General Sales Tax by July 1, 1990. | September 1988 |
| | | Proceed with the implementation of the program of action. | 1988/89-1989/90 |
| | | Effective implementation of the General Sales Tax. | July 1, 1990 |
| | | Guidelines issued to income tax panels to set criteria for initiating prosecution against tax evaders. | By Oct. 31, 1988 |
| | | Maintain income and profit tax exemption limits at current levels. | 1989/90-1990/91 |
| | | Review experience of self-assessment procedure for taxpayers earning less than PRs 100,000. | By July 1, 1989 |
| | | Removal of most exemptions from the standard customs duties, except for duty drawbacks for exports and incentives for industries as given in the 1988/89 budget. It is the authorities' intention that these exemptions will not be extended beyond 1990/91, except for backward areas as defined in the 1988/89 budget. | 1988/89-1990/91 |
| | | Continue implementation of tax reform. | 1989/90-1990/91 |
| c. Expenditure | Contain expenditure growth, with a view to lowering expenditure/GDP ratio to below 25 percent by the end of the program period, foster adherence to the overall fiscal deficit targets; increase effectiveness of expenditure control and monitoring. | Contain the growth rate of non-subsidy recurrent expenditures to less than nominal GDP growth rate; target development expenditures to grow slightly faster than the expansion of nominal GDP, contingent on available concessional external financing and available bank and nonbank domestic resources. | 1988/89-1990/91 |
| | | Substantially reduce cash and economic subsidies through price adjustments, rationalize government expenditures for certain major commodities; implement tightened expenditure control procedures, including a quarterly expenditure reporting and control system. | 1988/89-1990/91 |

Pakistan: Summary and Time Frame for Structural Adjustment Policies, 1988/89-1990/91 (Continued)

| Policy Areas | Objectives and Targets | Strategies and Measures | Timing of Measures |
|---|---|---|---|
| | | Tightening of control over provincial expenditures through containing federal transfers to and borrowing by provincial governments within the agreed target. | 1988/89-1990/91 |
| | | Continue to strengthen expenditure control procedures regarding spending by ministries. | 1988/89-1990/91 |
| II. Monetary Policy and Financial Reform | Contain domestic inflation to 10 percent in 1988/89 and gradually reduce it to 6 percent over 1989/90-1990/91. | Limit the rate of domestic credit expansion to significantly less than the growth of nominal GDP, at the targeted inflation rate, in 1988/89, and to growth of nominal GDP, at the targeted inflation rate, in 1989/90-1990/91. | 1988/89-1990/91 |
| | | Continue to maintain global ceilings on the annual rate of expansion of domestic credit. | 1988/89-1990/91 |
| | | Eliminate mandatory margin requirements for opening import letters of credit. | July 1, 1990 |
| | Improve domestic debt management. | Start to implement policy by rationalizing rate structure of the National Savings Schemes (NSS) and issuing auctioned debt instruments, beginning with pilot auction of treasury bills. | 1988/89-1989/90 |
| | | Establish appropriate public debt management organization in State Bank of Pakistan (SBP) and establish coordination mechanism with Ministry of Finance (MOF). | 1989/90 |
| | Monetary management to improve efficiency of credit allocation and maintain positive real rates of return on bank deposits and lending. | Maintain maximum ceiling of 20 percent on rates of return (ROR) on non-investment financing by commercial banks. | 1988/89-1990/91 |
| | | Move toward market-oriented rates of return for concessional credit schemes. | 1988/89-1990/91 |
| | Mandatory programs. | Within the credit budget, the ratio of mandatory allocations (to agriculture, fixed investment to industry, small businesses and industries, and tobacco, marketing, excluding special credit programs from foreign lending institutions) to the total allocation for private sector credit in respect of commercial banks will be limited to the level fixed in the credit budget for 1988/89 on a net basis, excluding special credit programs from foreign lending institutions. | 1989/90-1990/91 |
| | | Prepare strategy statement and program to introduce open market operations. | By November 1988 |
| | | Prepare a draft program and a timetable aimed at reducing automatic SBP refinance for special lending programs and substituting it with other resources. | By November 1988 |
| | Supervision/regulation of financial institutions. | Prepare improved prudential regulation for supervision of banks and other financial institutions, including improved procedures for accounting and auditing. | 1988/89 |
| | | Initiate legislation in order to unify supervision of financial institutions under SBP. | 1988/89 |
| | | Establish credit information bureau within the SBP. | 1989/90 |

Pakistan: Summary and Time Frame for Structural Adjustment Policies, 1988/89-1990/91 (Continued)

| Policy Areas | Objectives and Targets | Strategies and Measures | Timing of Measures |
|---|---|---|---|
| | Strengthening of the financial position of nationalized commercial banks (NCBs). | Completion of comprehensive portfolio audit. | By January 1989 |
| | | Formulation of a program for capital buildup. | June 1989 |
| | Establishment of private financial institutions. | Sanction private investment banks, which satisfies the criteria of the Government of Pakistan. | 1988/89 |
| | Enhance the autonomy and accountability of NCBs. | Initiate legal amendments and prepare implementation circulars with regard to performance evaluation and restructuring of Pakistan Banking Council and NCBs. | By January 1989 |
| | Credit policies and processes; organization. | Draft guidelines. | By January 1989 |
| | | Enforcement of guidelines. | From January 1989 |
| | Improve debt recovery. | Initiate measures, including legislation, as necessary; and establish a program to reduce arrears. | By January 1989 |
| | | Implement new legislation and program. | From January 1, 1989 |
| | Accelerate development of capital markets. | Eliminate official setting of share prices. | 1988/89 |
| | | Prepare measures to strengthen supervisory role of Corporate Law Authority (CLA) over stock exchange to increase public confidence. | 1988/89 |
| III. Exchange System | | | |
| a. Exchange Rate Policy | Improve resource allocation by complementing and reinforcing trade and industrial liberalization. Improve structure of balance of payments by stimulating exports, (especially of nontraditional exports) to offset decline in remittances; improve net foreign assets position. | Continue pursuit of a flexible policy consistent with maintaining external competitiveness and facilitating trade liberalization. Policy to be guided by quantitative assessments of specified indicators, including growth in export receipts and net international reserves. | 1988/89-1990/91 |
| | Eliminate multiple currency practice arising from foreign exchange bearer certificate scheme. | Take measures to narrow the premium between the market price of foreign exchange bearer certificates and the official exchange rate by increasing allowances for invisible transactions and unifying related procedures. | 1988/89 |
| b. Forward Cover Rates | Efficient allocation of resources; and avoidance of budgetary losses. | Continue to implement flexible market rates for forward cover, with exchange rate premiums that distinguish between different currencies; annual review to ensure flexibility is maintained. | 1988/89-1990/91 |
| c. Bilateral Payments | Promote multilateral system of payments. | Accelerate phasing out of existing agreements with Fund members in order to terminate bilateral agreements during program period. | Phasing down during 1988/89. Modify arrangements for China, Hungary, Poland and Islamic Republic of Iran by July 1990 with a view to achieving convertibility of foreign exchange balances at the end of specified period. |

Pakistan: Summary and Time Frame for Structural Adjustment Policies, 1988/89-1990/91 (Continued)

| Policy Areas | Objectives and Targets | Strategies and Measures | Timing of Measures |
|---|---|---|---|
| IV. External Debt Management | Limit the prospective debt service burden and maintain orderly relations with creditors. | Limit contracting of loans of 1-12 years' and 1-5 years' maturity. | 1988/89-1990/91 |
| | Improve the structure of debt. | Limit public and publicly guaranteed debt of 1 year or less, including debt of domestic banking system. | 1988/89-1990/91 |
| | Improve debt policy formulation and monitoring. | Computerize the collection of information on public and publicly guaranteed debt by Economic Affairs Division (Ministry of Finance and Economic Affairs) and private debt by the State Bank of Pakistan. Greater coordination between agencies collecting debt data to facilitate analysis and policy formulation. | Debt information data on computer by July 1, 1989 |
| V. Agriculture | | | |
| a. Investment | Increase agricultural productivity by a shift in the composition of public investment toward higher yielding projects and de-emphasizing public investment in areas where private sector can play a larger role. | Assure adequate funding for a three-year Core Investment Program covering high-priority projects in agriculture/irrigation. | 1988/89-1990/91 |
| | Develop an efficient irrigation/drainage sector to enhance agricultural productivity. | Complete study of water sector to refine investment priorities and improve sectoral planning capability. | September 1989 |
| | | Implementation of this program. | 1989/90-1990/91 |
| b. Agricultural Output Prices | Provide correct incentives to farmers and improve efficiency of resource allocation. | Review and adjust prices annually for key crops to keep these prices in line with trends and levels in world prices and exchange rate changes. | 1988/89-1990/91 (at beginning of each crop year) |
| | Improve the analytical basis for support price through adoption of a methodology that incorporates inter-crop substitution possibilities. | Implementation of annually agreed work program for APCOM, including training and technical assistance requirements. | 1988/89-1990/91 (by October 1 of each fiscal year) |
| | Raise efficiency of rice and cotton marketing. | Complete study of the cost structure of RECP and CECP to provide basis for recommendations for efficiency improvements. | By end-February 1989 |
| | | Complete action program on basis of study. | By April 1989 |
| | | Implement action program. | 1988/89-1990/91 |
| c. Agricultural Input Pricing | Efficient allocation of resources and elimination of subsidies for fertilizers. | Assure that the economic subsidy for nitrogenous fertilizer will not reappear. | July 1, 1988 |
| | | Implement an agreed schedule of reductions of economic subsidies, with a view to eliminating the subsidy for phosphatic fertilizers by October 1, 1991 and the subsidy for potash fertilizer by 1995. | 1988/89-1990/91 (price adjustments by July 1 or in the course of each fiscal year) |
| d. Irrigation Operations and Maintenance (O&M) and Cost Recovery | Enhance efficiency in operation of the irrigation system; improve provision of irrigation services and contain their budget costs. | Annually identify and establish a program of optimal O&M allocations for various types of irrigation facilities. | 1988/89-1990/91 (by July 1 of each fiscal year) |
| | | Improve assessment and collection of water charges, on the basis of the implementation plan. | 1988/89-1990/91 |
| | | Begin phasing out all public tubewells in fresh ground water areas, except south Rohri and Ghotki, and refrain from installing or replacing public tubewells in these areas. | 1988/89-1990/91 |

Pakistan: Summary and Time Frame for Structural Adjustment Policies, 1988/89-1990/91 (Continued)

| Policy Areas | Objectives and Targets | Strategies and Measures | Timing of Measures |
|---|---|---|---|
| VI. Industry and Trade | | | |
| a. Deregulation | Improve private and public sector productivity through increased competition and reliance on market forces. | Complete the implementation of the remaining recommendations of the Deregulation Commission. | By July 1, 1989 |
| | | Government will not expand the list of specified industries. | 1988/89-1990/91 |
| | | Annual inflation adjustments to the investment sanctioning limit of PRs 700 million as of July 1, 1988. | 1989/90-1990/91 |
| b. Public Enterprises | Improve industrial efficiency. | Divest partially or fully certain identified public enterprises. Develop corporate rationalization/restructuring program for the remaining enterprises. Meanwhile, continue application of "signaling system," institute complete autonomy and accountability, and introduce medium-term corporate planning. | 1989/90-1990/91 |
| c. Import Policy | Improve international competitiveness of industry, reduce the level and dispersion of incentives accorded to different activities, and equalize the relative incentives between producing for export and for the domestic market. | Replace nontariff barriers (except for well-specified reasons such as religion, security, and reciprocity considerations, and because of international agreements) by tariffs; and rationalize the tariff structure, with a view to reducing the average level and dispersion of the rates. | 1988/89-1990/91 |
| | | Lowering of the maximum tariff rate from 150 percent to 125 percent, and rationalization of the tariff rate structure. | July 1, 1988 |
| | | Removal of 162 categories of items (on the 1987/88 IPO basis) from the negative list, thereby reducing the number of banned items to 216, 51 categories of items (on the 1987/88 IPO basis) from the restricted lists, and elimination of the list of items importable by specific industries. | July 1, 1988 |
| | | 20 percent increase in value ceilings on imports of machinery and millwork against cash licenses, and a doubling of the ceiling on imports by actual users to PRs 10,000. | July 1, 1988 |
| | | Imposition of customs duty on items (i.e., air conditioners and refrigerators) covered under Transfer of Residence Allowances. | July 1, 1988 |
| | | Further rationalization of the tariff rate structure. | July 1, 1989 |
| | | Further removal of approximately 70 categories of items from the negative list (on the 1987/88 IPO basis) and further reduction in and rationalization of the restricted list. | July 1, 1989 |
| | | Significantly increase the real value of ceilings on imports of machinery and millwork against cash licenses and on imports by actual users. | July 1, 1989 |
| | | Further removal of approximately 70 additional items (on the 1987/88 IPO basis) from the negative list, with a view to limiting the remaining items to about 80 categories of items banned on account of religion, security, and reciprocity considerations and because of international agreements; and further reduction in and rationalization of the remaining items on the restricted list. | July 1, 1990 |

Pakistan: Summary and Time Frame for Structural Adjustment Policies, 1988/89-1990/91 (Continued)

| Policy Areas | Objectives and Targets | Strategies and Measures | Timing of Measures |
|---|---|---|---|
| | | Further reduction in the maximum tariff rate to 100 percent and rationalization of the tariff structure, with a view to rationalizing and lowering the import duty structure further in subsequent years. | July 1, 1990 |
| | | Introduction of special excise taxes on luxury consumer goods to be levied equally on imported and domestically produced goods. | July 1, 1990 |
| | | Continue to increase significantly the real value of ceiling on imports of machinery and millwork against cash licenses and on imports by actual users. | July 1, 1990 |
| VII. Energy | | | |
| a. Investment and Institutional Framework | Rationalize investments within and across various subsectors, minimize energy shortfalls, and meet demand at least cost. | In the context of the Seventh Plan, formulation and implementation of medium-term energy investment program based on least-cost principles. | July 1, 1988 |
| | | Continued reliance on core investment program and supporting financing arrangements to assure appropriate levels of investment. | 1988/89-1990/91 |
| | Facilitate growth and efficient development of energy resources through adjustments in institutional framework. | Implementation of program to separate WAPDA's distribution function from its generation and transmission functions. | 1990/91 |
| | | Agreement on a framework for allowing private generation of power and sales to the national grid. | July 1, 1988 |
| | | Implementation of this program. | 1988/89-1990/91 |
| b. Pricing, Resource Mobilization, and Demand Management | | | |
| Power Tariffs | Conserve energy and assure appropriate contribution by WAPDA toward financing of agreed investment program. | Annually adjust power tariffs as required to achieve 40 percent self-financing of agreed WAPDA investment program. Investment program for determining self-financing requirements has been changed from a retrospective to a prospective basis. | 1988/89-1990/91 (adjustment at the beginning of each fiscal year) |
| | Rationalization of structure of power tariffs to better reflect economic costs of supplying various types of consumers. | Completion of load research and management study and implementation of main recommendations of the study. | By July 1, 1989 |
| Petroleum | Creation of incentives for production of an appropriate mix of refined products at least cost. | Shift away from cost-plus formula to increase incentive for efficiency and to encourage new private sector investments in the refinery subsector. | 1988/89-1990/91 |
| | Restrain demand and generate resources for the government budget. | Pass through to consumers increases in the cost of domestic and imported petroleum above the average level assumed for the budget as well as effects of the depreciation of rupee. Review domestic product prices if international oil prices should decline. | 1988/89-1990/91 (by July 1 or in the course of each fiscal year, as required) |
| Gas Consumer Prices | Restrain demand and generate resources for government budget. | Annually adjust the prices for natural gas supplied to domestic household consumers, with a view to reaching 100 percent of the border price of fuel oil by 1992/93. | 1988/89-1989/90 (adjustment at the beginning of each fiscal year) |
| Gas Producer Prices | Provide adequate incentives to encourage foreign and private firms in exploration and development of gas resources. | Implement agreed gas producer pricing formula and adjust discount for new concessions as necessary if low world prices inhibit exploration and development. | 1988/89-1990/91 (price adjustments by July 1 or in the course of each fiscal year, as required) |

Pakistan: Summary and Time Frame for Structural Adjustment Policies, 1988/89-1990/91 (Continued)

| Policy Areas | Objectives and Targets | Strategies and Measures | Timing of Measures |
|---|---|---|---|
| c. Resource Development | Facilitate the efficient development of coal resources. | Agreement of program for restructuring public sector Pakistan Mineral Development Corporation and for encouraging greater private sector participation. | By July 1989 |
| | | Implementation of this program. | 1989/90-1990/91 |
| VIII. Public Sector Investment Program | Rationalization of public expenditure program to improve its contribution to economic growth and welfare. | Review of annual public expenditure program. | 1988/89-1989/90 (by July 1 of each fiscal year) |
| | | Implementation of annual public expenditure program, in line with available resources and with Seventh Plan objectives. | 1988/89-1989/90 (in connection with budget for each fiscal year) |
| IX. Infrastructure | | | |
| a. Urban Infrastructure | Rationalize investment planning within and across various urban services and prepare improved investment program. | Formulation and implementation of annual priority investment program to ensure appropriate levels of investment, in the context of the Seventh Plan. | 1988/89-1990/91 (by July 1 of each fiscal year) |
| | Improve cost recovery and resource mobilization through proper pricing of water and sewerage tariffs and other services' tariffs in urban areas. | Adjust water and sewerage tariffs annually. | 1988/89-1990/91 (by July 1 of each fiscal year) |
| | Improvements in local tax administration on assessment, rate determination, and collection. | Implementation of the improved system in Lahore. | 1988/89 |
| | Improve efficiency of operations of urban services. | Training of local government staff and introduction of monitoring system as well as accounting services through training of staff and provision of technical assistance to augment local administration. | 1988/89-1990/91 |
| b. Transportation | Improve transport sector's contribution to growth and welfare by rationalizing investment program to achieve better balance between sectors and between new investments; rehabilitation and maintenance. | In the context of the Seventh Plan, implementation of a public expenditure program for the transport sector. | 1988/89-1990/91 |
| | | Begin implementation of an investment program for the modernization of Karachi port and development of container facilities, with a view to improving efficiency of freight handling and movements. | 1988/89 |
| | | Continue implementation of this investment program. | 1989/90-1990/91 |
| | Rationalization of prices/charges to manage demand, allocate costs among beneficiaries, and mobilize public sector resources. | Phased adjustments in taxes, fees, user charges for roads, rail, ports and aviation. | 1988/89-1990/91 (by July 1 of each fiscal year) |
| | Improve institutional framework with a view to enhancing railway efficiency and foreign exchange earnings. | Start implementation of a program for restructuring Pakistan Railways. | 1989/90-1990/91 |
| | | Amend rules/regulations to permit resident companies to engage in international freight facilitation. | 1989/90 |
| | Improve the regulatory environment for private transport. | Deregulate bus fares; permit import of range of truck types and sizes. | 1988/89 |
| | Rationalize expenditure on highways. | Improve balance between new investment, maintenance, and rehabilitation; introduce modern planning and construction methods. | 1988/89-1990/91 |

Pakistan: Summary and Time Frame for Structural Adjustment Policies, 1988/89-1990/91 (Concluded)

| Policy Areas | Objectives and Targets | Strategies and Measures | Timing of Measures |
|---|---|---|---|
| X. Human Resources Investment Program | Raise living standards by emphasizing primary education and basic health care. | Expand primary school places for girls. | 1988/89-1990/91 |
| | | Increase basic health care facilities. | 1988/89-1990/91 |
| | Provide better services in existing public networks in education and health sectors and link expansion to improved quality of services. | Review utilization/staffing/procedures of operation and draw up plans for improvements. | 1988/89 |
| | | Phased expansion of network. | 1988/89-1990/91 |
| Institutional Changes | Improve technical and administrative efficiency of public agencies in the social sector; and promote public/private sector balance in social sector development. | Complete review of current organization and management procedures and develop strategy for private sector participation. | 1988/89 |
| | | Begin to implement recommendations. | July 1989 |
| | | Continue implementation of recommendations. | 1989/90-1990/91 |