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PAKISTAN

FISCAL TRANSPARENCY

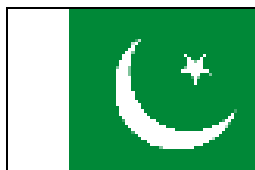
Country Report 2006

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PAKISTAN



COMPLIANCE RATINGS

<i>Fiscal transparency</i>	2006	2005	2004	2003
Clarity of roles	••	••	••	••
Availability of information	••	••	••	••
Budget preparation	•••	•••	•••	•••
Accountability	••	••	••	••
Score	2.50	2.50	2.50	2.50

OUTLOOK & COMMENTARY

Pakistan has made few significant developments towards fiscal policy transparency in 2006, a year dominated by the aftermath of the October 2005 earthquake, which required a substantial recovery and rehabilitation programme, and the approaching parliamentary elections in 2007.

Some of the targets set by the 2005 Fiscal Responsibility and Debt Limitation Ordinance have been, or are close to being, met. Public debt now stands at 56% of GDP --- below the target of 60% -- and revenue deficit is on course to being eliminated by the end of the fiscal year 2007-2008, although there are suspicions that the 2004 revision of GDP figures has ensured the meeting of these targets. The government intends to continue public debt reduction beyond its existing level. Full implementation of the Medium Term Budgeting Framework (MTBF) is progressing slowly, and the framework tends to be seen as an administrative procedure rather than a planning tool.

Pakistan is close to complying with the IMF's Special Data Dissemination Standards, and work is continuing on the remaining non-compliant data. However, reliable and timely fiscal data in general is still lacking, especially at the local level. The second stage of the World Bank-funded Project for Improvement in Financial Reporting and Auditing began this year to build capacity at the district level. This should improve data standards.

EXECUTIVE SUMMARY

2.50 Intent declared

There have been no substantial improvements to fiscal policy transparency in Pakistan in 2006, partly due to upcoming federal parliamentary elections in 2007. However, in line with the 2005 Fiscal Responsibility and Debt Limitation Law, the government has succeeded in achieving many of the targets which this law set. Public debt now stands at 56% of GDP -- below the target of 60% -- and the government plans to continue further reduction in debt by 2.5 percentage points per annum. In addition, the revenue deficit, which the law states should be fully eliminated, currently stands at only 0.4% of GDP and is expected to reach zero by the 2007-2008 fiscal year. However, expenditure estimates are also thought to be unreliable, and there are suspicions that the revision of GDP figures in 2004 has helped ensure that targets are met.

The implementation of the New Accounting Model and Chart of Accounts (NAM-CoA), introduced in 2005 for budget documents, has progressed. All federal and provincial budgets, and 110 out of 111 districts, use CoA. However, there are still some teething problems with NAM in the province of Baluchistan. Implementation of NAM-CoA is still suffering due to a lack of qualified staff and physical infrastructure; consequently, data are of poor quality.

The Project for Improvement in Financial Reporting and Auditing (PIFRA) began its second stage this year with 94 million US dollars devoted to building capacity in 132 district and sub-district sites. A further part of the project is focused on building capacity in the Offices of the Auditor General and Controller General of Accounts, and next year the project hopes to develop the number of active sites in Punjab and Sindh. Fifty-five computerised accounting sites are now online -- out of a total of 130 across the country's provinces, although Baluchistan continues to lag behind.

The full implementation of three-year rolling Medium Term Budgeting Frameworks (MTBF) is progressing slowly. Although the Ministries of Education, Women's Development, and Food and Agriculture joined the project last year, the MoF was also to be included, but backed out at the last minute. Three out of the four provinces have adopted a MTBF -- only Baluchistan remains -- but the framework appears to have become an accounting procedure rather than the strategic planning process it is designed to be. However, over the next few years, there are plans to introduce a three-year sectoral finance ceiling, and to bring the entire federal government under the system.

Reliable and timely fiscal data are still severely lacking, especially at the provincial and district level. However, Pakistan is close to complying with the IMF's Special Data Dissemination Standard and only needs to meet national accounts standards and develop quarterly wage figures. These should be ready in the next year. Information on quasi-fiscal activities remains limited; neither are there plans for an assessment of fiscal risks.

Pakistan's overall score is unchanged from last year.

1. CLARITY OF ROLES, RESPONSIBILITIES, AND OBJECTIVES



Enacted

The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.

Structure, functions, and responsibilities of government

The roles and responsibilities of the federal and provincial governments are stipulated in the 1973 Constitution of the Islamic Republic of Pakistan and the 1973 *Rules of Business*. Pakistan's constitution was temporarily suspended in October 1999, when the government of Prime Minister Nawaz Sharif was removed from power by the armed forces led by General Pervez Musharraf. A Provisional Constitution Order was then issued by the military government of President Musharraf. Since then, the constitution has been restored in phases, with full restoration taking effect in March 2003.

Under the constitution, there are three tiers of government: the federal government based in Islamabad, the municipal administrations, and the regional level. The latter is comprised of the governments of four provinces, one territory, and one capital territory. (The regions of Azad Kashmir and the Northern territories are also in practice under the government's remit, although the former is autonomous in theory.) The constitution specifies the structure and functions of government, providing for executive, legislative and judicial branches of government. The responsibilities of the federal and provincial governments are delineated in the constitution¹, as are rules governing the administrative relations between the federal government and the provinces.² Internationally accepted statistical definitions of general government activity are applied.³ The provinces enjoy legal, fiscal and financial independence.

The Musharraf government launched an ambitious devolution agenda in 2001, aimed at reconstructing the institutions of the state through the establishment of a democratically elected system of local government. However, Pakistan remains, constitutionally, a two-tier federal state. Government responsibilities are devolved in accordance with this structure. District governments have functional responsibility for delivering elementary and secondary education, primary and secondary health services, and building intra-district roads, while towns and *tehsils*⁴ have been assigned municipal service responsibilities.

Coordination and management of budgetary activities

The constitution establishes the basic framework for the management of public finance, the division of powers, and the distribution of revenues between the federation and the provinces. The competencies of government agencies are defined in the 1973 *Rules of Business*. The precise allocation of responsibilities for budget management is described in the *New System of Financial Control and Budgeting* introduced in 2000, which is further complemented by orders and instructions from the Ministry of Finance (MoF). The procedures for budget management at the provincial level replicate the central government system.⁵

Under the system established by the constitution, the proceeds of certain taxes, loans and loan repayments are paid into a consolidated fund that is then divided among the federation and the provinces to supplement the income they receive from their own revenue sources.⁶ The rules for payments from the consolidated fund are also stipulated in the constitution.⁷ Some essential expenditure, including public debt service, is automatically drawn from the

consolidated fund, while all other expenditures must be preceded by a formal 'demand for grants' and authorised by the legislature. The federal government meets any additional requirements of the provinces through various alternative mechanisms, including grants, subsidies and emergency relief.

Article 160 of the constitution also provides for the periodic establishment of a National Finance Commission (NFC), a body charged with making recommendations to the government on the operation of the consolidated fund, borrowing powers, grants-in-aid, and related issues. The NFC is also supposed to ensure that the share of tax revenue allocated to each province is commensurate to its needs, although in practice fiscal imbalances are common. The government is currently working on a new revenue-sharing arrangement between the federation and the provinces to reduce fiscal imbalances. Each province relies, in turn, on a Provincial Finance Commission (PFC) to allocate funds between provincial and district governments as stipulated by the 2001 Devolution Act. The National Reconstruction Bureau, which is accountable to the National Assembly, is responsible for advising the government on the devolution process.

While budgetary practices at the provincial level broadly replicate the federal standards, certain functions remain largely vested in the central administration. These include audit, accounting and taxation. The Auditor General is constitutionally independent from government and submits reports directly to the legislature. Provincial authorities can borrow funds only with the explicit consent of the federal government, if they have any outstanding credit obligations to the central administration.⁸

The lack of transparency in the disbursement of some funds remains a concern. While the NFC and PFC formulas for calculating allocations are publicly available,⁹ the disbursement of discretionary grants -- which can be a significant percentage of regional and local government revenues -- is more opaque. Indeed, the percentage of the Provincial Consolidated Fund that is transferred according to the established formula is less than 8% in all provinces, so that most funding for local government is, in effect, negotiated.¹⁰ Negotiated revenues provide opportunities for opaque fiscal management and for the allocation of revenues based on non-merit-related criteria. To address this issue, the Asian Development Bank has recommended that discretionary grants be replaced with mandatory revenue-sharing transfers to make transfers more transparent.¹¹

The Fiscal Responsibility and Debt Limitation Law (FRDLL) was passed by parliament in June 2005. Its main aim is to increase transparency and fiscal discipline by requiring the federal government to eliminate the revenue deficit by the end of the 2007-2008 fiscal year, to reduce public debt to no more than 60% of GDP through effective public debt management, to limit guarantees to public sector borrowings to no more than 2% of GDP, to limit poverty alleviation related spending to no more than 4.5% of GDP, and to achieve targets for revenue growth of 17.6% per annum. In addition, the law requires the federal government to provide the National Assembly with three economic policy statements in each financial year. The government is making good progress; the revenue deficit is currently at 0.4% of GDP, and revenues for the first quarter of 2006 amounted to 20% of GDP. Public debt stands at 56% of GDP, and although it is not legally obliged to go further, the government plans to continue to reduce the deficit by 2.5 percentage points each year.¹² However, commentators have mixed opinions regarding the government's efforts to meet FRDLL targets. Some have pointed out that the FRDLL does not stipulate any procedures for when targets are breached, and there are suspicions that the revision of GDP figures in 2004 has ensured that targets are met. Expenditure estimates are also thought to be unreliable.¹³

The legal independence of the provinces has created some problems for budgetary coordination. For instance, the FRDLL does not currently apply to provincial governments and will have to be replicated in local legislation to bring about nationwide compliance. The government can exert influence on the provinces by imposing conditionality on loans issued to sub-national governments.

Relations between government and public sector agencies

Even though the State Bank of Pakistan (SBP) enjoys considerable formal independence, it is required to consult with the government to ensure policy coordination. The SBP is authorised to provide advances to the federal, provincial and local governments, either through government securities or loans repayable within a three-month period.¹⁴ However, the actual interest rates, conditions, and maturities of advances by the SBP to federal, provincial and local governments are not available to the public.¹⁵ Aggregate figures on SBP lending to the federal and provincial governments are available on the SBP website.¹⁶

The SBP uses special funds to provide credit through commercial and development banks to a variety of entities. Such loans are primarily channelled to agriculture, industry, exports and loan guarantees. The credit funds derive their initial financing from SBP profits in accordance with a joint decision by the SBP and the government. All loans, with the exception of export credit, are issued at commercial rates. The activities of the funds are reported in the SBP Annual Report.

State-owned enterprises (SOEs) play a central role in the Pakistani economy and include the water and electricity utilities, gas distribution companies, refineries, railways and an airline. The government also holds a major stake in the fertilizer industry. Many publicly owned companies are subject to administrative direction and regulation. Pakistan Railways (PR) and the Post Office function as government departments, and PR receives regular subsidies.

Since the early 1990s, Pakistan has been pursuing a strategy of restructuring its public sector entities through deregulation, privatisation and transformation. SOEs are now increasingly run by managers pursuing commercial objectives.¹⁷ However, although the federal government has privatised the Karachi Electric Supply Corporation (KESC), it still subsidises the Pakistan Water and Power Development Authority (WAPDA): both have been a large drain on the budget in terms of implicit contingent liabilities. Limited financial information is available on the MoF website for major SOEs -- including PR, WAPDA and Pakistan International Airlines.¹⁸ WAPDA's balance sheet, available up until the fiscal year 2003-04, but no later, is also posted on its website.¹⁹

Government involvement in the private sector

As observed above, the division between the public and the private sector in Pakistan has been blurred. However, the government is committed to increasing the private sector's role in the provision of goods and services. A programme of restructuring and privatising public enterprises was initiated in 1991, and the process has significantly accelerated over past years.²⁰ The Privatisation Commission is entrusted with selling government assets and with offering concessions to operate them. The privatisation process constitutes an important element of fiscal consolidation, with 90% of revenues allocated to debt retirement and the remaining 10% going to poverty alleviation.²¹ As part of the programme, a legal framework aimed at establishing a fair and transparent mechanism for privatisation has been put in place.

Major privatisations have gradually moved forward in the past three years, and the government has succeeded in selling off a number of loss making enterprises, especially in the telecoms and banking sectors. The privatisation of Pakistan Telecommunication Company Limited (PTCL) was completed in 2006, and Pakistan State Oil may also be privatised in the near future. However, the process of unbundling WAPDA, although formally completed in December 2003, did not make the company fully autonomous in financial and managerial terms.²² While its 13 electricity distribution centres have been privatised, power generation will remain in public hands in the medium term. In addition, earlier this year, the government privatised Pakistan Steel Mills, but the process was overturned by a Supreme Court ruling, which declared that there have been acts of "omission and commission" in the bidding process. This ruling has been a setback to the government's privatisation plans.²³

In the financial services sector, all the major banks, apart from the National Bank of Pakistan (NBP), have been privatised. As of November 2005, about 85% of Pakistan's banking and financial sector is in private hands. The largest bank in the country, NBP, with a market share of approximately 20%, remains nearly 80% state-owned.²⁴ The

government has also pursued an Oil and Gas Reform Programme since 2000 designed to restructure and privatise companies in the sector. The privatisation commission has short-listed several companies for future privatisations, among which are the Kot Addu Power Company, the State Life Insurance Company, and Pakistan Petroleum Company.²⁵

At the same time, the government is in the process of deregulating the economy to create a 'more level playing field' between public and private enterprises. Tariffs and other types of protection are being reduced. The import regime has been liberalised, and the custom duty, which used to be a major revenue-generator, has fallen significantly. The excise duty has also been reduced.

There should be a clear legal and administrative framework for fiscal management.

Legal framework for budgetary activities

The constitution outlines the expenditure responsibilities of the federal government (Federal Legislative List) and the areas of shared responsibilities (Concurrent Legislative List). All residual functions are the domain of provincial governments. Local government functions are defined under provincial laws through the Local Government Ordinances (LGOs).

Articles 80-88 of the constitution lay down the budget procedures for which the MoF bears ultimate responsibility. Preparation of the budget is based on well-defined timetables. Circulars issued by the Finance and Planning Ministries initiate the process eight to ten months before submission of the budget. Agencies are requested to submit a statement of permanent expenditures on the current budget, projected expenditures on existing development projects, proposals for new expenditures, and proposals for expenditures on new development projects. By December or January each year, line departments submit budget proposals after review by the MoF Financial Advisors. Negotiations between the MoF, the Planning Division, and the respective ministries generally continue until March or April.

The federal government is required to present an annual budget statement to the National Assembly. If necessary, the legislature may approve a Supplementary Budget Statement or an Excess Budget Statement.²⁶ The existing budget procedures are described in a 1998 Finance Division manual entitled '*Revised System of Financial Control and Budgeting*'.²⁷ Information about key legislation and ordinance affecting budgetary activities, including the FRDLL, is available on the MoF website.

Legal framework for taxation

Historically, Pakistan has had a complex tax framework, but all taxes do have an explicit basis in law. The constitution assigns almost all taxes with any significant revenue potential to the federal government. The exceptions are the Agriculture Income Tax (AIT), Urban Immovable Property Tax (UIPT), Motor Vehicle Tax (MVT) and Stamp Duties. On the other hand, local government tax bases are assigned through Local Government Ordinances and not through the constitution, and therefore tax assignments between the provinces and local government can be changed according to changing requirements. The federal body responsible for tax administration in Pakistan is the Central Board of Revenue (CBR), which is a division of the MoF.²⁸

Making tax administration more transparent and efficient is one of Pakistan's more serious challenges. Widespread collusion between taxpayers and tax officials has been facilitated by the discretionary powers of tax officials, weak supervision and complex tax rules.²⁹ In July 2002, major changes were introduced through a new system based on universal self-assessment and risk-based audit and record keeping, which minimises taxpayer interaction with tax officials. The number of income tax exemptions was vastly reduced in 2003 with 20 exemption categories abolished,

together with the elimination of all so-called 'tax whitener' schemes, which used to be a common instrument of tax evasion.³⁰ Exemptions have continued to be eliminated since then, but at a much slower pace. Tax rates have also been cut in recent years to stimulate economic activity and to encourage compliance, which remains low.³¹ Personal tax rates have fallen from 5-35% to 5-25%, and from 2006-2007 a corporate tax rate of 35% will be introduced, which falls to 20% for small companies.³²

In 2002, the government launched initial reforms in the CBR to improve the quality of its human resources by adopting a recruitment policy of merit-based remuneration. A tax ombudsman's office has been established to deal with dispute resolution, and in 2004 the government set up two Large Taxpayers Units (LTUs) and six Medium Taxpayers Units (MTUs), which operate using an IT-based compliance management system. Thirteen regional tax offices handling income, sales and excise tax under one roof are now being developed and will be in operation by the end of the 2006-2007 financial year. Performance indicators, including revenue targets and changes in tax policies, are published on a quarterly basis and are also available on the CBR website; there has been growth of over 20% in tax revenues in the past year.³³

Further reforms have simplified the tax system by moves to self-assessment schemes for income and corporate tax in 2003, and subsequently excise (2005) and customs (2006).³⁴ However, there is still much work to be done. Commentators report that revenue receipts do not reconcile, and that corruption is still rife. Whilst income tax revenues have increased, corporate revenues have not, and tax-to-GDP ratios have stagnated.³⁵ Nevertheless, a 94 million US dollar World Bank project was set up in January 2005 with the aim of making the CBR more efficient and transparent through encouraging voluntary compliance, increasing collection and making the tax system more equitable. The project will run until 2009.³⁶

Ethical standards for public servants

The 'Government Servants (Conduct) Rules' of 1964 is the main legal document governing the behaviour of public servants in Pakistan. The rules address conflict-of-interest issues, require that public servants declare their assets each year, and prohibit them from conducting business or entering into agreements that may conflict with their official duties. The government has amended the 1973 Civil Servants Act to specify the rules governing the dismissal of civil servants.³⁷

Low pay and a lack of effective supervision have entrenched corruption, especially at the sub-national level. To address this problem, the government launched a National Anti-Corruption Strategy (NACS) in 2003. The strategy, which aims to reduce tolerance of corruption and improve accountability mechanisms, has moved forward to some extent since its inception, although critics say that it is only rhetoric and that there has to be a change in political will for noticeable progress to be made.³⁸ The National Accountability Bureau (NAB) is working with provincial anti-corruption agencies to enforce and prevent corruption in the civil service. Vigilance units have been set up in several government departments, and a broad awareness campaign was launched in the media in 2004. Efforts are also underway to contain the 'Benami' -- the practice whereby assets are held in the name of a person who is not the true beneficiary -- following a report to the cabinet in 2003 on this issue. As such, Punjab has launched a pilot project to computerise land records, and identity cards are also being introduced to contain this problem.³⁹ However, Transparency International's Corruption Perceptions Index shows a worsening in corruption over the past few years, and its score for 2006 was still only 2.2. It ranks Pakistan among the most corrupt countries in the world.⁴⁰

2. PUBLIC AVAILABILITY OF INFORMATION

●● Intent declared

The public should be provided with full information on the past, current, and projected fiscal activity of government.

Central government operations

Article 171 of the constitution stipulates that “the reports of the Auditor General relating to the accounts of the Federation shall be submitted to the President, who shall cause them to be laid before the National Assembly. The reports of the Auditor General relating to the accounts of a Province shall be submitted to the Governor of the Province, who shall cause them to be laid before the Provincial Assembly.”⁴¹

Currently, the MoF makes available through its website quarterly summaries of Pakistan’s fiscal operations, the budget speech of the finance minister⁴², a *Budget at a Glance* document summarising the fiscal position of the central government⁴³, a copy of the Finance Bill that gives effect to the proposed budget⁴⁴, and the *Economic Survey*.⁴⁵ The *Economic Survey* includes, among other categories, economic information by sector, and information about contingent liabilities, tax expenditures, and external debt and liabilities; it is published shortly before the budget.⁴⁶

The 2005 Fiscal Responsibility and Debt Limitation Law requires the federal government to provide the National Assembly with a set of economic policy statements for each financial year (1 July – 30 June). According to the legislation, these must “incorporate to the fullest extent possible all government decisions which have a material effect on the economic situation of the country, except those that have been excluded for specified reasons by the finance minister.”⁴⁷ The statements to be presented by the government must include the following: a Medium-term Budgetary Statement included in the Annual Budget Statement (ABS), an Annual Fiscal Policy Statement included in the ABS, an Annual Debt Policy Statement included in the ABS, a Mid-year Economic Report by the end of February, and an Annual State of the Economy Report by the end of June. The World Bank is assisting with the production of a debt policy statement, but there has been little progress in this area.⁴⁸

The timeliness of financial statements has improved, with annual accounts for the federal government being produced within six months of year-end. Quarterly fiscal reports are also published on the MoF’s website with a two month lag. Although monthly federal fiscal reports are also prepared, these are not published due to the long time lag involved, and data are still of low quality.⁴⁹

In the medium term, the government is implementing a new, countrywide, public-sector chart of accounts and financial reporting requirements under a computerised accounting system. This has been carried out through the World Bank-supported Project for Improvement in Financial Reporting and Auditing (PIFRA) begun in 1997. The first stage of PIFRA finished in 2005, and 55 computerised accounting sites are now online -- 22 (out of a total of 24 which must be made online) in the North Western Frontier Province (NWFP), 10 (out of 39) in Punjab, 9 (out of 37) in Sindh, and 5 (out of 30) in Baluchistan. Baluchistan continues to lag behind, as implementation has been hampered by the lack of infrastructure (buildings, electricity etc.) and qualified district accountants. However, the success of implementation in some states as opposed to others is thought by commentators to be primarily due to differences in attitude.

The second stage of PIFRA began last year with 94 million US dollars devoted to building capacity in 132 district and sub-district sites. A further part of the project is focused on capacity building in the Offices of the Auditor General and Controller General of Accounts, and next year the project hopes to develop the number of active sites in Punjab and Sindh. However, commentators say there are problems in the progress to the second stage, especially with training of PIFRA staff at the district level, where only one-third of the necessary trained officials are currently in place.⁵⁰

Pakistan joined the IMF's General Data Dissemination System (GDDS) in November 2003, and data on its statistical production and dissemination practices are consequently available on the IMF website.⁵¹ Under its GDDS membership, the MoF has made several commitments to improve data quality and dissemination standards. Pakistan's practices are consistent with most GDDS recommendations, with the exception of data on GDP and wages and earnings. With regard to complying to the Special Data Dissemination Standard (SDDS), Pakistan is close to complying, but still falls short in two areas: quarterly GDP figures are not yet available, although they should be ready by 2007, and quarterly wage figures have not yet been prepared. Work in this area is ongoing. GTZ, the German-based NGO, is funding a project which assists the Federal Bureau of Statistics in preparing national accounts on a quarterly basis, and the IMF has been assisting with a methodology for wages and unemployment data. Although unemployment figures are now prepared, Pakistan has such a large informal sector that it will be difficult to publish complete and accurate data for this area.⁵²

The methodologies for price indices and balance of payments statistics broadly follow international standards. However, in 2004 the IMF pointed to significant shortcomings in the methodological soundness of other macroeconomic statistics, especially those regarding the scope of the national accounts and the classification and sectorisation systems for government finance and monetary statistics.⁵³

Transparency appears to be improving in other respects. While there may have been a prior tendency by the government to overestimate revenues, there is agreement from a number of different sources that this practice no longer continues.⁵⁴ Also, in its *Economic Survey* the MoF reports actual cash flows to cover explicit and implicit contingent liabilities since 2001 and explains their fiscal significance.⁵⁵ Information on tax expenditures is also covered in the same report.

Public sector operations

The federal budget details central government grants to provinces, but comprehensive reports on provincial receipts and spending are presented only to the provincial assemblies. The MoF's *Economic Survey* provides an overview of the consolidated federal and provincial budgets since 2001-02.⁵⁶ The central bank, the State Bank of Pakistan (SBP), includes data on the combined federal and provincial budgets in its *Annual Report* based on a combination of budget documents and SBP data.

The Controller General of Accounts (CGA) prepares *Combined Finance and Revenue Accounts for the Federal and Provincial Governments of Pakistan* from audited accounts of each level of government. However, the materials have tended to be compiled with a considerable delay and are deemed in some instances to be inaccurate, although the situation is expected to improve with the implementation of the second stage of PIFRA which began this year. Every province had a director general appointed in 2003-04 for district and provincial audits. There have been systematic efforts in recent years to improve the quality of data reconciliation and the timeliness of data dissemination. At the federal level, virtually full reconciliation has been achieved between departmental spending and receipts records and the Accountant General of Pakistan Revenue (AGPR) accounts. Timeliness of reporting has improved, with reconciliation data available three weeks after the end of each calendar month. Progress has been more mixed at the provincial level.⁵⁷

There has also been no progress in reporting quasi-fiscal activities, something that was highlighted by the IMF in 2000 and again in 2004.⁵⁸ The *Economic Survey* discloses explicit and implicit contingent liabilities, and limited information on quasi-fiscal activities or the activities of public enterprises and institutions.⁵⁹

A commitment should be made to the timely publication of fiscal information

Debt reporting

The quality of information on public debt has improved dramatically in recent years. The MoF's *Economic Survey* provides a comprehensive overview of debt servicing costs and a breakdown of domestic debt broken down into permanent, floating, and unfunded debt. The *Survey* also includes data on foreign exchange liabilities and debt servicing, although debt statistics for the current and previous year are only provisional. Broad trends of overall public debt, accompanied by recent developments, are also discussed.⁶⁰ The government also produces detailed information on debt on both a monthly and a quarterly basis, in the *External Debt and Liabilities Quarterly Report*, although this information is not publicly disclosed. The SBP also compiles data on public debt. Quarterly data are provided on the external debt and liabilities, on service costs, and on the stock of outstanding domestic debt.⁶¹

The 2005 Fiscal Responsibility and Debt Limitation Law makes provisions for debt reporting in its Annual Debt Policy Statement, which is presented to parliament in January of each year. Targets have been set to reduce the revenue deficit to zero by 2007-08, and the government is already ahead of targets, with only a 0.4% of GDP surplus in 2005.⁶²

Advance release calendars

While the MoF is committed to regular provision of government fiscal data, and the statistics on its website are updated accordingly, there has been no progress in the production of formal advance release calendars in recent years. However, the Federal Bureau of Statistics publishes such a calendar for price and trade data.⁶³

3. OPEN BUDGET PREPARATION, EXECUTION, AND REPORTING



Enacted

Fiscal policy objectives, macroeconomic framework, and risks

Fiscal policy objectives

Fiscal policy objectives are clearly identified in the budget documents and are highlighted in the budget speech of the minister of finance. Budgets are placed in a three-year macroeconomic framework with targets set for all key variables. Broader fiscal policy objectives with a specific focus on poverty reduction are spelled out in the government's 2003 Poverty Reduction Strategy Paper (PRSP).⁶⁴ Medium-term fiscal objectives are outlined in the Medium Term Budgetary Statement and the Annual Fiscal Policy Statement.

Macroeconomic framework

The MoF produces an *Economic Survey* covering the current macroeconomic situation in the country, as well as future prospects. The survey is always included in the budget documents submitted to the national assembly in connection with a new finance bill. However, the MoF does not publish its macroeconomic model, nor is there a formal mechanism for consultations involving independent experts.⁶⁵

A three-year rolling Medium Term Budgeting Framework (MTBF) has been piloted in the Ministries of Health and Population Welfare, beginning in 2002.⁶⁶ The budget under MTBF (2005-08) for these ministries was presented to the parliament in the *Budget in Brief* document, together with the Federal Budget for the financial year 2005-06 which was announced in June 2005. The Ministries of Education, Women's Development and Food and Agriculture joined the project last year; the MoF was also to be included, but backed out at the last minute, and overall, progress has been slow. Three out of the four provinces have adopted a MTBF, with Baluchistan yet to do so. However, in all cases, capacity is a problem, and commentators reported that the framework had become an accounting procedure rather than the strategic planning process it is designed to be. Over the next few years, there are plans to introduce a three-year sectoral finance ceiling, and bring the entire federal government under the system. The use of computerised financial management to assist ministries in budget operations is also part of the MTBF project, but will not be implemented until the second stage of PIFRA is well underway.⁶⁷

In addition, budgetary planning has been carried out within the framework of the Poverty Reduction and Growth Facility (PRGF) 2002-2004, agreed with the IMF in 2001.⁶⁸ This project came to a close in December 2004, and the government chose not to withdraw the final two tranches (amounting to 270 million US dollars) available under the PRGF. Instead, the government is operating its own Poverty Reduction Strategy. Reports on the programme are made on a quarterly and annual basis.⁶⁹

Fiscal risks

The MoF does not publish any systematic analyses of sensitivity of its budget estimates to changes in economic conditions. Some discussion of macroeconomic factors bearing on the budget estimates is provided in the *Economic Survey*, but these do not amount to a formal assessment of fiscal risks.

However, transparency in this area is improving in some respects. As noted above, the reporting of contingent liabilities and tax expenditures has improved in recent years, and these are now presented in the *Economic Survey*.

However, they are not yet formally discussed or incorporated in the budget, although there are plans to include a table on these items in the future.⁷⁰ In addition, the 2005 Fiscal Responsibility and Debt Limitation Law (FRDLL) fixes specific limits on contractually binding guarantees (explicit liabilities) including those in rupee lending, bonds, rates of return, output purchase agreements and other claims that may threaten the future fiscal stance of the government.

A significant source of fiscal risks stems from a substantial build-up of nonperforming loans (NPLs) owing to lax lending practices by public commercial banks and development financial institutions. The Corporate and Industrial Restructuring Corporation was established in 2000 as an autonomous MoF unit with the main task of recovering overdue loans on behalf of state-owned banks and development financial institutions.⁷¹ While the aggregate NPL ratio for the banking system has been on a downward trend, it is still high and concentrated in the largest banks.⁷² The State Bank of Pakistan publishes detailed information on the extent of NPLs.⁷³

Fiscal sustainability

The budget documents put little emphasis on the sustainability of the budget deficit, but the issue is recognised as the central challenge for the government. The *Economic Survey*, particularly the section on 'Fiscal Development', discusses the sustainability of the debt position and shows both overall and primary budget deficits. The government has been reducing public debt, and is currently ahead of its FRDLL target.⁷⁴ This has been achieved despite the October 2005 earthquake which called for a substantial rescue and rehabilitation programme, totalling 0.8% of GDP in 2005 and 0.6% of GDP in 2006, and which will push the fiscal deficit up to 4.2% for fiscal year 2006-7.⁷⁵

Budget presentation

Data reporting

Federal budget data are produced in a timely manner, supplied within 15 days of the end of the reference period. Data for provincial and district governments are also sufficiently timely, despite problems related to the lack of full computer automation in sub-national government administrations. Complete, audited final accounts of the government are available approximately seven months after the end of the reference year.⁷⁶

Annual federal budget execution reports under the New Accounting Model and Chart of Accounts (NAM-CoA) began to be published in 2004, although they are not publicly available. The overall size of the budget documents prepared under the new system is twice the size of the old system documents, reflecting the additional details in the new budgets. Monthly publications are also released in a timely manner. The IMF has stated that these reports are better organised, and summary economic classification statements are now published.⁷⁷

Budget execution and monitoring

After legislative approval, the Finance Division of the government formally communicates the budget to the line ministries. The Finance Division keeps an appropriation ledger, which records initial budget distributions and subsequent adjustments.⁷⁸

The principal accounting officer (PAO) of each government entity is responsible for controlling spending. Drawing and disbursing officers have the duty to ensure that payment claims are approved in accordance with the Schedule of Authorised Expenditure. No request exceeding the available funds can be approved without a formal legal contract. In such an event, the PAO has the responsibility for locating the necessary funds. The procedures at the federal and provincial levels are identical.⁷⁹

However, mechanisms for internal control remain weak in some areas. The reports of the Auditor General show numerous instances across government of non-compliance of expenditure approvals with budget limits, delegation between authorities, and requirements for proper documentation of expenditures, misclassification of expenditures, and instances of fraud and misuse of public funds and assets.⁸⁰

The government is in the process of improving transparency and legislative oversight through the Public Accounts Committees (PACs) of the National and Provincial Assemblies, that review the findings of audit reports. PACs are now functioning at both the federal and provincial level, and are holding hearings for each department. Although PACs are recognised as being significantly powerful institutions, they differ in terms of performance. There is also a huge backlog of completed reports to review, with most PACs still three to four years behind, although the hope is that the backlog will be cleared by November 2007. Commentators have stated that the PACs also suffer from a lack of credibility because of shortcomings in technical capabilities; as such, it is hard to corroborate the quality and reliability of information contained in the audit reports submitted to them.⁸¹

Accounting basis

All accounting of fiscal flows currently takes place on a cash basis, with the procedures explained in government accounting manuals. The government is currently working on initial preparations for the eventual introduction of accrual accounting. The use of accrual accounting is likely to begin very gradually.

Data classification broadly conforms to Government Finance Statistics (GFSM) 2001 fiscal reporting requirements. Indeed, a GFSM-compatible New Accounting Model and Chart of Accounts (NAM-CoA) was introduced in 2005 for budget documents. Although all federal and provincial budgets use CoA, as do 110 out of 111 districts, there are still some teething problems with NAM in the province of Baluchistan related to lack of data, so both the old and new systems of accounting are still being used concurrently. Quetta, its capital, currently compiles all of the old-style accounts ledgers into the new accounting system. Implementation of NAM-CoA has suffered due to a lack of skilled officers to implement it, as well as a lack of physical infrastructure; data still lack consistency and quality. More training of staff is needed in the new accounting module.⁸²

Procurement and employment

Federal employees in the Superior Services (grade 17 and above) are appointed through a competitive examination administered by the Federal Public Service Commission.⁸³ The government has set up a Public Procurement Regulatory Authority, which will develop a procurement law and oversee its implementation.

Reducing corruption in the civil service, particularly at the provincial and local level, is a major challenge for Pakistan, and it affects procurement practices. The National Accountability Bureau (NAB), with a mandate to investigate alleged corruption, is complemented by individual Regional Accountability Bureaus in each of the country's four provincial capitals, and one in the federal area. If effective, these bodies will help reduce corruption in the procurement of government contracts. However, commentators have stated that the NAB's effectiveness is decreasing with time, and further measures to increase transparency, civil rights and political participation need to be implemented for accountability measures to be successful.⁸⁴

Progress to address the other shortcomings of Pakistan's procurement process has been slow. In May 2002, the president adopted an ordinance creating the Public Procurement Regulatory Authority (PPRA), but this has yet to promulgate national procurement rules applicable to all federal procurement. The pace of reform at the federal level has not accelerated as expected, although the PPRA has prepared new draft procurement rules that are compatible with international best practice.⁸⁵

Fiscal reporting

Pakistan has an overall framework of accounting and financial reporting overseen by the Accountant General of Pakistan for federal accounts and Accountants General for the provincial accounts. All these functions report to the Controller General of Accounts at the federal level.

The federal government fiscal data currently comprise the budgetary operations of the federal government and the public sector development programme. They exclude the *Zakat* extra-budgetary fund, social security funds, and locally financed operations of provincial and municipal governments. Data on interest payments are given separately and broken down into domestic and foreign. The system of classification broadly conforms to the IMF Manual on Government Finance Statistics. The data are provided on a quarterly basis with a delay of two months.⁸⁶

Under the FRDLL, the government is required to present the National Assembly with a Medium Term Budget Statement with a three-year rolling Fiscal Framework. The Annual Fiscal Policy statement is required to specify how the budget targets relate to the debt reduction strategy. An Annual Debt Policy Statement should explain borrowing strategies and potential risks, but this document has not yet materialised. An annual *State of the Economy* report will assess the performance of the economy against the targets set by the government.

Although data reconciliation has improved at the federal level, budget reporting at the provincial and districts levels remains an area of concern. Commentators stated that the standard of budgeting and accounting in local governments is poor, and there is little compliance with budget rules.⁸⁷ There is a wide degree of variation between districts in particular, and it can take up to one or two years to provide sufficient data to make benchmark comparisons between districts.⁸⁸ The IMF has stated that far more training and resources are required if provinces and districts are to be able to execute their budget and provide data on expenditures and revenues in a timely and accurate way.⁸⁹ The problem also stems from a legal aspect, since there are no formal legal requirements for reporting from the sub-district and district level to the provincial level. Equally, at the provincial level, there is no specific body allocated for the reporting of budgets. Improving fiscal reporting at the sub-national level is also particularly urgent in light of Pakistan's ambitious devolution programme.⁹⁰

4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY

●● Intent declared

Data quality standards

The government has significantly improved the quality of fiscal data in recent years. A federal Fiscal Monitoring Committee tracks fiscal flows and manages efforts to improve data quality. Similar committees are being created at the provincial level. The Accountant General Pakistan is fully involved with the MoF in the preparation of fiscal reports, which are published on a quarterly basis, accompanied by commentary on data quality.

A 2004 assessment by the IMF found that institutions collecting and disseminating data on national accounts generally exhibited an adequate awareness of data quality. However, there are multiple factors that negatively affect the quality of the data, including obsolete computing resources, weak efforts to encourage reporting, and outdated benchmarks.⁹¹ The Ministry of Finance is aware of these limitations in capacity and intends to invest in more training to improve the reporting of the national accounts.⁹²

Independent scrutiny of fiscal information

Independent Audit

The office of the Auditor General enjoys constitutional authority and reports directly to the president. In the past, the Auditor General was responsible for both auditing and accounting, but now the government has separated the two functions.

The PIFRA project supports institutional reform and policy initiatives designed to improve auditing and accounting standards. A central objective of the programme is to develop the Auditor General's office into an independent supreme audit institution. Methodological reforms are designed to reduce traditional compliance audits in favour of more performance-type assessments.⁹³

The timeliness of audits has improved markedly in recent years, with audit reports available within one year of the end of the fiscal year.⁹⁴ An Annual Audit Programme that sets out specific goals and targets has been published, and the Auditor General has started the process of recruiting 800 qualified auditors to enhance capacity to audit local governments. The decentralised accounts for districts are now audited by the Auditor General.⁹⁵

Chief Internal Auditors are now being appointed to each of the federal line ministries, which should relieve the external auditor, the Auditor General of Pakistan (AGP) of responsibilities in this area. Whilst these appointments and the implementation of the PIFRA internal audit manual are a good start to improving internal auditing procedures, it will take some time to reduce the lag in audited accounts. The review that resulted in the separation of auditing from accounting functions also involved the preparation of a draft Ordinance for Internal Control, but this ordinance has been delayed.⁹⁶

National Statistics Agency

The Federal Bureau of Statistics (FBS) is a department of the Statistics Division. The Statistical Act of 1974 authorises the bureau to collect information for statistical purposes. The FBS has been given legislative assurances of independence. The FBS compiles statistics from many sources and produces a range of publications, including the *Statistical Yearbook* and the *Pakistan Statistics Handbook*. Among other functions, it keeps an administrative record of public finance statistics compiled by the fiscal authorities.⁹⁷ In connection with Pakistan's GDDS membership, the FBS is working on a systematic overhaul of its data collection and dissemination practices.⁹⁸

The FBS has been recognised for its professionalism. FBS staff are appointed on a permanent basis after meeting civil service entry requirements, and the head of the FBS, who may only be appointed from the ranks of the staff, may remain in the post until retirement. However, the IMF has observed that the FBS, its operations and its credibility would benefit if it enjoyed greater autonomy from the government.⁹⁹

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Pakistan between 5 and 9 November 2006.

Ministry of Finance

5 November 2006

Dr Ashfaque Hassan Khan	Economic Advisor	Ministry of Finance
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State Bank of Pakistan

9 November 2006

Mr Riaz Riazuddin	Economic Advisor	Economic Policy Dept
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ADDITIONAL INTERVIEWS

5 November 2006

Dr Faisal Bari	Assistant Professor	Lahore University of Management Sciences
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6 November 2006

Henri Lorie	Senior Resident Representative	IMF
Riaz Hassan Naqvi	Former Chairman	Central Board of Revenue

7 November 2006

Sakib Sherani	Chief Economist	ABN Amro
Muhammad Yunis Khan	Auditor General of Pakistan	Supreme Audit Institution
Muhammad Tahir	Director General	PIFRA
Dr Khurum	Director	PIFRA
Riaz Hussain Naqvi	Former Chairman	Central Board of Revenue
Abdullah Yussuf	Chairman	Central Board of Revenue

8 November 2006

John Wall	Country Director	World Bank
Hanid Mukhtar	Senior Economist	World Bank
Manuela Ferro	Lead Country Economist	World Bank
Peter Fedon	Country Director	Asian Development Bank
Sandra Nicoll	Senior Governance Specialist	Asian Development Bank

9 November 2006

Aalishaan Zaidi	Country Distribution Manager	Standard Chartered
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