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Pakistan has, so far, signed 5 SBA, 3 ECF and 3 EFF agreements for stabilizing its fiscal position. However, none of the loans in the past accounted for that much enormous amount as taken in 2008 and 2013 under SBA and EFF respectively.

Elevated foreign debt – A challenge for the economy

Pakistan has been facing a challenging situation at its economic front since '08 which has forced its policy makers to take ambitious decisions to achieve sustainable economic development. Although, Pakistan was relatively less affected by the world recession of '08, the steep rise in fuel prices gave a dent to the balance of payment situation in the form of increased oil import bill. The major step taken by the govt. earlier after the outbreak of the global recession was opting for IMF's SBA (Stand-By Arrangement)[1] agreement under which the IMF agreed to lend the country SDR[2] 7,235.90Mn (equivalent to ~$ 10.7Bn) back in Nov '08. But, due to the stringent requirements of the Fund and failure of meeting the IMF's targets, the govt. could only manage to secure SDR 4,396.04Mn (equivalent to ~$ 7.6Bn) out of the approved amount.

Yet again in '13, due to distressing balance of payment position, steep devaluation of the national currency and to avoid any possibility of default on payments, Pakistan's govt. inked EFF[3] credit facility with IMF to seek financing of SDR 4,393.00Mn (equivalent to ~$ 6.8Bn) which accounts for 425% of its allocated quota.

History of Lending Arrangements between IMF and Pakistan

Pakistan has a long history of borrowing from the Fund (see Exhibit-1); the country has signed 5 SBA, 3 ECF and 3 EFF agreements till date for stabilizing its fiscal position. However, none of the loans in the past accounted for that much enormous amount as taken in '08 and '13 under SBA and EFF respectively.

Exhibit-1: Historic Snapshot of IMF loan borrowed by Pakistan (till Sep 30, 2013, SDR Mn)

Facility		Date of Arrangement	Date of Expiration or Cancellation	Amount Agreed	Amount Drawn
SBA	Standby Arrangement	28-Dec-88	30-Nov-90	273.15	194.48
SA	Structural Adjustment Facility Commitment	28-Dec-88	27-Dec-91	382.41	382.41
SBA	Standby Arrangement	16-Sep-93	22-Feb-94	265.40	88.00
ECF	Extended Credit Facility	22-Feb-94	13-Dec-95	606.60	172.20
EFF	Extended Fund Facility	22-Feb-94	13-Dec-95	379.10	123.20
SBA	Standby Arrangement	13-Dec-95	30-Sep-97	562.59	294.69
ECF	Extended Credit Facility	20-Oct-97	19-Oct-00	682.38	265.37
EFF	Extended Fund Facility	20-Oct-97	19-Oct-00	454.92	113.74
SBA	Standby Arrangement	29-Nov-00	30-Sep-01	465.00	465.00
ECF	Extended Credit Facility	6-Dec-01	5-Dec-04	1,033.70	861.42
SBA	Standby Arrangement	24-Nov-08	30-Sep-11	7,235.90	4,936.04
EFF	Extended Fund Facility	4-Sep-13	3-Sep-16	4,393.00	720.00*
Total				**16,734.15**	**8,256.55**

**Note: Amount drawn as at date of 2nd tranche*

Source: KCCI Research, IMF

[1] *SBA (Stand-By Arrangement): "it is the IMF's workhorse lending instrument for emerging and advanced market countries. Rates are non-concessional, although they are almost always lower than what countries would pay to raise financing from private markets.", http://www.imf.org/external/np/exr/facts/sba.htm*

[2] *SDR (Special Drawing Rights):* The SDR is an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves. Its value is based on a basket of four key international currencies, and SDRs can be exchanged for freely usable currencies.

[3] *EFF (Extended Funding Facility): "Compared to assistance provided under the Stand-by Arrangement, assistance under an extended arrangement features longer program engagement—to help countries implement medium-term structural reforms— and a longer repayment period.", http://www.imf.org/external/np/exr/facts/eff.htm*

Under EFF, Pakistan will be receiving 13 tranches of which initial 12 tranches will be of SDR 360Mn (equivalent to ~$ 552Mn) received on quarterly basis except for the last tranche which would be of SDR 73Mn (equivalent to $ 112Mn as displayed in Exhibit-2), provided that the country meets IMF's upfront requirements. The repayment of the EFF will be starting from Mar 6, 2018 as per the given schedule[4].

What led the govt. to opt for another IMF loan?

The steep drop in foreign currency reserves has been mainly due to heavy repayments of loans taken from foreign donors with IMF loan constituting the major chunk and the payments to meet the trade deficit.

It is important to evaluate as to what were the reasons which led Pakistan to seek another IMF loan even before the completion of repayments of the SBA package taken in Nov '08.

As already mentioned, the main reasons for the requirement of additional IMF loan was the weak economic situation, particularly the minimal level of foreign exchange reserves to meet the foreign obligations and financing of the country's import bill which could have led to a possible default. There have been several other factors responsible for the fragility of the economy like heavy debt servicing, low investment inflows, weak law and order situation, poor governance and after effects of the recession of '08 which included scarce employment opportunities and demand slackness.

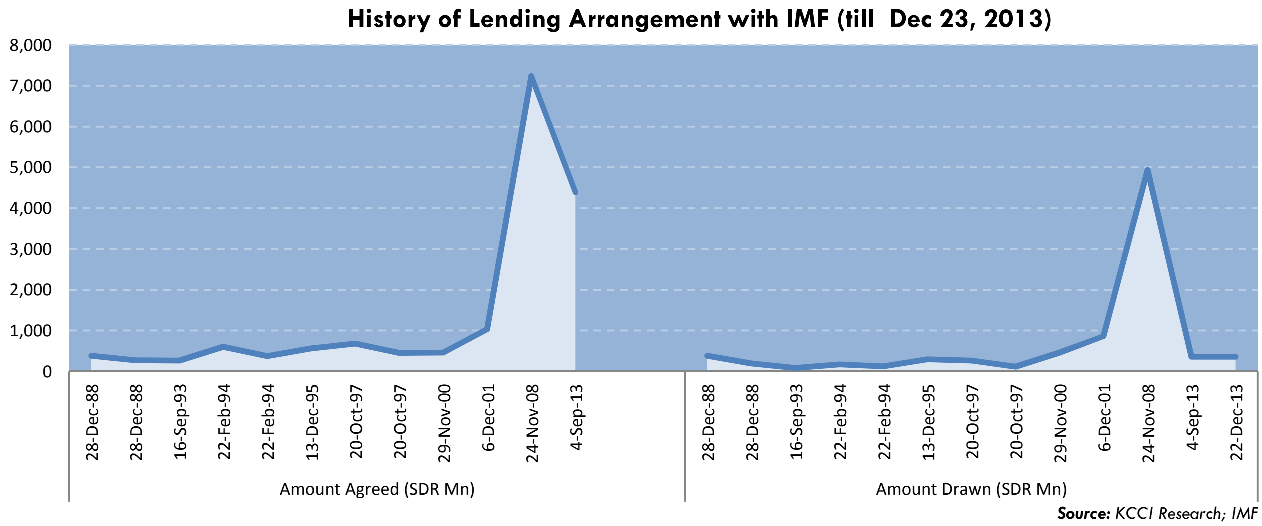
Exhibit-2: Pakistan's Schedule of Reviews and Purchases (EFF)

Date	SDR Mn	% of Quota	Conditions
September 4, 2013	360	35	Approval of arrangement
December 2, 2013	360	35	Approved by IMF
March 2, 2014	360	35	Second review*
June 2, 2014	360	35	Third review
September 2, 2014	360	35	Fourth review
December 2, 2014	360	35	Fifth review
March 2, 2015	360	35	Sixth review
June 2, 2015	360	35	Seventh review
September 2, 2015	360	35	Eighth review
December 2, 2015	360	35	Ninth review
March 2, 2016	360	35	Tenth review
June 2, 2016	360	35	Eleventh review
August 1, 2016	73	7	Twelfth review
Total	**4,393**	**425**	

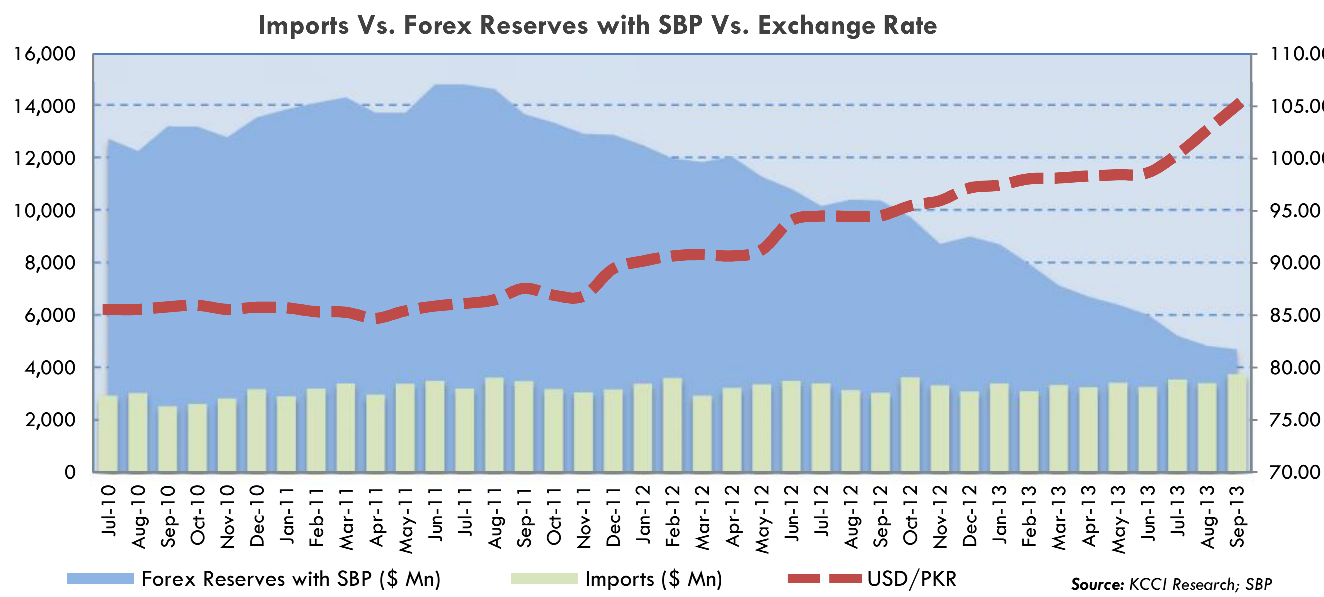
**Review represents previous quarter-end performance criteria*

Source: *KCCI Research; IMF*

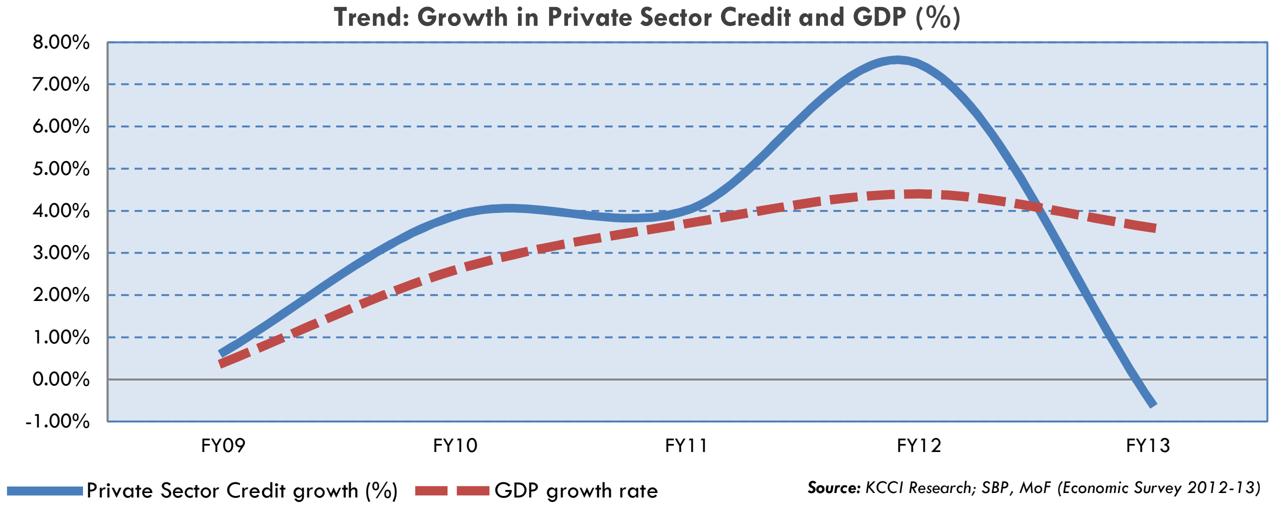
[4] *IMF webpage: http://www.imf.org/external/np/fin/tad/extforth.aspx?memberkey1=760anddate1key=2013-09-30andcategory=forthandyear=2013andtrxtype=repchgandoverforth=fandschedule=expandextend=y*



The fundamental factor of concern has been the alarming imports payment situation caused by the drop of foreign exchange reserves which were sufficient enough to cover just 4 to 5 weeks of the country's imports as of Sep-end '13. The steep drop in foreign currency reserves has been mainly due to heavy repayments of loans taken from foreign donors with IMF loan constituting the major chunk and the payments to meet the trade deficit.

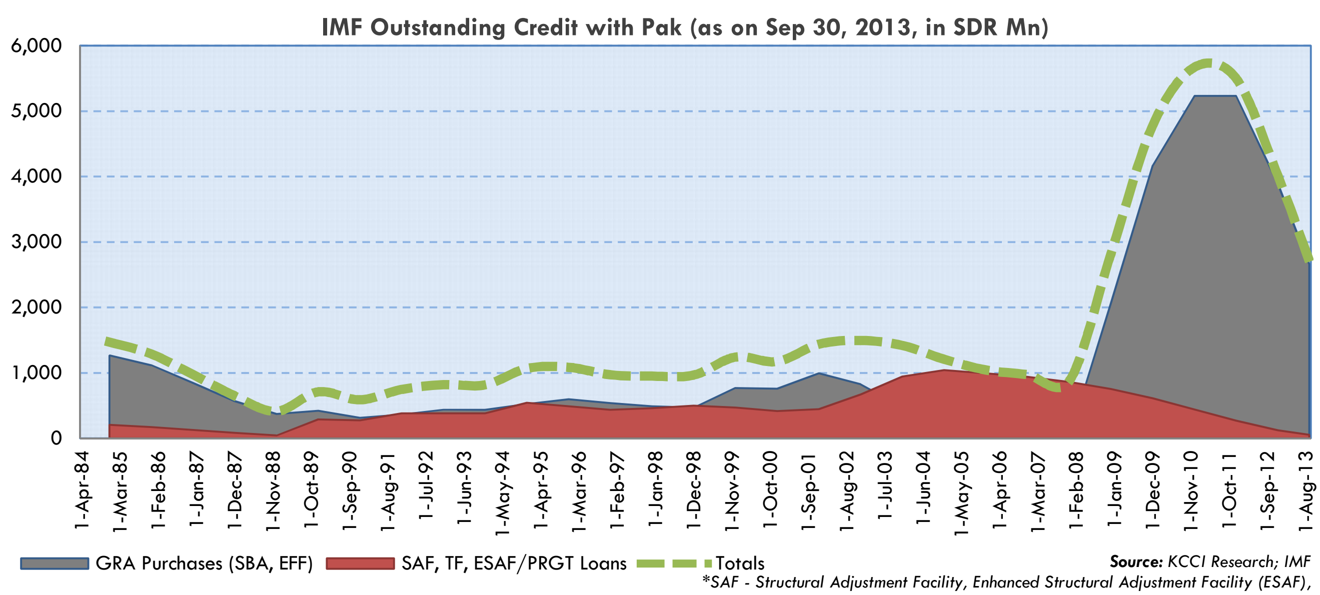


On the fiscal side, the shortfall in revenue collection, poor tax administration has resulted in massive borrowing from SBP by the govt. to finance the budget deficit. Consequently, heavy govt. borrowings have crowded out private sector's credit off-takes. The tax-to-GDP ratio of the country stood at 9.9% in FY13 against the target of 11%. All these factors have deteriorated the economic condition of the country calling for fast track corrective policy and administrative measures.



Source: *KCCI Research; SBP, MoF (Economic Survey 2012-13)*

Furthermore, weakness on both the external and internal front caused reluctance in donor agencies like World Bank, Asian Development Bank, etc. for further funding development projects, which limited the financing choices for the govt. Besides, energy crisis, poor law and order situation and governance issues contributed to low growth in the manufacturing sector and also discouraged the investors from further financing in different sectors of the country. Consequently, the govt. chose to go for IMF package along with its stiff and stringent conditions as a pragmatic option to pull the economy out of the precarious state.



Source: *KCCI Research; IMF*

**SAF - Structural Adjustment Facility, Enhanced Structural Adjustment Facility (ESAF), Poverty Reduction and Growth Trust (PGRT), Trust Fund (TF)*

Consequently, Pakistan resorted to opt for further financing from the IMF despite knowing its stringent (pre and post) conditions in order to bag successive tranches of EFF package.

What's different in the IMF package this time?

The govt. has so far managed to meet the pre-requisites set by the Fund and is confined to meet the fiscal and structural policy measures so as to comply and fetch the 3rd tranche of the EFF loan.

The demands by IMF for EFF in Sep '13 look relatively same as that of the SBA loan package of Nov '08. The govt. has been asked to take more or less the same tightening measures to comply with Fund's requirements; however, EFF has some more measures as compared to the earlier SBA (see Annexure-1 and Annexure-2).

The team of IMF gave green signal by mid-Dec '13 for 2nd tranche of SDR 360Mn (equivalent to around $ 552Mn). The govt. has so far managed to meet the pre-requisites set by the Fund and is bound to meet the fiscal and structural policy measures so as to ensure compliance for receiving the 3rd tranche of the EFF loan.

The major requirements of IMF are highlighted below:

Fiscal Adjustments:

- Fiscal adjustment measures are one of the core EFF package's requirements which include levy on natural gas, tax measures while identification of new sources, structural and administrative measures, purchase of greenback from open market and reduction of subsidies in energy sector (details available in Annexure-3).

New Gas Levy:

- By end-Dec '13, the govt. decided to implement a new gas levy which it expects to increase tax revenue by 0.4% of GDP which would be roughly ~PKR 91Bn an annualized basis. Though the levy has been proposed by the cabinet, it has been currently put on hold by Prime Minister.

Broadening the tax base:

- The Fund also proposed broadening of the tax base as one of its key demands and has asked the govt. to take stringent measures to curb tax evasions. Resultantly, the govt. issued 10,000 notices to major probable tax evaders. However, the exercise so far has not been able to achieve the desired results[5].

Structural and Administrative side policy:

- A number of structural and administrative policy measures were required by IMF which contains development and approval of Public Sector Enterprise (PSE) reform strategy for 30 firms among the 65 PSEs approved for privatization by Sep '13. The process of privatization has been initiated[6] by the govt. and is under process.

- Another demand under the structural policies was the privatization of 26% shares of PIA to strategic investors. The govt. has already initiated the process of privatization but it is still in preliminary stage[7].

- Likewise, conduct of technical and financial audit to identify the stock and flow of payables at all levels of the energy sector (including Power Sector

[5] *Dawn: Slow growth in tax base: http://dawn.com/news/1052781/slow-growth-in-tax-base*
[6] *Business Recorder: http://www.brecorder.com/business-and-economy/189:pakistan/1236871:thirty-soes-shortlisted-for-sell-off/?date=2013-10-01*
[7] *The Nation: http://www.nation.com.pk/pakistan-news-newspaper-daily-english-online/islamabad/12-Sep-2013/govt-announces-to-sell-26-shares-of-pia*

Holding Company Limited) was expected to be achieved by end-Nov '13. However, no mentionable progress has been heard so far about it from the government.

- For electricity theft, conformance with contracts and related crimes, approval of the amendments to the Pakistan Penal Code 1860 and the Code of Criminal Procedures 1898 was required to strengthen the legal framework by end-Dec '13.

Purchase of greenbacks from open market:

- It was a preliminary condition of IMF that the State Bank of Pakistan (SBP) should increase its purchase of foreign exchange to build up its reserves. As a result, SBP it collected $ 125Mn by Jul 1, '13. This caused shortfall in supply which drastically depreciated the value of rupee where it touched ~PKR 110 as on Sep 26, '13 against dollar in the open market reflecting a decline of 9.84% in Jun-Sep '13 period, which later recovered to PKR 106 by SBP through injection of ~$ 60Mn.

Tariff rate elevation – phasing out subsidies:

- Another pre-requisite for the EFF was that the govt. should develop and approve a three-year plan for phasing out Tariff Differential Subsidies (TDS) and increase the weighted average tariffs by 50% on industrial, commercial, and bulk users while, announcing a reduction of the subsidy on second group of consumers (those with consumption levels above 200kWh) through increasing the weighted average notified tariffs by 30%. This measure has been implemented by the govt. which has led to increase in cost of production and eventually in erosion of the purchasing power of the masses.

Relief measures to reduce effects of tariff hike:

- To mitigate the impact of removal of subsidy, the Benazir Income Support Program (BISP) formed by the previous govt. has been extended. So far BISP has been the largest targeted social assistance mechanism directly reaching 4.8Mn families (16% of the population).

- For FY14 budget, govt. increased its allocation to BISP to PKR 75Bn from PKR 70Bn which translates into an increase in the level of benefits from PKR 1,000 to PKR 1,200 per family per month reaching 5.7Mn families (approx. 20% of the population) and it would expand to cover 6.6Mn families (24% of the population) by FY16.

Other measures for stabilizing Economy, Businesses and Trade

Tariff simplification:

- The govt. has committed to begin its working on simplifying the tariff structure to return to the '03 framework, with 4 slabs and 0 to 25% rates.

- Design of the revised tariff system is expected to be completed by end-Dec '13, with application of the revised tariff rates and phasing out of trade SROs by June '14.

- Implementation of the new trade framework would be completed by end-June '16.

Normalizing trade relations:

- Govt. has also consented to consider eliminating the negative list on trade with India and granting most favored nation status to India, and shifting to "sensitive list" under SAFTA regime to increase regional trade.

Trade surplus through EU concessions:

- The govt. has developed a strategy to take full advantage of trade preferences available from the EU where the country has autonomous trade preferences in 75 items. Moreover, the EU has given GSP plus status to Pakistan with benefits (0% duty) from Jan 1, '14 on exports.

Other anticipated inflows to bridge the fiscal gap

- IMF projections suggest a financing gap of $ 15Bn through June '16, less than half of which would be filled by the extended arrangement under the EFF. Roughly $ 3.5Bn is expected to be met by the estimated improvement in the balance of payments.

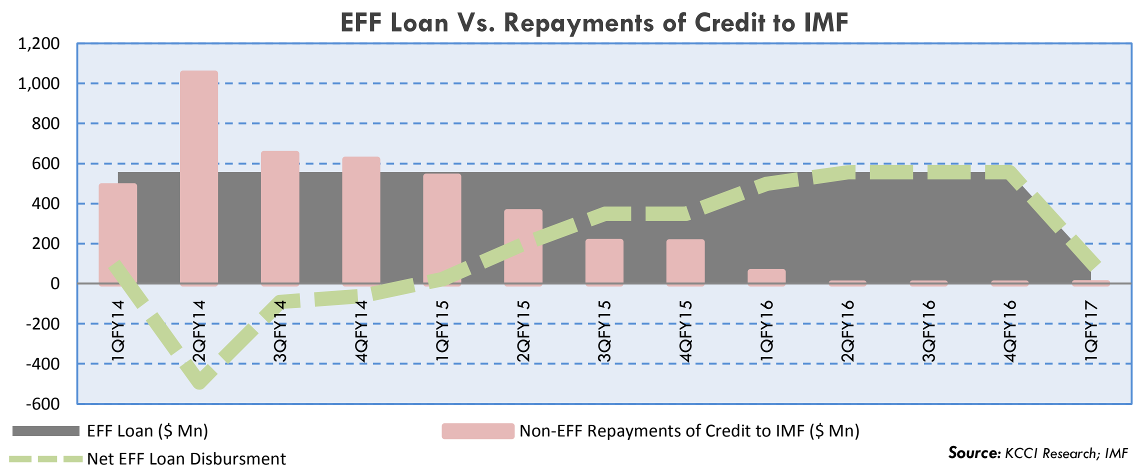
- Besides, additional external financing assurances are expected over the program period from the World Bank ($ 1.5Bn), Asian Development Bank ($ 1.6Bn), the United Kingdom ($ 0.5Bn), the United States ($ 0.4Bn), and others ($ 1.5Bn).

Post package challenges

A sustainable growth can only be achieved by creating growth-oriented investment and employment opportunities. It would mean increase in industrial production complimented by a healthy business climate.

As per IMF, economic growth would initially remain modest (about 2.5-3%) in FY14 due to the fiscal consolidation. CPI inflation would increase to 7.9% in 2013-14 and up to 9% in 2014-15. Monetary policy would likely be tightened gradually in later years to help pull back inflation to the 6-7% range.

Measures suggested by IMF may lead to deterioration in the general living conditions of the citizens. Some of the adverse effects have already become evident post implementation of measures required for EFF package. Issues like steep Rupee devaluation; rising inflation rate and unprecedented hike in power tariff[8] (up to 74%) have emerged. Moreover, the substantial heavy repayment (see Exhibit-4) to IMF for its outstanding credit has hurt the already weakened foreign currency reserves.



Source: *KCCI Research; IMF*

[8] *Dawn: http://dawn.com/news/1034421/tariff-increased-by-up-to-74pc-power-shock-for-business-and-industry*

Exhibit-4: Projected Payments to IMF

Description	Schedule Date	Total Amount Due (in SDR)	Total Amount Due (in ~US$)
Net SDR Charges	1-Nov-13	75,091	115,021
GRA Charges	1-Nov-13	7,146,098	10,946,036
GRA Repurchase (SBA)	11-Nov-13	95,837,500	146,271,984
PRGT Repayment (ECF)	12-Nov-13	17,228,000	26,251,510
GRA Repurchase (SBA)	18-Nov-13	95,837,500	146,428,200
GRA Repurchase (SBA)	26-Nov-13	258,425,000	394,842,389
GRA Repurchase (ENDA)	17-Dec-13	37,122,751	56,719,109
GRA Repurchase (SBA)	27-Dec-13	95,837,500	146,428,200
GRA Repurchase (SBA)	1-Jan-14	71,066,875	108,581,657
PRGT Repayment (ECF)	9-Jan-14	17,228,000	26,322,317
GRA Charges	1-Feb-14	5,823,284	8,897,279
Net SDR Charges	1-Feb-14	75,459	115,292
GRA Repurchase (SBA)	11-Feb-14	95,837,500	146,428,200
GRA Repurchase (SBA)	18-Feb-14	95,837,500	146,428,200
GRA Repurchase (ENDA)	17-Mar-14	37,122,751	56,719,109
GRA Repurchase (SBA)	28-Mar-14	95,837,500	146,428,200

Source: *KCCI Research; IMF*

Although, EFF loan's tranches would be received by Pakistan provided it implements the measures suggested by IMF; the important aspect is the way forward for the country in dealing with the post EFF situation. We believe that although, the narrowing of the expenditure along with administrative efforts to put the house in order may add some numbers in the revenue basket. Sustainable growth can only be achieved by creating growth-oriented investment and employment opportunities. It would mean increase in industrial production complimented by a healthy business climate.

Fortunately, Pakistan has been granted GSP plus by EU providing major tariff concessions which would be helpful in increasing exports. However, to properly reap its benefits, the country would need to improve its export capacity covering diverse range of export quality products at competitive cost. Moreover, effective utilization of the foreign inflows including that of EFF tranches and timely completion of development and power projects like Neelum Jhelum, etc. would turn out to be favorable for the country.

Annexure-1: Pre and Post Measures requirements for IMF 2013 package realization

Item	Measure	Time (by End Period)
Prior Actions (implemented before Board consideration of the program)		
1	Net purchase of $ 125Mn by the SBP in the foreign exchange spot market from July 1, 2013.	Implemented by govt.
2	Develop and approve a three-year plan by the Government for phasing out Tariff Differential Subsidies (TDS), and implement the first step by: i) the notification of new tariffs for FY2012/13; ii) increasing the weighted average tariffs by 50 % on industrial, commercial, bulk, and AJandK consumers' electricity consumption; and iii) Announcing a reduction of the subsidy on second group of consumers (as defined in the TMU) through increasing the weighted average notified tariffs by 30 % that will be in effect from October 1st, 2013.	Implemented by govt.
3	Implement a series of fiscal adjustment measures (including those in the 2013/14 budget) totaling 2% of GDP on an annualized basis.	Implemented by govt.
4	Impose a balanced budget requirement on provinces and agree with provinces to save additional revenues generated by the program.	Implemented by govt.
5	Issue 10 thousand notices based on large potential fiscal liabilities.	Implemented by govt.
Structural Benchmarks		
Fiscal sector		
1	Develop and launch initiatives to enhance revenue administration for sales tax, excises, and customs similar to that prepared for income tax.	end-December 2013
2	Announce a rationalization plan for gas prices which will involve a levy to generate 0.4 % of GDP fiscal savings by end-December 2013.	end-December 2013
Monetary sector		
3	Enact the amendments to the SBP law to give SBP autonomy in its pursuit of price stability as its primary objective, while strengthening its governance and internal control framework, in line with Fund staff advice.	end-March 2014
Financial sector		
4	Prepare detailed plans to achieve compliance of all banks that fall below minimum capital adequacy, including specific actions, end dates, and contingency arrangements. Also detail a plan for recapitalization, consolidation or liquidation of 9 banks that fall below the minimum capital requirement but not CAR.	end-December 2013
5	Enact the Deposit Protection Fund Act, in line with Fund staff advice	end-September 2014
6	Enact the Securities Bill, in line with Fund staff advice.	end-December 2014
Structural Policies		
7	Develop and approve PSE reform strategy for thirty firms among the 65 PSEs approved for privatization by the Council of Common Interest (CCI).	end-September 2013
8	Hire a professional audit firm to conduct a technical and financial audit of the system to identify the stock and flow of payables at all levels of the energy sector (including Power Sector Holding Company Limited).	end-November 2013
9	Make Central Power Purchasing Agency (CPPA) operational by separating it from the National Transmission and Despatch Company (NTDC), hire key staff, issue CPPA rules and guidelines, and initiate the payment and settlement system.	end-December 2013
10	Enact the amendments to the Pakistan Penal Code 1860 and the Code of Criminal Procedures 1898.	end-December 2013
11	Privatize 26 % of PIA's shares to strategic investors.	end-June 2014

Source: *KCCI Research; IMF*

Annexure-2: Pre and Post Measures requirements for IMF 2008 package realization

Item	Measure
Prior Actions (implemented before Board consideration of the program)	
1	The SBP's discount rate was increased by 200 basis points
2	Electricity tariffs were increased by an average 18 percent effective September 5, 2008.
3	The SBP and the government agreed on quarterly volumes of treasury bills to be issued, and published the expected volume for the remainder of the second quarter of 2008/09.
Performance Criteria	
1	Amendments to the banking legislation will be submitted to Parliament to enhance the effectiveness of SBP enforcement powers in the area of banking supervision.
2	The government will submit, draft legislative amendments to parliament to harmonize the income tax and GST laws, including for tax administration purposes, and to reduce exemptions for both taxes.
Benchmarks	
1	A contingency plan for handling problem private banks will be finalized.
2	A full description of required reforms in the area of tax administration, including an action plan for harmonizing the GST and income tax administration will be finalized
3	In close collaboration with the World Bank, the government will finalize the schedule for further electricity tariff adjustments during 2008/09, by end-December 2008, with a view to eliminating tariff differential subsidies.
4	The SBP's provision of foreign exchange for furnace oil will be eliminated.
5	In close collaboration with the World Bank, the government will develop a strategy and a time-bound action plan, for the adoption of specific measures to strengthen the social safety net and improve targeting to the poor.
6	The government will prepare a plan for eliminating the inter-corporate circular debt.
7	The transition to a single treasury account will be completed.

Source: *KCCI Research; IMF*

Annexure-3: Annualized Yield of Key Measures under the Program (% of GDP)

	2013/14	2014/15	2015/16
Total	**2.08**	**1.20**	**1.06**
Tax measures included in the budget	0.74	-	-
Tax measures to be identified	-	0.75	0.75
New levy on natural gas	0.40	0.00	0.00
Reduction of energy subsidies	0.79	0.45	0.31
Savings on current non-wage spending	0.15	0.00	0.00
Memorandum			
Increase in BISP	0.06	0.11	0.05

Source: *KCCI Research; IMF*

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