The President of the Islamic Republic of Pakistan

for and on behalf of

the Islamic Republic of Pakistan

U.S.$500,000,000 7.125% Notes due 2016

U.S.$300,000,000 7.875% Notes due 2036

Issue price of 2016 Notes: 100.00%
Issue price of 2036 Notes: 100.00%

The U.S.$500,000,000 7.125% Notes due 2016 (the **2016 Notes**) and the U.S.$300,000,000 7.875% Notes due 2036 (the **2036 Notes**, and together with the 2016 Notes, the **Notes**) are issued by The President of the Islamic Republic of Pakistan for and on behalf of the Islamic Republic of Pakistan (the **Issuer**) and are direct, unconditional and unsecured obligations. Interest on the 2016 Notes will be payable semi-annually in arrear on March 30 and September 30 in each year commencing on September 30, 2006 except that the final interest period will be from and including September 30, 2015 to but excluding the 2016 Maturity Date (as defined below). Interest on the 2016 Notes will accrue from and including March 30, 2006 and will be at a rate of 7.125% per annum. The 2016 Notes will mature on March 31, 2016 (the **2016 Maturity Date**). Interest on the 2036 Notes will be payable semi-annually in arrear on March 30 and September 30 in each year commencing on September 30, 2006 except that the final interest period will be from and including September 30, 2035 to but excluding the 2036 Maturity Date (as defined below). Interest on the 2036 Notes will accrue from and including March 30, 2006 and will be at a rate of 7.875% per annum. The 2036 Notes will mature on March 31, 2036 (the **2036 Maturity Date**). Payments on the Notes will be made in U.S. dollars without deduction for or on account of taxes of the Islamic Republic of Pakistan to the extent described under "*Terms and Conditions of the Notes — Taxation*".

Application has been made to admit the Notes to listing on the Official List of the Luxembourg Stock Exchange and to trading on the Euro MTF market of the Luxembourg Stock Exchange.

Application has been made to have the Notes accepted for trading in the Private Offerings, Resales and Trading through Automated Linkages System (**PORTAL**) of the National Association of Securities Dealers, Inc.

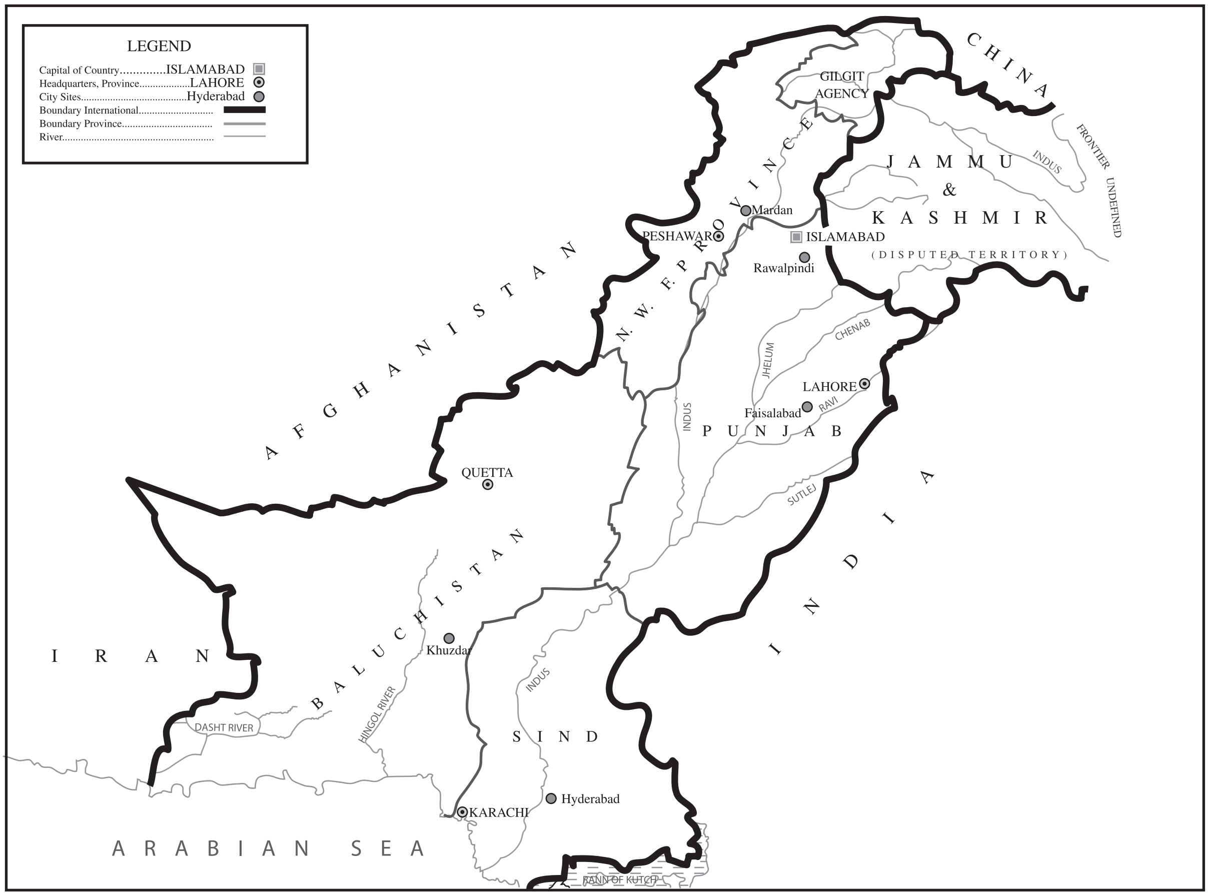
An investment in the Notes involves certain risks. For a discussion of these risks see "*Risk Factors*" beginning on page 7 of this Offering Circular.

The Notes have not been registered under the U.S. Securities Act of 1933, as amended (the **Securities Act**), and are being offered only (1) to qualified institutional buyers (**QIBs**) under Rule 144A under the Securities Act (**Rule 144A**) and (2) outside the United States in compliance with Regulation S under the Securities Act (**Regulation S**). Prospective purchasers are hereby notified that sellers of the Notes may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A. For a description of certain restrictions on resale or transfer, see "*Transfer Restrictions*" and "*Plan of Distribution*."

The Notes will initially be represented by global certificates in registered form (the **Global Certificates**). 2016 Notes and 2036 Notes offered and sold in reliance on Rule 144A will be represented by restricted global certificates (the **2016 Restricted Global Certificate** and the **2036 Restricted Global Certificate**, respectively, and together the **Restricted Global Certificates**). 2016 Notes and 2036 Notes offered and sold in reliance on Regulation S will be represented by unrestricted global certificates (the **2016 Unrestricted Global Certificate** and the **2036 Unrestricted Global Certificate**, respectively, and together the **Unrestricted Global Certificates**). Each Global Certificate will be registered in the name of Cede & Co., as nominee for DTC. It is expected that delivery of the Global Certificates will be made on March 30, 2006 or such later date as may be agreed (the **Closing Date**) by the Issuer and the Managers (as defined under "*Plan of Distribution*").

Citigroup **Deutsche Bank Securities** **JPMorgan**

The date of this Offering Circular is March 23, 2006.


LEGEND
Capital of Country.............ISLAMABAD
Headquarters, Province..................LAHORE
City Sites.......................................Hyderabad
Boundary International............................
Boundary Province..................................
River..
CHINA
GILGIT AGENCY
FRONTIER UNDEFINED
INDUS
JAMMU & KASHMIR
(DISPUTED TERRITORY)
N. W. F. PROVINCE
Mardan
PESHAWAR
ISLAMABAD
Rawalpindi
AFGHANISTAN
JHELUM
CHENAB
LAHORE
Faisalabad
RAVI
INDUS
PUNJAB
QUETTA
SUTLEJ
INDIA
BALUCHISTAN
Khuzdar
IRAN
DASHT RIVER
HINGOL RIVER
INDUS
SIND
Hyderabad
KARACHI
ARABIAN SEA
RANN OF KUTCH

The Issuer, having made all reasonable enquiries, confirms that this Offering Circular contains or incorporates all information which is material in the context of the Notes, that the information contained or incorporated in this Offering Circular is true and accurate in all material respects and is not misleading, that the opinions and intentions expressed in this Offering Circular are honestly held and that there are no other facts the omission of which would make this Offering Circular or any of such information or the expression of any such opinions or intentions misleading. The Issuer accepts responsibility accordingly.

No person has been authorized to give any information or to make any representation other than those contained in this document in connection with the offering of the Notes and, if given or made, such information or representations must not be relied upon as having been authorized by the Issuer or the Managers. Neither the delivery of this document nor any sale made hereunder shall, under any circumstances, constitute a representation or create any implication that there has been no change in the affairs of the Issuer since the date hereof. This document does not constitute an offer of, or an invitation by, or on behalf of, the Issuer or the Managers to subscribe for, or purchase, any of the Notes in any jurisdiction in which such offer or invitation is unlawful. This document does not constitute an offer, and may not be used for the purpose of an offer to, or a solicitation by, anyone in any jurisdiction or in any circumstances in which such an offer or solicitation is not authorized or is unlawful.

The Managers have not separately verified the information contained herein. Accordingly, no representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by the Managers or any of them as to the accuracy or completeness of the information contained in this Offering Circular or any other information provided by the Issuer in connection with the Notes or their distribution.

This Offering Circular is not intended to provide the basis of any credit or other evaluation and should not be considered as a recommendation by the Issuer or the Managers that any recipient of this Offering Circular should purchase any of the Notes. Each investor contemplating purchasing Notes should make its own independent investigation of the financial condition and affairs, and its own appraisal of the creditworthiness, of the Issuer.

For a description of certain restrictions on the offering and sale of the Notes and on distribution of this document, see "*Plan of Distribution*" below.

The Notes are not being offered or sold and may not be offered or sold directly or indirectly in Pakistan, to residents in Pakistan or to, or for the account or benefit of, such persons.

The Islamic Republic of Pakistan is a foreign sovereign state. Consequently, it may be difficult for investors to obtain or realize upon judgments of courts in England or their own jurisdiction against Pakistan. Further, it may be difficult for investors to realize upon judgments of courts in England or their own jurisdiction against Pakistan in the courts of Pakistan. See "*Risk Factors - Enforcement of foreign judgments in Pakistan*".

The issue of the Notes by The President of the Islamic Republic of Pakistan for and on behalf of the Islamic Republic of Pakistan is in accordance with Article 173(3) of the Constitution of the Islamic Republic of Pakistan which states "All contracts made in the exercise of the executive authority of the Federation or of a Province shall be expressed to be made in the name of the President or, as the case may be, the Governor of the Province."

In connection with the issue and distribution of the Notes, the Managers may over-allot Notes or effect transactions with a view to supporting the market price of the Notes at a level higher than that which might otherwise prevail. However, there is no assurance that the Managers (or persons acting on behalf of the Managers) will undertake stabilization action. Any stabilization action may begin on or after the date on which adequate public disclosure of the terms of the offer of the Notes is made and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the issue date of the Notes and 60 days after the day of the allotment of the Notes.

The Notes have not been approved or disapproved by the United States Securities and Exchange Commission or any other securities commission or other regulatory authority in the United States, nor have the foregoing authorities reviewed or passed upon the accuracy or adequacy of this Offering Circular. Any representation to the contrary is a criminal offence.

This Offering Circular is being submitted on a confidential basis in the United States to a limited number of QIBs for informational use solely in connection with the consideration of the purchase of the Notes. It may not be copied or reproduced in whole or in part nor may it be distributed or any of its contents disclosed to anyone other than the prospective investors to whom it is originally submitted.

Each purchaser or holder of interests in the Notes will be deemed, by its acceptance or purchase of any such Notes, to have made certain representations and agreements as set out in *"Plan of Distribution"*.

Notwithstanding anything herein to the contrary, from the commencement of discussions with respect to the transaction contemplated by this offering circular, all persons may disclose to any and all persons, without limitation of any kind, the tax treatment and tax structure of the transaction described herein and all materials of any kind (including opinions and other tax analyses) that are provided to such persons relating to such tax treatment and tax structure, except to the extent that any such disclosure could reasonably be expected to cause this transaction not to be in compliance with securities laws. For purposes of this paragraph, the tax treatment of this transaction is the purported or claimed U.S. federal income tax treatment of this transaction and the tax structure of this transaction is any fact that may be relevant to understanding the purported or claimed U.S. federal income tax treatment of this transaction.

NOTICE TO NEW HAMPSHIRE RESIDENTS

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENSE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE REVISED STATUTES WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE OF NEW HAMPSHIRE THAT ANY DOCUMENT FILED UNDER CHAPTER 421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER OR CLIENT ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.

PRESENTATION OF FINANCIAL AND OTHER INFORMATION

Certain amounts included in this Offering Circular have been subject to rounding adjustments; accordingly, figures shown as totals in certain tables may not be an arithmetic aggregation of the figures which precede them.

Unless otherwise specified or the context requires, references to **dollars**, **U.S. dollars** and **U.S.$** are to United States dollars and references to **Rupees** and **Rs.** are to the lawful currency of the Islamic Republic of Pakistan. Historical amounts translated into Rupees or U.S. dollars have been translated at historical rates of exchange. Such translation should not be construed as a representation that the amounts in question have been, could have been or could be converted into U.S. dollars at that or any other rate. The spot mid rate between the Rupee and the U.S.$ on March 17, 2006 as quoted by the State Bank of Pakistan (**SBP**) was Rs. 60.1820 to U.S.$1.00. References to **billions** are to thousands of millions. References to **SDR** are to the Special Drawing Right, a unit of account having the meaning ascribed to it from time to time by the Rules and Regulations of the International Monetary Fund. References to **Pakistan** are to the Islamic Republic of Pakistan and references to the **Government** are to the Government of Pakistan. References to any individual period as **2000-01** and so on are references to a fiscal year commencing on 1 July in one year and ending on 30 June in the subsequent year. References to the **Economic Survey 2004-2005** herein are to the Economic Survey 2004-2005 published on June 4, 2005 by the Government of Pakistan, Finance Division, Economic Advisor's Wing, Islamabad. The Economic Survey, which is published each year a few days before the presentation of the Federal Budget and presents a view on the national economy based on provisional data for the first three quarters of the fiscal year, is followed by the publication of its Statistical Supplement, in which the data series are provisionally updated for the whole fiscal year. It should be noted that certain historic data set out herein may be subject to minor amendment as a result of more accurate and updated information becoming available.

FORWARD-LOOKING STATEMENTS

Some of the statements contained in this Offering Circular under "*The Islamic Republic of Pakistan*" and "*The Pakistan Economy*" are forward-looking. These statements are not historical facts, but are based on the Government's current plans, estimates, assumptions and projections. Future events may differ materially from those expressed or implied by such forward-looking statements. Therefore, prospective investors should not place undue reliance on them. Forward-looking statements speak only as of the date they are made, and the Issuer undertakes no obligation to update any of them in light of new information or future events. Forward-looking statements involve inherent risks. The Issuer cautions you that many factors could affect the future performance of the Pakistani economy. These factors include, but are not limited to:

External factors, such as:

- interest rates in financial markets outside Pakistan;
- the impact of changes in the credit rating of Pakistan;
- the impact of changes in the international prices of commodities;
- economic conditions in Pakistan's major export markets; and
- the decisions of international financial institutions regarding the terms of their financial assistance to Pakistan; as well as

Internal factors, such as:

- general economic and business conditions in Pakistan;
- present and future exchange rates of the Pakistani currency;
- foreign currency reserves;
- natural disasters;
- the level of domestic debt;
- domestic inflation;
- the ability of Pakistan to implement important economic reforms;
- the levels of foreign direct and portfolio investment; and
- the levels of Pakistani domestic interest rates.

EXCHANGE RATE INFORMATION

Pakistan moved from a managed floating exchange rate policy to a multiple exchange rate system in July 1998. The multiple exchange rate was then replaced with a market-based unitary exchange rate system in May 1999. Under the unitary exchange rate system, the floating inter-bank rate applies to all foreign exchange receipts and payments both in the public and private sectors. This free-floating exchange system, which was adopted in July 2000, remains operative. See "*The Pakistan Economy-Exchange Rates.*"

The following table sets forth the average exchange rates for the periods presented, expressed in Rupees per U.S. dollar and not adjusted for inflation as published by the State Bank of Pakistan. The Federal Reserve Bank of New York does not report a noon buying rate for Rupees.

Period	Exchange Rates Average During Period Indicated
2000-01	58.4378
2001-02	61.4258
2002-03	58.4995
2003-04	57.9745
2004-05	59.3576
July-Dec, 2005	59.7201
January, 2006	59.8396
February, 2006	59.8855

Source: State Bank of Pakistan

Currency conversions contained in this Offering Circular should not be construed as representations that Rupees have been, could have been, or could be converted into U.S. dollars at the indicated or any other exchange rate.

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OFFERING CIRCULAR SUMMARY

The following summary does not purport to be complete and is qualified in its entirety by reference to, and must be read in conjunction with, the detailed information appearing elsewhere in this Offering Circular and related documents referred to herein.

References in this summary to a "Condition" are to the numbered condition corresponding thereto set out in the Conditions of the 2016 Notes or the 2036 Notes, as applicable.

The Islamic Republic of Pakistan

General

Pakistan is a federal republic located in south-central Asia between India, China, Afghanistan, Iran and the Arabian Sea. Its population based on the Economic Survey 2004-05 was approximately 152.53 million as of June 30, 2005 with over 96.0% of the population believed to belong to the Muslim religion. The capital of Pakistan is Islamabad, and English is the official language. Pakistan has a federal parliamentary system, and, following parliamentary ratification of the Legal Framework Order 2002 on December 31, 2003, President Pervez Musharraf received a vote of confidence in the Electoral College on January 1, 2004, and was declared elected to hold the office of President under the Constitution. In recent years the economy has grown steadily, and in 2004-2005, Pakistan realized a real gross domestic product (**GDP**) of approximately Rs. 6.5 trillion (approximately U.S.$110.0 billion), reflecting a real GDP growth rate of 8.4% for the fiscal year ended June 30, 2005.

Economy

In 2001, the Government began to implement a number of measures designed to maintain fiscal discipline, promote economic growth and advance social development. These measures were taken within the context of four major economic policy objectives:

Stability. The Government focused on reducing the fiscal and current account deficits and increasing foreign exchange reserves. In addition, the Government launched a formal Debt Reduction Strategy in 2001, which aimed to reduce fiscal account deficits, reduce the cost of borrowing and procure financing from international institutions on concessionary terms.

Reviving Growth. The Government initiated measures intended to increase the tax base, improve tax collections, control expenditures, liberalize trade, manage the country's debt levels and promote investment.

Poverty Reduction. The Government instituted anti-poverty programs that are intended to raise literacy rates, train teachers, eliminate gender disparities in education, rehabilitate school buildings and improve health.

Governance. The Government has attached a high priority to improving governance. While initial actions focused on accountability, especially with respect to loan and tax defaulters, the Government is currently focused on devolution and decentralization of state power to the local level; downsizing of government offices; judicial and police reform; and introducing transparency in economic decision-making processes.

Benefiting from these measures, Pakistan's real GDP increased at an average rate of 4.9% per annum from June 30, 2000 to June 30, 2005. GNP per capita income in dollar terms increased from approximately U.S.$500 in fiscal year 2000-01 to approximately U.S.$736 in fiscal year 2004-2005. Pakistan's rate of inflation decreased to an average of 5.1% in the period between June 30, 2001 to June 30, 2005 although it was 9.3% for 2004-2005. On February 28, 2006, the National Economic Council announced that a survey had shown that the percentage of the population living in poverty had fallen approximately 7 percentage points from 32.0% in 2000-01 to 25.0% in 2004-05. For the same period, urban poverty decreased by 6 percentage points (from 23.0% in 2000-01 to 17.0% in 2004-05) while rural poverty decreased by 7 percentage points (from 39.0% in 2000-01 to 32.0% in 2004-05).

The fiscal deficit was 3.2% of GDP in 2004-2005 compared with an average of almost 7.0% of GDP during the 1990s. During the five years from June 30, 2001 to June 30, 2005, tax collection by the Central Board of Revenue (**CBR**) increased by 50.1% The revenue deficit narrowed from 2.6% of GDP in 2000-01 to 0.7% of

GDP in 2004-2005. However, domestic debt declined from 43.2% of GDP in 2000-01 to 33.0% in 2004-2005. Domestic debt servicing as a percentage of total revenue declined from 55.9% in 2000-01 to 33.7% in 2004-2005. External debt and foreign exchange liabilities were U.S.$35.8 billion as of June 30, 2005, down from approximately U.S.$37.2 billion as of June 30, 2001. With respect to balance of payments, exports f.o.b. increased by 61.8% from U.S.$8.9 billion in 2000-01 to U.S.$14.4 billion in 2004-2005. Imports f.o.b. increased by 83.3% from U.S.$10.2 billion in 2000-01 to U.S.$18.7 billion in 2004-2005. Foreign direct investment increased from U.S.$322.4 million in 2000-01 to U.S.$1,524.0 million in 2004-2005. Workers' remittances increased from U.S.$1.1 billion in 2000-01 to U.S.$4.2 billion in 2004-2005. Primarily due to substantial increases in private inflows and assistance from donor agencies, total reserves (excluding gold) increased from U.S.$3.2 billion as of June 30, 2001 to U.S.$12.4 billion as of June 30, 2005, an increase of 490.0%.

Fiscal Responsibility. To promote continued fiscal discipline, the Fiscal Responsibility and Debt Limitation Act was adopted by Parliament in June 2005. The law aims, among other things, to: eliminate the revenue deficit by not later than June 30, 2008 and to thereafter maintain a revenue surplus; reduce the public debt to 60.0% of estimated GDP by June 30, 2013; and by June 30, 2013, reduce the total public debt by not less than 2.5% of the estimated GDP in every fiscal year, provided that the social and poverty related expenditures are not reduced below 4.5% of the estimated GDP and budgetary allocation as a percentage of GDP to education and health will be doubled from the existing level within ten years. However, the law also provides that the Government may depart from these goals on grounds of unforeseen demand on the finances of the Government due to national security or natural calamity, which are required to be determined by the National Assembly. Any such departure shall be temporary and the Minister for Finance of the Government shall in accordance with the law specify (i) the reasons for the Government's departure from these goals, (ii) the approach or measures the Government intends to take to return to these goals; and (iii) the period of time that the Government expects to take to return to these goals. See "The Pakistan Economy—Reforms—Fiscal Responsibility and Debt Limitation Act 2005".

Reforms

In addition to the fiscal and governance reforms discussed above, the Government has undertaken initiatives covering trade, privatization, financial sector reforms and human development and social protections.

Trade Reforms. Pakistan follows a policy of export-led growth and has liberalized its trade and investment regime in recent years. Recent bilateral and regional trade agreements entered into by Pakistan include a Trade and Investment Framework Agreement with the United States intended to encourage bilateral trade and investment, an Economic Cooperation Organization Trade Agreement intended to reduce tariff levels among the members of the Economic Co-operation Organization (**ECO**) and a South Asian Free Trade Agreement (**SAFTA**) that aims to reduce tariffs to between nil and five percent for all members of the South Asian Association for Regional Co-operation (**SAARC**) by 2008.

Privatization. The Government's privatization policy seeks to reduce demand on Government resources, raise funds for priority sectors and stimulate direct investment through the sale of state-owned enterprises (**SOEs**). From January 1991 to December 31, 2005, the Government earned approximately Rs. 357.4 billion from 158 privatization transactions, of which approximately Rs. 43.0 billion was raised from July 2004 to June 30, 2005. In March 2006, the Government sold to United Arab Emirates telecom company Etisalat a 26.0% interest in Pakistan Telecommunication Company Limited (**PTCL**) and management control of the company for U.S.$2.6 billion.

Financial Sector Reforms. The responsibility for supervision and regulation of non-bank financial companies has been transferred to the Securities and Exchange Commission of Pakistan (the **SECP**) to enable the SBP to focus on the supervision of the banking sector. The SBP has revised banking regulations with a view to providing greater flexibility and authority to banks. To promote consolidation in the banking sector, the SBP has increased minimum capital requirements and encouraged financial institutions to engage in mergers and acquisitions. Banks have been permitted to raise funds from the capital markets in the form of rated and listed subordinated debt securities, which can be included in the banks' supplementary capital. In addition, the Financial Institutions (Recovery of Finances) Ordinance 2001 was enacted to provide for the expedited recovery of defaulted loans, including the right of foreclosure and sale of mortgaged property with or without court intervention.

Human Development and Social Protection. Development-related expenditures have increased from Rs. 89.8 billion, or 2.2% of GDP, in 2000-01 to Rs. 272.0 billion, or 3.6% of projected GDP, in the 2005-2006 budget. The Government has launched a national literacy campaign throughout the country that aims to raise the literacy rate to 60% by 2006. Approximately 270,000 adult literacy centres are expected to open for this purpose. Recent public health programs include HIV/AIDS prevention, tuberculosis and malaria control, family planning, primary healthcare and immunization programs. Other initiatives taken by the Government include the extension of micro-finance services to the poor and the advancement of gender equality in education.

The policies, initiatives and programs described above were reflected in Pakistan's Poverty Reduction Strategy Paper, which was supported by an SDR 1.034 billion Poverty Reduction and Growth Facility (**PRGF**) from the IMF. Pakistan has undergone all reviews under the PRGF, and has met all quantitative performance criteria. Pakistan did not request a successor arrangement with the IMF when the PRGF expired in December 2004.

The following table sets out certain major economic indicators from 2000-01 to 2004-05.

Major Economic Indicators

	2000-01	**2001-02**	**2002-03**	**2003-04**	**2004-05**
GDP at Current MP (Rs. million)(1)	4,162,654	4,401,699	4,822,842	5,532,663	6,547,590
GNP at Current MP (Rs. million)(1)	4,108,172	4,425,364	4,974,654	5,657,141	6,672,814
Population (million)(2)	140.47	145.96	146.75	149.65	152.53
GNP per Capita (Rs.)	29,246	30,319	33,899	37,802	43,748
Exports f.o.b. (U.S.$ million)	8,933	9,140	10,889	12,396	14,401
Imports f.o.b. (U.S.$ million)	10,202	9,434	11,333	13,604	18,753
Balance of Trade (U.S.$ mn)	(1,269)	(294)	(444)	(1,208)	(4,352)
Total Reserves Minus Gold (U.S.$ million)(3)	3,244	6,398	10,747	12,324	12,421
Overall Budgetary Deficit (as % of GDP)	4.3	5.5	3.7	2.4	3.2
GDP Growth (FC) (%)(4)	1.8	3.1	4.8	6.4	8.4
Inflation (%)	4.4	3.5	3.1	4.6	9.3
Total Investment (as % of GDP) (MP)(1)	17.2	16.8	16.9	17.3	16.9
National Savings (as % of GDP)	16.5	18.6	20.8	17.7	15.7
Current Account (Deficit)/Surplus excluding official transfers (as % of GDP)	(0.7)	1.9	3.8	1.4	(1.6)

(1) (MP) Market Price.
(2) Ministry of Finance estimate.
(3) Includes both reserves held by the State Bank of Pakistan and by commercial banks.
(4) (FC) Factor Cost.
Source: Ministry of Finance; State Bank of Pakistan.

The Offering

Issuer	The President of the Islamic Republic of Pakistan for and on behalf of the Islamic Republic of Pakistan.
Notes being issued	7.125% Notes due 2016 in the aggregate principal amount of U.S.$500,000,000 and 7.875% Notes due 2036 in the aggregate principal amount of U.S.$300,000,000.
Issue Price of 2016 Notes	100.00% of the principal amount of the 2016 Notes.
Issue Price of 2036 Notes	100.00% of the principal amount of the 2036 Notes.
Issue Date	March 30, 2006.
Maturity and redemption	The 2016 Notes will mature on March 31, 2016 and will be redeemed at par on that date. The 2036 Notes will mature on March 31, 2036 and will be redeemed at par on that date. The Notes are not redeemable prior to maturity.
Interest	The 2016 Notes will bear interest from and including March 30, 2006 to but excluding March 31, 2016 at the rate of 7.125% per annum, payable semi-annually in arrear on March 30 and September 30 in each year commencing on September 30, 2006, except that the last interest payment shall be made on March 31, 2016 in respect of the period from and including September 30, 2015 to but excluding March 31, 2016. The 2036 Notes will bear interest from and including March 30, 2006 to but excluding March 31, 2036 at the rate of 7.875% per annum, payable semi-annually in arrear on March 30 and September 30 in each year commencing on September 30, 2006, except that the last interest payment shall be made on March 31, 2036 in respect of the period from and including September 30, 2035 to but excluding March 31, 2036.
Status	The 2016 Notes will be direct, unconditional and (subject to the provisions of Condition 4) unsecured obligations of the Issuer and (subject as provided above) will rank *pari passu*, without any preference among themselves, with all other present and future unsecured and unsubordinated External Indebtedness (as defined in Condition 10) of the Issuer. The 2036 Notes will be direct, unconditional and (subject to the provisions of Condition 4) unsecured obligations of the Issuer and (subject as provided above) will rank *pari passu*, without any preference among themselves, with all other present and future unsecured and unsubordinated External Indebtedness (as defined in Condition 10) of the Issuer. The due and punctual payment of the Notes and the performance of the obligations of the Issuer with respect thereto are backed by the full faith and credit of the Issuer.
Negative Pledge and Cross Default	So long as any of the Notes of a series remains outstanding, the Issuer has undertaken that it will not secure any of its present or future Public External Indebtedness (as defined in Condition 4) without, at the same time or prior thereto, securing the Notes of such series equally and rateably therewith, except in certain limited circumstances as set out in Condition 4. Condition 10 provides that Noteholders who hold not less than 25% in aggregate principal amount of the Notes of a series then outstanding may declare the Notes of such series to be immediately due and payable at their principal amount if, *inter alia*, the Issuer is in default in relation to any External Indebtedness or guarantee thereof in excess of U.S.$25,000,000, the Issuer declares a moratorium in

	respect of its External Indebtedness or the Issuer ceases to be a member of the International Monetary Fund or ceases to be eligible to use the general resources of the International Monetary Fund; all as more particularly described in Condition 10. A declaration of acceleration may be rescinded in certain circumstances by the adoption of an Extraordinary Resolution in accordance with the procedures in Condition 13 or of a written resolution of holders of not less than two-thirds in aggregate principal amount of the Notes of that series then outstanding.
Withholding tax	All payments by the Issuer under the Notes are to be made without withholding or deduction for or on account of Taxes (as defined in Condition 8), unless the withholding or deduction for taxes is required by law. In such circumstances, the Issuer will be required to pay additional amounts so that Noteholders will receive the full amount which otherwise would have been due and payable under the Notes; all as more particularly described in Condition 8.
Noteholder meetings	A summary of the provisions for convening meetings of Noteholders of each series of Notes to consider matters relating to their interests as such is set out in Condition 13.
Listing	Application has been made to admit the Notes to listing on the Official List of the Luxembourg Stock Exchange and to trading on the Euro MTF market of the Luxembourg Stock Exchange.
Settlement	Each series of Notes will initially be represented by two Global Certificates. The Restricted Global Certificates will be issued in respect of Notes offered and sold in reliance on Rule 144A. The Unrestricted Global Certificates will be issued in respect of Notes offered and sold in reliance on Regulation S. Each Global Certificate will be registered in the name of Cede & Co., as nominee for DTC. It is expected that delivery of the Global Certificates will be made on or about March 30, 2006 through the book-entry facilities of DTC, against payment therefor in U.S. dollars in immediately available funds.
Form and Denomination	The Notes will be in registered form and will be offered and sold in a minimum denomination of U.S.$100,000 and integral multiples of U.S.$1,000 thereof.
Transfer Restrictions	The Notes have not been registered under the Securities Act, and are subject to certain restrictions on transfers. See "*Transfer Restrictions*" and "*Plan of Distribution*".
Use of proceeds	The net proceeds from the sale of the Notes will be used for the Government's general budgetary purposes.
Fiscal Agent	Citibank, N.A. London Branch.
Registrar	Citigroup Global Markets Deutschland AG & Co. KGaA.
Further Issues	The Issuer may from time to time, without notice to or the consent of the registered holders of the Notes, issue additional securities that will form a single series with the Notes of the applicable series, provided that either (i) such additional securities do not have, for purposes of U.S. federal income taxation (regardless of whether any holders of such securities are subject to the U.S. federal income tax laws), a greater amount of original issue discount than the Notes of the applicable series as of the date of issuance of such additional securities or (ii) such additional securities are issued in a "qualified

	reopening" for U.S. federal income tax purposes. These additional securities will have the same terms as to status, redemption or otherwise as the Notes of the applicable series and will rank equally with the Notes of the applicable series in all respects, except for the payment of interest accruing prior to the issue date of these additional securities or except for the first payment of interest following the issue date of these additional securities.
Governing Law	The Agency Agreement and the Notes are governed by, and will be construed in accordance with, English law, except for the authorization and execution of the Notes and the Agency Agreement which will be governed by the laws of Pakistan.

RISK FACTORS

The Issuer believes that the following factors may affect its ability to fulfil its obligations under the Notes. These factors are contingencies which may or may not occur, and the Issuer is not in a position to express a view on the likelihood of any such contingency occurring.

In addition, factors which are material for the purpose of assessing the market risks associated with Notes are also described below.

The Issuer believes that the factors described below represent the principal risks inherent in investing in Notes, but the inability of the Issuer to pay interest, principal or other amounts on or in connection with any Notes may occur for other reasons and the Issuer does not represent that the statements below regarding the risks of holding the Notes are exhaustive. Prospective investors should also read the detailed information set out elsewhere in this Offering Circular and reach their own views prior to making any investment decision.

Factors that may affect the Issuer's ability to fulfil its obligations under the Notes

Shariat Law Position on the Payment of Interest

Presently, there are no laws or regulations or binding judgments of any superior court in Pakistan which expressly bar a lender's right to receive interest, including interest on late payments, from a borrower under a debt obligation such as the Notes. The following constitutional and legal provisions and the interpretation thereof by the superior courts of Pakistan could, however, adversely affect such right:

(a) ***The Constitution***: Under the Constitution of Pakistan 1973 (the **Constitution**), Islam is the state religion and Article 38(f) of the Constitution provides that Pakistan, as one of its "Principles of Policy", shall eliminate *riba* as early as possible. The Constitution also requires all existing laws to be brought into conformity with the injunctions of Islam and provides that no law can be enacted that is repugnant to the Injunctions of Islam (Article 227). However, the Constitution, while requiring the elimination of *riba*, does not define the term. The meaning of this term also cannot be found in any legislative enactment. As a result, there is some controversy over the exact meaning of the Islamic term *riba*. Some consider it as being analogous to interest while others equate it with usury.

By the Revival of the Constitution Order, 1985 a new Article 2A was incorporated in the Constitution whereby the principles and provisions set out in the Objectives Resolution (the "Resolution") and made an Annex to the Constitution, were made a substantive part of the Constitution. The Resolution was passed by Pakistan's first Constituent Assembly and sets out basic principles to guide the framing of a constitution. Certain references in the Resolution gave rise to an argument that the Injunctions of Islam provided a touchstone for testing the repugnancy of all laws and that by virtue of Article 2A of the Constitution, the Resolution now has a supra-constitutional position above the Constitution itself. Since 1985, the point has been discussed and considered by the superior courts of Pakistan on a number of occasions leading to a number of conflicting decisions. The position that Article 2A has no effect on other constitutional provisions can now be regarded as settled on the basis of a Supreme Court judgment. The Supreme Court has also held in another judgment that Article 2A is not available for declaring void sub-constitutional laws, on the basis of repugnancy to the Injunctions of Islam. Therefore, unless these Supreme Court judgments are reversed or unless legislative action is taken to similar effect, Article 2A of the Constitution does not provide any basis for rendering void an obligation for the payment of interest.

(b) ***The Enforcement of Shari'ah Act 1991*** (the **Shariat Act**): The Shariat Act provides that the injunctions of Islam as laid down in the Holy Quran and Sunnah shall be the supreme law of Pakistan. Pursuant to the Shariat Act, the Government has appointed a commission with terms of reference including, *inter alia*, the following:

- to recommend measures and steps, including suitable alternatives, by which the economic system enunciated by Islam could be established in Pakistan;
- to undertake the examination of any fiscal law or any banking or insurance law or practice and procedure to determine whether these are repugnant to the Shari'ah and to make recommendations to bring such laws, practices and procedures into conformity with the Shari'ah; and
- to oversee the process of elimination of *riba* from every sphere of economic activity in the shortest possible time and also to recommend such measures to the Government as would ensure the total elimination of *riba* from the economy.

Until such time as an alternative system is introduced, the Shariat Act protects financial obligations incurred and contracts made, *inter alia*, involving a foreign lender. However, such protection can be removed by an act of parliament or if the courts hold that such protection is unlawful because it is repugnant to the supreme law of the land, namely the Injunctions of Islam as laid down in the Holy Quran and Sunnah, as declared by the Shariat Act itself.

(c) ***The Federal Shariat Court***: The Federal Shariat Court (the **Shariat Court**) is a constitutionally established body which has jurisdiction to determine whether any law or any provision of any law, including any custom or usage having the force of law, in Pakistan violates the principles of Islam, the official State religion.

In November 1991, the Shariat Court ruled that a number of statutory provisions in Pakistan violated Islamic principles relating to *riba* and held them to be void on that basis and instructed the Government to conform these provisions to Islamic principles.

The ruling of the Shariat Court was appealed to the Shariat Appellate Bench of the Supreme Court of Pakistan (the **Appellate Bench**), The Appellate Bench dismissed the appeal and upheld the decision of the Shariat Court (the **Appellate Bench Judgment**). Against this Appellate Bench Judgment a Review Petition was filed, which was allowed by the Order dated June 24, 2002 (the **Review Order**). Pursuant to the Review Order, a differently constituted Appellate Bench set aside the judgment of the Shariat Court and the Appellate Bench Judgment and remanded the case to the Shariat Court for *de novo* determination of this issue after taking into consideration various aspects noted therein.

To summarize the position in Pakistan regarding the payment of interest:

- presently, the law in Pakistan does not prohibit the payment of interest pursuant to a contract to borrow money;

- an obligation to pay interest may be held to be unenforceable by the ordinary civil courts if:

  - the Supreme Court reverses itself on its findings in respect of Article 2A of the Constitution (subsection (a) above); or

  - the protection to financial obligations incurred and contracts made *inter alia* involving a foreign lender is removed (subsection (b) above); or

  - the Shariat Court *de novo* determines the issue afresh but holds to the same effect as previously decided and the Shariat Appellate Bench of the Supreme Court substantially upholds the judgment of the Shariat Court (subsection (c));

- any decision of a civil court declaring interest unenforceable will only operate between the parties to it;

- any such decision will not form a binding precedent until upheld by the provincial High Court to which such civil court is subordinate or the decision is delivered by such High Court itself, in which case the High Court's decision will be binding only on all civil courts subordinate to it;

- a single judge of a High Court is not bound by the decision of another single judge of the same High Court but is bound by a division bench (a bench of two judges) decision of that High Court. One division bench is not bound by the decision of another division bench but all judges of that High Court are bound by the full bench decisions (a bench of three or more judges) of that High Court. In the event that a single judge finds that he cannot agree with a previous decision of another single judge, then the matter must be referred to the Chief Justice of that High Court for the constitution of a larger bench to settle the issue (subject to the outcome of any appeal to the Supreme Court). A similar procedure applies where one division bench is in disagreement with another division bench;

- the decision of one provincial High Court will not bind High Courts in other provinces;

- any such decision will operate as a precedent binding on all courts in Pakistan only if the Supreme Court of Pakistan upholds such a decision and to the extent that it decides a question of law or is based upon or enunciates a principle of law; and

– any decision of any court in Pakistan (including the Appellate Bench or the Shariat Court) in relation to the unenforceability of an obligation to pay interest will have no effect whatsoever on any obligation to pay the original sum borrowed or advanced.

The Government is, as a matter of policy, committed to eliminate *riba* and to promote Islamic banking in the country, while keeping in view its linkages with the global economy and existing commitments to local and foreign investors. Despite the fact that the Supreme Court remanded the "*riba case*" to the Federal Shariat Court (see subsection (c) above), the Government took various measures in line with the guidelines and directions of the Supreme Court, including the introduction by the SBP of Islamic banking in the country, in parallel with conventional banking.

Factors which are material for the purpose of assessing the market risks associated with Notes

The Notes may not be a suitable investment for all investors

Each potential investor in the Notes must determine the suitability of that investment in light of its own circumstances. In particular, each potential investor should:

(i) have sufficient knowledge and experience to make a meaningful evaluation of the Notes, the merits and risks of investing in the Notes and the information contained in this Offering Circular or any applicable supplement;

(ii) have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the Notes and the impact the Notes will have on its overall investment portfolio;

(iii) have sufficient financial resources and liquidity to bear all of the risks of an investment in the Notes, including where the currency for principal or interest payments is different from the potential investor's currency;

(iv) understand thoroughly the terms of the Notes and be familiar with the financial markets; and

(v) be able to evaluate (either alone or with the help of a financial adviser) possible scenarios for economic, interest rate and other factors that may affect its investment and its ability to bear the applicable risks.

Risks related to the Notes generally

Set out below is a brief description of certain risks relating to the Notes generally:

Modification and waivers

The conditions of each series of Notes contain provisions for calling meetings of Noteholders of the applicable series to consider matters affecting their interests generally, including material changes to the terms of the Notes of the applicable series and rescission of acceleration. These provisions permit defined majorities voting at a meeting or executing written consents to bind all Noteholders of the applicable series including Noteholders of the applicable series who did not attend and vote at the relevant meeting and Noteholders of the applicable series who voted in a manner contrary to the majority.

EU Savings Directive

Under EC Council Directive 2003/48/EC on the taxation of savings income, Member States are required, from July 1, 2005, to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to an individual resident in that other Member State. However, for a transitional period, Belgium, Luxembourg and Austria are instead required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries). A number of non-EU countries and territories including Switzerland have agreed to adopt similar measures (a withholding system in the case of Switzerland) with effect from the same date.

If, following implementation of this Directive, a payment were to be made or collected through a Member State which has opted for a withholding system and an amount of, or in respect of tax were to be withheld from that payment, neither the Issuer nor any Paying Agent nor any other person would be obliged to pay additional amounts with respect to any Note as a result of the imposition of such withholding tax. If a withholding tax is imposed on payment made by a Paying Agent following implementation of this Directive, the Issuer will be required to maintain a Paying Agent in a Member State, if any, that will not be obliged to withhold or deduct tax pursuant to the Directive. Holders of the Notes should consult their own tax advisors regarding the implications of the Directive in their particular circumstances.

Change of law

The conditions of the Notes are based on English law in effect as at the date of this Offering Circular. No assurance can be given as to the impact of any possible judicial decision or change to English law or administrative practice after the date of this Offering Circular.

Risks related to the market generally

Set out below is a brief description of the principal market risks associated with an investment in the Notes, including liquidity risk, exchange rate risk, interest rate risk and credit risk:

No guarantee that listing will be approved

Application has been made to admit the Notes to listing on the Official List of the Luxembourg Stock Exchange and to trading on the Euro MTF market of the Luxembourg Stock Exchange. There is no guarantee that the application to the Luxembourg Stock Exchange will be approved.

The secondary market generally

The Notes will not have an established trading market when issued, and one may never develop. If a market does develop, it may not be very liquid. Therefore, investors may not be able to sell their Notes easily or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market.

Exchange rate risks and exchange controls

The Issuer will pay principal and interest on the Notes in U.S. dollars. This presents certain risks relating to currency conversions if an investor's financial activities are denominated principally in a currency or currency unit (the **Investor's Currency**) other than U.S. dollars. These include the risk that exchange rates may significantly change (including changes due to devaluation of U.S. dollars or revaluation of the Investor's Currency) and the risk that authorities with jurisdiction over the Investor's Currency may impose or modify exchange controls. An appreciation in the value of the Investor's Currency relative to U.S. dollars would decrease (1) the Investor's Currency-equivalent yield on the Notes, (2) the Investor's Currency-equivalent value of the principal payable on the Notes and (3) the Investor's Currency-equivalent market value of the Notes.

Government and monetary authorities may impose (as some have done in the past) exchange controls that could adversely affect an applicable exchange rate. As a result, investors may receive less interest or principal than expected, or no interest or principal.

Interest rate risks

Investment in the Notes, as they bear a fixed rate of interest, involves the risk that subsequent changes in market interest rates may adversely affect the value of the Notes.

Credit ratings may not reflect all risks

One or more independent credit rating agencies may assign credit ratings to the Notes. The ratings may not reflect the potential impact of all risks related to structure, market, additional factors discussed above, and other factors that may affect the value of the Notes. A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the rating agency at any time.

Legal investment considerations may restrict certain investments

The investment activities of certain investors are subject to legal investment laws and regulations, or review or regulation by certain authorities. Each potential investor should consult its legal advisers to determine whether and to what extent (1) the Notes are legal investments for it, (2) the Notes can be used as collateral for various types of borrowing and (3) other restrictions apply to its purchase or pledge of any Notes. Financial institutions should consult their legal advisors or the appropriate regulators to determine the appropriate treatment of the Notes under any applicable risk-based capital or similar rules.

Enforcement of foreign judgments in Pakistan

Messrs. Kabraji & Talibuddin, legal advisers to the Managers in Pakistan, have advised as follows:

In Pakistan, statutory recognition is given to foreign judgments under Section 13 of the Pakistan Code of Civil Procedure 1908 (the **Code**). This provides that a foreign judgment shall be conclusive as to any matter thereby directly adjudicated upon except (a) where it has not been pronounced by a court of competent jurisdiction, (b) where it has not been given on the merits of the case, (c) where it appears on the face of the proceedings to be founded on an incorrect view of international law or a refusal to recognize the law of Pakistan in cases where such law is applicable, (d) where the proceedings in which the judgment was obtained were opposed to natural justice, (e) where it has been obtained by fraud, or (f) where it sustains a claim founded on a breach of any law in force in Pakistan.

Section 44A of the Code provides that where a foreign judgment has been rendered by a court in any country or territory outside Pakistan which the Government has by notification declared to be a reciprocating territory, it may be enforced in Pakistan as if the judgment has been rendered by the relevant court in Pakistan. The High Court of Justice in England is a court in a reciprocating territory for the purposes of Section 44A and, accordingly, a money judgment of that court would, subject to the exceptions contained in Section 13 of the Code, be enforceable as if the judgment were the judgment of a district court in Pakistan. Accordingly, upon obtaining a foreign judgment, three possible courses are open to the holder:

(i) obtaining execution of the judgment by proceedings under section 44A, where these provisions are applicable, as they are in the case of a judgment of the High Court of Justice in England, for which the limitation period for initiating proceedings in Pakistan is three years from the date of the English judgment;

(ii) filing a suit in Pakistan on the basis of the foreign judgment treating it as the cause of action, for which the limitation period is six years from the date of the foreign judgment;

(iii) filing a suit in Pakistan on the original cause of action, for which the limitation period is three years from when the cause of action arises.

In the case of proceedings described in paragraph (iii) above, where the Pakistan court will have the power to assess the damages, it is possible that a Pakistani court will not award damages on the same basis as a foreign court, especially if it viewed the award of such damages as being contrary to Pakistani public policy.

Section 82 of the Code requires a decree against the Government to specify a period within which it is to be satisfied. If it remains unsatisfied at the expiry of such period, the Court (issuing such decree) is required to issue a report for the Orders of the Provincial Government within which such Court is situated. Execution proceedings can only be initiated against the Government three months after the date of such report.

USE OF PROCEEDS

The net proceeds of the issue of the Notes, expected to amount to approximately U.S.$798,000,000 after deduction of fees and expenses, will be used for the Government's general budgetary purposes.

THE ISLAMIC REPUBLIC OF PAKISTAN

Location and Geography

Pakistan is a federal republic located in south-central Asia between India, China, Afghanistan, Iran and the Arabian Sea. The country consists of four provinces – Punjab, Sindh, North-West Frontier Province (**NWFP**), and Balochistan – and the Federally Administered Tribal Areas. The country's land area is 796,295 square kilometres.

The capital of Pakistan is Islamabad, which is a federal territory (the Federal Capital Territory) carved out of the province of Punjab. Karachi (the capital of Sindh) is the main financial, commercial and industrial city in Pakistan. Karachi is linked by air, rail and road networks to all major cities of the country, and is also the country's main seaport. The other provincial capitals are Lahore (Punjab), Peshawar (NWFP) and Quetta (Balochistan).

The northern region of Pakistan is famous for its high mountain ranges, the Himalayas and the Karakorum. NWFP comprises both hilly areas and fertile valleys. Most of Punjab and Sindh is a plain formed by the River Indus and its tributaries. The Indus valley is known for its extensive network of canals and rich agricultural land. Balochistan, in the southwest, is mainly an arid plateau.

Population, Religion and Language

The total population of Pakistan based on the Economic Survey 2004-05 was an estimated 152.53 million as of June 30, 2005. The annual population growth rate has declined steadily from 2.3% in 1998 to 1.9% in 2005. The urban and rural population distribution is estimated to be 34% and 66%, respectively. Over 96% of the population of Pakistan is Muslim. English is the official language and Urdu is the most widely spoken and understood language throughout the country. The main regional languages are Punjabi, Sindhi, Pushto and Balochi.

Government and Politics

Political History and Recent Political Developments

Pakistan gained independence in August 1947 upon the partition of British-ruled India. The country originally comprised two predominately Muslim regions, West Pakistan and East Pakistan, separated by over 800 miles (1,280 kilometres) of Indian territory. In Kashmir, a mostly Muslim region, the reigning Hindu Maharaja was reluctant at the time of partition to accede to either India or Pakistan and later sought military assistance from India to keep his hold on Kashmir. The Maharaja announced accession to India in October 1947 and allowed Indian troops into the state. The Government of Pakistan did not accept the accession on the basis of its belief that such accession was contrary to the underlying principles of the partition of the subcontinent. The matter was, therefore, placed before the U.N. Security Council. The U.N. Security Council, through its various resolutions, resolved that the final disposition of the issue of the State of Jammu and Kashmir would be made in accordance with the will of the people expressed through a free and impartial plebiscite conducted under the auspices of the United Nations. To this day, the U.N. Security Council resolutions have not been implemented and Jammu and Kashmir remain a disputed territory between India and Pakistan. More recently, Pakistan and India have opened a dialogue in an attempt to resolve this issue, along with various other issues between the two countries.

Pakistan was a parliamentary democracy from 1947 to 1958, which period saw the deaths of Head of State, Mohammed Ali Jinnah, in 1948 and the first Prime Minister, Liaqat Ali Khan, in 1951. The Constitution was ratified in 1956. In 1958, then President, Iskander Mirza, suspended the Constitution, imposed martial law and suspended elections scheduled for January 1959. General elections were eventually held in 1970. In the general elections of 1970, the Pakistan Peoples' Party (**PPP**), led by Zulfikar Ali Bhutto, won a majority in West Pakistan while Awami League, led by Sheikh Mujibur Rehman, had the majority in East Pakistan. Neither party had an overall majority in the country. The political dispute eventually led to civil war and the emergence of East Pakistan as the independent state of Bangladesh. Bhutto formed a civilian government for the remaining western portion of Pakistan and began an extensive program of economic regulation and nationalization.

In 1977, General Mohammed Zia ul-Haq became Chief Martial Law Administrator after removing the civilian government and later became President.

After General Zia died in 1988, the PPP took a majority within a coalition government in general elections. Benazir Bhutto, the leader of the PPP, became Prime Minister. However, several political developments between 1988 and 1999 led to alternating administrations between Bhutto and Nawaz Sharif, the leader of the opposition coalition, known as the Islamic Democratic Alliance. Both Benazir Bhutto and Nawaz Sharif were twice elected as Prime Minister during this period with interim governments in between.

On October 14, 1999, the Chief of Army Staff, General Pervez Musharraf, declared a state of emergency and issued the Provisional Constitutional Order (**PCO**) which suspended Parliament, the Provincial Assemblies and the Constitution. He took over as Chief Executive of the country. On May 12, 2000, Pakistan's Supreme Court unanimously validated the takeover and granted executive and legislative authority to the Chief Executive for a period of three years through October 2002.

In June 2001, General Musharraf became President and Head of State, and dissolved the suspended assemblies. In August 2001, he announced plans for the transition to democracy in Pakistan, with provincial and national elections to take place by October 2002 as mandated by the Supreme Court. In a referendum held in April 2002, President Musharraf's term as President was extended for a further period of five years.

On August 24, 2002, President Musharraf issued the Legal Framework Order 2002 (the **LFO**) pursuant to the authority that was granted to him by the Supreme Court of Pakistan in its decision made on May 12, 2000 with the objective of ensuring a sustainable democracy including a smooth and orderly transition of power from the President and Chief Executive to a newly elected Prime Minister. Through the LFO, the President and Chief Executive revived the Constitution of Pakistan, except for certain articles. In October 2002, National and Provincial elections were held. No single party won an overall majority in the National Assembly but a coalition elected Zafarullah Jamali as Prime Minister. Senate elections were held in February 2003 (see "*Form of Government – Legislature*").

Following the general election of October 2002 and the submission to the Parliament of the LFO, a dispute arose over the distribution of power between President Musharraf and Parliament. The parliamentary opposition parties argued that the LFO was unconstitutional because it was not approved by a two-thirds majority of Parliament and asked President Musharraf to announce a date on which he would resign as Chief of Army Staff. In order to address the concerns of the opposition parliamentary parties, the Government initiated a dialogue with the opposition parties regarding the Constitution. The Parliament, by the requisite majority under the Constitution, passed the Constitution Bill 2003 (Seventeenth Amendment) which amended certain provisions of the Constitution, and which, after assent by the President on December 31, 2003, became an Act of Parliament. The principal amendments to the Constitution under the Seventeenth Amendment include the following:

- The President can hold the office of the Chief of Army Staff only until December 31, 2004.
- The President is required, upon exercise of his power to dissolve the National Assembly under Article 58(2)(b), to refer the matter to the Supreme Court within 15 days. The decision of the Supreme Court will be final.
- The Chiefs of the Armed Forces will be appointed by the President in consultation with the Prime Minister.
- All laws and actions enacted and taken between October 12, 1999 and December 31, 2003, when the Seventeenth Amendment came into force, are deemed to have been validly made.

On January 1, 2004, President Musharraf received a vote of confidence by an electoral college, consisting of members of Parliament and all the Provincial Assemblies. Having obtained a vote of confidence, President Musharraf was declared elected to hold the office of the President for a term of five years under the Constitution.

In addition, the National Security Council (the **NSC**) was established as a forum for consultation on matters of national security including the sovereignty, integrity, defense and security of the State pursuant to an Act of Parliament (Act No. 1 of 2004). The NSC is chaired by the President, and its members include the Prime Minister, the Chairman of the Senate, the Speaker of the National Assembly, Leader of the Opposition, the Chief Ministers of the Provinces, the Chairman of the Joint Chiefs of Staff Committee and the Chiefs of Staff of the Army, Navy and Air Force.

On June 26, 2004, a peaceful and democratic transfer of power was effected when Mir Zafarullah Khan Jamali resigned as the Prime Minister in the parliamentary party's meeting and proposed Chaudhry Shujat Hussain as his successor. There was a further peaceful and democratic transfer of office by Prime Minister Chaudhry Shujat Hussain in favour of Mr. Shaukat Aziz on August 25, 2004. Mr. Shaukat Aziz, after being elected as Leader of the House and securing 191 votes in the National Assembly, took oath as the twenty-third Prime Minister of Pakistan on August 28, 2004.

On September 15, 2004, the Government, citing a change in the national situation, announced that President Musharraf would continue to hold the office of the Chief of Army Staff beyond December 31, 2004. On November 1, 2004, Parliament approved a bill allowing the President to continue in both offices. The bill, having been signed by the acting President on November 30, 2004 in accordance with Article 75(1) of the Constitution, came into force on December 31, 2004.

The Government under Prime Minister Aziz has strived to maintain continuity and consistency in the policy framework that was developed in 1999 under the leadership of President Musharraf. The Government has presented a wide ranging agenda of reforms aimed at strengthening democracy, enhancing internal and external security, promoting good governance, accelerating the pace of economic development, expanding the existing infrastructure, taking the benefits of economic growth to all segments of society, promoting inter-provincial harmony and preserving the country's cultural heritage.

In consultation with the Provincial Governments, a comprehensive review of the Local Government Ordinance 2001 was undertaken and certain changes were made to consolidate and further strengthen local governments in the overall context of the devolution plan formulated in 2000. In June 2005, the Provincial Governments promulgated certain amendments in the relevant Provincial Local Government Ordinances relating to the creation of district service, restructuring of provincial departments, disciplinary powers of *nazims* (mayor) and *naib nazims* (deputy mayor), improvement of enforcement mechanisms, and functions of provincial local government commissions. These amendments were intended to further strengthen the accountability process over the local governments and to clarify the roles and powers of the Chief Executives of the Provinces and the Provincial Local Government Commissions. Under the supervision of the Election Commission of Pakistan, elections for the new local Union Councils were held in three phases on August 18, 2005, August 25, 2005 and October 6, 2005.

The next general elections are due to be held in 2007.

Form of Government

Pakistan has a federal parliamentary system.

Executive. General Pervez Musharraf is President, Chief of Army Staff and constitutional Head of State. The Prime Minister, Shaukat Aziz, is the Head of the Government. The Constitution provides that if the office of the President becomes vacant by reason of death, resignation or removal of the President, then the Chairman of the Senate or, if he is unable to perform the functions of the office of the President, the Speaker of the National Assembly, will act as President until a new President is elected.

Legislature. Pakistan has a bicameral federal legislature comprising a National Assembly (the lower house) and a Senate (the upper house). The National Assembly is elected for a term of five years, most recently in October 2002. Of the 342 seats in the National Assembly, 272 are directly elected according to popular vote, 60 are reserved for women and 10 are reserved for non-Muslim minorities. The 70 reserved seats are allocated on the basis of proportional representation to parties that win more than 5% of the directly elected seats.

Senators are elected for a term of six years. The Senate consists of 100 members: of whom fourteen are elected by members of each Provincial Assembly; eight are elected from the Federally Administered Tribal Areas; two (including one woman and one technocrat including an *aalim*, or a religious scholar) are elected from the Federal Capital; four women are elected by the members of each Provincial Assembly; and, four technocrats including *ulema*, or religious scholars, are elected by the members of each Provincial Assembly. Elections in February 2003 chose 100 Senators. The terms of 50 of the 100 Senators, chosen by lot, ended on March 10, 2006, and 50 Senators were chosen in elections held on March 6, 2006 and March 10, 2006. Of the 50, 21 are Senators who stood for reelection.

The following table shows the current composition of the National Assembly by party affiliation.

Distribution of Legislative Seats by Party

Party Name		National Assembly	Senate
Pakistan Muslim League (Quaid-i-Azam)	PML (Q)	131	38
Muttahida Majlis-e -Amal Pakistan	MMA	59	17
Pakistan Peoples Party Parliamentarians	PPPP	55	9
Pakistan Muslim League (N)	PML (N)	17	4
Muttahidda Quami Movement(1)	MQM	17	6
Pakistan Peoples Party Parliamentarians (Patriots)	PPPPP	19	0
National Alliance	NA	15	1
Pakistan Muslim League (F)	PML (F)	5	1
Pakistan Muslim League (J)	PML (J)	3	0
Awami National Party	ANP	0	2
Balochistan National Party (Mengal)	BNP (M)	0	1
Balochistan National Movement	BNM	0	0
Balochistan National Party	BNP	1	1
Jamhoori Wattan Party	JWP	1	1
Pakistan Awami Tehreek	PAT	0	0
Pakistan Muslim League (Z)	PML (Z)	1	0
Pakistan Tehreek-e-Insaf	PTI	1	0
Pakistan Pakhtoonkhawa Milli Awami Party	PPMAP	1	3
Pakistan Peoples Party (Sherpao)	PPP(S)	0	3
Jamiat Ulema-i-Islam (S)	JUI	0	1
Candidates who have not joined a political party	IND	16	12
Total		342	100

(1) Includes one vacancy due to the death of a member on February 24, 2006.

Source: Election Commission of Pakistan

The four provinces enjoy considerable autonomy from the central government. Elections for Pakistan's provincial assemblies were also held in October 2002. The MMA performed strongly in the provincial elections; it now governs in the NWFP, and governs in alliance with the PML-Q in Balochistan.

Judiciary. The Supreme Court of Pakistan hears appeals from the provincial high courts and also has original jurisdiction and advisory jurisdiction in certain matters. Each province has a separate court system. The provincial court systems consist of a provincial high court, civil and district courts to hear civil cases and magistrate courts and sessions courts to hear criminal cases. The provincial high courts hear both federal and provincial cases.

The Federal Shariat Court, created in 1980 by constitutional amendment, has the power to examine any law or provision of law and to decide whether any law violates the principles of Islam. Decisions of the Shariat Court may be appealed to the Supreme Court, and do not take effect until appeals to the Supreme Court have been exhausted.

The Government has established special courts and tribunals to deal with matters under certain statutes. Appeals from the final decisions of these courts lie with the Supreme Court, subject to leave. These special courts include the Banking and Labour Courts and Income Tax and Customs Tribunals. The decisions of these courts are subject to judicial review.

International Relations

International Organizations. Pakistan has diplomatic and trade relations with most nations of the world. Pakistan is a member of the United Nations (the **U.N.**), the Organization of the Islamic Conference (the **OIC**), the Non-Aligned Movement, the Commonwealth (an organization of former colonies of the British Empire), the World Trade Organization, as well as the International Monetary Fund (the **IMF**), the World Bank, the Asian Development Bank and the Islamic Development Bank.

During 2004, Pakistan was a non-permanent member of the UN Security Council. As a non-permanent member of the UN Security Council, Pakistan focused on issues of non-proliferation and disarmament, economic and social development, human rights, financial health of the organization and international law. Pakistan's term on the U.N. Security Council ended on December 31, 2004.

At the OIC summit in October 2003, President Musharraf proposed his concept of "Enlightened Moderation" to bridge the gap between the West and the Islamic world and to reform the OIC. This concept has been endorsed by the OIC. President Musharraf's concept of "Enlightened Moderation" urges the OIC to combat religious militancy and extremism. President Musharraf has proposed economic transformation through raising growth rates and educational levels, poverty reduction through improvements in the welfare of women, minorities and vulnerable segments of society, and through foreign direct investment. The Government is committed to fighting extremism and intends to continue implementing the President's policies.

Regionally, Pakistan is a member of the Economic Cooperation Organization (**ECO**), an organization that promotes economic and trade ties between Iran, Pakistan, Turkey and the Central Asian Republics. Pakistan is also a founding member of the South Asian Association for Regional Cooperation (**SAARC**), which also includes Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal and Sri Lanka (with China and Japan participating as observers). Pakistan is also seeking to upgrade its relationship with the Association of South East Asian Nations (**ASEAN**) to full dialogue partnership. Pakistan is a member of ASEAN Regional Forum (**ARF**), the security related organ of ASEAN. Pakistan is also a member of the Developing-8 (**D8**), comprising Bangladesh, Egypt, Iran, Indonesia, Malaysia, Nigeria, Pakistan and Turkey. The D8 countries are negotiating a preferential trade agreement.

In early January 2004, Pakistan hosted the 12th SAARC Summit in Islamabad. At the Summit, members of SAARC:

- approved a Framework Agreement on the South Asia Free Trade Area (**SAFTA**);
- adopted a social charter that would aim to improve regional cooperation in addressing social development;
- endorsed a comprehensive strategy for poverty alleviation; and
- signed an Additional Protocol to the 1987 SAARC Regional Convention on Suppression of Terrorism that proposes measures to combat terrorism and its financing in accordance with U.N. Security Resolution 1373.

Pakistan ratified SAFTA in February 2006, with the possibility of the agreement coming into force, with retrospective effect, from January 1, 2006. *See "The Pakistan Economy – Foreign Trade and Balance of Payments – Foreign Trade*."

Given Pakistan's growing prominent role in the region, the Shanghai Cooperation Organization (**SCO**), comprised of China, Russia, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan, extended observer status to Pakistan in July 2005.

International Relief Assistance. Pakistan, with close to 10,000 deployed troops, is one of the largest contributor of troops to U.N. peacekeeping operations worldwide. It has participated in twenty-seven U.N. peacekeeping missions as well as other international aid efforts. These have included providing emergency food relief to various African countries as well as contributing troops to the U.N. peacekeeping operations in Sierra Leone, East Timor, Kosovo, Congo, Liberia, Ivory Coast, Burundi and Haiti.

At the Abu Dhabi Donors' Conference in February 2004, the Government announced a U.S.$10.0 million humanitarian assistance package for the people of Iraq. This included relief goods of U.S.$3.3 million which have already been supplied. In addition, Pakistan also provided training to 10 Iraqi diplomats at the Foreign Service Academy during 2003.

In response to the December 2004 tsunami disaster, the Prime Minister approved Rs. 50.0 million in relief assistance. In addition, aircraft, navy vessels, helicopters, a task force and medical teams were dispatched to assist with the relief effort in the disaster stricken areas. It is expected that Government expenditure on the relief effort will amount to approximately Rs. 856.0 million.

Relations with Afghanistan. Pakistan has pledged U.S.$250.0 million to Afghanistan's reconstruction efforts and provided support to the Afghan government in the October 2004 presidential elections. Pakistan continues to host 2.6 million registered Afghan refugees who fled Afghanistan during its conflict with the Soviet Union and continued to flee to Pakistan to escape the ensuing civil war in the 1990s and the 2001 coalition war against Al-Qaeda and the Taliban regime. The Government estimates that there are an additional 1.5 million unregistered Afghan refugees in the country. Pakistan is assisting with the voluntary repatriation of Afghan refugees in liaison with the U.N. High Commissioner for Refugees.

Exercising effective control over the Federally Administered Tribal Areas and other parts of the border with Afghanistan poses significant challenges for any government due to a combination of difficult terrain, the remoteness of the region and strong tribal loyalties among the local population. To improve security and to prevent the entry of suspected al-Qaeda and Taliban elements, Pakistan has deployed 75,000 troops along the Pakistan-Afghanistan border and has substantially improved its intelligence and technical assets as well as aerial surveillance in this regard. The authorities have continued to act against suspected al-Qaeda activities and supporters throughout Pakistan. More than 700 suspects have been arrested throughout the country. The Government has proscribed 13 militant organizations and has placed a further two organizations on a watch list pursuant to the Anti-Terrorism Act 1997. The Government is also in the process of preparing a bill to strengthen legislation against terrorist financing.

Relations with India. Since the partition of British India into Pakistan and India in 1947, the two countries have gone to war three times, most recently in 1971. Relations with India remain tense over the disputed area of Jammu and Kashmir. The U.N. Security Council passed resolutions calling for a U.N. supervised plebiscite in Jammu and Kashmir.

The Kashmir dispute has caused intermittent border exchanges along the cease-fire line, which is supervised by U.N. security forces. Recently, there has been some movement towards easing tensions between India and Pakistan. Following the prolonged military standoff in 2002, Pakistan and India announced several confidence building measures in 2003. As a result of the agreement between the two countries, Pakistani and Indian High Commissioners joined their posts in Delhi and Islamabad, respectively, and the bus service between Lahore and Delhi resumed in the second half of 2003. Since then, both Governments have restored air and rail links which were suspended by India in December 2001, are exploring the possibility of starting new road and rail links, and have agreed to re-establish sporting ties.

On January 5, 2004, after a meeting in Islamabad between President Musharraf and the then Indian Prime Minister Atal Bihari Vajpayee during the SAARC Summit, the two leaders agreed to commence a composite dialogue process to address all issues between the two countries including the issue of Jammu and Kashmir. The subsequent meeting of the two leaders in New York on September 24, 2004 was positive and raised hopes of a peaceful resolution to all outstanding issues. In late November 2004, Prime Minister Shaukat Aziz made his first visit to India where he met the Indian Prime Minister and Foreign Minister. Also in late November 2004, India began to withdraw some of its troops from the region. Talks on Jammu and Kashmir at the foreign secretary level continue to be pursued. The possibility of a gas pipeline running from Iran through Pakistan and to India, which should strengthen economic ties, is also under discussion. Pakistan also has welcomed India’s participation in discussions for Turkmenistan-Afghanistan-Pakistan and Gulf-South Asia gas pipeline projects. The World Bank has raised the possibility of economic assistance for Kashmir if it would help promote peace in the divided region.

Pursuing the composite dialogue process with India, President Musharraf visited New Delhi in April 2005, accelerating the conclusion of several confidence building measures between the two sides. Following such meeting, Indian Prime Minister Manmohan Singh and President Musharraf agreed to increase the frequency of bus service between the two countries, allow commercial trucking along the same bus route to promote increased trade and add more routes of service between the two countries in the future.

Nuclear Restraint. On May 11 and May 13, 1998, India carried out nuclear weapons tests. In response, Pakistan carried out nuclear tests on May 28 and May 29, 1998. Since the nuclear tests of 1998, Pakistan has held a regular dialogue with the United States of America (**U.S.A.**) and other countries on regional security and non-proliferation issues. During the dialogue, Pakistan has presented a number of proposals to promote nuclear restraint and responsibility including a Strategic Restraint Regime in South Asia. Pakistan’s strategic nuclear assets are under stringent organizational, administrative and command and control structures. As a matter of strategic policy, the Government has not proliferated sensitive nuclear technologies. Further, in 2003 the Government conducted internal debriefing sessions to ascertain if any Pakistani individuals had been involved in the transfer of sensitive nuclear technologies. On January 31, 2004, the Government announced the removal of Dr. Abdul Qadeer Khan from his post as scientific adviser to the Prime Minister after Dr. Khan confessed to investigators that he had, in his personal capacity, provided certain nuclear technologies to other countries. On February 5, 2004, President Musharraf announced a pardon of Dr. Khan with respect to these matters. Furthermore, in September 2004, Pakistan’s parliament passed the Export Control Act which prohibits the diversion of controlled goods and technologies.

Relations with the U.S.A. Pakistan has enjoyed good relations with the U.S.A. in recent years. The two countries have cooperated in the war against terrorism. In 2004, the U.S.A. designated Pakistan a major non-NATO ally under Section 517 of the Foreign Assistance Act of 1961, enabling Pakistan to receive economic and military assistance. Since then, military and economic assistance to Pakistan has steadily increased with the U.S.A. clearing the sale of military equipment worth U.S.$1.3 billion in November 2004 which was followed by an announcement on the sale of F-16 aircraft in March 2005. As of March 31, 2005, Pakistan had received nearly U.S.$0.6 billion in assistance from the U.S.A. since 2002. Pakistan is also seeking to strengthen trade ties with the U.S.A. and, in September 2004, Pakistan and the U.S.A. held trade talks in Washington at which the U.S.A. agreed to restore tariff concessions and to negotiate a bilateral investment treaty. The good relations between Pakistan and the U.S.A. were underlined by the visit of US President Bush to Islamabad in March 2006.

Relations with China. Pakistan continues to enjoy close and stable relations with China, which have remained unaffected by radical changes in the international environment. The two countries share a common interest, particularly in the preservation of balance and stability in the region. The political and economic fundamentals of the relations remain sound and are reflected in the frequent high-level exchanges, cooperation, understanding and support for each other's positions at the international level, and extensive cooperation in the economic field. Economic cooperation between the countries extends to Chinese investments and financial assistance in port, railway, mining, coal and nuclear power projects. The strong bonds of friendship and cooperation between Pakistan and China were further strengthened during Premier Win Jiabao's visit to Pakistan in April 2005 when the two countries signed a landmark Treaty of Friendship. During his return visit to Beijing in February 2006, President Musharraf urged increased economic cooperation between Pakistan and China to match their political and diplomatic ties.

Other Recent Developments

Earthquake in Pakistan. On October 8, 2005, Pakistan experienced the worst earthquake in its history with a magnitude of 7.6 on the Richter scale. The earthquake struck the eastern parts of the North West Frontier Province (**NWFP**) and Azad Jammu and Kashmir (**AJK**), killing at least 73,000 people, severely injuring another 70,000, and leaving 2.8 million people without shelter. Eastern NWFP and AJK have also suffered extensive damage to economic assets and infrastructure, with social service delivery, commerce, and communications either debilitated or destroyed. Although the President has established an Earthquake Reconstruction and Rehabilitation Authority to facilitate and support the rebuilding and repair of damaged infrastructure, including housing, roads, bridges, government buildings, schools and hospitals, the reconstruction effort will pose a large cost to Pakistan. A preliminary damage and needs assessment study published by the Asian Development Bank and the World Bank on November 12, 2005 estimated the direct cost associated with the earthquake at approximately U.S.$5.2 billion which includes estimated costs for relief, livelihood support for victims, and reconstruction. As of February 20, 2006, the Government has received total pledges in support of the relief effort of approximately U.S.$6.5 billion, including loans in the amount of U.S.$4.0 billion. The proceeds from these funds to the extent they are required by the Government are expected to be received over the next three to five years.

The Government anticipates that inflation may increase in the short run due to food supply disruptions from the earthquake damaged areas and increased demand for raw materials for reconstruction. Imports of raw material and machinery also may rise, thereby negatively affecting the trade deficit. The Government estimates that GDP growth may decrease by 0.5% of GDP for 2005-06, although increased production of housing, medicine and other necessities, as well as expected growth in construction activity, may offset the decline.

Violent Protests Over Newspaper Cartoons of the Prophet Mohammad. Mocking cartoons of the prophet Muhammad that were first published in a Danish newspaper in September 2005 and were subsequently republished by other newspapers in several European countries have aroused intense anger and sometimes violent protests across the Muslim world. On February 14, 2006, angry protesters, shouting anti-Western slogans, attacked and destroyed Western businesses in the city of Lahore and stormed a diplomatic enclave in Islamabad. The protests in Lahore resulted in the tragic deaths of at least two protesters who were shot by a security guard when they attempted to storm a bank. Violent protests also occurred in other cities such as Peshawar, where protesters damaged a Christian school. Pakistan recalled its ambassador to Denmark for consultations, although its Embassy in Copenhagen continues to function and registered diplomatic protests with the governments of Norway, Denmark and Sweden. The Government has strongly condemned both the cartoons and the violence and has warned that it will not tolerate any violence or damage to the lives and properties of the people and that the religious issue should not be used for political gains.

Avian Influenza. The continuing spread of the H5N1 strain of the avian influenza virus has become a worldwide concern for agriculture and health officials, because of the potentially devastating impact on local poultry industries and the fear that the virus might mutate into a form capable of human-to-human transmission. There have been confirmed cases of the virus in many countries in Asia, the Middle East, Europe and Africa, including Pakistan. In connection with the threats posed by avian influenza, the Government is taking all possible precautionary measures including increased surveillance and expanded disease testing facilities across the country. The Government estimates that the cost of implementing precautionary measures against the spread of the virus is Rs. 271.0 million for 2005-06. On February 20, 2006, the Government also announced that it is taking steps to ban import of poultry products and live birds from a number of countries where cases of avian influenza have been reported.

Armed conflict in Northern Waziristan. As a part of Government of Pakistan's policy of fighting against international terrorism, the Pakistani security forces took military action in March 2006, in the North Waziristan region of NWFP province along the Afghan border to rid the area of foreign militants and restore law and order. Pakistani security forces killed more than 100 foreign militants and succeeded in restoring law and order in the affected area. The Government will continue to use military action as a natural response whenever armed foreign elements enter Pakistani territory and it has urged the Afghan Government to increase its own efforts in securing the mutual border and in providing intelligence about the whereabouts of foreign militants in Pakistan.

THE PAKISTAN ECONOMY

Overview of Pakistan's Economy

Economic History

For most of the l980s, Pakistan's economy grew steadily, with GDP increasing in real terms by, on average, over 6.0% per year. The late 1980s, however, saw increasing fiscal and external deficits, infrastructure deficiencies and disruptions in production.

During the first half of the 1990s, Pakistan suffered severe natural calamities (floods in 1992-93, drought in 1993-94 and leaf curl virus attacks on the cotton crop in both 1992-93 and 1993-94), all of which harmed the agricultural sector. At the same time, Pakistan's economy also experienced the impact of external factors, such as the effect of the first Gulf War on the price of oil in 1990-91 and the world-wide recession between 1991 and 1993. Nevertheless, the economy grew at an average rate of 5.0% per year between 1991 and 1996.

The effects of the financial crisis in East Asia in 1997 eroded Pakistan's ability to mobilize external sources of financing. The situation worsened significantly following the nuclear detonation by India on May 11, 1998. This immediately affected investor confidence, resulting in a depreciation in the open market exchange rate for the Rupee against the U.S. dollar and the significant withdrawal of foreign currency deposits. Pakistan's nuclear detonation in response to the Indian detonation was followed by the imposition of economic sanctions by Japan and the United States. Additionally, the G-8 countries suspended all non-humanitarian financial support to Pakistan from the multilateral financial institutions and other official sources, which further contributed to the erosion of investor confidence and a deterioration in the balance of payments.

In response to the repercussions of sanctions following the Government's nuclear tests, the Government declared a state of emergency on May 28, 1998. Subsequent economic measures were taken to prevent a foreign exchange crisis in the country. The Government began accumulating arrears on debt while foreign currency accounts in the country were frozen on May 29, 1998 and foreign currency account holders were given the option to either convert their holdings to Rupees or to buy U.S. dollar denominated bonds with three-, five- or seven-year maturities. A multiple exchange rate system was introduced with official, composite and open market rates operated simultaneously in the economy. The State Bank of Pakistan (**SBP**) temporarily reduced reserve and liquidity requirements to protect the liquidity of the banking system.

In January 1999, Pakistan reached an agreement with the Paris Club of official creditors in respect of U.S.$3.3 billion of payment arrears outstanding on December 31, 1998 and principal and interest payments falling due in the period up to the end of 2000. The rescheduling agreement incorporated a 20-year repayment schedule (of which the first 10 years are grace periods) for the Official Development Assistance (**ODA**) portion of the restructured debt. For non-ODA debt, the repayment period is 18 years (of which the first three years are grace periods). On July 6, 1999, agreement was reached with commercial banking creditors who agreed to reschedule the stock of short-term trade-related debt over three years, and in December 1999, Pakistan effected an exchange of outstanding external bonds for new bonds maturing in installments from 2002-05 all of which have now been repaid.

Economic Policy Objectives

Upon taking power in 1999, the Government perceived that if the large fiscal and current account deficits associated with the build up of public and external debt were left uncorrected, the worsening macroeconomic balance could cause the higher accumulation of debt, a loss of national sovereignty, an uncertain environment for investment, and jeopardize the prospects for sustaining high economic growth.

This situation led the Government to set four major economic policy objectives that continue to guide the Government's fiscal policies: first, to achieve macroeconomic stability; second, to revive economic growth; third, to reverse the trend of increasing poverty; and fourth, to improve governance.

These four policies were reflected in Pakistan's Poverty Reduction Strategy, which was supported by an SDR 1.034 billion Poverty Reduction Strategy Facility (**PRGF**) from the IMF. The Poverty Reduction Strategy provided a framework for economic, structural and social policies to encourage growth and reduce poverty. Pakistan's three-year arrangement under the PRGF ended in December 2004 concluding a long period of financial support from the IMF. In the future, Pakistan plans to rely primarily on domestic and international markets to meet its financing needs together with continued support from official creditors.

Stability. In order to address the issues of severe macroeconomic instability and to place the economy on a path of high sustained growth, financial stability, and improved external balances, in 1999 the Government initiated a major change in the orientation of economic policy and introduced a comprehensive set of economic stabilization and structural reform measures. The Government focused on reducing the fiscal and current account deficits to minimize aggregate imbalances, and on increasing foreign exchange reserves to strengthen the shock absorbing capacity of the economy.

To improve Pakistan's debt situation which had reached an unsustainable level due to the persistence of large fiscal and current account deficits during the 1990s, the Government launched a formal Debt Reduction Strategy in 2001, which aimed to reduce fiscal account deficits, reduce the cost of borrowing, and procure financing from international institutions on concessionary terms.

Reviving Growth. The increasing debt burden of the 1990s slowed private sector investment and forced public sector investment to decline. The overall investment rate declined by almost 4.0% of GDP in the 1990s. Declining investment rates caused growth to decelerate as well. As compared to average growth of 6.1% in the 1980s, economic growth slowed to 5.1% and then to 4.0% during the first and second half of the 1990s. To revive economic growth on a sustained basis, the Government increased the tax base, improved tax collections and controlled defense expenditures while also increasing development expenditures, liberalizing trade, managing the country's debt levels and promoting investment. Pursuant to these initiatives, the Government identified five sectors of the economy which act as the major drivers of growth. These include: agriculture, small and medium enterprises (**SMEs**), the oil and gas sector, housing and construction and information technology.

Poverty Reduction. Poverty in Pakistan rose significantly in the 1990s. The Government instituted anti-poverty programs pursuant to the PRGF. These programs involve raising literacy rates, training teachers, eliminating gender disparities in education, rehabilitating school buildings and initiating health programs. Poverty related expenditures have continued to increase since the release of the initial Poverty Reduction Strategy Paper (**PRSP**) by the government in 2001. PRSP expenditures increased from Rs. 167.3 billion or 3.8% of GDP in 2001-02 to Rs. 316.2 billion or 4.8% of GDP for 2004-05. On February 28, 2006, the National Economic Council announced that a survey had shown that the percentage of the population living in poverty had fallen approximately 7 percentage points from 32% in 2000-01 to 25% in 2004-05. For the same period, urban poverty decreased by 6 percentage points (from 23% in 2000-01 to 17% in 2004-05) while rural poverty decreased by 7 percentage points (from 39% in 2000-01 to 32% in 2004-05).

Governance. Weak governance was identified by the Government as an important source of Pakistan's macroeconomic difficulties in the 1990s. Poor governance slowed Pakistan's economic growth and severely reduced the effectiveness of public expenditures; weakened overall macroeconomic management; undermined investors' confidence; and encouraged tax evasion, loan defaults, non-payment of utility bills and corruption. The Government has now given a high priority to improving governance. While initial actions focused on accountability, especially with respect to loan and tax defaulters, the Government has more recently embarked on a series of reform measures designed to improve governance. The key elements of the reform measures included devolution and decentralization of state power to the local level; downsizing/rightsizing of government offices; judicial and police reform; and the introduction of transparency in economic decision-making processes.

Overview of Results of Economic Policies

As a result of the policies and reforms implemented by the Government since 1999, despite external and domestic shocks generated by the events of September 11, 2001 and thereafter, continuing tensions with India, the war in Afghanistan, and periods of severe drought throughout Pakistan, Pakistan's economy has made significant progress over the last six years.

Both exports and imports registered robust growth, foreign exchange reserves remained at relatively high levels despite continued repayment of external debt. A strong and broad-based recovery in the global economy helped increase demand for Pakistani exportable goods. This increase was, however, outweighed by high international oil prices and rising imports of machinery and raw materials for making consumer and capital goods, resulting in an increase in the trade deficit.

The following table sets out certain major economic indicators from 2000-01 to 2004-05.

Major Economic Indicators

	2000-01	2001-02	2002-03	2003-04	2004-05
GDP at Current MP (Rs. million)(1)	4,162,654	4,401,699	4,822,842	5,532,663	6,547,590
GNP at Current MP (Rs. million)(1)	4,108,172	4,425,364	4,974,654	5,657,141	6,672,814
Population (million)(2)	140.47	145.96	146.75	149.65	152.53
GNP per Capita (Rs.)	29,246	30,319	33,899	37,802	43,748
Exports f.o.b. (U.S.$ million)	8,933	9,140	10,889	12,396	14,401
Imports f.o.b. (U.S.$ million)	10,202	9,434	11,333	13,604	18,753
Balance of Trade (U.S.$ mn)	(1,269)	(294)	(444)	(1,208)	(4,352)
Total Reserves Minus Gold (U.S.$ million)(3)	3,244	6,398	10,747	12,324	12,421
Overall Budgetary Deficit (as % of GDP)	4.3	5.5	3.7	2.4	3.2
GDP Growth (FC) (%)(4)	1.8	3.1	4.8	6.4	8.4
Inflation (%)	4.4	3.5	3.1	4.6	9.3
Total Investment (as % of GDP) (MP)(1)	17.2	16.8	16.9	17.3	16.9
National Savings (as % of GDP)	16.5	18.6	20.8	17.7	15.7
Current Account (Deficit)/Surplus excluding official transfers (as % of GDP)	(0.7)	1.9	3.8	1.4	(1.6)

(1) (MP) Market Price.
(2) Ministry of Finance estimate.
(3) Includes both reserves held by the State Bank of Pakistan and by commercial banks.
(4) (FC) Factor Cost.
Source: Ministry of Finance; State Bank of Pakistan.

Real GDP. Real GDP grew at an average rate of 4.9% per annum during the period from July 1, 2000 to June 30, 2005. Manufacturing GDP grew by 9.5% per annum during the same period. Real GDP grew by 6.4% in 2003-04, reflecting 2.2%, 14.1% and 6.0% growth in agriculture, manufacturing and services, respectively. Real GDP grew by 8.4% in 2004-05, led by strong growth in manufacturing (12.5%) and continuing robust performance in the services (7.9%) and agriculture (7.5%) sectors. Per capita income rose to approximately U.S.$736 in 2004-2005 compared to approximately U.S.$500 in 2000-01.

Exports and Imports. As a result of the reform programs begun in 1999, Pakistan's share of total trade (exports f.o.b. plus imports f.o.b.) in GDP grew by two percentage points from 28.0% in 2000-01 to 30.0% in 2004-05, highlighting the growing importance of merchandise trade in Pakistan's economy. Exports f.o.b. averaged U.S.$9.0 billion from 2000-01 to 2001-02, growing at an annual rate of 2.3%. Exports f.o.b. rose to U.S.$10.9 billion in 2002-03, increased to U.S.$12.4 billion in 2003-04, and reached U.S.$14.4 billion in 2004-05, increasing by 19.1%, 13.8% and 16.2%, respectively. For the first half of 2005-06, exports f.o.b. increased by 13.0%, rising to U.S.$7.8 billion from U.S.$6.9 billion for the first half of 2004-05.

While exports f.o.b. averaged U.S.$9.0 billion from 2000-01 to 2001-02, imports f.o.b. averaged U.S.$9.8 billion during the same period, resulting in large trade deficits for those years. Imports f.o.b. rose to U.S.$11.3 billion in 2002-03, increased to U.S.$13.6 billion in 2003-04, and reached U.S.$18.8 billion in 2004-05, increasing by 20.1%, 20.0% and 37.8%, respectively. For the first half of 2005-06, imports f.o.b. increased by 28.6%, rising to U.S.$11.7 billion from U.S.$9.1 billion for the first half of 2004-05. As a result of the faster rise in imports than exports, Pakistan's trade deficit has grown from an average of U.S.$925.4 million for the five year period 1999-00 to 2003-04 to U.S.$4.4 billion in 2004-05. For the first half of 2005-06, the trade deficit was U.S.$3.9 billion. Growth in non-food non-oil imports of machinery, equipment and raw materials (certain of which was related to Earthquake relief), together with rising international oil prices, caused the relatively larger increase in imports than exports in the first half of 2005-06.

Foreign Investment. The inflow of foreign investment in Pakistan declined after 1995-96 due to several factors, including: the saturation of investment in the power sector; the Asian financial crisis of 1997; the economic sanctions imposed on Pakistan after its nuclear tests and the Government's subsequent freezing of foreign currency accounts in May 1998; public disputes with IPPs and Hub Power Company Limited (**Hubco**); low levels of foreign exchange reserves and the threat of default on external debt payment obligations; and unstable relations with the International Financial Institutions (**IFIs**).

However, over the last six years the Government believes it has successfully addressed each of these constraints. The IPP disputes have been resolved; foreign exchange reserves have reached a comfortable position;

economic fundamentals have improved; and most economic sanctions have been lifted. Pakistan has also executed a reform program with the IFIs and the currency has stabilized. With the removal of these impediments and the significant improvements in the country's macroeconomic environment, the flow of investment has increased. Foreign direct investment was U.S.$949.4 million in 2003-04, which was significantly higher than the U.S.$322.4 million of foreign investment in 2000-01. In 2004-05 total foreign direct investment amounted to U.S.$1,524.0 million, an increase of 81.8% compared to 2003-04. In the first six months of 2005-06, foreign direct investment totaled U.S.$1,103.3 million.

Current Account Balance. After registering surpluses for four consecutive years from 2001-02 to 2003-04, Pakistan's current account balance (excluding official transfers) posted a deficit of U.S.$1.8 billion or 1.6% of GDP in 2004-05. In 2003-04, the current account (excluding official transfers) posted a surplus of U.S.$1.3 billion or 1.4% of GDP. The deterioration in the current account was primarily due to a wider trade deficit and higher net outflows from the services account. The wider trade deficit was a primarily a result of higher oil import bills and strong domestic demand for non-oil imports. The net outflows under the services account was primarily due to higher freight charges and fuel cost for shipping, as well as growth in personal travel. For the first half of 2005-06, the current account (excluding official transfers) posted a deficit of U.S.$3.0 billion compared to a deficit of U.S.$0.8 billion for the first half of 2004-05.

Foreign Exchange Reserves. Foreign exchange reserves held by SBP (excluding gold) stood at U.S.$2,088.0 million at June 30, 2001. See "—Foreign Trade and Balance of Payments—Foreign Reserves". Prudent macroeconomic policies pursued by the Government resulted in improvements in the trade and current account balances. Since the adoption of those policies, there have been substantial increases in private inflows, and in assistance from donor agencies, which has led to an increase in foreign exchange reserves held by SBP (excluding gold) from U.S.$2,088.0 million at the end of 2000-01 to U.S.$10,487.0 million at the end of 2004-05 and to U.S.$9,969 million at December 31, 2005, an increase of 377.4% from the end of 2000-01 figure, but a decrease of 4.9% over the level of U.S.$10,487.0 million on June 30, 2005. The build up of foreign reserves has not only strengthened the Rupee against the U.S. dollar, but also strengthened the Rupee against other currencies and strengthened the currency's ability to withstand external economic shocks.

Remittances. Workers' remittances have been the major source of foreign currency inflows to Pakistan since the second half of the 1970s. With macroeconomic conditions improving and the confidence of expatriate Pakistanis improving, the flow of workers' remittances increased from a low of U.S.$984 million in 1999-00 to more than U.S.$4.2 billion in 2002-03, the highest level in Pakistan's history. In 2003-04 workers' remittances stood at U.S.$3.9 billion.

In 2004-05, workers remittances, the second largest source of foreign exchange inflow after exports, reached U.S.$4.2 billion, an increase of 8.5% from the same period last year and an increase of U.S.$0.4 billion over the full year target of U.S.$3.8 billion. Workers remittances totaled U.S.$2.4 billion in the first seven months of 2005-2006, compared to U.S.$2.3 billion in the same period last year. As of January 31, 2006, the United States continued to be the single largest source of cash workers remittances accounting for 28.5% followed by Saudi Arabia (15.8%), UAE (14.8%), UK (9.7%) and Kuwait (5.5%).

Inflation. Inflation averaged 4.4% per annum in 2001-02 and 3.1% in 2002-03 and was slightly higher at 4.6% in 2003-04. The low levels of inflation were a result of better supply of essential commodities, appreciation of the Rupee against the U.S. dollar, prudent fiscal management and continued management of the monetary impact of substantial foreign exchange inflows. In 2004-05, inflation was estimated to be at 9.3% due to significant price increases in all categories of goods and services due to high domestic demand, oil price pressures and supply shortage of food items.

Inflationary pressures have recently begun to ease, potentially in response to both a tightening of monetary policy by the State Bank of Pakistan, which slowed the uptrend in core inflation, and better supply management of essential food items by the Government, which helped decrease food inflation. As a result, annualized consumer price inflation decreased to an estimated 8.4% for the first six months of 2005-06 from 8.8% in the corresponding period in 2004-05.

Fiscal Development. Pakistan's tax collection and administration system has been challenged by the existence of a large informal sector, the small share of wages in total national income and the dominance of agricultural sector in the economy. The Government has sought to address the weaknesses of Pakistan's tax structure by launching a series of wide-ranging tax and tariff reforms and increasing fiscal transparency, with a view to shifting the tax burden from imports and investment to consumption. Among the various tax policy reforms initiated by the Government, the most significant were the continuous raising of the basic threshold of income tax, the reduction in the corporate tax rate to ensure parity between the tax rates applicable to private, public, and banking companies, the broadening of the general sales tax (GST), and the continuous reduction and rationalization of tariff rates. In terms of tax administration, the Government streamlined the processing of sales tax refunds, established a tax ombudsman's office and instituted a large taxpayers unit to improve tax collection. Wide-ranging tax and tariff reforms, as well as reforms in tax administration, have been beneficial although challenges remain. During the five years from 2000-01 to 2004-05, tax collection by the CBR increased by 62.8%. However, while the tax-to-GDP ratio improved from 10.6% in 2000-01 to 10.9% in 2001-02 and further to 11.5% in 2002-03, it has recently decreased to 11.0% in 2003-04 and 10.1% in 2004-05. The revenue deficit (the difference between total revenue and total current expenditure), a measure of government dis-saving, was at a deficit of 0.7% of GDP in 2004-05 compared to a deficit of 2.6% in 2000-01.

The Government's fiscal deficit as a percentage of GDP averaged almost 7.0% during the 1990s. However, better fiscal discipline lowered the fiscal deficit to 3.2% of GDP in 2004-05. As a result of this improved fiscal discipline, expenditures on interest payments as a percentage of GDP have declined considerably during the five years from 2000-01 to 2004-05. Interest payments were approximately 5.6% of GDP in 2000-01 and declined to 3.2% of GDP in 2004-05. The additional capital made available from the reduced spending in this area has been used to finance poverty and social sector related spending. Poverty and social sector related expenditures which were Rs. 167.3 billion or 3.8% of GDP in 2001-02 increased to Rs. 316.2 billion or 4.8% of GDP in 2004-05. In the first half of 2005-06, the fiscal deficit was only 2.1% of projected GDP for the year, or 56.2% of the full year deficit target of Rs. 285.0 billion.

Debt Situation. Domestic debt grew at an annual rate of 16.0% from 1990 to 1999 and reached almost 43.4% of GDP by 1999-00 from 44.1% of GDP in 1990-91. Pakistan's total external debt and foreign exchange liabilities grew from U.S.$23.0 billion as of 30 June 1991 to almost U.S.$38.9 billion as of 30 June 1999. As a result of the sharp accumulation of both domestic and external debt, the country's debt servicing liability rose sharply in the 1990s. In 1990-91, 37.6% of the Government's total revenue was consumed by debt servicing and by 1998-99, debt servicing reached 64.0% of total Government revenue, leaving 36.0% to be spent on defence, civil administration, development work in general and social sectors. Consequently, the Government's annual development budget continued to shrink from 6.4% of GDP to 2.5% of GDP during the same period. Both physical and human capital deteriorated sharply during the period, constraining the country's future growth potential. After implementing reforms and following the 2001 Debt Reduction Strategy, domestic debt declined from 43.4% of GDP in 1999-00 to 33.0% in 2004-05. Furthermore, domestic debt servicing as a percentage of total revenue declined to 33.7% by 2004-05. External debt and foreign exchange liabilities were U.S.$35.8 billion at end of 2004-05 compared to U.S.$37.1 billion at the end of 2000-01, a reduction of U.S.$1.3 billion in absolute terms or from 52.2% of GDP to 32.5% of GDP.

Reforms

The Government's stabilization program was supplemented by a series of wide-ranging structural reform measures, which are needed to enhance economic incentives and improve resource allocation, as well as to remove impediments to private sector development. The Government believed that Pakistan's economic problems were structural in nature and objectives of sustaining high growth, low inflation, and external payment viability could not be achieved without removing certain structural barriers. In addition to the fiscal reforms, tax reforms and governance reforms discussed above, major structural reforms have included tax legislation, trade reforms, further privatization, financial sector reforms, and human development and social protections.

Fiscal Responsibility and Debt Limitation Act 2005. The Government has sought to reduce the fiscal deficit through a number of reforms. These reforms include the enactment of the Fiscal Responsibility and Debt Limitation Act 2005. The Act provides measures to eliminate the revenue deficit and minimize public debt to a prudent level by effective debt management. The principles included in the Act are:

(a) to eliminate the revenue deficit by not later than June 30, 2008 and to thereafter maintain a revenue surplus;

(b) to ensure that within a period of ten fiscal years beginning from July 1, 2003, the total public debt at the end of the tenth fiscal year (ending June 30, 2013) does not exceed 60% of estimated GDP for that year and thereafter to maintain total public debt below 60% of GDP for any given fiscal year;

(c) by June 30, 2013, to reduce the total public debt by not less than 2.5% of the estimated GDP in every fiscal year, provided that the social and poverty related expenditures are not reduced below 4.5% of the estimated GDP for any given fiscal year; and

(d) to not issue any new guarantees, including those on Rupee lending, bonds, rates of return, output purchase agreements and all other claims and commitments that may be prescribed from time to time for any amount exceeding 2.0% of the estimated GDP in any fiscal year. The renewal of existing guarantees will be considered as issuing new guarantees.

In addition to the above, budgetary allocation, expressed as a percentage of GDP, to education and health must be doubled from the existing level within ten years. The Government may depart from any of the above principles on grounds of unforeseen demand on the finances of the Government caused by a national security emergency or a natural calamity, as determined by the National Assembly. The law provides that any such departure shall be temporary and the Minister for Finance of the Government shall in accordance with the law, specify (i) the reasons for the Government's departure from the law, (ii) the approach or measures the Government intends to take to return to the requirements of the law; and (iii) the period of time that the Government expects to take to come within the parameters of the law again.

Trade Reforms. In recent years, the Government has significantly liberalized its trade regime. In its policy review in 2002, the World Trade Organization (**WTO**) noted favourably the trade reforms by Pakistan. As a result of tariff reform, which included the rationalization of the tariff structure, the average tariff rate has declined to as low as 8.9% per annum compared to over 25.0% per annum in 1996-97. The Government has lowered its tariffs both on agricultural products and non-agricultural products considerably below its WTO requirements. The share of customs duties in tax revenue receipts during 2004-05 was reduced to 17.8%, compared to 33.0% in 1996-97. Reduction and rationalization of tariffs has led to reducing tariffs to levels of 5.0%, 10.0%, 20.0% and 25.0% depending on the goods or services being imported.

Pakistan ratified SAFTA in February 2006, with the possibility of the agreement coming into force, with retroactive effect, from January 1, 2006. In addition, Pakistan is also in the process of negotiating bilateral free trade agreements with various other countries. See "The Pakistan Economy - Foreign Trade and Balance of Payments - Foreign Trade."

Privatization. The principal objectives of the privatization policy of successive Governments have been to reduce the demand on Government resources, raise funds for priority sectors, improve the efficiency of the economy through the sale of state owned enterprises (**SOEs**) and stimulate direct investment in the country.

The privatization program in Pakistan was initiated in 1990, with the establishment of a Divestment and Deregulation Committee. The purpose of this committee was to identify SOEs for Privatization. This was followed by the formation of the Privatization Commission in 1991, the purpose of which was to evaluate SOEs for privatization, start the bidding process and make recommendations to the Cabinet Committee on Privatization (**CCOP**). On October 28, 2000 the Government passed the Privatization Commission Ordinance which strengthened the position of the Privatization Commission and specified that 90.0% of privatization proceeds shall be utilized for retirement of Federal Government debt and 10.0% for poverty alleviation. In November 2000 a Ministry of Privatization was created to oversee the Privatization Program.

The Government has used a variety of methods to implement its privatization program. The primary model adopted by the Government has been the sale of strategic interests, along with management control, to investors. Small to medium-sized industrial operations have been privatized, following an open bidding process without a pre-qualifying process, whereas for larger entities, the Government has used a pre-qualification stage and a more formal sealed bidding process. Pakistan has also used to a lesser extent both domestic and international capital markets for the divestment of SOE's shares in order to provide an opportunity to the public to participate directly in the privatization process.

Between October 1999 and December 31, 2005, 55 transactions, realizing proceeds of Rs. 300.1 billion, had been completed.

The following table summarizes the results of the Government's privatization programme as of December 31, 2005.

Privatization Summary

Sector	From 1991 to June 30, 2004		From July 1, 2004 to June 30, 2005		From July 1, 2005 to December 31, 2005		Total through December 31, 2005	
	No.	Amount[(1)]	No.	Amount[(1)]	No.	Amount[(1)]	No.	Amount[(1)]
Banking	7	41,023	-	-	-	-	7	41,023
Capital Market Transaction	14	19,440	3	11,204	1	1,040	18	31,684
Energy	12	20,904	1	16,415	1	20,240	14	57,559
Telecom	2	30,558	-	-	2	155,500	4	186,058
Automobile	7	1,102	-	-	-	-	7	1,102
Cement	13	8,606	2	49	1	3,205	16	11,860
Chemical/Fertilizer	18	10,204	3	14,151	-	-	21	24,355
Engineering	7	183	-	-	-	-	7	183
Ghee Mills	22	838	-	-	1	8	23	846
Rice/Roti Plants	23	328	-	-	-	-	23	328
Textile	2	87	-	-	1	128	3	215
Newspapers	5	270	-	-	-	-	5	270
Tourism	3	594	1	1,211	-	-	4	1,805
Others	5	152	1	8	-	-	6	160
Total	140	134,289	11	43,038	7	180,121	158	357,448

(1) Amounts are in Rupees in millions.
Source: Privatization Commission.

From November 2001 to December 2005, major transactions that reflect the increasing size and complexity of the privatization program include:

(a) United Bank Limited: Sale of 51.0% interest to a consortium of Abu Dhabi Group and Best Way Group in October 2002 for Rs. 12.4 billion.

(b) Pakistan Oilfields Limited: Sale of 26.0% interest on the capital markets in October 2002 for Rs. 5.1 billion.

(c) Bank Al-Falah: sale of interest to the Abu Dhabi Group in December 2002 for Rs. 620.0 million.

(d) Attock Refinery Limited: sale of interest on the capital markets in January 2003 for Rs. 1.0 billion.

(e) Sui Southern Gas Limited: sale of 10.0% interest on the capital markets in February 2003 for Rs. 1.7 billion.

(f) Investment Corporation of Pakistan – State Enterprises Mutual Fund: sale of management rights to Pakistan Industrial Credit and Investment Corporation in April 2003 for Rs. 787.0 million.

(g) National Bank of Pakistan: sale of 13.2% interest on the capital markets in three lots between November 2001 and October 2003 for Rs. 1.4 billion.

(h) Oil and Gas Development Company Limited: sale of 5.0% interest on the capital markets in November 2003 for Rs. 6.9 billion.

(i) Associated Cement: sale of interest to National Transport in November 2003 for Rs. 255.0 million

(j) Thatta Cement: sale of interest to EMG in January 2004 for Rs. 794.0 million

(k) Habib Bank Limited: sale of 51.0% interest to the Aga Khan Foundation for Economic Development on January 1, 2004 for Rs. 22.4 billion.

(l) Falleti's Hotel, Lahore Sale: to 4-B Marketing in May 2004 for Rs. 1.2 billion.

(m) Kohinoor Oil Mills Limited: sale of interest to Iqbal Khan in May 2004 for Rs. 80.7 million.

(n) Pakistan International Airlines Corporation: sale of 5.8% interest on the capital markets in July 2004 for Rs. 1.1 billion.

(o) Pakistan Petroleum Limited: sale of 15.0% interest on the capital markets in July 2004 for Rs. 5.7 billion.

(p) Kot Addu Power Company (KAPCO): Sale of 20.0% interest on the capital markets in April 2003 for Rs. 4.6 billion.

(q) National Refinery Limited: sale of 51.0% interest to Consortium of Attock Refinery Limited in May 2005 for Rs. 16.4 billion

(r) Karachi Electricity Supply Corporation: sale of 73.0% interest to Consortium of Hassan Associates, Al-Jamaih Holding Co. & Premier Mercantile Services for Rs. 20.2 billion which was completed in December 2005.
(s) Pak Arab Fertilizers Limited: sale of 100% interest to Export Reliance Consortium for Rs. 14.2 billion, which closed in May 2005.
(t) Pakistan Telecommunication Company Limited: sale of 26.0% interest with management control to United Arab Emirates telecom company Etisalat. The investors have paid U.S.$259 million of the U.S.$2.6 billion purchase price, with a total of U.S.$1.4 billion (including the U.S.$259 million first payment) due before the transfer of management control and the remaining U.S.$1.2 billion of the proceeds due in nine semi-annual installments. A 12.0% interest had already been divested in 1994 through the capital markets.

Pakistan has a number of privatization transactions planned for the coming months. Major proposed transactions include:

(a) Pakistan Petroleum Limited: the sale of a 51.0% interest to a strategic investor. The privatization is expected to be completed in the second quarter of 2006.
(b) Faisalabad Electricity Supply Company: four parties have been pre-qualified to acquire a 56.0% interest.
(c) Peshawar Electricity Supply Company: requests for expressions of interest are expected to be published in 2006.
(d) State Life Insurance Company: the Government has announced that it will privatize the State Life Insurance Company through an initial public offering.
(e) Jamshoro Power Company Limited: 11 parties have submitted expressions of interest to acquire a 51.0% interest and management control.
(f) Sui Southern Gas Corp Limited: Strategic sale of 51% with transfer of management control, scheduled for the second quarter of 2006.
(g) Sui Northern Gas Pipelines Limited: Strategic sale of 51% with transfer of management control, scheduled for the second quarter of 2006.
(h) Oil and Gas Development Corporation Limited: Sale of 51% of the shares of OGDCL with the transfer of management control. The sale is expected to take place following the sale of shares in Pakistan Petroleum Limited.
(i) National Investment Trust: Sale of up to 55.33% shares with transfer of management rights.
(j) Investment Corporation of Pakistan: Sale of 51% with transfer of management control.
(k) Pak-American Fertilizer Limited: Sale of 94.3% of the company's shares along with management control.
(l) Pakistan Steel Mills Corporation: Sale of a 51-75% equity interest in the company along with management control.
(m) Pakistan State Oil: sale of a 51.0% interest. Pakistan State Oil is Pakistan's largest company in terms of revenue and is the most actively traded company on the Karachi Stock Exchange.

Most of Pakistan's nationalized commercial banks, such as Habib Bank Limited, United Bank Limited and Muslim Commercial Bank have been privatized. The Government has indicated that the National Bank of Pakistan will not be privatized in the near future because it handles the pensions of government employees and deals in Treasury bills in areas where SBP has no branches. However, the Privatization Commission has offered the shares of the National Bank of Pakistan through the domestic stock exchanges and has already sold 23.2% of shares in the National Bank of Pakistan in three phases. In addition, the Zarai Taraqiati Bank Limited (former Agricultural Development Bank of Pakistan) and Industrial Development Bank of Pakistan have not been included in the privatization program.

Reform of the Water and Power Development Authority (**WAPDA**). WAPDA has unbundled its generation, distribution and transmission functions into 15 separate entities (nine distribution companies, four thermal generation companies, WAPDA (hydro-electric) and the National Transmission and Dispatch Company) but these companies are not fully autonomous as details of separate final tariff arrangements for the distribution companies are awaited from the National Electric Power Regulatory Authority. WAPDA, therefore, still receives revenue from the unbundled companies, and the companies rely on WAPDA for input purchases. The Government believes that completion of the corporatization process will be an important step in attracting private sector investment in WAPDA and a key to ending financial support from the Government. See "Principal Sectors of the Economy - Energy."

Financial Sector Reforms. The supervision and regulation of non-bank financial companies has been transferred to the Securities and Exchange Commission of Pakistan (**SECP**) to enable the SBP to focus on the supervision of the banking sector. The SBP has revised banking regulations with a view to providing greater flexibility and authority to banks. The SBP has also issued numerous new regulations and/or guidelines some of which include regulations and/or guidelines (i) to facilitate the development and growth of primary and secondary asset backed securitization markets and commercial paper, (ii) on the write-off of defaulted loans which are intended to accelerate the recovery process of defaulted loans, (iii) revising the forms of accounts for banks to strengthen disclosure requirements, (iv) to strengthen the governance, disclosures and transparency in the practices of commercial banks, including providing that any appointment of a chief executive officer of a bank must be approved by the SBP, and (v) instructing banks to become connected through shared ATM networks. To promote consolidation in the banking sector, the SBP has increased minimum capital requirements and encouraged financial institutions to engage in mergers and acquisitions. To strengthen the financial markets, banks have been permitted to raise funds from the capital markets in the form of rated and listed subordinated debt securities, which can be included in the bank's supplementary capital. The Financial Institutions (Recovery of Finances) Ordinance 2001 was enacted to provide for the expedited recovery of defaulted loans, including the right of foreclosure and sale of mortgaged property with or without court intervention.

The Government has established a demutualized commodity futures exchange. The Commodity Exchange and Futures Contracts Rules, 2005 set out the law relating to the operation of a commodity exchange and with respect to dealings in commodity futures contracts on such exchange. However, trading will not commence until a new futures trading act is enacted to provide a legal framework for transactions on this exchange.

An Islamic Banking Department has been created in the SBP to regulate and promote Islamic Banking in Pakistan in a gradual manner. SBP has also become a founding member of the Malaysian-based Islamic Financial Services Board which is responsible for preparing standards and guidelines for Islamic financial institutions.

Legal Reforms. The Government has launched a program to reform the legal system in Pakistan called the Access to Justice Program (**AJP**). The program is supported by a U.S.$350.0 million loan facility provided by the Asian Development Bank. The program comprises: (i) judicial reforms, such as the construction of Federal Courts at Lahore, Islamabad and Karachi, development of national judicial policy and an increase in the number of judges to hear cases; (ii) legal reforms, such as the enactment of new laws and the review of existing laws and the development of continuous legal education programs for the legal profession; and (iii) police reforms by improving accountability and reorganizing the force along functional lines.

Human Development and Social Protection. The Government has undertaken a significant number of programs to improve the welfare of its citizens, particularly the poor. The Government launched a Micro Finance Section Development Program (**MSDP**) to provide a conducive environment and institutional capacity to retail micro finance services to the poor. This included the launch of the Khushali Bank (**KB**) in August 2000, which within a period of just over five years of its commercial launch, has established a network of 64 branches and 142 service centres in 75 districts across Pakistan. As of December 31, 2005, KB had also processed over 630,204 loans totaling more than Rs. 6.4 billion across 423,000 households.

Under the Education Sector Reforms 2001-06 (**ESR**), a national literacy campaign was launched throughout the country. The campaign envisages enhancing the literacy rate to 60.0% by 2006. Approximately 27,000 adult literacy centres are expected to open for this purpose. Pakistan has raised the literacy rate from 26.0% in 1981 to 53.0% in 2003-04. The ESR also aims to reform Madrassas and bring them into the mainstream education system. In addition, the Ministry of Education has established a policy to advance gender equality in education. By 2003-04, Pakistan had approximately 154,970 Primary Schools and total enrolment was approximately 19.8 million. The share of education in the public sector budgetary allocation has increased to Rs. 139.3 billion in 2004-05 compared to Rs. 75.9 billion in 2000-01. Of the 6,240 schools upgraded in Punjab and NWFP, 3,787 or 60.8% are schools particularly devoted to female education. Furthermore, 50.0% of all educated development allocations are being provided to schools for girls.

A virtual university has been established and a model university ordinance has been approved. A Higher Education Commission has been established to formulate policies, guiding principles and priorities for higher education institutions for the promotion of the socio-economic development of the country.

Various health priority programs with a special focus on the major public health problems of the country have been carried out. These include, HIV-AIDS prevention, tuberculosis and malaria control, family planning, primary healthcare and immunization programs.

The National Housing Policy 2001 was implemented to provide various measures to boost the housing and construction sector, including:

(a) tax incentives to homeowners, and

(b) strengthening and streamlining loan recovery through promulgation of the Financial Institutions (Recovery of Finance) Ordinance, 2001.

In addition, the SBP has issued guidelines for banking companies to undertake asset securitization, and allow banks to issue long-term debts to facilitate the financing of home loans. The House Building Finance Corporation, Pakistan's largest specialized housing finance provider, has been put under a new and professional Board of Directors and management with a mandate to restructure the institution into a commercially viable and self-sustaining entity.

Gross Domestic Product

The composition of Pakistan's gross domestic product has undergone considerable changes over the last three decades. While the share of the manufacturing sector has remained relatively constant at between 16.0% to 19.0% of GDP, the agriculture sector declined from its highest level of approximately 39.0% of GDP in 1969-70 to 23.1% of GDP in 2004-05 and the services sector increased from 38.0% of GDP in 1969-70 to 52.4% of GDP in 2004-05. During such period, the share of major crops (such as wheat, sugarcane, cotton and rice) decreased from 23.4% of GDP to 7.5% of GDP.

Real GDP growth was 1.8% in 2000-01, 3.1% in 2001-02 and 4.8% in 2002-03. Over the two most recent years, Pakistan's economy grew much faster than in prior years as real GDP grew by an average of 6.5% from 2002-03 to 2004-05.

In 2003-04, real GDP grew at a rate of 6.4% which was higher than the targeted growth of 5.3% and is the first time since 1996 that the GDP growth rate has crossed the 6.0% mark. Growth was aided by 14.1% and 6.0% growth in the manufacturing and services sectors, respectively. The performance of agriculture fell short of the target by growing at 2.2% against a target of 4.2% and was lower than last year's growth of 4.1%. Fiscal stimulus in the shape of large public sector spending and a conducive interest rate environment provided important support to this growth picture in Pakistan.

In 2004-05, provisional results show that real GDP grew at a rate of 8.4%, the highest level in two decades. Economic expansion was led by growth in manufacturing (15.4%) and continued in the services sector (7.9%) and agriculture sector (7.5%). Higher consumption and availability of low-cost credit raised domestic demand while greater external demand for Pakistan exports fueled additional industrial activity.

The following tables set out Pakistan's GDP at both constant 1999-00 factor cost and at current cost, the GDP growth rates, and the contribution of various sectors of the economy to GDP in recent years:

	Gross Domestic Product At Constant Factor Cost of 1999-00				
	2000-01	**2001-02**	**2002-03**	**2003-04**[1]	**2004-05**[2]
			(Rs. Million)		
Commodity Producing Sectors					
Agriculture	903,499	904,433	941,942	962,527	1,034,292
Mining & Quarrying	47,561	51,031	59,266	61,509	64,609
Manufacturing	571,357	596,841	638,044	727,733	818,448
Construction	87,846	89,241	92,789	86,402	91,783
Electricity & Gas Distribution	120,465	112,026	98,932	119,809	122,358
Services Sectors					
Transport, Storage and Communication	422,195	427,296	445,552	470,015	496,171
Wholesale & Retail Trade	649,564	667,615	707,665	764,688	856,531
Finance and Insurance	112,455	131,761	130,081	135,972	165,553
Ownership of Dwellings	114,593	118,604	122,466	126,764	131,214
Public Administration and Defence	225,152	240,585	259,148	269,959	267,750
Other Services	339,437	366,285	389,067	409,166	431,141
GDP (FC)	3,594,124	3,705,718	3,884,952	4,134,544	4,479,850

[1] revised
[2] provisional
(FC) Factor Cost
Source: Federal Bureau of Statistics.

Gross Domestic Product

	At Current Factor Cost				
	2000-01	**2001-02**	**2002-03**	**2003-04**[1]	**2004-05**[2]
			(Rs. million)		
Commodity Producing Sectors					
Agriculture	945,301	968,291	1,059,316	1,149,129	1,322,641
Mining & Quarrying	59,151	65,997	84,238	107,990	121,836
Manufacturing	608,132	642,850	725,434	902,870	1,118,391
Construction	94,670	95,197	100,880	120,487	143,916
Electricity & Gas Distribution	133,091	134,350	120,556	150,707	156,301
Services Sectors					
Transport, Storage and Communication	512,997	542,828	609,929	699,782	902,247
Wholesale & Retail Trade	691,854	720,812	785,776	922,667	1,107,296
Finance and Insurance	116,997	142,424	144,989	158,476	210,683
Ownership of Dwellings	124,359	126,454	135,139	146,293	165,456
Public Administration and Defence	235,039	260,042	285,854	312,105	337,560
Other Services	354,434	395,967	429,301	472,104	543,349
GDP(FC)	3,876,025	4,095,212	4,481,412	5,142,610	6,129,676

[1] revised
[2] provisional
(FC) Factor Cost
Source: Federal Bureau of Statistics.

GDP Growth Rates

	2000-01	2001-02	2002-03	2003-04[1]	2004-05[2]
Commodity Producing Sectors	0.5	1.3	4.4	6.9	8.9
Agriculture	(2.2)	0.1	4.1	2.2	7.5
Mining & Quarrying	(1.7)	7.3	16.1	3.8	5.0
Manufacturing	9.3	4.5	6.9	14.1	12.5
Construction	0.5	1.6	4.0	6.9	6.2
Electricity & Gas Distribution	(13.7)	(7.0)	(11.7)	21.1	2.1
Services Sectors	3.1	4.8	5.2	6.0	7.9
Transport, Storage and Communication	5.3	1.2	4.3	5.5	5.6
Wholesale & Retail Trade	4.5	2.8	6.0	8.1	12.0
Finance and Insurance	(15.1)	17.2	(1.3)	4.5	21.8
Ownership of Dwellings	3.8	3.5	3.3	3.5	3.5
Public Administration and Defense	2.2	6.9	7.7	4.2	(0.8)
Other Services	5.6	7.9	6.2	5.2	5.4
GDP(FC)	1.8	3.1	4.8	6.4	8.4

1 revised
2 provisional
(FC) Factor Cost
Source: Federal Bureau of Statistics.

Sectoral Shares in GDP

	2000-01	2001-02	2002-03	2003-04[1]	2004-05[2]
Commodity Producing Sectors	48.2	47.3	47.1	47.4	47.6
Agriculture	25.1	24.4	24.2	23.3	23.1
Mining & Quarrying	1.3	1.4	1.5	1.5	1.4
Manufacturing	15.9	16.1	16.4	17.6	18.3
Construction	2.4	2.4	2.4	2.1	2.0
Electricity & Gas Distribution	3.4	3.0	2.5	2.9	2.7
Services Sectors	51.8	52.7	52.9	52.6	52.4
Transport, Storage and Communication	11.7	11.5	11.5	11.4	11.1
Wholesale & Retail Trade	18.1	18.0	18.2	18.5	19.1
Finance and Insurance	3.1	3.6	3.3	3.3	3.7
Ownership of Dwellings	3.2	3.2	3.2	3.1	2.9
Public Administration and Defense	6.3	6.5	6.7	6.5	6.0
Other Services	9.4	9.9	10.0	9.9	9.6
GDP(FC)	100.0	100.0	100.0	100.0	100.0

1 revised
2 provisional
(FC) Factor Cost
Source: Federal Bureau of Statistics.

Principal Sectors of the Economy

Agriculture

Agriculture remains the largest sector of the national economy. In 2004-05, it accounted for 23.1% of GDP and employed approximately 43.0% of the total work force. In addition, agriculture contributes to growth as an important supplier of raw materials to industry as well as a market for industrial products and is the main source of foreign exchange. Approximately 66.7% of the country's population live in rural areas and are reliant on agriculture for their livelihood.

The agriculture sector consists of crops, livestock, fishing and forestry sub-sectors. The crop sub-sector comprises major crops (primarily wheat, cotton, rice and sugar cane as well as maize and gram) and minor crops (such as pulses, potatoes, onions, chillies and garlic). The internal composition of the agriculture sector has changed over time and the crops sub-sector share in agriculture has gradually declined from 65.1% of the agriculture sector in 1990-91 to 49.4% in 2004-05. By contrast, the share of livestock in the agriculture sector has increased from 29.8% in 1990-91 to 46.8% in 2004-05. Fishing and forestry contribute a relatively small share of overall agriculture – 1.3% and 2.5%, respectively for 2004-05.

Growth in the agricultural sector was restrained for the four years prior to 2004-05. The agriculture sector contracted by 2.2% in 2000-01 which was primarily the result of a drought that caused a shortage of irrigation water in both *kharif* (May-September) and *rabi* (October-April) seasons. The drought continued to affect the agriculture sector in 2001-02, which consequently did not register any significant growth over the previous year, despite a 3.7% increase in the livestock sub-sector. The agriculture sector grew by 4.1% in 2002-03, surpassing the Government's target of 2.5%. The performance of the agricultural sector remained less than satisfactory in 2003-04 as it grew by only 2.6% with major crops and livestock sharing growth of 1.9% and 2.8% respectively.

The Government's long-term aim to improve the productivity of the agriculture sector has resulted in a number of incentives being offered to the sector in recent years. On June 10, 2004, the President of Pakistan announced a package of measures to boost agriculture. The package included proposals to line watercourses, reduce the price of some fertilizers, provide over 600 bull-dozers for land development over three years, tax and duty relief for tractors and agricultural implements, loan and mark-up relief and the extension of agricultural credit facilities. In order partially to address the country's future water needs, and deal with its vulnerability to water shortages due to its reliance on only one river system, the Indus, and a lack of water storage capacity, existing dams will be upgraded and new dams constructed. This includes upgrading the Mangla Dam, Gomal Zam Dam, Mirani Dam, Subak Zai Dam and Sadpara Dam.

The Government's goal of improving production in the agriculture sector began to show results in 2004-05 with the sector growth rate reaching unprecedented levels. The agricultural sector grew by 7.5% in 2004-05 mainly due to significant increases in cotton production and wheat production. The production of major crops in 2004-05 posted a 17.3% increase over 2003-04.

Based on preliminary results in the first half of 2005-06, the agricultural sector is expected to grow by 4.2%, compared with 7.5% during the previous year. Cotton production is expected to be lower in 2005-06 by 11.2% compared to the previous year. Sugarcane production is estimated to be lower in 2005-06 by 15.1% compared to the previous year, while wheat and rice production are estimated to increase by 1.6% and 9.5%, respectively.

The following tables set out information regarding the area under cultivation and production volumes of Pakistan's major crops for the periods indicated.

Area and Production of Certain Major Crops

	2000-01		2001-02		2002-03		2003-04		2004-05	
	Area(1)	Production(2)	Area	Production	Area	Production	Area	Production	Area	Production
Wheat	8,181	19,024	8,058	18,227	8,034	19,183	8,216	19,500	8,358	21,612
Rice	2,377	4,803	2,114	3,882	2,225	4,479	2,461	4,848	2,520	5,025
Sugarcane	961	43,606	1,000	48,042	1,100	52,056	1,075	53,419	966	47,244
Cotton(3)	2,927	10,732	3,116	10,613	2,794	10,211	2,989	10,048	3,193	14,265
Barley	113	99	111	100	108	100	102	98	93	92
Gram	905	397	934	362	963	675	982	611	1,094	868
Maize	944	1,643	942	1,664	936	1,737	947	1,897	982	2,797
Rapeseed & Mustard	272	231	269	221	281	235	280	238	257	216
Tobacco	46	85	49	95	47	88	46	86	51	101

(1) Area: Thousand hectares.
(2) Production: Thousand Tonnes.
(3) Cotton Production: Thousand Bales.
Source: Ministry of Food, Agriculture and Livestock (Economic Wing).

Wheat, rice, cotton and sugarcane accounted for approximately 90.4% of value added in major crops in 2004-5. The value added in major corps accounts for 37.2% of the value added in overall agriculture. Wheat production is central to Pakistan's self-sufficiency in food.

Wheat. Wheat is the main staple food of the country's population and largest grain crop of the country. In 2004-05, it contributed 13.8% to the value added in agriculture and represented 3.2% of GDP. The size of the wheat crop in 2004-05 was 21,612 thousand tonnes which was 10.8% higher than in 2003-04. The higher growth in wheat production is attributable to higher market prices of wheat in 2004-05 which encouraged farmers to grow more wheat crop than in 2003-04. Increased availability of fertilizer through imports and a 2.4% increase in availability of certified seed also affected wheat growth. Most important, however, were timely winter rains that preceded the strong growing season.

Cotton. Cotton is an important cash crop. It accounted for 10.5% of value added in agriculture and 2.4% of GDP in 2004-05. Raw cotton is generally used by the local textile industry, and surplus lint cotton is exported. Production of cotton totaled 14.3 million bales in 2004-05 which was the highest production ever recorded in Pakistan and an increase of 42.0% over 2003-04.

Rice. Rice is a key food as well as a cash crop in Pakistan. It is also one of Pakistan's two principal export crops and in 2004-05, Pakistan earned U.S.$932.5 million from exports of rice. In 2004-05, rice accounted for 5.7% in value added in agriculture and 1.3% of GDP. Production of rice during 2004-05 was provisionally estimated at 5.0 million tonnes which was 2.9% higher than in 2003-04. The higher production is due to improved weather conditions and better agronomic practices as well as good seed availability.

Sugarcane. Sugarcane is a highly water intensive, important cash crop for Pakistan. Sugar production in the country mostly depends on sugarcane, though a small quantity of sugar is also produced from sugarbeet. The size of the 2004-05 sugarcane crop was 47.2 thousand tonnes which was 11.6% lower than in 2003-04. The lower production of sugarcane in 2004-05 was mainly due to a decrease in the area of land cultivated for sugarcane from 1,075 thousand hectares in 2003-04 to 966 thousand hectares in 2004-05, a 10.1% decrease. The reduction in production area was due to farmers choosing to produce sunflower and cotton which were yielding higher prices per hectare than sugarcane. A decrease in water supply during the growing season also contributed to the decline in production. As a result, sugar imports rose sharply in 2004-05 and in the first six months of 2005-2006.

Forestry. Forestry plays an important role in the Pakistani economy. Forests are important for the protection of land and water resources, particularly in prolonging the lives of dams, reservoirs and the irrigation network of canals. Forestry is also essential for maintaining a sustained supply of wood and wood products. Pakistan has only 5% of its total land area under forest which is very low as compared to other Asian countries. Of the 5% of total landmass that has forest cover, 85% is public forest, which includes 40% coniferous and scrub forests on the northern hills and mountains. The balance is made up of irrigated plantations and riverain forests along major rivers on the Indus plains, mangrove forests on the Indus delta and trees planted on farmlands. The total forested area of Punjab, NWFP, Sindh and Balochistan is 0.51, 1.33, 0.84 and 1.36 million hectares respectively. It is estimated that state forests contribute only 14% of timber and 10% of fuel wood, whereas 46% of timber and 90% of fuel wood requirements come from farmland. During 2004-05, forests contributed 456 thousand cubic meters of timber and 456 thousand cubic meters of firewood as compared to 464 thousand cubic meters of timber and 454 thousand cubic meters of firewood in 2003-04. In order to enhance tree cover in the country, tree planting campaigns are held each year. During spring and monsoon season year 2004-05, 119.33 million saplings (spring 58.62 and monsoon 60.71 million) were planted.

Livestock. Because livestock is less vulnerable to adverse weather conditions as compared to crops, it provides an alternative source of rural income. This sub-sector has grown by an average growth rate of 5.8% in the past ten years. In 2004-05 livestock accounted for 46.8% of agricultural value added and about 10.8% of GDP. The role of livestock in the rural economy is critical, with approximately 35 million people located in rural areas engaged in raising livestock, which generates approximately 30-40% of their income. Livestock includes: cattle, buffalos, sheep, goats, camels, horses, asses and mules.

Manufacturing

Manufacturing is the second largest sector of the economy, accounting for 18.3% of GDP in 2004-05. It is also tied to the agricultural sector with crops such as cotton, sugarcane and tobacco serving as raw material for the manufacturing sector.

The main contributors to the 15.6% growth in 2004-05 were the textile and apparel group (24.7%), chemicals (11.2%), petroleum group (9.4%), tyres and tubes group (6.7%), non-metallic mineral products (16.8%), engineering goods group (14.9%), electrical items group (44.8%), and automobile group (32.8%). The items that registered positive growth were cotton yarn (18.2%), cotton cloth (28.9%), nitrogenous fertilizer (3.6%), phosphatic fertilizer (37.8%), cooking oil (15.1%), cement (16.9%), cigarettes (10.3%), jeeps and cars (28.3%), tractors (21.2%), light commercial vehicles (67.6%), motorcycles/scooters (45.6%), paper and paper board (3.7%), T.V sets (7.8%), motor tyres (14.3%), refrigerators (27.1%) and caustic soda (10.2%). The individual items exhibiting negative growth include: sugar (23.1%), bicycles (11.5%) and billets (26.7%).

Large-scale manufacturing, accounted for 69.5% of overall manufacturing, registered growth of 15.6% in 2004-05 against a target of 12.2% and registered growth of 18.2% in 2003-04. The high levels of liquidity in the banking system, an investment friendly interest rate environment, a stable exchange rate, low inflation, comfortable foreign exchange reserves, stronger domestic demand for consumer durables and high business confidence were responsible for the surge in industrial production.

The textile sector has traditionally lead the export of manufactured goods contributing 58.9% of the country's export earnings in 2004-05. Its share in the economy along with its contribution to exports, employment, foreign exchange earnings, investment and value added in industry, make it the single largest determinant of growth in the manufacturing sector. In 2004-05, it had a 46.0% share in overall manufacturing activity. Pakistan has emerged as a major cotton textile product supplier in the world market with a share in the world yarn trade of about 30.0% and 8.0% in cotton cloth. The share of textiles in export earnings is 68.0% with a value of around U.S.$7.0 billion. The value addition in the sector accounts for 9.0% of GDP and its share in overall employment is 35.0%.

There are currently 18 automobile manufacturing units in Pakistan involved in the assembling / manufacturing business with the support from over 850 auto parts manufacturers. During the current fiscal year the automobile industry has continued its growth momentum for the fourth consecutive year. The demand in the auto sector has been spurred, by low interest rates in the financial markets, a persistent inflow of home remittances, cheaper and easy availability of car financing and frequent model changes induced by competition in the car industry. The production of trucks registered a growth of 65.4% during July-December 2005-06, followed by LCV's (38.0%), cars (28.4.%), motorcycles (21.0.%) and tractors (15.5%).

Mining and Quarrying

Pakistan has economically exploitable reserves of coal, rock salt, limestone and onyx marble, china clay, dolomite, fire clay, gypsum, silica sand and granite, as well as precious and semi-precious stones. Mineral deposits which may have sizeable reserves but require greater exploration include gold, copper, tin, silver, antimony, the platinum group of elements, tungsten, lead, bauxite and fluorite.

The mining and quarrying sector grew by 5.0% in 2004-05. However, the sector contributed only 1.4% to GDP in 2004-05. The main contribution to the growth of the mining and quarrying sector came from mining of chromites, limestone and the extraction of natural gas which grew by 183.3%, 19.3% and 19.3%, respectively, in the first nine months of 2004-05.

Because much of the country's mining reserves exist in remote areas, infrastructure improvements are necessary to attract higher investment in this sector. Since 2000, the Government has implemented a mining policy under which imports of machinery have been allowed free of tariffs and restrictions on repatriation of profits by foreign investors have been removed. These measures have been successful in attracting foreign investment in the mining and quarrying sector.

Foreign direct investment (**FDI**) in the mining and quarrying sector was 26.3% of total FDI in 2000-01 and 56.7% in 2001-02. In 2001-02, the sector was the largest recipient of FDI, primarily by way of oil and natural gas exploration. Although FDI in the mining and quarrying sector decreased to U.S.$188.2 million in 2002-03 from U.S.$274.8 million in 2001-02, it remained the second largest component of Pakistan's FDI, representing 23.6% of Pakistan's FDI in that period. In 2003-04, FDI in the mining and quarrying sector increased to U.S.$203.5 million and accounted for 21.4% of total FDI for that year and then decreased to U.S.$194.3 million or 12.7% of total FDI in 2004-2005.

Energy

The Energy sector in Pakistan comprises power, gas, petroleum and coal. The total primary energy supplies measured in terms of tonnes of oil equivalent (TOE) stood at 55.5 million TOE in 2004-05. With the growth in the Pakistani economy, primary energy supplies have been rising steadily over the last several years. Energy supply totaled 47.1 million TOE in 2002-03, increased by 7.9% in 2003-04 to 50.8 million TOE and further grew by 9.3% in 2004-05 to 55.5 million TOE. Oil, natural gas, electricity, coal and LPG contribute 29.4%, 50.3%, 12.2%, 7.6% and 0.4%, respectively to primary energy supplies in 2004-05.

At June 30, 2005 Pakistan had estimated recoverable reserves of crude oil of 308.6 million barrels and an average oil production of 66,079 barrels per day in 2004-05, a 7.0% increase from the 61,774 barrels the previous year. This satisfied about one-sixth of Pakistan's current oil requirements with the balance being met through imports from Kuwait, Saudi Arabia, the United Arab Emirates and Iran. Pakistan also had estimated recoverable reserves of natural gas of 32.8 trillion cubic feet and 185 billion tonnes of coal at June 30, 2005.

Until recently, Pakistan obtained half of its electricity from hydro-electric sources and the balance from thermal generation. Thermal capacity was at 12,423 MW as of June 30, 2005, which included approximately 5,832 MW from the private sector.

The energy sector has undergone and is anticipated to continue to undergo significant privatization. As discussed under "Pakistan Economy – Overview of Pakistan's Economy – Reforms", the Privatization Commission is in the process of selling certain interests in PSO and OGDCL. In addition, the Privatization Commission has announced its intention to privatize Faisalabad Electric Supply Company, Peshawar Electric Supply Company and Jamshoro Power Company Limited.

Private sector power generation commenced in Pakistan in 1996, with the commissioning of Hubco, with a capacity of 1,292 MW. The Hubco project, which was supported over an eight-year period by successive Governments, led to the development of a general framework of incentives for IPPs in March 1994. Under this framework, the Government guaranteed for each project the performance of the state-owned utility, WAPDA, and the privatized KESC, under a power purchase agreement, as well as the obligations of the relevant state-owned entity under a fuel supply agreement. The Government also provided certain guarantees, including availability and remittance of foreign exchange.

Financial arrangements have been concluded for 14 projects in addition to Hubco. These arrangements include funding from multilateral sources, such as the ADB, the International Finance Corporation and the World Bank, and funding from bilateral official sources and commercial financial institutions, mostly under co-financing agreements. All 14 IPPs have successfully completed commissioning and are now integrated with either WAPDA or the KESC system A list of the 14 projects, in addition to Hubco, for which financial arrangements have been concluded is set out in the following table:

IPP Project	**Net Capacity (MW)**
AES Lalpir Ltd	351
AES Pak. Gen. Co	344
Altern Energy (Pvt.) Ltd	10
Fauji Kabirwata Power Ltd	150
Gul Ahmed Energy Ltd (a KESC project)	125
Habibullah Coastal Power	126
Japan Power Generation Ltd	107
Kohnoor Energy Ltd	126
Liberty Power Project	210
Rousch (Pak) Power Ltd	355
Saba Power Co	120
Southern Electric Power Co. Ltd	112
Tapal Energy Ltd. (a KESC project)	120
Uch Power Ltd	548
Total	2,801

Source: Private Power & Infrastructure Board.

In October 2002, the Government announced a new policy for power generation projects (Power Policy 2002) that is aimed at addressing an estimated power supply deficiency by 2010. Power Policy 2002 has among its prime objectives, provision of sufficient capacity for power generation at the least cost while encouraging the exploitation of indigenous resources.

Among other things, Power Policy 2002 provides that:

- Projects in the private and public sectors and public-private partnerships are within its scope;
- indigenous resources for power generation (including gas, hydro-electric, coal and wind) must be utilized;
- the Private Power & Infrastructure Board **(PPIB)** will provide a one-window facility for projects above 50 MW for private power investors;
- the provinces will provide one-window facility for projects up to 50 MW;
- hydro-electric projects will be on Build-Own-Operator-Transfer **(BOOT)** basis, while thermal projects will be on Build-Own-Operate **(BOO)** or **(BOOT)** basis;

- projects may be implemented through solicited and unsolicited proposals;
- special incentives may be granted to coal, gas and hydro-electric projects;
- the Government will guarantee the terms of the executed agreements including the payment terms except fuel supply agreements, as fuel suppliers are being privatized; and
- Concessionary duties and taxes regime will be granted.

Following the announcement of the Power Policy 2002, the PPIB received a number of proposals from local and international investors for establishment of power projects based on a variety of fuels. After PPIB reviewed the proposals, 21 projects with a total capacity of over 4200 MW were granted letters of interest. These projects are at various stages of implementation. The Government is also in the early stages of exploring the feasibility of a number of gas pipelines that would supply Pakistan with gas from Iran, Turkmenistan or the Persian Gulf region.

Services Sector

The services sector in Pakistan consists primarily of wholesale and retail trade; transport, storage and communications; and financial and insurance services. In 2004-05, the services sector accounted for over 52.0% of GDP and approximately one-third of employment in Pakistan. The services sector has been an important contributor to Pakistan's economic growth, particularly as the commodity-producing sector exhibited limited growth on average over the past five years. The services sector grew by 5.2% in 2002-03, by 6.0% in 2003-04 and by 7.9% in 2004-05. Growth in the services sector in 2004-05 was primarily attributable to growth in the finance and insurance sector, better performance of wholesale and retail trade sector and expansion in the communications sector.

Value added in the wholesale and retail trade sector is based on the margins taken by traders on the transaction of commodities traded in the wholesale and retail market. In 2004-05, the gross value added in whole and retail trade increased by 12.0% from the previous year, compared to 8.1% growth in 2003-04.

Value added in the transport, storage and communications sector is based primarily on the profits and losses of Pakistan Railways, Pakistan International Airlines and other airlines, Pakistan Posts & Courier Services and PTCL. In 2004-05, this sector grew by 5.6% from the previous year compared to 5.5% growth in 2003-04. The increase in the growth rate resulted primarily from strong consumer demand for mobile phones and internet services of PTCL.

Transportation and Communications

Transportation

Pakistan's transport system has come under pressure as the pace of economic development has accelerated. The Government is intensifying its efforts to develop and modernize the sector through increasing public expenditure on transportation projects. The transport system in Pakistan is comprised of roads and highways, railways, air transport services, and ports and shipping services.

Roads and Highways. In 2004-05, road transportation in Pakistan was responsible for carrying approximately 90% of passengers and goods transport. As of March 2005, the total length of roads in Pakistan was 259,758 kilometres which includes 162,879 kilometres of high type and 98,879 kilometres of low type roads. The total length of roads in Pakistan increased by 52% from June 1991 to March 2005.

The National Highway Authority (**NHA**) is responsible for the construction and maintenance of the national highways and strategic roads. The total length of roads under the responsibility of the NHA is 9,031 kilometres which accounts for 3.5% of the entire road network in the country. The Government, through the NHA, has a number of on-going projects and programs to develop the road network.

Railways. Pakistan Railways is owned and operated by the Government through the Secretary, Ministry of Railways, who is also the Chairman of the Railway Board.

The performance of Pakistan Railways declined continuously beginning in the early seventies due to competition from the growing road sector and the Government's low priority in making investments in the railway system which caused a sharp deterioration of railway assets. As a result, the present Government decided to revitalize Pakistan Railways through additional investment.

For fiscal year 2005-06, Rs. 9,848.6 million was provided by the Government for the revitalization program of Pakistan Railways including the procurement and/or manufacture of diesel engine locomotives, passenger coaches and high capacity freight wagons and the rehabilitation and improvement of its tracks on the system.

Civil Aviation. The Civil Aviation Authority promotes and regulates civil aviation activities in Pakistan. A selective open skies policy has been adopted with a number of countries on the basis of bilateral reciprocity. Additionally the Government has encouraged private sector participation in this sector. Three private airlines, namely Shaheen Air International, Aero Asia and Air Blue currently operate on domestic routes. Shaheen Air International and Aero Asia also operate international routes. Pakistan International Airlines (**PIA**) is the primary national carrier and is 90.0% owned by the Government and Government-controlled entities. PIA's network covers 43 international destinations and domestic destinations covering nearly all parts of the country.

Ports and Shipping. Karachi Port and Port Mohammed Bin Qasim, both located in Karachi, are the two major ports in Pakistan. Karachi Port is the main port of the country and handles most dry and liquid cargo. Port Qasim, located 50 kilometres south-east of Karachi, is Pakistan's second deep sea port and was built in 1980 for overflow from Karachi Port and to handle raw material imports for Pakistan Steel Mills. It has grown into a fully functional port offering facilities for general and bulk cargo, specialized terminals for oil and liquid chemicals and container handling. Pakistan is currently developing a new 10-berth port facility at Gwadar East Bay, approximately 460 kilometres from Karachi, that is intended to function as a regional hub in South Asia. The port is being developed in two phases with financial assistance from the People's Republic of China. Completion of phase two is anticipated by end of 2005-06. Pakistan National Shipping Corporation is the national flag carrier and has a fleet of 14 vessels.

Communications

Postal Services. The Post Office is a Government entity which provides postal facilities through a network of approximately 12,250 post offices across the country.

Telecommunications. On January 1, 1996, the telecommunication system was reorganized by the enactment of the 1995 Ordinance which was later consolidated with certain amendments into the Telecommunication (Reorganisation) Act, 1996. The effect of the law was to dissolve Pakistan Telecommunications Corporation (**PTC**) and established the Pakistan Telecommunications Authority (**PTA**), the National Telecommunications Corporation (**NTC**), the Frequency Allocation Board (**FAB**), the Pakistan Telecommunications Employees Trust (**PTET**) and PTCL. The PTA was created to regulate the establishment and operation of the telecommunication system in Pakistan. The NTC was established to meet the telecommunications requirements of the Government and the Defense services. The function of the FAB is to allocate frequency spectrum bands to the Government, telecommunication companies and other users. PTET is a trust which took over the statutory functions of disbursing pension and other benefits to employees of PTCL.

PTCL provides local, long distance, IDD and core infrastructure services while PTCL's fully owned mobile subsidiary is one of six GSM operators in the country. PTCL's subsidiary Paknet is currently an important internet and data network service provider. In addition PTCL has leveraged its Intelligent Network (**IN**) platform to develop value added high growth business such as pre-paid calling cards and premium rate services. PTCL is the largest publicly listed company in Pakistan accounting for about 12.0% of the Karachi Stock Exchange's total market capitalization. PTCL is majority owned by the Government, which controls 88.0% of the company. The remaining 12.0% is owned by the general public. In March 2006, the Government reached an agreement with Etisalat, the United Arab Emirates telecom company, to sell a 26% interest in PTCL together with management control of the company.

Since its transformation from a public sector corporation into a publicly listed limited company in 1996, PTCL has been aggressively engaged in implementing a restructuring program and has made significant progress in terms of its network, tariff rebalancing, quality of service, value added services and profitability. The primary aim of the restructuring program has been to improve profitability through increased customer focus and efficiency in order to effectively compete in the post monopoly environment.

Under the private sector participation policy, the Government has privatized and deregulated a large number of new telecommunications services (such as cellular, paging and data transmission services and card operated public phones), and has permitted the manufacturing and marketing of telecommunications equipment. As a result of increased competition in the telecommunications sector, the density of fixed and mobile lines increased from 4.6 telephone lines per 100 inhabitants as of June 2003 to 17.82 telephone lines per 100 inhabitants as of December 2005. Mobile operators invested approximately U.S.$883.0 million in the telecommunications sector in 2004-05 with an additional U.S.$3.0 billion expected to be invested over the next three years. Foreign direct investment in the telecommunications sector amounted to U.S.$494.4 million in 2004-05, compared to U.S.$207.0 million in 2003-04.

Financial Sector

The financial sector in Pakistan consists of the State Bank of Pakistan (**SBP**), commercial banks, development finance institutions, microfinance banks, non-banking finance companies (such as leasing companies, investment banks, discount houses, housing finance companies, venture capital companies and mutual funds), modarabas (which are comparable to mutual funds but are organized to comply with Islamic law), stock exchanges and insurance companies. The SBP supervises banks, development finance institutions and microfinance banks, while the SECP monitors the remaining financial institutions.

Banking and Financial Institutions

At present the banking industry in Pakistan consists of 39 scheduled banks, 7 development finance institutions, 5 microfinance banks and commercial banks operating in Pakistan, the activities of which are regulated and supervised by the SBP. The commercial banks comprise 2 nationalized banks, 5 privatized banks, 22 private sector banks, 11 foreign banks, 4 provincial scheduled banks and 4 specialized banks.

State Bank of Pakistan. The SBP was established in 1948. The SBP regulates the monetary and credit systems, determines and implements monetary policy and enforces compliance with regulations supporting the stability of financial institutions. The SBP regulates circulation of the national currency and controls money supply through open market operations and through reserve and liquidity requirements. In the open market, the SBP maintains a portfolio of Government securities to effect repurchases, reverse repurchases, direct sales and direct purchases.

Under the State Bank of Pakistan Act, 1956 (the **SBP Act**), the SBP is an autonomous entity supervised by the Central Board of Directors. The Central Board is appointed by the President and consists of the Governor, the Secretary of Finance and seven other directors (one director from each province to be nominated by the Government ensuring representations of the agricultural, banking and industrial sectors). The Central Board has power to regulate the monetary and exchange policy and the credit system of Pakistan.

The Governor of the SBP, on behalf of the Board, has the authority to conduct the business and manage the affairs of the banks and the SBP. The Governor is appointed for a term of three years, which is extendable for another three-year term.

The SBP is also entrusted with the responsibility to supervise and regulate the banking sector. The relevant provisions of law which vest powers in the SBP to carry out inspection of banks are contained in the SBP Act, the Banking Companies Ordinance, 1962, the Banks Nationalization Act, 1974, and delegated legislation (statutory rules and orders (SROs)) made in the exercise of statutory powers.

Under the Banking Companies Ordinance, 1962 the SBP is authorized to regulate and supervise banks and development finance institutions. In 1997, amendments were made to the banking laws granting autonomy to the SBP in relation to regulation of the banking sector. Under the Banking Companies Ordinance, as amended, it is the responsibility of the SBP systematically to monitor the performance of every banking company to ensure compliance with banking laws, rules and regulations. In every case in which the management of a bank fails to discharge its responsibility in accordance with the applicable statutory criteria or the banking rules and regulations or fails to protect the interests of the depositors or advances loans and finance without due regard to the best interests of the bank, the SBP is empowered to take the necessary remedial steps as may be required in accordance with the law, including reporting violation of banking company's management to the Government every quarter or more frequently of required, along with recommendations for remedial action. The SBP can, among other things, exercise the following powers vested in it under the Banking Companies Ordinance: prohibit the bank from giving loans, advances and credits; prohibit the bank from accepting deposits; cancel its banking license; remove the chairman, directors, chief executive or other managerial persons from office and appoint others in their places; direct the prosecution of directors, the chief executive or other officers; caution or prohibit the bank against entering into any particular transaction; require the bank to make changes in management; wind up the bank through judicial means; apply to the Government for an order of moratorium and a plan of reconstruction or amalgamation; or impose penalties.

The SBP is empowered to determine statutory liquidity and cash reserve requirements for banks and development finance institutions. Presently the cash reserve requirement is 5.0% on a weekly average basis (subject to daily minimum of 4.0%) of a bank's time and demand liabilities. In addition, banks are required to maintain a statutory liquidity requirement of 8.0% of their time and demand liabilities. Similarly, development finance institutions are required to maintain a statutory liquidity requirement of 14.0% and a cash reserve of 1.0% of their specified liabilities. Furthermore, the 1997 amendments to the Banking Companies Ordinance empowered the SBP to impose capital requirements for banks. The SBP has established minimum capital requirements for banks based on the Basle capital structure. Banks are required to maintain a capital adequacy ratio such that their capital and unencumbered general reserves are, at a minimum, 8.0% of their risk weighted assets and as of December 31, 2005 the minimum paid-up capital required of banks was raised to Rs. 2.0 billion (to be further increased by Rs. 1.0 billion by the end of each calendar year until 2009). These capital requirements also apply to development financial institutions. Capital adequacy requirements for specific banks and development financial institutions may be increased by the SBP depending on the SBP's risk assessment rating given to the institutions.

Commercial Banking Sector. The commercial banking sector comprises both Pakistani and foreign commercial banks. There are also government-owned specialized banks which provide finance to agriculture, industry and co-operatives. A number of development non-bank financial institutions, many of which are government-owned, extend loans to manufacturing companies and provide credit for regional development and small investors. Also, official joint ventures, such as Saudi Pak Industrial and Agricultural Investment Company and Pak-Kuwait Investment Company, provide financial assistance to promote investment in industry, agriculture and trade. The National Investment Trust (**NIT**) and the Investment Corporation of Pakistan (**ICP**) are state-owned collective investment institutions which the Government plans to privatize. The NIT is an open-ended mutual fund and the ICP manages a series of closed-ended mutual funds.

Under Pakistan's WTO commitments, the operational status of the branch network of foreign banks operating in Pakistan as of December 31, 1997 has been frozen. New foreign banks wishing to enter into the banking business in Pakistan are required to incorporate as domestic banks under local law. Branches of foreign banks operating in Pakistan can be converted into local commercial banks by incorporating under the local laws and subject to a minimum paid up capital (presently Rs. 2 billion), provided that foreign ownership is restricted to a maximum of 49.0%

Other entities within the financial sector include investment banks, a state-owned life insurance company (State Life Insurance Company), private life insurance companies, private general insurance companies, housing finance companies, leasing companies and *modarabas*.

There is only an embryonic fixed income market and the equity market has only recently been opened to free market reforms. As a result of deregulation, a corporate debt market has emerged in the form of Term Financial Certificates (**TFCs**), Short Term Finance Certificates and Bankers' Acceptances.

Pakistan is continuing to restructure its financial system to strengthen the financial soundness of the banking sector. Recent initiatives taken to achieve this goal include:

- allowing banks to enter the domestic capital markets as issuers of TFCs;
- revising the minimum paid-up capital requirements of financial institutions;
- establishing guidelines on corporate governance, risk management and asset securitization;
- drafting an anti-money laundering law granting several government agencies the authority to investigate and prosecute incidents of money laundering;
- establishing guidelines for non-performing loans and their write-off;
- allowing the opening of Islamic commercial banks and the establishment by existing banks of branches or subsidiaries engaged in Islamic banking;
- amending the Banking Companies Ordinance, 1962, to promote consolidation of financial institutions;
- developing a regulatory framework for the establishment of micro-finance institutions (**MFIs**) and the provision of credit to SMEs;
- creating a special Housing Financing Window for refinancing by banks at concessional rates; and
- requiring banks to link their corporate lending products with the Karachi Inter Bank Offer Rate (**KIBOR**).

Corporate Bonds. Prior to 2003, banks were not permitted to assume a significant role in the corporate debt market. Beginning in 2003, the SBP allowed banks to enter the domestic capital market as issuers of TFCs.

Banks can now raise funds from the capital market in the form of rated and listed subordinated debt instruments, which can also be included in the banks' supplementary capital. However, to be eligible for inclusion in supplementary capital, the instrument must be fully paid-up, unsecured, subordinated as to payment of principal and profit to all other indebtedness of the bank and not redeemable before maturity without prior approval by the SBP. The market for these long-term instruments provides an additional venue for matching long-term assets such as mortgages and project finance. Since 2001, there have been 38 issues of TFCs with a total face value of approximately Rs. 30.0 billion floated on the Karachi Stock Exchange (the **KSE**).

Increased Paid-up Capital Requirements. In order to strengthen financial institutions' competitive ability and increase their equity to a level considered adequate for the protection of depositors' interests, the SBP revised the applicable minimum paid-up capital requirements. The minimum paid-up capital free of losses which banks and development finance institutions are required to meet has been increased from Rs. 1.0 billion as of December 31, 2003 to Rs. 2.0 billion as of December 31, 2005 (and to be further increased by Rs. 1.0 billion by the end of each calendar year until 2009). Banks not able to comply with the requirement are to be permitted only to operate in the inter-bank market, make investments in government securities, and finance import/export businesses within such limits as may be specified by the SBP.

Anti-Money Laundering Measures. Measures taken by the SBP with respect to money laundering includes promoting the enactment of an anti-money laundering law and participation in regional efforts against money laundering. The SBP has adopted a two-pronged strategy against money laundering. First, a comprehensive money laundering law for the country was formulated by the Ministry of Finance. Under this proposed law, the National Accountability Board would have full authority to investigate and prosecute in the existing special courts. A National Financial Intelligence Center will also be set up to collect and analyse data on suspicious transactions. A "confiscated assets fund" will also be created. Second, in upgrading its own capacity and expertise in the area, SBP has undertaken the following measures: (a) issued a directive to all banks in June 2002 advising them to put in place appropriate procedures to ensure that all branches strictly follow "Know Your Customers" requirements; (b) issued guidelines for the appointment and designation of a compliance officer, so as to ensure that the activities of banks and development financial institutions are in compliance with applicable laws and regulations; (c) advised the banks to properly monitor client accounts; (d) asked the banks to maintain records for at least 5 years; (e) required the banks to exercise extra care in correspondent banking relationships; (f) asked the banks to report suspicious transactions; and (g) froze bank accounts of entities specified under various U.N. Conventions.

Islamic Banking. Article 38(f) of the Constitution of the Islamic Republic of Pakistan 1973 provides that the state, as one of its "Principles of Policy", shall eliminate riba as early as possible. However, the Constitution, while requiring the elimination of riba, does not define the term. The meaning of this term also cannot be found in any legislative enactment. As a result, there is some controversy over the exact meaning of the Islamic term riba. Some consider it as being analogous to interest while others equate it with usury.

In November 1991, the Shariat Court ruled that a number of statutory provisions in Pakistan violated Islamic principles relating to riba and held them to be void on that basis and instructed the Government to conform these provisions to Islamic principles.

The ruling of the Shariat Court was appealed to the Shariat Appellate Bench of the Supreme Court of Pakistan (the **Appellate Bench**). The Appellate Bench dismissed the appeal and upheld the decision of the Shariat Court. Against such judgment of the Appellate Bench, a Review Petition was filed, which was allowed by the Order dated June 24, 2002 (the **Review Order**) and the case was remanded to the Shariat Court for de novo determination of this issue after taking into consideration various aspects noted therein.

Presently, the law in Pakistan does not prohibit the payment of interest pursuant to a contract to borrow money. See "Risk Factors—Factors that may affect the Issuer's ability to fulfill its obligations under the Notes—Shariat Law Position on the Payment of Interest."

Following the decision by the Shariat Appellate Bench of the Supreme Court of Pakistan upholding the previous judgment of the Federal Shariat Court declaring riba as un-Islamic, the SBP adopted a three-pronged strategy for the promotion of Islamic banking in parallel with conventional banking by:

- allowing the opening of fully-fledged Islamic commercial banks in the private sector;
- allowing existing banks to establish subsidiaries for Islamic banking; and
- allowing existing banks to open separate branches for Islamic banking.

In December 2001, the SBP issued detailed criteria for the establishment of Islamic commercial banks in the private sector. Al-Meezan Investment Bank Limited was granted such license to operate as the first fully-fledged Islamic bank in January 2002 and which started operations in March 2002. The second license for a fully fledged Islamic bank has been granted to Albaraka Islamic Bank (operating as foreign bank) in September 2004.

In order to allow existing banks to open subsidiaries for Islamic banking, an amendment was made in the Banking Companies Ordinance 1962 in November 2002. On January 1, 2003, SBP issued policies for the promotion of Islamic banking which set out criteria for the establishment of Islamic banks in the private sector, Islamic banking subsidiaries and stand-alone branches of conventional banks. These policies include eligibility conditions, licensing requirements, and guidelines on physical set up, along with Shariat compliance and other operational matters. In addition to the two Islamic banks, six conventional banks have started Islamic banking operations through 13 stand-alone branches.

In recognition of the need for a separate department for the regulation and promotion of the Islamic banking sector, an Islamic Banking Department (**IBD**) was established in the SBP in September 2003.

The SBP has also established a Shariat Board to advise the authorities on the modes, procedures, laws and regulations for Islamic banking and ensuring Shariat compliance. The Shariat Board is made up of experts in the field of Shariat, banking, accounting and law.

The SBP has participated actively on the international front and is one of the founding members of the Islamic Financial Services Board (**IFSB**), which is committed to the promotion and development of international standards consistent with Shariat in order to ensure transparency in the Islamic financial services industry. The IFSB is dedicated to developing international prudential regulatory standards in accordance with the distinct features and risks of Islamic financial institutions to ensure soundness and stability. The SBP is represented in the technical committee and the risk management and corporate governance working groups. The working groups will prepare risk management guidelines for Islamic financial institutions.

The SBP has entered into cooperation arrangements with the Bahrain Monetary Agency (**BMA**) in the area of Islamic banking regulations and sukuks. The SBP and the BMA have signed a memorandum of understanding to strengthen cooperation between the two central banks on a host of issues including supervision, technical expertise and training assistance. To enhance investment opportunities and strengthen linkages with the global Islamic financial market, the SBP is also a member of the International Islamic Financial Market. An objective of the SBP is to strengthen the efficacy of the Islamic financial system of the country.

In September 2002, a musharaka based Islamic export finance scheme was introduced in order to provide Islamic finance to eligible exporters. Al-Meezan Investment Bank Limited was allowed to provide export finance under the scheme. Other Islamic banks and Islamic bank branches can also provide finance on the same lines.

Currently, Islamic banks and Islamic bank branches are permitted to maintain statutory liquidity and capital requirements in the form of current accounts with the SBP up to the extent of 40.0% of the requirements applicable to commercial banks.

The Securities Market

At present, there are three stock exchanges in Pakistan: the Karachi Stock Exchange (**KSE**) in Karachi, the Lahore Stock Exchange in Lahore (the **LSE**) and the Islamabad Stock Exchange in Islamabad (the **ISE**). The KSE opened in 1949, the LSE opened in 1970 and the ISE opened in 1993. Virtually all of the companies listed on the LSE and the ISE are also listed on the KSE.

The following table sets out the number of listed companies on the stock exchanges as of June 30 of each year from 2001 to 2005 and at December 31, 2005.

Listed Companies on the Stock Exchanges

	Number of Companies Listed					
	At June 30,					At December 31,
Name of Exchange	**2001**	**2002**	**2003**	**2004**	**2005**	**2005**
Karachi Stock Exchange	747	711	700	661	659	661
Lahore Stock Exchange	614	581	583	537	524	523
Islamabad Stock Exchange	281	282	282	235	232	238

Source: Securities and Exchange Commission of Pakistan.

Both debt and equity securities are traded on the KSE. Corporate debt securities are issued through TFCs, which normally carry a five-year maturity. There are currently 50 listed corporate debt securities.

Regulatory Framework. The SECP was established under the Securities and Exchange Commission of Pakistan Act, 1997, and became operational on January 1, 1999. It succeeded the Corporate Law Authority, a Government department attached to the Ministry of Finance. The SECP regulates the capital markets, corporate entities, non-bank financial companies and insurance companies.

Central Depository System. The Central Depository Company of Pakistan Limited was incorporated in 1993 to manage and operate the Central Depository System (**CDS**). The CDS is an electronic book entry system to record and transfer securities. Its operations are consistent with international practice and it has effectively replaced the manual system of handling and settlement of shares at stock exchanges.

Stock Market Indices. Two indices are used to measure the performance of the KSE: the Karachi Stock Exchange-100 Index (the **KSE Index**), produced by the KSE, and the SBP Index of Share Prices (the **General Index**), produced by the SBP. The KSE Index, the most widely accepted stock index in Pakistan, is published daily, whereas the General Index is published on a weekly basis. The General Index is an all-share index, while the KSE Index is based on 100 representative securities representing about 75.6% of the total market capitalization on KSE. The KSE Index uses a base date of November 1, 1991, when it was set at 1,000. The KSE Index is a market capitalization – weighted, broad-based, total-return index.

The following table shows the movements in the KSE Index since 2000, together with its level as of December 31 in each year from 2000 to 2005.

	KSE-100 Index		
Year	**High**	**Low**	**Close**
2000	2,054.43	1,276.05	1,507.60
2001	1,550.42	1,075.16	1,273.07
2002	2,701.47	1,322.07	2,701.47
2003	4,604.02	2,356.48	4,471.60
2004	6,222.27	6,106.93	6,218.40
2005	10,303.13	6,220.28	9,497.35

Source: Securities and Exchange Commission of Pakistan.

By the end of 2005, the KSE-100 Index had increased for a fourth year in a row. This result was in part the outcome of the Government's macro-economic policies, the effective implementation of the reform agenda by the SECP and the return to confidence of both local and foreign investors. The KSE-100 Index rose by 52.7% in 2005, compared to a 39.1% gain in 2004. During 2005, the aggregate market capitalization of the KSE grew by 45.5% to Rs. 2,068.0 billion. In terms of U.S. dollars, based on an exchange rate of Rs. 59.7770 to US$1.00, the market capitalization of the KSE was approximately U.S.$35.7 billion as of December 31, 2005, compared with U.S.$24.3 billion as of December 31, 2004.

The exceptional performance of the stock market during the previous four years can be attributed to a number of positive factors, namely:

- capital market reforms initiated by the SECP;
- continuation of pro-growth and investment friendly policies pursued by the Government;
- strong economic growth and substantial improvements in economic fundamentals;
- a positive privatization process through the capital markets; and
- huge build-up of Rupee liquidity driven, in large, by continuing foreign exchange flows into Pakistan.

Bond Market Indices and Bond Stripping. In order to provide further depth to the bond market in Pakistan, the SBP successfully launched the GOP Bond Index in February 2005. The GOP Bond index provides domestic and international investors with a fair view of the history of sovereign bonds in Pakistan.

A corporate Bond Index is expected to be launched following the implementation of the GOP Bond Index.

The Government is considering introducing bond stripping on Pakistan Investment Bonds (**PIB**) at a future date. Bond stripping, which involves separating the coupon payments and principal payment from the bond, is expected to provide further liquidity in the sovereign bond market, allow investors to match their liquidity requirements, and help in developing a zero coupon yield curve in the country.

Financial Derivatives. At present financial derivatives transactions may only be undertaken by banks with the prior approval of the SBP if the institution is not an authorized derivate dealer (**ADD**) or non market maker financial institution (**NMI**). In November 2004, the Financial Derivatives Business Regulations were issued by the SBP. The regulations proposed a two-tier system in which the SBP will approve banks and development finance institutions who meet eligibility criteria to act as ADDs and NMIs. Non-market makers will not be allowed to carry market risk in their books but will undertake derivative hedges provided to the customers on a back to back basis with the market makers. These regulations include regulations in respect of FX Options, Forward Rate Agreements and Interest Rates Swaps transactions.

National Commodity Exchange Limited. The National Commodity Exchange Limited (**NCEL**) is Pakistan's first technology driven mutualized and on-line commodity futures exchange. It is being previewed by SECP and is expected to commence operations in 2006.

NCEL intends to start its operations by trading gold contracts and later introduce agri-commodity contracts such as cotton, rice, wheat and sugar, which the Government believes are more suited to the Pakstani capital markets. Once its business develops, it also intends to increase its scope to financial futures contracts.

Measures to Improve Corporate Governance. The SECP introduced Pakistan's first Code of Corporate Governance in March 2002. The Code of Corporate Governance has been incorporated in the listing regulations of the country's stock exchanges. It is based on internationally recognized principles and emphasizes openness and transparency in reporting of corporate affairs. Moreover, the SECP, in cooperation with the United Nations Development Program, has planned various awareness activities for investors and stakeholders with respect to good corporate governance practices.

Other Market Reforms. The SECP has also initiated the following reforms to strengthen risk management at the stock exchanges, increase transparency, improve investor protection and improve market efficiency: (i) implementing a T+3 settlement system; (ii) requiring independent management at each stock exchange; (iii) switching to a system of undisclosed trading; (iv) requiring that quarterly accounts of listed companies be published; (v) closing the Group Account Facility of CDS participants in order to prohibit unfair trade practices; (vi) introducing Standardized Account Opening Form (SAOF) for brokers; (vii) requiring position limits for brokers in the futures market (5% of free float); (viii) requiring pre-trade margin verification at the exchanges; (ix) allowing eligibility of scrips in futures market with at least Rs. 50.0 million as free float; (x) prohibiting brokers from trading through the account of other brokers; (xi) requiring an exit mechanism at the stock exchanges to provide investors an opportunity to exit the market.

The Government is considering adopting legislation governing futures trading and amending the existing securities laws. The approval of legislation governing futures trading is required for trading to begin on the commodity futures exchange established in 2005.

Wages and Employment

The population of Pakistan as of June 30, 2005 was an estimated at approximately 154.0 million. The percentage of the population living in rural areas has declined from approximately 85.0% at the time of independence (1947) to approximately 66.0% in 2005. On the basis of an overall labour force participation rate of 30.41%, the total labour force is estimated at approximately 46.8 million, of which 18.6 million were engaged in agriculture, 6.0 million in manufacturing and mining and 6.4 million in trade. The remaining 15.8 million were engaged mainly in the construction, transport and finance sectors. The level of unemployment is currently estimated at 3.6 million or 7.7% of the labour force as compared to 7.8% in 2001.

The following table sets out certain population and employment information as of June 30 in each year from 2001 to 2005.

Population and Labour Force

	End of June				
	2001	2002	2003	2004	2005
	(millions, except as indicated)				
Population	142.86	145.96	149.03	150.47	153.96
Crude Activity Rate (%)	28.97	28.97	29.97	30.41	30.41
Labour Force	41.38	43.21	44.12	45.76	46.82
Unemployment	3.24	3.57	3.65	3.52	3.60
Employed Labour Force	38.14	39.64	40.47	42.24	43.22
Agriculture	18.47	16.68	17.03	18.18	18.60
Mining & Manufacturing	4.40	5.51	5.63	5.93	5.96
Construction	2.21	2.40	2.45	2.46	2.52
Electricity & Gas Distribution	0.26	0.32	0.33	0.28	0.29
Transport	1.92	2.34	2.39	2.42	2.48
Trade	5.15	5.99	6.01	6.25	6.39
Others	5.73	6.50	6.63	6.82	6.98

Sources: Federal Bureau of Statistics; Planning and Development Division.

The following table sets out the daily wages of certain categories of construction workers in different cities in Pakistan. Similar daily wage information for the specified periods is not officially available for workers in other sectors of the economy.

Daily Wages of Construction Workers in Different Cities*

Category of Workers and Cities	2001	2002	2003	2004	2005
			(in Rupees)		
Carpenter					
Islamabad	225.00	225.00	250.00	325.00	350.00
Karachi	291.34	298.08	301.92	337.00	330.77
Lahore	262.50	262.50	265.50	277.00	325.00
Peshawar	225.00	225.00	225.00	250.00	275.00
Quetta	250.00	250.00	250.00	275.00	275.00
Mason (Raj)					
Islamabad	225.00	225.00	250.00	325.00	350.00
Karachi	291.34	298.08	301.92	337.00	350.00
Lahore	262.50	262.50	262.50	318.00	330.80
Peshawar	225.00	225.00	225.00	275.00	275.00
Quetta	250.00	250.00	250.00	275.00	275.00
Labourer (Unskilled)					
Islamabad	120.00	120.00	130.00	160.00	185.00
Karachi	176.34	182.11	183.27	150.00	150.00
Lahore	145.00	145.00	145.00	167.00	210.00
Peshawar	90.00	90.00	90.00	134.00	133.32
Quetta	100.00	112.00	111.67	150.00	177.50

* Data pertains to month of November of each year.
Source: Federal Bureau of Statistics.

Foreign Trade and Balance of Payments

Foreign Trade

Since its formation in 1947, Pakistan has been committed to multilateral trade. Pakistan is a founding member of the General Agreement on Tariffs and Trade (**GATT**) and the World Trade Organization (**WTO**) and actively participates in multilateral trade negotiations. The Government is following a policy of export-led growth and has liberalized its trade and investment regime in recent years.

The review of Pakistan's trade policy conducted by the WTO in 2002 noted favourably the trade reforms made by the Government. For example, to implement obligations under the WTO agreement on trade-related intellectual property rights, Pakistan upgraded its existing laws on copyrights, trademarks and patents and enacted new laws governing industrial designs and integrated circuits. In addition, Pakistan has enacted WTO-compliant anti-dumping laws.

With respect to its trade regime, Pakistan has lowered its tariffs both on agricultural and non-agricultural goods.

Pakistan is a member of the Trade Preferential System of the OIC and the Asia Cooperation Dialogue and is a Sectoral Dialogue Partner of ASEAN.

Pakistan's recent bilateral and regional trade agreements include the following:

- In July 2003, Pakistan signed the Economic Cooperation Organization Trade Agreement under the auspices of ECO, whereby all member states (Pakistan, Iran, Turkey, Afghanistan, Azerbaijan, Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan and Uzbekistan) agreed to reduce their maximum tariff levels to 10.0% within five years.
- In June 2003, Pakistan signed a Trade and Investment Framework Agreement with the U.S.A., which created an institutional framework to encourage bilateral trade and investment. Negotiations toward a bilateral investment treaty are in progress.
- Pakistan signed a Preferential Trade Arrangement with China, whereby China has granted a preferential tariff on the import of 777 items from Pakistan including garments, leather products and fruits/ vegetables, and in return Pakistan has offered similar concessions to China with respect to Pakistan's import of 192 items from China. Effective January 1, 2006, Pakistan and China have agreed upon an Early Harvest Programme under which tariffs on certain products will be reduced to zero by January 2008. Under the program, China will eliminate tariffs on products such as industrial alcohol, leather garments, cotton and synthetic fabrics, home textiles, marble, surgical goods and sports goods, among other things, while Pakistan will grant market access to China for organic chemicals and machinery. Both China and Pakistan will grant market access to each other on items such as vegetables, fruits and certain mineral products.
- Pakistan and Malaysia have agreed upon an Early Harvest Programme that will become effective on June 1, 2006. Under the agreement, Pakistan will receive market access covering 20% of its exports to Malaysia for products such as citrus fruits, apples, apricots, synthetic yarn, cotton, synthetic fabrics and jewelry of precious metals. Malaysia will receive market access in Pakistan for certain product covering 10% of Malaysia's exports to Pakistan. Products originally taxed at 5% duty would be reduced to zero duty while products taxed at 10% duty would be reduced to 5% duty.
- Pakistan and Iran entered into a Preferential Trade Agreement under which Pakistan reduced tariffs on 338 items and Iran reduced tariffs on 309 items by an average of 18%. Concession lists and rules of origin were also agreed upon.
- On January 2, 2004, members of SAARC agreed on a South Asian Free Trade Agreement that came into force on January 1, 2006. Under the agreement, tariffs in developing countries will be reduced to 20.0%, while tariffs in least developed countries will be reduced to 30.0%, within two years of entry into force. Thereafter, tariffs in India and Pakistan will be reduced to between zero and 5.0% within five years, in Sri Lanka in six years and in least developed countries in eight years. The agreement, among other things, also provides for the harmonization of standards and customs classifications, removal of barriers to investments and national treatment for each member state in accordance with WTO principles.
- To have a greater market access, Pakistan is negotiating preferential trade and free trade agreements with certain of its trading partners. Pakistan has entered into a free trade agreement with Sri Lanka and is in negotiations for a free trade agreement with Bangladesh and preferential trade agreements with Turkey, Indonesia, Mauritius, Morocco, Yemen, Tajikistan, Singapore, Zaos, Nepal, Thailand, and the D-8 countries.
- Pakistan, along with China, Kazakhstan and the Kyrgyz Republic, signed a Quadrilateral Transit Trade Agreement to facilitate "traffic in transit" among the contracting states.

Balance of Payments

In 2000-01, Pakistan's balance of payments deficit was U.S.$1,736.0 million compared with the U.S.$3,895.0 million deficit in 1999-00. A change in the accounting treatment of the Saudi Oil Facility from non-food aid (loan) to a straight forward grant (official transfers) and higher than projected purchases of hard currency from the kerb market combined with a lower trade deficit and higher current transfers supported the decrease in the overall balance of payments deficit. The Saudi Oil Facility is no longer in operation.

The balance of payments position continued to improve in 2001-02 as Pakistan decreased its deficit by more than half to U.S.$732.0 million. A number of developments contributed to the enhancement of the balance of payments profile: (i) the kerb premium collapsed and the Rupee appreciated both in the kerb and interbank markets, following international measures against undocumented currency transactions; (ii) the increase in the remittances through banking channels, resulting in an improvement in the current account surplus; (iii) improved relations with major creditors leading to greater assistance from sovereign creditors and international financial institutions; and (iv) restructuring of external debt by Paris Club creditors. In 2001-02, total trade in goods remained at approximately the same level as the previous fiscal year with U.S.$9,434.0 million worth of imports f.o.b. and U.S.$9,140.0 million worth of exports f.o.b. The performance of exports in 2001-02, were affected by the events of September 11, 2001. The contraction of Pakistan's three main markets, the U.S.A., Europe and Japan reduced the demand for Pakistan's products. The events of September 11, 2001 also affected imports in 2001-02 by disrupting shipping and cargo services, raising marine freight rates, and witnessing imposition of war risk surcharges.

In 2002-03, Pakistan registered a balance of payments surplus of U.S.$2.5 billion after recording a deficit in the previous five years. This was primarily due to improvements in the current account components: (i) substantial growth in exports; (ii) workers' remittances registered 77.3% growth to reach U.S.$4.2 billion; (iii) interest payments declined following retirement of expensive debt as well as a partial substitution of expensive debt with soft loans from international financial institutions; (iv) Pakistan received the Saudi Oil Facility and cash grants amounting to U.S.$846.0 million from other countries; and (v) exports f.o.b. earnings rose to U.S.$10.9 billion. Total trade in 2002-03 increased by 51.0% with imports f.o.b. at U.S.$11.3 billion and exports f.o.b. at U.S.$10.9 billion.

In 2003-04, the overall balance experienced a sharp fall over the preceding year to a deficit of U.S.$1.0 billion, resulting from a deterioration in both the current account and capital account. The deterioration under the capital account was mainly due to a one-off large pre-payment of expensive external debt. Excluding this one-off pre-payment the overall balance recorded a U.S.$2.4 billion surplus in 2003-04.

Pakistan recorded a current account surplus (including official transfers) of 2.0% of GDP (U.S.$1.9 billion) in 2003-04 as compared to 5.1% of GDP in 2002-03 (U.S.$4.2 billion). This contraction in the magnitude of the current account surplus was due to higher import levels coupled with a fall in workers remittances and a higher deficit in the services account.

The trade deficit in 2003-04 (U.S.$1.2 billion) increased by 172.1% from 2002-03 (U.S.$0.4 billion). The sharp jump in trade deficit during 2003-04 was caused by a 20.0% growth in imports f.o.b., which overshadowed a 13.8% increase in exports f.o.b. Rising international prices of major imports, especially oil, were the major reason for the increased trade deficit in 2003-04.

In 2004-05, the overall balance deficit increased by 157.0% to U.S.$2.6 billion, resulting primarily from the deterioration in the current account. The deterioration under the current account was mainly due to a larger deficit in the trade balance and higher net outflows in the services account. The deficit in the trade balance was higher as imports f.o.b. rose by 37.8% from the previous year while exports f.o.b. increased by only 16.2% during the same period. A higher oil import bill and an increase in non-food and non-oil imports resulting from increased domestic demand contributed to the substantial increase in the trade deficit. Higher net outflows from the services account was primarily due to higher freight charges and fuel costs for shipping, as well as increased personal travel.

For the first half of 2005-06, Pakistan's trade deficit was U.S.$3.9 billion. Imports f.o.b. for the first half of 2005-06 were at U.S.$11.7 billion, compared to U.S.$9.1 billion for the same period in 2004-05, while exports f.o.b. for the first half of 2005-06 were at U.S.$7.8 billion as compared to U.S.$6.9 billion for the same period in 2004-05. The current account deficit excluding official transfers stood at U.S.$3.0 billion in the first half of 2005-06, compared with U.S.$0.8 billion in the same period the previous year.

The following chart summarizes Pakistan's balance of payments position from 2000-01 to 2004-05.

Balance of Payments

	2000-01	2001-02	2002-03	2003-04	2004-05
	(in U.S.$ million)				
Current account (excl. official transfers)	(1,951)	94	3,165	1,314	(1,753)
Current account balance	(1,112)	1,589	4,203	1,893	(1,344)
Trade balance	(1,269)	(294)	(444)	(1,208)	(4,352)
Exports f.o.b[(1)]	8,933	9,140	10,889	12,396	14,401
Imports f.o.b[(2)]	10,202	9,434	11,333	13,604	18,753
Services (net)	(3,142)	(2,617)	(2,128)	(3,594)	(5,841)
Of which Interest payments	(1,661)	(1,579)	(1,277)	(1,057)	(1,037)
Private transfers (net)	2,460	3,005	5,737	6,116	8,440
Workers remittances	1,087	2,390	4,237	3,871	4,168
FCA (Res.)	534	285	(12)	367	521
Other	839	330	1,512	1,878	3,751
Official transfers (net)	839	1,495	1,038	579	409
Of which Saudi oil facility	683	579	637	302	0
Of which additional grant pledges	–	742	209	202	231
Of which grants for Afghan refugees	2	20	8	2	2
Capital account	(624)	(2,321)	(1,710)	(2,903)	(1,248)
Public medium and long-term capital	(651)	(1,612)	(1,656)	(2,087)	(334)
Project and non-project loans	(332)	(981)	(1,840)	(1,985)	(843)
Disbursements	1,463	532	581	434	591
Amortization	(1,795)	(1,513)	(2,421)	(2,419)	(1,434)
Commercial banks and IDB (net)	(76)	(224)	(158)	(33)	(16)
Other (i)	(243)	(407)	342	(69)	525
Public sector short-term (net) (iii)	(59)	(1,065)	(268)	(872)	(418)
Private medium and long-term (ii)	345	(80)	164	693	858
Of which FDI	323	368	612	951	1,162
Private short-term (incl. errors & omissions) (iv)	(259)	436	50	(637)	(1,354)
Overall balance, before debt relief	(1,736)	(732)	2,493	(1,010)	(2,592)
Financing	1,736	732	(2,493)	1,010	2,592
Reserves assets (Increase)	(1,085)	(3,082)	(5,261)	(399)	(227)
SBP (incl. FE-25)	(726)	(2,717)	(5,911)	(422)	493
Deposit money banks	(359)	(365)	650	23	(720)
Use of Fund credit (net)	(239)	(194)	(418)	(672)	(400)
Net Exceptional financing	3,060	4,008	3,186	2,081	3,219
Accumulation arrears	(462)	–	–	0	0
Debt relief public & publicly guaranteed	1,586	1,209	910	0	0
Repayment of Arrears	(64)	–	–	0	0
Rollover FCDS and deposits at SBP & NBP	1,676	1,314	900	1,200	1,200
Debt relief from Commercial Banks	–	–	100	100	100
Principal and interest arrears paid	–	–	–	0	0
Eurobond rescheduling	–	–	–	0	0
Additional Commercial Bank Borrowing	–	–	–	–	–
Possible additional borrowing from IFIs	324	1,368	1,090	781	1,556
World Bank IDA	–	699	213	192	725
ADB	–	185	408	344	576
Other (including IMF)	324	484	469	245	255
Grant Pledgee	–	–	–	0	0
Privatization receipts	–	117	186	0	363
Financing gap	–	–	–	0	0
SBP Gross reserves	2,088	4,809	10,727	11,182	10,687
SBP Reserves excl. Compulsory Reserve Ratio (maintained by commercial banks) & India Sinking Fund (outstanding claims against India following the partition)	1,681	4,329	9,521	10,556	9,797
Sinking fund	–	–	730	65	200
CRR	399	472	468	553	682

(1) Exports f.o.b. are on actual receipt basis.
(2) Imports f.o.b. are on actual payment basis.
Source: State Bank of Pakistan.

Exports and Imports

In 2004-05 exports based on customs receipts increased to U.S.$14.4 billion from U.S.$12.3 billion in 2003-04 which represented an increase of 16.9%. During this period, products which experienced the largest gains in exports were raw cotton (130.6%), petroleum products (61.7%), rice (47.0%) and leather manufactures (27.2%). Exports of textile manufactures constituted 65.9%. of total exports in this period. The export of other non-traditional items also increased with the other manufactures category registering an increase of 25.1%.

Pakistan's exports are highly concentrated in cotton, leather, rice, synthetic textiles and sports goods. These five categories of exports accounted for 33.9% of total exports in 2004-05. Among these categories, the cotton group (raw cotton, cotton yarn, cotton cloth and cotton bags and sacks) alone contributed 21.1%, followed by rice (6.5%), leather (3.7%), and sports goods (2.1%) synthetic textiles (2.1%).

Pakistan trades with a large number of countries. In 2004-05, the main export destinations were U.S.A. (23.9%), United Kingdom (6.2%), United Arab Emirates (7.6%), Germany (4.8%), Hong Kong (3.9%) and Saudi Arabia (2.4%).

The following tables set out details of the composition of Pakistan's exports.

Export Markets of Pakistan

Country	**2000-01**	**2001-02**	**2002-03**	**2003-04**	**2004-05**
	%	%	%	%	%
U.S.A	24.4	24.7	23.4	23.9	23.9
Germany	5.3	4.9	5.2	4.9	4.8
Japan	2.1	1.8	1.3	1.1	1.1
United Kingdom	6.3	7.2	7.1	7.6	6.2
Hong Kong	5.5	4.8	4.6	4.7	3.9
United Arab Emirates	5.3	7.9	9.3	7.7	7.6
Saudi Arabia	2.9	3.6	4.3	2.8	2.4
Sub-total	51.8	54.9	55.0	52.7	49.9
Other countries	48.2	45.1	45.0	47.3	50.1
Total	100.0	100.0	100.0	100.0	100.0

Source: Federal Bureau of Statistics

Major Exports(1)

Commodity	2000-01	2001-02	2002-03	2003-04	2004-05
			(U.S.$ million)		
Primary Commodities	1,199.9	1,073.1	1,263.9	1275.0	1,676.5
Rice	525.5	448.2	555.5	634.5	932.5
Raw cotton	139.3	24.7	49.0	47.7	110.0
Raw wool	0.7	0.9	1.3	1.4	1.0
Fish and fish preparations	137.8	125.6	134.5	152.9	138.9
Leather	232.9	239.9	234.8	251.7	303.6
Guar and guar products	20.5	16.4	23.8	20.2	26.5
Fruits	78.7	83.1	83.2	102.7	91.2
Vegetables	36.9	29.1	31.5	31.3	34.9
Crude animal material	15.8	13.2	13.5	15.5	16.2
Oil, seeds, nuts and kernels	11.8	20.5	7.2	11.2	21.6
Wheat	11.0	71.4	129.6	6.0	—
Textile Manufactures	5,790.9	5,810.6	7,263.1	8,073.0	8,482.9
Cotton yarn	1,073.5	929.7	928.4	1,126.9	1,056.5
Cotton cloth	1,032.5	1,130.8	1,345.7	1,711.5	1,862.9
Knitwear	911.4	845.9	1,146.7	1,458.7	1,635.0
Bed wear	744.9	918.6	1,329.1	1,383.3	1,449.5
Towels	241.7	267.7	374.8	403.5	520.5
Cotton bags and sacks	19.0	15.8	17.0	15.5	14.1
Ready-made garments	826.8	875.0	1,092.6	993.3	1,088.0
Tents, canvas and tarpaulin	49.2	49.7	73.3	74.8	66.6
Tule and lace embroidery	10.4	9.7	11.2	11.4	12.3
Art, silk and synthetic textile	544.6	410.0	574.3	470.8	300.3
Made-up articles	330.9	350.9	359.8	416.6	466.0
Waste material of textile fabrics	6.0	6.9	10.3	6.8	11.2
Other Manufactures	1,577.9	1,530.3	1,688.8	1,776.2	2,356.0
Carpets, rugs and mats	288.7	249.6	220.9	231.4	277.8
Petroleum products	183.9	190.7	248.6	294.5	476.1
Sports goods	270.6	304.5	335.2	324.8	307.1
Leather manufactures	425.5	383.2	386.5	414.3	526.8
Surgical and medical instruments	124.1	145.0	150.0	132.6	182.9
Cutlery	26.4	24.5	29.6	29.7	34.3
Onyx, manufactured	12.0	10.0	11.7	11.6	8.7
Chemicals and pharmaceutical products	164.3	152.8	260.9	262.9	452.6
Molasses	41.3	68.7	45.5	46.9	72.4
Sugar	–	1.3	7.7	27.6	17.3
Others	632.9	720.6	944.4	1,189.1	1,875.8
Total	9,201.6	9,134.6	11,160.2	12,313.3	14,391.1

Source: Federal Bureau of Statistics.
(1) Amounts are based on customs records.

Pakistan's imports are highly concentrated in machinery, petroleum and petroleum products, agri-chemicals, edible oil (soyabean oil and palm oil), iron & steel, fertilizer and tea. These eight categories of imports accounted for approximately 74.7% of total imports during 2004-05. Among these categories machinery, petroleum and petroleum products and agri-chemicals accounted for 65.6% of total imports. Over the last five years, the share of machinery in total imports has steadily increased due to higher levels of investment in the country. The share of chemicals in total imports also has been increasing due to higher imports of fertilizer, insecticides and plastic material, while the share of edible oil and petroleum and petroleum products has started to decline primarily due to higher domestic production in the case of edible oil and rising international prices and higher domestic production in case of petroleum and petroleum products.

Pakistan's major imports are highly concentrated in few countries. Approximately half of major imports originate from seven countries: U.S.A., Japan, Kuwait, Saudi Arabia, Germany, the UK and Malaysia. The shares of the USA and Japan, with some fluctuations, mostly exhibited a declining trend from 1990-91 to 2004-05 due to the shift in the import of machinery and capital goods and raw materials to other sources. On the other hand, the share of Pakistan's imports from Saudi Arabia has been rising during the same period due to higher imports of petroleum products.

Pakistan's imports based on customs records rose by 32.1%, from U.S.$15.6 billion in 2003-04 to U.S.$20.6 billion in 2004-05. The largest contributors to the increase came from the machinery group, the petroleum group and the agri-chemicals group. The machinery group accounted for 33.9% of the increase in total imports from 2003-04 to 2004-05. The growth in machinery imports was driven largely by imports of textile machinery, road motor vehicles and other machinery. The agri-chemicals group increased by 28.8% from 2003-04 to 2004-05 mainly due to an increase in imports of fertilizer, plastic materials and other chemicals (such as dyeing, tanning and color materials used as inputs in the leather and textile industries). The petroleum group increased by 26.3% from 2003-04 to 2004-05 mainly due to higher international oil prices.

The following table sets out details of the composition of Pakistan's imports.

Major Imports(1)

Commodity	2000-01	2001-02	2002-03	2003-04	2004-05
			(U.S.$ million)		
Food Group	1,131.4	823.2	978.0	1,033.3	1,407.4
Milk & milk food	20.0	16.1	22.8	21.3	34.2
Wheat, unmilled	15.4	50.0	28.7	23.6	93.0
Dry fruits	37.2	31.2	25.8	18.3	43.6
Tea	206.4	156.6	172.7	192.5	222.6
Spices	18.6	17.0	23.0	40.8	46.0
Soyabean oil	44.1	12.7	47.5	45.6	54.5
Palm oil	283.5	380.3	539.3	613.0	703.2
Sugar	393.3	23.5	2.6	3.3	87.9
Pulses	113.0	135.9	115.6	74.9	122.5
Machinery Group	2,066.3	2,175.8	2,942.3	4,220.4	5,918.2
Power-generating machines	197.9	203.8	268.5	277.8	392.6
Office machines	233.1	224.3	211.5	209.5	273.5
Textile machinery	370.2	406.9	531.9	598.0	928.6
Constructing & mining machinery	82.5	118.6	101.2	101.5	140.6
Electrical machinery & appliances	131.6	128.0	216.7	258.1	355.5
Motor vehicles	320.9	329.9	501.2	652.8	1,068.8
Aircraft, ship & boats	79.7	132.3	134.1	789.8	169.2
Agricultural machinery & implements	23.8	16.1	36.8	37.7	73.8
Others	601.0	577.6	890.8	1,222.8	2,515.6
Petroleum Group	3,360.8	2,807.0	3,066.4	3,166.6	3,999.7
Petroleum products	2,000.3	1,576.2	1,699.9	1,401.4	2,148.8
Petroleum, crude	1,360.6	1,230.8	1,366.5	1,765.1	1,850.9
Textile Group	161.8	187.5	221.6	260.5	317.2
Synthetic fibre	77.8	74.4	92.0	106.1	146.9
Silk yarn (synthetic & artificial)	59.5	82.4	91.8	118.0	130.2
Worn clothing	24.5	30.7	37.8	36.4	40.2
Agri-chemicals Group	1,901.7	1,862.1	2,160.7	2,797.7	3,604.7
Fertilizer	170.5	176.2	239.8	284.7	416.9
Insecticides	61.2	85.9	58.5	124.1	139.7
Plastic material	354.3	352.7	421.1	549.3	792.9
Medicinal products	238.7	228.1	221.8	274.6	292.3
Others	1,077.0	1,019.9	1,219.6	1,564.9	1,962.8
Metal Group	361.4	433.9	507.4	687.7	1,218.3
Iron & steel scrap	43.0	50.6	47.9	93.6	222.1
Iron & steel	277.9	336.1	402.3	512.0	890.2
Aluminium, wrought & worked	40.4	47.2	57.2	82.1	106.1
Miscellaneous Group	265.5	285.4	306.4	378.3	482.9
Rubber, crude and synthetic	39.2	41.1	49.1	68.2	86.0
Rubber tyres & tubes	62.5	66.6	78.3	89.0	133.8
Wood & cork	15.3	14.7	26.4	25.8	28.9
Jute	23.2	26.2	21.0	30.9	39.0
Paper & paper board	125.3	136.8	131.7	164.4	195.1
Others	1,480.0	1,763.8	2,037.3	3,047.3	3,649.7
Total	10,728.9	10,339.5	12,220.3	15,591.8	20,598.1

Source: Federal Bureau of Statistics.

(1) Amounts are based on customs records and cost, insurance, freight (CIF) basis.

Foreign Investment

Pakistan has a liberal foreign investment regime which allows for 100.0% foreign ownership of companies and for full repatriation of capital, capital gains, dividends and profit in most sectors of the economy.

Both domestic and foreign investment have risen over the last five fiscal years. Total investment as a percentage of GDP has remained stable at an average of 17.0% for the past five years. In 2004-05, total foreign investment rose by 81.9%, increasing from U.S.$0.9 billion in 2003-04 to U.S.$1.7 billion in 2004-05. Despite the strong performance of the Pakistani stock exchanges, the bulk of foreign investment in 2004-05, amounting to U.S.$1.5 billion, took the form of foreign direct investment (**FDI**), with portfolio investment of U.S.$0.2 billion. FDI has continued to increase from 2000-01 to 2004-05 despite the security situation in neighbouring Afghanistan. Higher privatization revenue is expected to help increase FDI in 2005-06. FDI increased by 147.9% in the first six months of 2005-06, increasing from U.S.$445.0 million in the comparable period in 2004-05 to U.S.$1.1 billion.

The following table sets out foreign direct investment in Pakistan by economic group for the periods indicated.

Foreign Direct Investment

Economic Group	2000-01	2001-02	2002-03	2003-04	2004-05
			(U.S. $million)		
Power	40.3	36.4	32.8	(14.2)	73.3
Chemical, pharmaceutical & fertilizer	26.3	17.8	92.4	28.5	89
Construction	12.5	12.8	17.6	32.0	42.7
Mining & quarrying, oil and gas	84.7	274.8	188.2	203.5	194.3
Food, beverages & tobacco	45.1	(5.1)	7.0	4.5	22.9
Textile	4.6	18.4	26.1	35.4	39.3
Trade, transport, storage & communications	94.7	69.4	153.2	266.3	580.3
Electrical machinery	2.2	10.5	10.5	8.7	3.4
Electronics	2.8	15.9	6.7	7.5	10.3
Financial Business	(34.9)	3.5	207.5	242.1	269.4
Petro-chemical & refining	8.7	5.0	3.0	72.4	24.8
Cement	15.2	0.4	(0.4)	1.9	13.1
Others	20.2	23.9	52.5	133.2	161.2
Total	322.4	484.7	798.0	949.4	1,524.0

Source: State Bank of Pakistan.

The FDI figures include the following:
(i) cash brought in;
(ii) reinvested earnings; and
(iii) capital equipment

While the data at (i) for cash brought in is obtained through mandatory reporting by banks at the time of remittance, the figures for (ii) and (iii) are obtained through periodic voluntary surveys of companies, which involves a degree of uncertainty due to delays and incompleteness in responses.

In 2001-02, mining & quarrying, oil and gas accounted for the largest portion of FDI at 56.7% of total FDI, while trade, transport, storage and communications accounted for 14.3% of total FDI.

In 2002-03, the increase in FDI was more diversified than in 2001-02. By sector, financial business accounted for the largest portion of FDI at 26.0%, while mining and oil and gas exploration accounted for 23.6%, the power sector accounted for 4.1% of FDI. Trade, transport, storage and communication accounted for 19.2% of FDI, while the chemical, pharmaceutical & fertilizer group accounted for 11.6%.

FDI increased by 19.0% to U.S.$949.4 million during 2003-04 compared to U.S.$798 million in 2002-03. The U.S.A. accounted for 25.1% of FDI inflows, followed by Switzerland (21.6%), the United Arab Emirates (14.2%) and the United Kingdom (6.8%) in 2003-04. Trade, transport, storage & communications accounted for 21.4% of FDI inflows, followed by communication at 28.0%, financial business at 25.5% and mining & quarrying, oil and gas at 21.4%. The increase in communication sector FDI was due in part to the issuance of two cellular licenses amounting to U.S.$291.0 million each.

FDI increased by 60.5% to U.S.$1,524.0 million in 2004-05 compared to U.S.$949.4 million in 2003-04. In 2004-05, the United Arab Emirates accounted for U.S.$367.5 million of FDI inflows, followed by the U.S.A. (U.S.$.326.0 million), the United Kingdom (U.S.$181.5 million), Japan (U.S.$45.2 million), the Netherlands (U.S.$36.7 million) and Hong Kong (U.S.$32.3 million). In 2004-05, portfolio investment also registered an inflow of U.S.$152.6 million, compared to an outflow of U.S.$27.7 million in 2003-04, bringing net foreign private investment to U.S.$1,676.6 million in 2004-05 compared to U.S.$921.7 million in 2003-04, an increase of 81.9%. Trade, transport, storage & communications, financial business and mining & quarrying, oil and gas remained the highest recipients of FDI inflows with 38.1%, 17.7% and 12.7%, respectively.

FDI continued to increase during the first six months of 2005-06 and reached U.S.$1,103.0 million compared to U.S.$445.0 million during the same period in 2004-05, an increase of 147.9%. Portfolio investment also registered an inflow of U.S.$359.6 million during the first six months of 2005-06 bringing net foreign private investment to a total of U.S.$1,462.6 million. Saudi Arabia accounted for U.S.$267.1 million of FDI inflows during the first six months of 2005-06, followed by the U.S.A. (U.S.$236.7 million), the United Kingdom (U.S.$87.0 million), the Netherlands (U.S.$54.7 million), the United Arab Emirates (U.S.$36.2 million), Germany (U.S.$24.7 million) and Japan (U.S.$23.8 million). As in previous years, trade, transport, storage & communications, financial business and mining & quarrying, oil and gas were the highest recipients of FDI inflows with 34.2%, 10.6% and 14.5%, respectively.

The following table sets out net foreign investment in Pakistan for the periods indicated.

Net Foreign Private Investment

	2003-04			2004-05			Jul-Dec 2005-06		
Country	**Direct**	**Portfolio**	**Total**	**Direct**	**Portfolio**	**Total**	**Direct**	**Portfolio**	**Total**
					(U.S.$ million)				
U.S.A	238.4	21.4	259.8	326.0	47.0	373.0	236.7	230.5	467.2
United Kingdom	64.9	(23.0)	41.9	181.5	17.6	199.1	87.0	23.7	110.7
United Arab Emirates	134.6	11.9	146.5	367.5	49.8	417.3	36.2	38.0	74.2
Germany	7.0	(3.0)	4.0	13.1	2.1	15.2	24.7	(3.3)	21.4
France	(5.6)		(5.6)	(3.6)	0.1	(3.5)	1.9	-	1.9
Hong Kong	6.3	(1.3)	5.0	32.3	28.9	61.2	14.3	48.8	63.1
Italy	1.9	(1.9)	3.0	0.4	0.0	0.4	0.0	-	-
Japan	15.1	(3.5)	11.6	45.2	(3.5)	41.7	23.8	(4.0)	19.8
Saudi Arabia	7.2	(1.9)	5.3	18.4	(0.2)	18.2	267.1	1.0	268.1
Canada	0.5		0.5	1.9	0.1	2.0	2.8	0.1	2.9
Netherlands	14.0	(1.9)	12.1	36.7	23.2	59.9	54.7	7.3	62.0
Others	465.1	(24.5)	440.6	504.6	(12.5)	492.1	354.1	17.2	373.2
Total	949.4	(27.7)	921.7	1,524.0	152.6	1,676.6	1,103.3	359.3	1,462.6

Source: SBP.

Foreign Reserves

The following table sets out the historical levels of Pakistan's gold and foreign exchange reserves:

Exchange and Gold Reserves
(held by SBP)(1)

	End of Fiscal Year					December 31,
	2000-01	**2001-02**	**2002-03**	**2003-04**	**2004-05**	**2005**
			(U.S.$ million)			
Total reserves, (excluding gold)	2,088	4,809	9,997	11,117	10,487	9,969
SDR	4	8	244	238	227	216
Reserve position in the International Monetary Fund	–	–	–	–	–	–
Foreign Exchange	2,084	4,801	9,753	10,879	10,260	9,753
Gold (national valuation)	566	667	725	831	917	917

(1) Amounts indicated do not include reserves held by commercial banks.
Source: SBP.

By the end of 2004-05, total reserves held by SBP (excluding gold) stood at U.S.$10.5 billion. The SBP attributed the 5.7% decrease in total reserves held by SBP (excluding gold) in 2004-05 compared to the prior year to payments for loans and oil imports only being partially offset by concessional debt inflows from the World Bank, the Asian Development Bank and the U.S.A., receipts on account of logistic support provided by Pakistan to support the U.S.A. led coalition operation in Afghanistan and receipts from the sovereign *Sukuk* offering.

During the first six months of 2005-06, Pakistan's total reserves held by SBP (excluding gold) further declined to U.S.$10.0 billion as of December 31, 2005, a decrease of 4.9% compared to June 30, 2005. The SBP has attributed the decline to a robust growth in imports.

The SBP has established a risk management unit that would diversify Pakistan's foreign exchange reserves from U.S. dollars into other currencies and has appointed international investment banks to manage investment of the reserves.

Inflation, Money and Monetary Policy

Inflation

Historical Inflation. Annual inflation in Pakistan generally remained above 10.0% during the first seven years of the 1990s, compared to an average of 7.3% in the 1980s. High inflation was due to currency depreciation, large fiscal deficits, natural calamities (such as the 1994 leaf virus attack on the cotton crop), increases in the international price of palm oil, increases in the electricity and gas tariffs and increases in the support prices of major crops such as wheat, rice, cotton and sugar cane.

Inflation in 2000-01 was 4.4%, compared to 3.6% in 1999-00. Food inflation was 3.6% compared to 2.2% for the previous year, and non-food inflation was 5.3% compared to 5.0% for the previous year. The increase in inflation was due to shortages of essential food items such as pulses, sugar and tea, as well as increases in prices of fuel, transportation and drugs.

Inflation in 2001-02 was 3.5%, compared to 4.4% in 2000-01. The low inflation rate was mostly due to a low food inflation rate of 2.5% in 2001-02, compared to 3.6% in 2000-01. Non-food inflation declined from 5.3% to 4.4%. Monetary management, increased availability of food and essential consumer items, and moderate price increases in major imports such as sugar, pulses, edible oil and crude oil helped keep inflation low despite relatively higher increases in prices of fuel, lighting and transport.

Inflation was 3.1% during 2002-03, its lowest level in the last three decades. The low level of inflation in the midst of an 18.0% increase in money supply was the result of better supply of essential commodities, appreciation of the relative value of the Rupee, prudent fiscal management and continued management of the monetary impact of increased foreign exchange inflows. Food and non-food inflation for 2002-03 was 2.8% and 3.3%, respectively, as against 2.5% and 4.4%, respectively, for 2001-02.

Due to both higher levels of demand and supply factors, inflation increased in 2003-04 to 4.6% from the low point of 3.1% in 2002-03. In terms of demand, strong economic growth in 2002-03 and 2003-04 (being 4.8% and 6.4% respectively) contributed to increased income levels and corresponding increases in consumer demand. The wholesale price index increased by 7.9% during 2003-04 as compared with a 5.6% increase in 2002-03 and 6.2% in 2001-02.

Current Inflation Trends and Prize Stabilization Measures. During 2004-05 inflation accelerated further to 9.3% as against 4.6% in 2003-04. Food inflation was 12.5% as against 6.0% in 2003-04. Core inflation, also rose 7.0% as against 3.7% in 2003-04. Food inflation was the result of supply of shortages in wheat, meat and other edibles while the increase in non-food component was mainly due to house rent inflation and higher oil prices.

Inflationary pressures have recently begun to ease, potentially in response to both a tightening of monetary policy by SBP, which arrested the uptrend in core inflation, and better supply management of essential food items by the Government, which helped a fall in food inflation. Core inflation only decreased marginally from its peak of 7.9% in April 2005 to an estimated 7.6% in July-December 2005. Year-on-year food inflation, however, declined significantly from its peak of 15.7% in April 2005 to an estimated 7.6% in July-December 2005, which resulted in a decline in annualized consumer price inflation to an estimated 8.4% for the first six months of 2005-06 from 8.8% in the corresponding period in 2004-05.

Currently, the Government's general policy is to temper inflationary pressures through economic measures rather than through formal price controls. However, additional measures such as the discouragement of wheat hoarding, a reduction in oil import duties, supply augmentation and other similar measures may be undertaken to ensure price stability.

The following table sets out the percentage changes in CPI and WPI for the years indicated:

Inflation

Year/Month (Base 2000-01)	CPI Inflation %	WPI Inflation %
2001-02	3.54	2.13
2002-03	3.10	5.57
2003 -04	4.57	7.91
2004 -05	9.28	6.75
July 2005	8.99	9.36
July – August 2005	8.70	10.53
July – September 2005	8.65	10.98
July – October 2005	8.55	11.02
July – November 2005	8.41	11.00
July – December 2005	8.43	11.00
July – January 2006	8.48	10.97

Source: Federal Bureau of Statistics.

Money and Monetary Policy

Starting in 2001-02, the SBP moved towards a monetary policy intended to defend the Rupee. The SBP achieved a degree of market calm, following subsequent 1.0 percentage point reductions in the discount rate in each of July and August 2001. The events of September 11, 2001, however, created an uncertain external environment under which monetary policy had to be conducted. In the uncertain environment following the events of September 11, 2001, the SBP reduced the discount rate by another 2.0 percentage points in October 2001. Shortly afterwards, the decision was followed by a further cut of 1.0 percentage point in January 2002, bringing down the rate to 9.0% from 14.0%. T-bill rates and lending rates declined further after December 2001. The SBP reduced the discount rate to a record low of 7.5% in November 2002 and kept the discount rate unchanged until April 2005 despite an increasing spread to the benchmark six-month T-bill rates in order to discourage speculation in government debt instruments and avoid further pressure on declining market rates.

Current monetary policy seeks to moderate Rupee appreciation and inflation. The SBP also took a number of policy measures to boost exports, ensure availability of adequate and timely credit to growers and farmers, promote consumer financing and improve governance of the financial system.

The SBP's monetary policy stance has undergone considerable changes during 2004-05, switching from a broadly accommodative stance to an aggressive tightening since April 2005. SBP opted to raise interest rates moderately throughout the period but kept the benchmark rates well below inflation.

In April 2005, the SBP increased the discount rate to 9.0% from 7.5%. As a result, the weighted average lending rates have increased from 4.6% in July 2004 to 9.5% in December 2005.

The tables below provide further information on monetary expansion:

Money Supply
(in Pakistani Rupees millions)

	Narrow Money		Monetary Assets		Broad Money	
End June	(M1)	% Change	(M2)	% Change	(M3)	% Change
1999	643.04	33.9	1,280.55	6.2	1,921.47	15.1
2000	739.03	14.9	1,400.63	9.4	2,137.19	11.7
2001	761.43	3.0	1,526.04	9.0	2,313.87	8.3
2002	876.84	15.2	1,761.37	15.4	2,640.94	14.1
2003	1,106.25	26.2	2,078.71	18.0	3,102.00	17.5
2004	1,371.64	24.0	2,486.56	19.6	3,517.00	13.4
2005	1,624.23	18.4	2,965.62	19.3	3,959.60	12.6

M1 = Currency in Circulation+Demand Deposits with Scheduled Banks+Other Deposits with the SBP.
M2 = M1+Time Deposits with Scheduled Banks and Residents' Foreign Currency Deposits.
M3 = M2+NDFC Bearer Certificates+Deposits in National Saving Schemes (NSSs)+Deposits of Federal Bank for Co-operatives.

Source: Finance Division/SBP.

Monetary Assets

	End June					31 December
	2001	2002	2003	2004	2005	2005(P)
	(Rs. Million)					
1. Public Sector Borrowing (net)	601,870	677,054	598,623	656,729	752,515	821,445
Net Budgetary Support	499,888(a)	567,208(b)	511,186(b)	574,886(b)	646,682(b)	731,563(b)
Commodity Operations	95,311	100,642	74,047	65,873	87,836	72,713
Zakat Fund, privatization proceeds and National Debt Retirement Program (NDRP) Fund	(25,524)	(22,991)	(18,805)	(16,224)	(14,198)	(15,027)
Utilisation of privatization proceeds by Govt./ WAPDA	37,657	37,657	37,657	37,657	37,657	37,657
Use of privatization proceeds/NDRP Fund	(5,749)	(5,749)	(5,749)	(5,749)	(5,749)	(5,749)
Payment to HBL on account of HC&EB	287	287	287	287	287	287
2. Non-Government Sector	902,603	921,596	1,048,262	1,363,669	1,782,368	2,076,514
Autonomous Bodies	75,240	60,159	55,370	34,293	32,224	29,583
Net Credit to Private Sector & PSCEs	827,363	861,437	992,892	1,329,376	1,750,144	2,046,930
Private Sector	750,211	803,180	949,030	1,274,245	1,712,093	2,009,744
Public Sector Corp. other than Autonomous Bodies	37,036	35,563	32,386	53,852	44,838	44,800
PSEs Special Account Debt Repayment	(12,241)	(15,183)	(18,802)	(22,108)	(23,714)	(23,028)
Other Financial Institutions (NBFIs)	52,357	37,877	30,278	23,387	16,927	15,416
3. Counterpart Funds	(562)	(536)	(586)	(628)	(539)	(525)
4. Other Items (Net)	(6,204)	(67,463)	(107,258)	(116,405)	(204,929)	(260,840)
5. Domestic Credit (1+2+3+4)	1,497,707	1,530,651	1,539,041	1,903,367	2,329,415	2,636,594
6. Foreign Assets (Net)	28,338	230,718	539,664	583,190	636,938	570,267
7. Monetary Assets (5+6)	1,526,046	1,761,370	2,078,704	2,486,556	2,966,352	3,206,861

(a) Adjusted for funds placed in Special Debt Repayment Account.
(b) Adjusted for Banking Sector Restructuring & Privatization Account, ADB's Financial Market & Government Program loans placed with the SBP.
(p) Preliminary figures.

Source: State Bank of Pakistan.

Note: Figures in parenthesis are negative.

During 1999-00, the Government increased its borrowing from the banking system and encouraged a decrease in T-bill rates through retirement of its commercial debt. The six-month weighted average of T-bill rates stood at approximately 10.0% for the first half of 1999-00 and decreased to 7.2% in the latter half of the fiscal year.

Subsequently, by the second quarter of 2000-01, the 6-month weighted average of T-bill rates rose by 3.9 percentage points primarily due to pressure on the Rupee. Thereafter, the T-bill rates were relatively stable at approximately 11.5% for the rest of the fiscal year except in the first week of June 2001 when the pressure on the relative value of the Rupee caused the rates to further rise above 12.0%.

In December 2000, the Government launched the Pakistan Investment Bond (**PIB**), a new long-term government instrument to meet the needs of banks, non-banking financial institutions, insurance companies, pension funds and corporations. PIBs carry three, five and ten-year maturities and were initially auctioned every two months. By April 2001, PIBs were auctioned monthly, with the auction of the three and five-year bonds held in one month and the ten-year bonds in the next. By the end of 2000-01, approximately Rs. 46.1 billion was invested in PIBs with three, five and ten-year bonds carrying average yields of 12.5%, 13.0% and 14.0%, respectively.

In 2001-02, the benchmark weighted-average 6-month T-bill yields fell by 6.6 percentage points to settle at 6.3% at the end of June 2002. During the same period, investors purchased approximately Rs. 107.6 billion of PIBs with three, five and ten-year bonds carrying average yields of 8.8%, 9.8% and 10.9%, respectively.

Fiscal year 2002-03 saw an increase in the external account surplus and a more relaxed monetary stance by the SBP resulting in a more liquid money market. As a result, interest rates remained under pressure for the second successive year. The weighted average yield for six-month T-bills fell 463 basis points largely because of the SBP's foreign exchange market and smaller sterilization actions. Consequently, market interest for government paper grew as commercial banks sought to lock-in relatively high-yielding assets ahead of an anticipated decline in interest rates thus flattening the yield curve on PIBs. A total of Rs. 74.8 billion was invested in PIBs in 2002-03 with three, five and ten-year bonds carrying average yields of 3.1%, 4.2% and 5.6%, respectively.

Fiscal year 2003-04 evidenced the impact of the accommodative monetary stance pursued by the SBP over the previous two years. The relaxed monetary stance was instrumental in instigating an increase in aggregate demand, which drove real GDP growth to over 6.0% for the first time since 1995-96, but also contributed to rising inflationary pressures in the economy.

Although the SBP was confronted with a number of conflicting objectives in 2003-04, it used monetary policy to stimulate economic activity in the country, and accepted a modest rise in inflationary pressures as the cost of accelerating economic growth.

This policy stance achieved a broad based recovery of the economy led by the manufacturing sector. The low interest rates led to record growth in private sector credit of Rs.325.2 billion. Increasing share of personal loans in this credit expansion also suggest that, bank credit is now within the reach of the small borrowers, thus making the banking system more effective in terms of its benefits to the public.

Bank deposits and credit in 2003-04 recorded strong increases. This performance was helped by both the falling burden of outstanding non-performing loans, as well as by the stemming of inflows of new non-performing loans.

The weighted-average 6-month T-bill yield rate was 2.0756% at the end of 2003-04. A total of Rs. 107.7 billion was invested in PIBs in 2003-04 with three, five and ten year bonds carrying average yields of 4.10%, 5.05% and 6.44%

At the start of 2004-05, the SBP shifted from an accommodative policy to a monetary tightening stance in order to curb inflationary pressures from rising prices of oil, food and housing. The SBP raised the discount rate by 150 basis points to 9.0% in April 2005. Following such increase, yields on three, six and twelve-month T-bills increased by 576 basis points, 577 basis points and 620 basis points, respectively, to settle at 7.51%, 7.99% and 8.45%, respectively. Although short term interest rates increased significantly, long term interest rates did not rise as much because the government did not issue new PIBs.

During the first half of 2005, the process of interest rate hikes slowed down. For the period July to February 2006, yields on three, six and twelve-month T-bills were higher by 59 basis points, 30 basis points and 34 basis points, respectively, settling at 8.1%, 8.2% and 8.7%, respectively.

Exchange Rates

Pakistan moved from a managed floating exchange rate policy to a multiple exchange rate system in July 1998. The multiple exchange rate was then replaced with a market based unitary exchange rate system in May 1999. Under the unitary exchange rate system, the floating inter-bank rate applies to all foreign exchange receipts and payments both in public and private sectors. This free-floating exchange rate system, which was adopted in July 2000, remains operative.

All foreign exchange requirements for all approved purposes including imports, services and debt repayment are met by the authorized dealers that form the inter-bank market. The authorized dealers would neither approach the SBP for release of foreign exchange for any purpose, nor would they have to surrender it to the SBP. While each authorized dealer is free to fix its own buying and selling rates, the spread between the spot buying and selling rate should not exceed Rs. 0.5 per U.S. dollar. The SBP does not provide forward cover to the authorized dealers. However, authorized dealers may provide forward cover for exports, imports and other permitted transactions for any duration, in accordance with the conditions prevailing in the market.

As a part of its exchange rate management policy, the SBP may intervene in the market for the sale and purchase of foreign exchange on its own account at the rates and timing of its choice. The SBP may purchase and sell foreign exchange not only from the inter-bank market but also from any source within and outside the country, thus broadening the scope of SBP intervention in the foreign exchange market.

After decades of depreciation, the Rupee has been relatively strong in recent years due to higher remittances, increased aid, higher inflows of foreign direct investment, strong export growth and debt rescheduling. The SBP has also been supporting the Rupee by directly financing oil payments. The inter-bank average exchange rate per U.S. dollar has largely remained stable over the last five years and the Pakistani Rupee weakened only slightly against the U.S. dollar in the first half of 2005-06. The inter-bank exchange rate per U.S. dollar averaged Rs. 59.7 during the first half of 2005-06, compared to an average of Rs. 59.4 during full 2004-05. The Pakistani Rupee has, however, weakened significantly against the Euro since the Euro's introduction in 2001. In the first half of 2005-06, however, the Rupee has regained some of the lost ground against the Euro and the exchange rate fell from an average of Rs. 75.5 per Euro in 2004-05, to an average of Rs. 71.9 per Euro in the first half of 2005-06.

The following table sets out the average exchange rates between the Rupee and selected currencies for the years indicated:

Exchange Rates

		Average During Fiscal Year					July-December
	Currency	**2000-01**	**2001-02**	**2002-03**	**2003-04**	**2004-05**	**2005**
U.S.A.	Dollar	58.4378	61.4258	58.4995	57.5745	59.3576	59.7201
European Monetary Union	Euro	-	54.9991	61.3083	68.6226	75.5359	71.9349
Hong Kong	Dollar	7.4906	7.8720	7.4990	7.3970	7.6176	7.6927
Japan	Yen	0.5109	0.4884	0.4888	0.5203	0.5558	0.5238
Saudi Arabia	Riyal	15.5868	16.3792	15.5961	15.3488	15.8027	15.9238
United Arab Emirates	Dirham	15.9133	16.7231	15.9261	15.6727	16.1586	16.2598
United Kingdom	Pound Sterling	84.7395	88.5691	92.7433	100.1672	110.2891	105.4583
IMF	SDR	74.7760	78.0627	79.3198	83.2470	88.5631	86.5154

Source: State Bank of Pakistan.

Public Finance and Taxation

Background

Pakistan's fiscal year begins on 1 July and ends on the following 30 June. Each year, a detailed annual plan setting forth planned current and development expenditures, projected revenues, plans for financing projected budget deficits and projections for macro-economic indicators is developed and published in June. The planning process is undertaken by the Planning Commission (principally involved in formulating plans for developmental expenditures) and the Budget Wing of the Ministry for Finance & Economic Affairs (responsible for determining projections for current expenditure and government revenues). These groups co-ordinate revenue and expenditure plans and formulate the annual plan.

Weak fiscal balance was a major source of macroeconomic difficulty in the past. After almost six years of extensive efforts through the reform of the tax system and tax administration, Pakistan has succeeded in substantially lowering its overall fiscal deficit and level of public debt. The overall fiscal deficit which averaged nearly 7.0% of GDP in 1990s has declined to 3.2% in 2004-05. The revenue deficit has narrowed from 2.6% of GDP in 2000-01 to 0.7% in 2004-05.

Budgets

The Constitution governs Pakistan's budgetary process. The executive branch prepares the national budget and presents it to the Parliament. The Parliament has the opportunity to review the budget but does not have the power to amend the budget as a whole. Parliamentary rules allow for three types of motions with respect to a proposed budget: (1) a disapproval of policy cut, which allows for a member to present his disapproval to a specified policy and advocate an alternative policy; (2) an economy cut, which allows for the reduction in a budgetary item or the omission or reduction of a budgetary item; and (3) a token cut, which allows for the reduction by Rs. 100.0 in light of a specific grievance. Thereafter, the Prime Minister authenticates a schedule of authorized expenditures. No expenditure is deemed authorized unless it is presented before the National Assembly.

2004-05 Budget. The federal budget for 2004-05 envisaged higher revenues (6.0%) and expenditures (8.9%) compared to the previous year. Revenue receipts were estimated at Rs.841.9 billion compared with

Rs.794.1 billion for 2003-04. Tax revenue was estimated to increase by 12.4% while total CBR revenue was estimated to grow by 11.1%. Total expenditures were budgeted at Rs.1,040.8 billion or 8.9% higher than the previous year. Expenditures for the Public Sector Development Program was estimated at Rs.202.0 billion which was 25.8% higher than that of the previous year. Transfer to provinces was budgeted to increase by 19.2% to Rs.239.2 billion in 2004-05 from Rs.200.6 billion in 2003-04. The share of tax revenue in total revenues was estimated to increase from 77.0% to 81.6% while the share of current expenditures was estimated to increase from 81.1% to 82.3% during 2004-05 compared to the previous year.

2004-05 Actuals. Revenue receipts exceeded the budgeted amount by Rs. 5 billion or 9.5% while current expenditures were over the budgeted amount by Rs. 51.8 billion or 7.4%. Consequently, the overall budget deficit increased by Rs. 87.6 billion or 67.7% compared to last year. Financing of the Public Sector Development Program by the provinces exceeded the budgeted amount by Rs. 56.7 billion or 171.3%. Expenditures for PSDP exceeded the target of Rs. 202.0 billion by Rs. 25.7 billion.

2005-06 Budget. The 2005-06 budget represents a significant departure from past trends as it did not seek to further compress the fiscal deficit. The 2005-06 fiscal deficit, is budgeted to rise to Rs. 285.0 billion or 3.8% of (projected) GDP. This change resulted from the Government's increased focus on raising poverty related spending as well as public investment to improve infrastructure, in order to sustain high growth rates in the long-term. The budget reduced taxes and the number of tax bands as well as lowering import tariffs. Moreover, in order to expand such expenditures, the Government plans to reduce public debt to below 60.0% of GDP earlier than originally contemplated by the Fiscal Responsibility and the Debt Limitation Act 2005.

The following table summarizes the fiscal position of the Government since fiscal year 2000-01.

Consolidated Federal and Provincial Governments' Revenues and Expenditures

	2000/01	2001/02	2002/03	2003/04	Prov. Act. 2004/05	Budget Estimates 2005-06
				(in Rs. Billions)		
A. Revenue	552.9	624.1	720.8	805.8	900.0	990.3
a) Tax revenue	441.5	478.1	555.8	617.9	659.4	768.8
i) Federal	422.5	459.3	534.0	583.4	624.7	726.1
CBR revenue	392.1	403.9	461.6	521.9	588.4	690.0
Direct tax	124.6	142.6	152.0	164.5	176.9	224.6
Federal excise duty	49.0	46.9	44.0	45.8	58.7	62.3
Sales tax	153.5	166.3	195.1	220.6	235.5	294.0
Customs duties	65.0	48.1	68.8	90.9	117.2	121.2
Petroleum surcharges	17.9	36.6	46.9	44.6	10.6	16.6
Gas surcharges	12.3	17.7	21.3	16.8	16.2	32.5
- Other	0.2	1.1	4.2	0.1	2.1	36.5
ii) Provincial	19.0	18.8	21.8	34.1	34.5	42.7
b) Non tax revenue	111.4	146.0	165.0	187.9	248.4	221.5
Federal	91.5	124.7	139.6	162.1	225.8	175.6
Provincial	19.9	21.3	25.4	25.8	22.5	45.9
B. Expenditure	732.8	866.5	898.2	904.4	1,195.5	1275.4
a) Current expenditure	660.6	740.5	791.7	763.1	942.7	1019.5
i) Federal	660.6	740.5	579.9	582.4	688.6	719.8
- Interest payments	234.5	245.2	207.2	196.3	210.2	236.0
- Domestic	183.5	184.6	166.9	154.8	170.5	190.2
- Foreign	51.0	60.6	40.2	41.4	39.7	45.8
- Defense	104.7	149.0	159.9	180.4	211.7	223.5
- General Administration	70.7	56.3	67.4	75.5	81.4	103.1
Pensions for defense and civil government	30.9	27.2	40.6	32.5	32.3	46.5
- Subsidies	19.9	23.7	51.5	37.0	57.8	86.3
- Grants	18.1	22.8	23.5	34.3	94.7	38.4
- Other*	181.8	216.3	57.9	0.6	0.5	0.0
ii) Provincial	0.0	0.0	191.9	180.7	254.1	299.7
b) Development expenditure and net lending	72.2	126.0	106.5	177.3	252.8	265.9
Public Sector Development Prog	89.8	126.2	129.2	161.0	228.0	272.0
Net lending	(17.6)	(0.2)	(22.7)	16.3	24.8	6.1
C. Budget balance	(179.9)	(242.4)	(180.6)	(134.5)	(217.0)	(285.0)

* Mainly includes provincial expenditure. Source: Ministry of Finance, Budget Wing.

Revenues and Expenditures

Revenues. The structure of Pakistan's taxation changed considerably since the 1990s. The share of direct taxes in tax revenues increased from 18.0% in 1990-91 to 26.8% in 2004-05. The share of indirect taxes in tax revenues declined from 82.0% to 66.8% during the same period. The basic philosophy of tax and tariff reforms has been to move away from investment and production based taxes towards income and consumption based taxes.

During the 1990s, Pakistan suffered from fiscal imbalances and a heavy debt burden. The total revenue to GDP ratio was 15.0% while the tax to GDP ratio was 12.0% and primarily due to the existence of a narrow tax base, over-reliance on taxes on imports, the complexity of the tax regime and weak tax administration.

In 2000-01, the Government tightened fiscal management and implemented structural reforms across all major sectors of the economy. Tax administration reform was focused on improving tax compliance. Improvements in tax collection were sought by implementing a tax amnesty scheme and extending the general sales tax to the services sector. Lower debt servicing and defense expenditures coupled with revenue-enhancing measures resulted in a reduction of the fiscal deficit to 4.3% of GDP.

In 2001-02, fiscal reforms and efforts to improve tax compliance continued. Nevertheless, the fiscal deficit rose to 5.5% of GDP as a result of international political developments, unanticipated defense expenditures and some one-off adjustments on the expenditure side such as the grant to the CBR allowing it to clear accumulated income tax arrears owed to banks, substantial investment in KESC to restructure its finances before privatization and the settlement of WAPDA arrears. The decline in revenues was explained by the slowdown in domestic economic activity, the decline in imports and a decline in ad-valorem tax receipts due to a decline in domestic inflation and the appreciation of the Rupee against the U.S. dollar.

In 2002-03, the Government's efforts to widen the tax base and improve tax administration led to an increase in revenues of 15.5% compared to the previous year. Higher revenues combined with a continued decrease in debt servicing costs resulted in a further decrease in the fiscal deficit to 3.7% of GDP in 2002-03.

In 2003-04, revenues grew by 11.8% from the previous year, mainly due to higher tax and non-tax receipts. The increase in Government revenues compared to the prior year was primarily due to an increase of 32.1% in revenues from customs duties as a result of an increase in imports. During the same period, expenditures increased by 4.7% largely due to an increase in spending on social and development projects. The fiscal deficit for 2003-04 further declined to 2.4% of GDP compared to 3.7% of GDP in the prior year.

Total revenues were Rs. 900.0 billion in 2004-05 compared to Rs. 805.8 billion in 2003-04, an increase of 11.7%. This was primarily due to a significant increase in non-tax revenue of 32.2% and to a lesser extent also due to an increase in federal tax revenues, which grew by 7.1%. Non-tax revenue consists of receipts from civil administration and defence, profits of SBP, PSE and user charges of services, etc. The reason for the Rs. 60.5 billion increase in non-tax revenue was increase in SBP profits and defence receipts. The federal tax receipts consist of revenue collected by the CBR, surcharges (gas and petroleum) and some other minor collections.

Central Board of Revenue. CBR tax collection increased by 50.1% from 2000-01 to 2004-05. The CBR sustained the momentum of tax collection generated in 2003-04. Net tax collection during 2004-05 stood at Rs. 588.4 billion against the target of Rs. 580.0 billion, thus surpassing the target. Tax revenue grew by 6.7% in 2004-05.

In 2005-06, the CBR aims to collect Rs. 690.0 billion in tax revenue which is Rs. 101.6 billion more than CBR revenues for 2004-05 (Rs. 588.4 billion). CBR tax collection in the first six months of 2005-06 surpassed the target by 5.0%. Net collection stood at Rs. 323.9 billion against the target of Rs. 308.6 billion and collections in the comparable period in 2004-05 of Rs. 262.5 billion, thereby registering an increase of 23%.

Allocation of Revenue Between the Federal Government and Provinces. The Constitution governs the relationship between the Government and the provinces with respect to the distribution of a divisible pool of taxes. According to the Constitution, every five years, the President forms a National Finance Commission (**NFC**) consisting of the Minister of Finance of the Government, the Minister of Finance of each of the provincial governments and other presidential appointees. The NFC then recommends to the President the distribution to be made between the Federal Government and the provinces with respect to the divisible pool of taxes consisting of income tax, sales tax, export duties on cotton, excise duties and any other tax that may be specified by the President. The President then determines the share of the taxes to be allocated to the provinces and the

Government. The recommendations of the NFC together with an explanatory memorandum of action taken thereon are required to be sent to both Houses and to Provincial Assemblies. Under the Constitution, the President has the power to amend or modify the distribution of revenues as may be necessary or expedient. Since 1997, the share of the Government in the divisible pool has been fixed at 62.5% while the share of the provincial governments has been fixed at 37.5%. Beginning 2006-07, the share of the provincial governments in the divisible pool will rise annually to 41.5%, 42.5%, 43.75%, 45.0% and 46.25% thereafter.

Expenditure. Total expenditure was Rs. 1,195.5 billion in 2004-05, which was 32.2% higher than 2003-04. Out of the total expenditure for 2004-05, current expenditure (interest payments, defense, and expenditure on general administration) was Rs. 942.7 billion or 78.9% of total expenditure compared to Rs. 763.1 billion or 84.4% of total expenditure in 2003-04. Development expenditure increased to Rs. 252.8 billion or 21.1% of total expenditure in 2004-05, compared to Rs. 177.3 billion or 19.6% of total expenditure in 2003-04.

Interest Payments. Interest payments as a percentage of total expenditure continued to decline from 21.7% in 2003-04 to 17.6% in 2004-05. In absolute terms, however, interest payments increased from Rs. 196.3 billion in 2003-04 to Rs. 210.2 billion in 2004-05 – an increase of 7.1%. This increase was attributable to less rollover policy.

Defense Expenditure. Defense expenditure has been increasing in absolute terms from Rs. 104.7 billion in 2000-01 to 211.7 billion in 2004-05. Defense expenditures in 2004-05 increased by 17.4% from the prior year and was 32.4% greater than in 2002-03. Defense spending as a percentage of GDP also increased from 2.5% of GDP in 2000-01 to 3.3% of GDP in 2003-04, but declined to 3.2% of GDP in 2004-05.

General Administration. After interest payments and defense, the third major component of current expenditure is expenditure on general administration including pensions. Expenditure under this item was Rs. 81.4 billion in 2004-05, 7.8% higher than in 2003-04. It accounted for 1.2% of GDP during 2004-05 as against 1.4% of GDP in 2003-04.

Provincial Current Expenditure. Provincial current expenditure grew by 40.6% in 2004-05, increasing from Rs. 180.7 billion in 2003-04 to Rs. 254.1 billion. However, provincial current expenditure as percentage of total expenditure has declined over the last three years. As a percentage of GDP, provincial current expenditure has declined from 3.3% in 2003-04 to 3.9% in 2004-05.

Public Sector Development Program. The size of the PSDP has increased substantially during the last five years. In 2000-01, expenditures for PSDP was Rs. 89.8 billion, or 12.3% of total expenditures. In 2001-02, expenditures were higher both in absolute terms (Rs. 126.2 billion) and as a percentage of total expenditures (14.6%). While expenditures for PSDP decreased to 14.4% of total expenditures in 2002-03, the rising trend in absolute terms continued as expenditures for PSDP reached Rs. 129.2 billion in 2002-03. The overall size of PSDP in 2004-05 was Rs. 228.0 billion compared to Rs. 161.0 billion in 2003-04, an increase of 41.6% over the prior year. As a percentage of total expenditures, expenditures for PSDP in 2004-05 was 19.1% of total expenditures compared to 17.8% of total expenditures in 2003-04.

Fiscal Deficit. In 2004-05, Pakistan had an overall fiscal deficit of Rs. 217.0 billion, or 3.2% of GDP. This revenue-expenditure gap was financed through external and domestic sources. Out of the gap of Rs. 217.0 billion, financing from external sources was Rs. 120.4 billion. The gap of Rs. 96.6 billion was financed from domestic sources. Within domestic sources, financing from non-bank sources amounted to Rs. 8.1 billion while Rs. 60.2 billion was from bank sources, and Rs. 28.3 billion was financed through privatization proceeds.

The 2005-06 budget targets a fiscal deficit of Rs. 285.0 billion or 3.8% of GDP, 0.6 percentage points higher than in 2004-05. This is due to a continued shortfall in petroleum surcharges on the revenue side and an increase of over 19.3% in expenditure on the public sector development program.

Public Debt

Public debt of the Government has two distinct facets. Domestic debt has been incurred principally to finance fiscal deficits over the years. External debt, however, is raised primarily to finance development expenditure.

Pakistan's public debt grew by an average annual rate of 18.0% and 15.0% in the 1980s and 1990s, respectively. Public debt was 55.9% of GDP in 1980, increased to 92.0% in 1990, and surpassed 100.0% in 2000. Public debt consists of both debt payable in Rupees and debt payable in foreign exchange. Over the 1980s and

1990s, the share of public debt in Rupees in total public debt increased from 38.5% to 52.8% by the end of 1999-00. On the other hand, public debt payable in foreign exchange as a percentage of total public debt declined from 61.5% to 48.8% during the same period. By the end of 2004-05, the share of public debt in Rupees to total public debt was 52.8% while the share of the public debt in foreign exchange to total public debt was 47.2%. Public debt was 317.1% of total revenues in 1980, increased to 504.6% by 1990, and was 631.0% in 2001.

As a result of considerable improvement in fiscal balance as a result of the Government's reforms aimed at reducing the overall deficit as well as reducing Pakistan's cost of borrowing, the public debt situation has improved in recent years. Not only has the pace of accumulation been slowed but the burden of public debt has declined as well. During 2004-05, public debt grew by 6.7%. As a percentage of GDP, public debt has declined from 68.4% in 2003-04 to 61.7% in 2004-05. Public debt was 478.6% of total revenue in 2003-04 and it declined to 437.2% in 2004-05. Public debt further declined to 55.7% of projected GDP and 418.5% of total revenue by end December 2005. In absolute terms, public debt grew by 2.9% during the first six months of 2005-06.

During the last three years the ratio of debt service to total revenues has improved from 42.5% of total revenues in 2002-03, to 42.2% in 2003-04 and further to 31.5% in 2004-05. As a percentage of GDP, debt service also has shown improvement during the same period as debt service to GDP ratio was 6.3% in 2002-03, 6.2% in 2003-04 and 4.1% in 2004-05.

Public Domestic Debt

Before 1990, money management was conducted primarily through the requirement for commercial banks to deposit money with the SBP at fixed rates of interest. Since the start of the reform of the financial markets in 1990, the emphasis has shifted to funding through monthly auctions of Treasury Bills (six month notes issued at a discount) and Federal Investment Bonds (fixed rate bonds with three, five and ten year maturities). The balance of domestic public debt is derived from various types of savings accounts and different types of certificates. Domestic debt in Pakistan consists of permanent debt (medium and long-term), floating debt (short- term) and unfunded debt (mostly related to the national saving scheme).

Fiscal sector improvements during the last six years have led to a slow down in the rise of domestic debt compared to the 1990s. Domestic debt stood at Rs. 1,799.0 billion in 2000-01, declined to Rs. 1,774.7 billion in 2001-02 (a reduction of 1.4%), but thereafter rose again to Rs. 1,894.5 billion in 2002-03, and Rs. 2,012.2 billion as of 30 June 2004.

Domestic debt in absolute terms also increased in 2004-05 to Rs. 2,158.4 billion as a result of a rise in the nominal value of the fiscal deficit. The economy's debt carrying capacity, measured by the ratio of domestic debt to GDP, improved as the stock of domestic debt declined to 33.0% of GDP by end June 2005 from 43.2% in June 2001 – a decline of 10.2 percentage points.

In the first half of 2005-06, domestic debt in absolute terms increased by Rs. 132.5 billion from Rs. 2,158.0 billion at end of June 2005 to Rs. 2,290.9 billion at the end of December 2005 due to an increase in the issuance of short-term debt.

The following tables provide a summary of outstanding domestic debt and domestic debt service requirements for the periods indicated.

Outstanding Domestic Debt

	End June				
	2001	**2002**	**2003**	**2004**	**2005R.E**
			(Rs. million)		
Permanent Debt*	349,21212	424,767	468,768	570,009	526,178
Floating Debt**	737,776	557,807	516,268	542,943	778,163
Unfunded Debt***	712,010	792,137	909,500	899,215	854,044
Total	1,798,998	1,774,711	1,894,536	2,012,167	2,158,385
Total Domestic Debt as percentage of GDP	43.2	40.3	39.3	36.4	33.0

* Market Loans, Federal Government Bonds, Income Tax Bonds, Government Bonds (L.R. – 1977), Special Government Bonds For SLIC (Original), Special Government Bonds for SLIC (Capitalization), Bearer National Fund Bonds (BNFB), Special National Fund Bonds, Fe

** Treasure Bills (3 Months), Market Treasury Bills, MTBs for Replenishment.
*** Defence Savings Certificates, National Deposit Certificates, Khas Deposit Certificates, Special Savings Certificates (Reg), Special Savings Certificate (Bearer), Regular Income Certificates, Bahbood Savings Certificates, Khas Deposit Accounts, Saving
R.E.: Revised Estimate.

Source: Debt Management Section, Ministry of Finance.

Domestic Debt & Debt Servicing

	2000-01	2001-02	2002-03	2003-04(R.E.)	2004-05(R.E.)
			(Rs. Billion)		
Outstanding Domestic Debt (end of fiscal year)	1,798,998	1,774.711	1,894,536	2,012,167	2,158,385
Debt Servicing	309.1	313.4	255.9	276.1	311.5
Debt Servicing as percentage of Total Tax Revenue	70.0	65.4	46.0	45.4	47.1
Debt Servicing as percentage of Total Revenue	55.9	50.2	35.5	34.9	33.7
Debt Servicing as percentage of Current Expenditure	47.9	44.8	32.3	35.6	32.7
Debt Servicing as percentage of Total Expenditure	43.1	37.9	28.8	28.9	27.4

R.E.: Revised Estimate.
Source: Ministry of Finance.

External Debt

Outstanding external debt includes all Government debt denominated in foreign currency, loans contracted by enterprises with Government ownership of more than 50.0%, as well as the external debt of the private sector which is registered with the SBP and benefits from a foreign exchange convertibility guarantee from the SBP. As of June 30, 2005, Pakistan's total outstanding external debt was U.S.$34.0 billion.

Total Stock of External Debt and Foreign Exchange Liabilities. Pakistan's total stock of external debt and foreign exchange liabilities stood at U.S.$21.9 million in 1990 and reached almost U.S.$38.9 billion by end-June 1999. Following a strategy of debt reduction over the last six years, Pakistan has succeeded in both slowing the rising trend in external debt and foreign exchange liabilities and reducing them in absolute terms. External debt and foreign exchange liabilities were reduced by U.S.$0.7 billion between 2000-01 and 2001-02. During 2002-03, Pakistan retired an additional U.S.$1.0 billion worth of debt and liabilities. By the end of June 2005, the total outstanding external debt and foreign exchange liabilities stood at U.S.$35.8 billion, down from U.S.$37.1 billion in June 2001. Furthermore, after implementing reforms and following the 2001 Debt Reduction Strategy, external debt as a percentage of GDP exhibited a downward trend from 2000-01 to 2004-05. In 2000-01, the external debt to GDP ratio was at 49.5% of GDP compared to 45.6% of GDP in 2001-02. The external debt to GDP ratio further improved to 40.0% of GDP in 2002-03, to 35.0% of GDP in 2003-04, and to 31.0% of GDP in 2004-05.

The following table summarizes the country's external debt at June 30 of each year from 2001 to 2005 and at December 31, 2005.

External Debt and Foreign Exchange Liabilities

	End June				
	2001	2002	2003	2004	2005
			(U.S.$ billion)		
Public & Publicly Guaranteed Debt	28.1	29.2	29.2	29.9	31.1
Medium & long term (Paris Club, Multilateral & other bilateral)	25.6	27.3	28.1	28.6	29.2
Other medium & long term (Bonds & Military)	1.2	1.5	0.7	1.0	1.5
Short term (IDB & Commercial)	1.4	0.5	0.4	0.2	0.5
Private Non-guaranteed Debt	2.5	2.2	2.0	1.7	1.3
IMF	1.5	1.9	2.1	1.8	1.6
Total External Debt	32.1	33.4	33.4	33.3	34.0
Foreign Exchange Liabilities	5.0	3.1	2.1	2.0	1.8
Total Debt and Liabilities	37.2	36.5	35.5	35.3	35.8
Official liquid reserves	1.7	4.3	9.5	10.6	9.8
Net Debt and Liabilities	35.5	32.2	26.0	24.7	26.0

Source: Ministry of Finance.

Public and Publicly Guaranteed Debt. As of June 30, 2005, medium and long-term public and publicly guaranteed debt amounted to U.S.$29.2 billion, of which almost 52.7% is owed to multilateral creditors. Approximately 44.5%, or U.S.$13.0 billion, is owed to Paris Club official creditors.

As of June 30, 2005, medium and long-term public and publicly guaranteed debt also included U.S.$805.0 million owed to official creditors that are not represented in the Paris Club, as well as U.S.$1.3 billion of international bonds and U.S.$188.0 million of military debt.

As of June 30, 2005, public and publicly guaranteed short-term debt amounting to U.S.$271.0 million was owed to the Islamic Development Bank and U.S.$182.0 million of loans were owed to commercial banks.

The following table describes in detail the country's external debt outstanding as of December 31, 2005.

External Debt (Provisional)

	Outstanding as of December 31, 2005
	(U.S.$ million)
TOTAL EXTERNAL DEBT (I+II)	33,634
I) Public and Publicly Guaranteed Debt	32,670
MEDIUM AND LONG TERM	32,326
A) Multilateral credits	17,164
ADB	6,313
IBRD	2,238
IDA	6,865
IMF	1,492
Other	256
EIB	20
IDB	56
IFAD	126
Nordic Development Fund	16
Nordic Investment Bank	16
OPEC FUND	22
B) Bilateral creditors	13,315
1) Paris Club Countries	12,473
Austria	68
Belgium	68
Canada	480
Finland	6
France	1,897
Germany	1,617
Italy	216
Japan	5,233
Korea, Rep. of	661
Netherlands	107
Norway	42
Russia	130
Spain	83
Sweden	156
Switzerland	84
United Kingdom	14
U.S.A	1,611
2) Non Paris Club Countries	842
Bahrain	12
China, P.R. of	607
Czech	1
Kuwait	79
Libya	5
New Zealand	3
Saudi Arabia	43
Turkey	26
United Arab Emirates	66
C) Bonds	1,218
Eurobond	1,100

		Outstanding as of December 31, 2005
		(U.S.$ million)
	Construction Company bonds (NHA)	109
	Saindak Copper/Gold Project bonds	9
D)	Foreign Currency Bearer Certificates (SBP)	1
E)	Commercial Banks	166
	Bahrain	166
	Japan (Jexim)	0
	Russia	0
F)	Collateralized Credits	325
	ABN AMRO (PTCL)	0
	ANZ BANK	0
	Bank of Oman/PARCO	0
	PIA (Hire/Purchase (Long Term) (SBP)	325
G)	Defense	137
	CHINA P.R. of (Supplier)	137
H)	Supplier credits	0
	Austria	0
SHORT-TERM DEBT		344
A)	Multilaterial Creditors	343
	IDB	343
B)	Short-Term Dollar Bearer Certificates (SBP)	1
II)	Private-Sector Debt (with SBP foreign-exchange convertibility guarantee)	964
	Multilateral Creditors	250
	Paris Club (Countries)	710
	Non-Paris Club (Countries)	4
III)	Memorandum Items	1,695
Foreign Currency Accounts (FCAs) (OLD)		121
	Resident	89
	Non-Resident	32
	FE-25 (FCAs-New)	3,507
Deposits with SBP		1,200
	NBP	0
	UAE	450
	Kuwait	250
	Deposits with NBP (Bank of China)	500
	NBP (GOP)	0
	Libyan Arab Deposit	0
Special U.S.D Bond		368
Foreign-Exchange Bearer Certificates		6

Notes:

1. Figures are based on the application of the exchange rate of December 31, 2005.
2. Figures may be changed after signing of remaining rescheduling agreement due to detailed reconciliation of rescheduled loans account and its effects.
3. ADB, IBRD and IDA's figures are donor based.
4. Memorandum items are not added in the total external debt.
5. Memorandum item (FE-25) not added in the total of Memorandum items.

Source: Economic Affairs Division/State Bank of Pakistan.

Debt Restructuring

Paris Club. Pakistan has approached the Paris Club of creditors three times since 1998 to seek debt relief and a rescheduling of its external bilateral debt. The first debt rescheduling agreement was reached in January 1999 and granted U.S.$2.4 billion in debt relief. It covered debt service maturities due from January 1, 1999 to February 29, 2000 (including debt service payments arrears from July 1998). The Paris Club Agreed Minute, which was signed on January 30, 1999, made clear that the traditional Paris Club policy of comparability of treatment from private creditors was to extend to cover all external debt of Pakistan, including its outstanding external debt securities.

The second debt rescheduling agreement was signed in January 2001 for debt service payments falling due during the period from March 1, 2000 to September 30, 2001. The amount of debt relief under this agreement was U.S.$1.7 billion. These two reschedulings were "flow" reschedulings which limited rescheduling to the debt servicing (principal plus interest) falling due within a specified period (consolidation period) which usually coincides with a country's program with the IMF.

The third rescheduling agreement was negotiated with the Paris Club in December 2001. Unlike the previous two reschedulings, the third rescheduling received "stock" treatment which takes into account the entire outstanding stock (principal plus accumulated arrears) and reprofiles it over an extended period of time. The stock treatment is rare as it is restricted by the Paris Club to only Highly Indebted Poor Countries (**HIPCO**). Pakistan has been the fourth non-HIPCO country to get stock treatment of its debt after Egypt, Poland and Yugoslavia. Pakistan did not seek standard Paris Club terms, but instead negotiated special terms particular to Pakistan. Also, only the bilateral Paris Club debt (and not multilateral debt) received stock treatment during the third rescheduling.

The third rescheduling agreement reschedules Pakistan's total bilateral public and publicly guaranteed debt of over one year maturity, outstanding as on November 30, 2001. The total stock of bilateral debt, eligible for debt rescheduling, was estimated at U.S.$12.6 billion, outstanding as on November 30, 2001 (including the debt service payments in arrears and the amount of previously rescheduled debt). The Paris Club also agreed to defer 100.0% of principal and interest due and not paid between November 30, 2001 and June 30, 2002 in respect of loans signed after the cut-off date of September 30, 1997 (including deferment of 100.0% of the amount of moratorium interest on rescheduled debt due between November 30, 2001 and June 30, 2002 as well as 20.0% of the amount of moratorium interest due between July 1, 2002 and June 30, 2004).

The total debt of U.S.$12.6 billion eligible for restructuring consists of U.S.$8.7 billion in Official Development Assistance (**ODA**) debt and U.S.$3.9 billion in non-ODA debt. Debt contracted on concessionary terms (with long maturities and/or below-market interest rates such that they have a grant element of 35.0% or more) is commonly referred to as ODA debt, while export credits and other market-related debt are known as non-ODA debt. The ODA rescheduled debt will be repayable over a period of 38 years (including a 15-year grace period) and carries an interest rate lower than that under the original contracts. Non-ODA rescheduled debt is to be repaid over a period of 23 years (including a 5-year grace period) at an appropriate market rate. The deferred debt in respect of loans incurred after the cut-off date will be repaid in four consecutive equal semi-annual installments starting May 31, 2005 and ending November 30, 2006.

As a result of the third debt rescheduling, an estimated U.S.$1.2 billion to U.S.$1.5 billion accrued annually in payments of debt servicing on external debt from 2001-02 to 2004-05. Two Paris Club creditors, Denmark and the Commonwealth Development Corporation of UK, waived their entire outstanding debt of U.S.$18.4 million and U.S.$29.5 million, respectively, while the Netherlands gave remission in debt service payments falling due during October 2001 to December 2002, equivalent to U.S.$14.3 million and the U.S.A. cancelled an amount of U.S.$1.5 billion of their debt.

Overall, U.S.$1.562 billion in debt payments have been cancelled. All the bilateral agreements with the Paris Club creditors have been signed. With respect to non-Paris Club creditors, rescheduling arrangements have been finalized with the Saudi Fund, Kuwait, Exim Bank, Turkey and Czech Republic, while the bilateral agreements with the UAE and Libya are still being negotiated.

Exchange Offer. In fulfillment of the comparability of treatment obligations imposed under the Paris Club Agreed Minute, in November 1999, Pakistan made an exchange offer to holders of three series of outstanding notes. In furtherance of the exchange offer, on December 13, 1999 and subsequent dates, Pakistan issued approximately U.S.$623.0 million of U.S. dollar denominated 10.0% Notes due 2002/2005. Pakistan has since repaid these notes in full in accordance with their terms.

External Debt Service. On January 29, 2004, the Government prepaid 14 loans worth U.S.$1.2 billion to the Asian Development Bank (**ADB**). These loans, which carried interest rates between 6.5% per annum and 11.0% per annum, were originally scheduled for repayment between 2009 and 2019. With this pre-payment Pakistan recorded a saving of U.S.$300.0 million against future interest payments. Importantly this pre-payment did not disrupt flows in the inter-bank market as SBP financed this transaction from its sinking fund.

The following table sets out Pakistan's external debt service for the periods indicated.

External Debt Service

Item	2002-03 Actual Paid	2002-03 Rescheduled/ Rollover	2003-04 Actual Paid	2003-04 Rescheduled/ Rollover	2004-05 Actual Paid	2004-05 Rescheduled/ Rollover
			(in U.S.$ millions)			
1. Public and Publicly Guaranteed	1,857.3	1,008.1	3,526.2	100.0	1,811.2	100.0
A. Medium and Long Term (> 1 Year)	1,667.4	1,008.1	3,330.1	100.0	1,802.7	100.0
Paris club	302.0	760.8	839.5	–	532.9	0.0
Principal	110.0	485.9	521.9	–	151.6	0.0
Interest	192.0	274.9	317.6	–	381.3	0.0
Multilateral	951.0	–	2,126.0	–	899.1	0.0
Principal	630.0	–	1,801.8	–	692.3	0.0
Interest	321.0	–	324.2	–	206.8	0.0
Other Bilateral	93.0	25.8	54.4	–	51.9	0.0
Principal	71.0	21.5	38.9	–	26.7	0.0
Interest	22.0	4.3	15.5	–	25.2	0.0
Eurobonds and Sandak Metal	223.0	–	197.3	–	217.2	0.0
Principal	161.5	–	158.0	–	157.7	0.0
Interest	61.5	–	39.3	–	59.5	0.0
Military	0.0	121.5	73.5	–	79.0	0.0
Principal	0.0	100.7	58.5	–	67.0	0.0
Interest	0.0	20.9	15.0	–	12.0	0.0
Commercial Loans/Credits	98.4	100.0	39.4	100.0	22.6	100.0
Principal	84.0	100.0	33.3	100.0	16.3	100.0
Interest	14.4	–	6.1	–	6.3	0.0
B. Short-Term (< 1 Year)	189.9	–	196.1	–	8.5	0.0
IDB	189.9	–	196.1	–	8.5	0.0
Principal	182.9	–	191.1	–	8.3	0.0
Interest	7.0	–	5.0	–	0.2	0.0
2. Private Non-Guaranteed	833.7	–	743.5	–	482.4	0.0
A. Medium and Long Term (> 1 Year)	833.7	–	743.5	–	482.4	0.0
Private Loans/Credits	833.7	–	743.5	–	482.4	0.0
Principal	663.0	–	612.6	–	373.7	0.0
Interest	170.7	–	130.9	–	108.7	0.0
B. Short -Term (< 1 Year)	–	–	–	–	0.0	0.0
3. IMF	459.3	–	699.4	–	422.5	0.0
Repurchases/Principal	419.0	–	673.6	–	399.6	0.0
Charges/Interest	40.3	–	25.8	–	22.9	0.0
Total Debt Servicing (1 Through 3)	3,150.3	1,008.1	4,969.1	100.0	2,716.1	100.0
4. Central Bank Deposits	70.8	400.0	14.6	700.0	23.5	700.0
Principal	50.0	400.0	0.0	700.0	0.0	700.0
Interest	20.8	–	14.6	–	23.5	0.0
5. NBP/BOC Deposits	18.3	500.0	15.3	500.0	16.4	300.0
Principal	0.0	500.0	0.0	500.0	0.0	300.0
Interest	18.3	–	15.3	–	16.4	0.0
6. Special US Dollar Bonds	316.0	–	196.8	–	163.2	0.0
Principal	283.3	–	167.1	–	130.2	0.0
Interest	32.7	–	29.7	–	33.0	0.0
7. Foreign Currency Bonds (NHA)	29.0	–	26.5	–	0.0	0.0
Principal	21.9	–	21.9	–	21.9	0.0
Interest	7.1	–	4.6	–	3.3	0.0
8. Swaps	235.0	–	0.0	–	0.0	0.0
9. FCAs	411.6	–	1.3	–	0.7	0.0
FE-45 (Institutional)	238.1	–	–	–	0.0	0.0
Principal	233.9	–	0.0	–	0.0	0.0
Interest	4.2	–	0.0	–	0.0	0.0
FE-13 (Interest)	2.4	–	1.3	–	0.7	0.0
FE-31	171.1	–	–	–	0.0	0.0
10. NDRP	68.5	–	3.6	–	1.0	0.0
11. FEBCs/FCBCs/DBSs	46.0	–	47.1	–	19.0	0.0
Principal	26.0	–	20.8	–	8.0	0.0
Interest	20.0	–	26.3	–	11.0	0.0
Total	4,345.5	1,908.1	5,274.3	1,300.0	2,965.1	1,100.0
Principal	3,411.1	1,608.1	4,303.1	1,300.0	2,054.3	1,100.0
Interest	934.4	300.1	971.2	–	910.8	0.0

Source: Statistics Department, State Bank of Pakistan.

Relationship with the International Monetary Fund and other Multilateral Creditors

Pakistan has received economic assistance from the IMF, the World Bank, the Asian Development Bank (**ADB**) and the Islamic Development Bank.

IMF. Since 1988, Pakistan has entered into various lending arrangements with the IMF such as the Stand-by Arrangement, Poverty Reduction and Growth Facility **(PRGF)**, Extended Fund Facility, and Contingency and Compensatory Financing Facility. Stand-by Arrangements are designed to provide short-term financial assistance while Extended Fund Facilities give medium-term assistance to members with balance of payments problems resulting from structural economic changes. Contingency and Compensatory Financing Facilities compensate shortfalls in earnings and help maintain adjustment programs resulting from external shocks.

On December 6, 2001, the IMF approved a PRGF for Pakistan worth SDR1.034 billion (approximately U.S.$1.3 billion). The PRGF was a three-year concessional loan in support of poverty reduction. PRGF-supported programs were articulated in a Poverty Reduction Strategy Paper that was required by the IMF and provides the basis for assistance under the facility. PRGF loans carry a fixed annual interest rate of 0.5% and are repayable over 10 years with a 66-month grace period on principal payments. Disbursements under the PRGF were scheduled to be made in 6 equal installments in the amount of SDR86.14 million each. Pakistan has undergone all reviews under the PRGF and met all quantitative performance criteria. Pakistan did not request a successor arrangement with the IMF on the expiry of the PRGF on December 5, 2004.

As of December 31, 2005, SDR 56.9 million under the Stand-by Arrangement, SDR56.9 million under the PRGF, SDR 990.3 million under the PRGF and SDR1,047.2 million under the Extended Fund Facility was outstanding.

World Bank. From 1952 to December 31, 2005, the World Bank had provided approximately U.S.$20.5 billion in loans and soft credits to Pakistan. Of that amount, approximately half came from the International Bank for Reconstruction and Development (IBRD) while the remainder came from the International Development Association (**IDA**). In 2004-05, the Government received U.S.$1.9 billion from the IDA and U.S.$358.2 million from the IBRD. Funds of U.S.$101.0 million were disbursed under the Punjab Educational Reform Adjustment Credit facility which aims to support the educational reform program of the Puijab. The Government also received a U.S.$90.0 million loan from the IDA under the NWFP Second Structural Adjustment Credit. The facility was directed at strengthening governance, social reform and fiscal and financial management reforms. In September 2004, the World Bank approved a U.S.$300.0 million loan to Pakistan under the poverty reduction strategy credit. During the first half of 2005-06, Pakistan received additional loans of U.S.$214.0 million from the IDA, and paid U.S.$168.0 million to the World Bank. As of December 31, 2005, U.S.$9.1 billion of debt was outstanding to the World Bank and the IDA.

Asian Development Bank. The ADB approved loans to Pakistan in the aggregate amount of U.S.$709.0 in million in 2003-04 and U.S.$921.0 million in 2004-05. In 2004-05, U.S.$563.3 million was actually disbursed. For 2005-06, the Government expects U.S.$1.5 billion of loans to be approved by the ADB. As of December 31, 2005, U.S.$6.3 billion of debt was outstanding to the ADB.

Islamic Development Bank. From 1975 to December 31, 2005, the IDB extended approximately U.S.$5.0 billion of financial assistance, including approximately U.S.$4.5 billion of trade financing mainly for petroleum imports and approximately U.S.$500.0 million for project finance. Prior to 2001-02, the IDB had provided trade financing at an average of approximately U.S.$100.0 million per year. In 2001-02, the IDB increased this amount to approximately U.S.$362.0 million per year. However, during 2002-03, Pakistan only used U.S.$186 million of available financing for the year. In 2003-04, Pakistan further decreased its use of financial assistance to U.S.$8.3 million because of improved foreign currency reserves. In 2004-05, Pakistan used U.S.$330 million of the loan facility. As of December 31, 2005, approximately U.S.$56.0 million in medium and long-term loans and U.S.$343 million in short-term loans were outstanding.

European Union. Since 1976, the European Commission has extended grants amounting to approximately Euro365 million under the Pakistan European Community Cooperation Agreement. The focus of the assistance was primarily for social sector development. In April 2003, the EU entered into another Euro 71 million agreement to lend for social development programs. In addition, the EU provided U.S.$44.3 million as budgetary support and U.S.$47.7 million as bilateral assistance.

Bilateral Economic Assistance

Pakistan has also received bilateral economic assistance from various countries.

U.S.A. In 2002-03, the U.S.A. disbursed U.S.$305.0 million to Pakistan for programs covering economic support, improvement of children's health, narcotics control and military education and training. In May 2003, an agreement to provide a further U.S.$108.0 million over the next five years was made with the U.S.A. to address narcotics control and reproductive health care services in Pakistan. A supplemental appropriation in the 2003 budget of the U.S.A. includes U.S.$175.0 million in military financing and U.S.$25.0 million for narcotics control. The 2004 budget request to the U.S. Congress included an allocation of U.S.$395.3 million for Pakistan, primarily for economic support (U.S.$200.0 million), military financing (U.S.$75.0 million) and development assistance (U.S.$50.0 million).

On October 1, 2004, the U.S. Congress approved a U.S.$3.0 billion assistance package for Pakistan. The package allocates half of the total amount of the assistance package for economic assistance and half for military assistance. As of December 31, 2005, disbursements have totaled U.S.$271 million with further disbursements of U.S.$600.0 million annually to take place until 2009. In 2004-05, Pakistan received U.S.$269.0 million from the U.S.A. for programs, covering narcotics control, governance, economic growth, education, health and population welfare.

Kuwait. Since 1976, the Kuwaiti Fund for Arab Economic Development has extended U.S.$244.0 million in economic assistance to Pakistan for various projects, including construction or development of transmission lines, grid stations, gas pipelines, dam repairs and road projects. On 18 May 2003, Kuwait rescheduled U.S.$25.0 million of debt repayments.

United Arab Emirates. Pakistan has received approximately U.S.$950.0 million and Rs. 150.0 million in assistance from the UAE since 1974. Funds were used for, among other things, balance of payments support, drought assistance and other infrastructure projects. In April 2002, a bilateral agreement was signed between the two countries to reschedule approximately U.S.$23.0 million of debt owed by Pakistan.

Oman. In 2001, Oman agreed to invest approximately U.S.$94.0 million in different projects in Pakistan. In addition, another U.S.$157.0 million in grants and assistance has been committed by Oman, of which U.S.$50.0 million was for immediate investment and another U.S.$50.0 million was for projects in Balochistan.

Qatar. In 1974, Qatar extended a loan in the amount of U.S.$10.0 million to Pakistan. Subsequently, an unpaid balance of U.S.$4.1 million on the loan was converted into a grant. In 1984, Qatar provided another grant for U.S.$10.0 million. Furthermore, the Amir of Qatar has donated U.S.$5.0 million for Pakistan's Development Program.

Saudi Arabia. Since 1974, the Saudi Fund for Development, the official aid agency of the Kingdom of Saudi Arabia, has provided financial assistance of approximately U.S.$1.0 billion for several projects, including highway construction and financing of transmission lines and thermal power projects.

France. As of December 31, 2005, approximately U.S.$2.0 billion in loans from France were outstanding.

United Kingdom. Since 2000-01, the UK has extended approximately 45 million pounds sterling annually for project and technical assistance in Pakistan.

TERMS AND CONDITIONS OF THE 2016 NOTES

The following is the text of the Terms and Conditions of the 2016 Notes which (subject to modification and except for the paragraphs in italics) will be endorsed on the Certificates issued in respect of the 2016 Notes:

The U.S.$500,000,000 7.125% Notes due 2016 (the **Notes**, which expression shall in these Conditions, unless the context otherwise requires, include any further notes issued pursuant to Condition 14 and forming a single series with the Notes) of The President of the Islamic Republic of Pakistan for and on behalf of the Islamic Republic of Pakistan (the **Issuer**) are issued subject to and with the benefit of a Fiscal Agency Agreement dated March 30, 2006 (such agreement as amended and/or supplemented and/or restated from time to time, the **Agency Agreement**) made between the Issuer, Citigroup Global Markets Deutschland AG & Co. KGaA as registrar (the **Registrar**), Citibank, N.A., London Branch as fiscal agent and principal paying agent (the **Fiscal Agent**) and the other initial paying agents named in the Agency Agreement (together with the Fiscal Agent, the **Paying Agents**) and the other agents named in it (together with the Fiscal Agent, the Registrar and the other Paying Agents, the **Agents**).

The statements in these Conditions include summaries of, and are subject to, the detailed provisions of and definitions in the Agency Agreement. Copies of the Agency Agreement are available for inspection during normal business hours by the holders of the Notes (the **Noteholders**) at the specified office of each of the Paying Agents. The Noteholders are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Agency Agreement applicable to them. References in these Conditions to the Fiscal Agent, the Registrar, the Paying Agents and the Agents shall include any successor appointed under the Agency Agreement.

*Euroclear Bank S.A./N.V. (**Euroclear**) and Clearstream Banking, société anonyme (**Clearstream, Luxembourg**) will initially hold Notes represented by the Unrestricted Global Certificate on behalf of their participants through their respective depositaries, which are participants in DTC. Transfers within DTC, Euroclear and Clearstream, Luxembourg will be in accordance with the usual rules and operating procedures of the relevant system. Cross-market transfers between investors who hold or who will hold Notes through DTC and investors who hold or will hold Notes through Euroclear and Clearstream, Luxembourg will be effected in DTC through the respective depositaries of Euroclear and Clearstream, Luxembourg, subject to certain restrictions. The owners shown in the records of Euroclear, Clearstream, Luxembourg, and DTC of book-entry interests in Notes are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Agency Agreement applicable to them.*

1. Form, Denomination and Title

1.1 Form and Denomination

The Notes are issued in registered form in amounts of U.S.$100,000 and integral multiples of U.S.$1,000 in excess thereof (referred to as the **principal amount** of a Note). A note certificate (each a **Certificate**) will be issued to each Noteholder in respect of its registered holding of Notes. Each Certificate will be numbered serially with an identifying number which will be recorded on the relevant Certificate and in the register of Noteholders which the Issuer will procure to be kept by the Registrar.

The Notes are not issuable in bearer form. Except in the limited circumstances described herein (see "The Global Certificates - Registration of Title"), owners of interests in the Notes will not be entitled to receive physical delivery of Certificates.

1.2 Title

Title to the Notes passes only by registration in the register of Noteholders. The holder of any Note will (except as otherwise required by law) be treated as its absolute owner for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any interest or any writing on, or the theft or loss of, the Certificate issued in respect of it) and no person will be liable for so treating the holder. In these Conditions **Noteholder** and (in relation to a Note) **holder** means the person in whose name a Note is registered in the register of Noteholders.

For a description of the procedures for transferring title to book-entry interests in the Notes, see "Clearing and Settlement Arrangements".

2. TRANSFERS OF NOTES AND ISSUE OF CERTIFICATES

2.1 Transfers

A Note may be transferred by depositing the Certificate issued in respect of that Note, with the form of transfer on the back duly completed and signed, at the specified office of the Registrar or any of the Agents.

For a description of certain restrictions on transfers of interests in the Notes, see "Transfer Restrictions".

2.2 Delivery of new Certificates

Notes represented by Certificates issued in exchange for interests in the Restricted Global Certificate shall be **Restricted Notes**. Notes represented by Certificates issued in exchange for the Unrestricted Global Certificate shall be **Unrestricted Notes**. Each new Certificate to be issued upon transfer or exchange of Notes will, within five business days of receipt by the Registrar or the relevant Agent of the duly completed form of transfer endorsed on the relevant Certificate, be mailed by uninsured mail at the risk of the holder entitled to the Note to the address specified in the form of transfer. For the purposes of this Condition, **business day** shall mean a day on which banks are open for business in the city in which the specified office of the Agent with whom a Certificate is deposited in connection with a transfer is located.

The issue of Certificates upon transfer of Notes is subject to compliance by the transferor and transferee with the certification procedures described above and in the Agency Agreement and, in the case of Restricted Notes, compliance with the Securities Act Legend.

Where some but not all of the Notes in respect of which a Certificate is issued are to be transferred a new Certificate in respect of the Notes not so transferred will, within five business days of receipt by the Registrar or the relevant Agent of the original Certificate, be mailed by uninsured mail at the risk of the holder of the Notes not so transferred to the address of such holder appearing on the register of Noteholders or as specified in the form of transfer.

2.3 Formalities free of charge

Registration of transfer of Notes will be effected without charge by or on behalf of the Issuer or any Agent but upon payment (or the giving of such indemnity as the Issuer or any Agent may reasonably require) in respect of any tax or other governmental charges which may be imposed in relation to such transfer.

2.4 Closed Periods

No Noteholder may require the transfer of a Note to be registered during the period of 15 days ending on the due date for any payment of principal or interest on that Note.

2.5 Regulations

All transfers of Notes and entries on the register of Noteholders will be made subject to the detailed regulations concerning transfer of Notes scheduled to the Agency Agreement. The regulations may be changed by the Issuer with the prior written approval of the Registrar. A copy of the current regulations will be mailed (free of charge) by the Registrar to any Noteholder who requests one.

3. STATUS

The Notes are direct, unconditional and (subject to the provisions of Condition 4) unsecured obligations of the Issuer and (subject as provided above) rank and will rank *pari passu*, without any preference among themselves, with all other present and future unsecured and unsubordinated External Indebtedness (as defined in Condition 10) of the Issuer. The due and punctual payment of the Notes and the performance of the obligations of the Issuer with respect thereto are backed by the full faith and credit of the Issuer.

4. NEGATIVE PLEDGE

4.1 Negative Pledge

So long as any Note remains outstanding (as defined in the Agency Agreement) the Issuer will not, save for the exceptions set out below in Condition 4.3 create, incur, assume or permit to subsist any Security upon the whole or any part of its assets or revenues to secure (i) any of its Public External Indebtedness; (ii) any of its Guarantees in respect of Public External Indebtedness; or (iii) the Public External Indebtedness of any other person; without at the same time or prior thereto securing the Notes equally and rateably therewith or providing such other arrangement (whether or not comprising Security) as shall be approved by an Extraordinary Resolution (as defined in the Agency Agreement) of Noteholders.

4.2 Interpretation

In these Conditions:

(a) **Guarantee** means any obligation of a person to pay the Indebtedness of another person including without limitation:

(i) an obligation to pay or purchase such Indebtedness;

(ii) an obligation to lend money or to purchase or subscribe shares or other securities or to purchase assets or services in order to provide funds for the payment of such Indebtedness;

(iii) an indemnity against the consequences of a default in the payment of such Indebtedness; or

(iv) any other agreement to be responsible for such Indebtedness;

(b) **Indebtedness** means any obligation (whether present or future) for the payment or repayment of money which has been borrowed or raised (including money raised by acceptances and leasing);

(c) **person** means any individual, company, corporation, firm, partnership, joint venture, association, organization, state or agency of a state or other entity, whether or not having a separate legal personality;

(d) **Public External Indebtedness** means any Indebtedness which (i) is payable, or at the option of the relevant creditor may be payable, in any currency other than Pakistani Rupees, and (ii) is in the form of, or is represented by, bonds, notes or other securities with a stated maturity of more than one year from the date of issue which may be quoted, listed or ordinarily purchased or sold on any stock exchange, automated trading system, over the counter or other securities market; and

(e) **Security** means any mortgage, pledge, lien, hypothecation, security interest or other charge or encumbrance or preferential arrangement which has the practical effect of constituting a security interest (which, for the avoidance of doubt, does not include Islamic sale and leaseback (*sukuk alijara*) financing) whether in effect on the date of the Agency Agreement or thereafter.

4.3 Exceptions

The following exceptions apply to the Issuer's obligations under paragraph 4.1 of this Condition:

(a) any Security upon property to secure Public External Indebtedness of the Issuer incurred for the purpose of financing the acquisition of such property and any renewal and extension of such Security which is limited to the original property covered thereby and which (in either case) secures any renewal or extension of the original secured financing;

(b) any Security existing on property at the time of its acquisition to secure Public External Indebtedness of the Issuer and any renewal or extension of any such Security which is limited to the original property covered thereby and which secures any renewal or extension of the original secured financing;

(c) any Security arising by operation of law (or pursuant to any agreement establishing a Security equivalent to one which would otherwise exist under relevant local law) in connection with Public External Indebtedness; and

(d) any Security securing Public External Indebtedness of the Issuer or any Guarantee by the Issuer of Public External Indebtedness of any other person incurred for the purpose of financing all or part of the costs of the acquisition, construction or development of a project; provided that (A) the holders of such Public External Indebtedness or Guarantee expressly agree to limit their recourse to the assets and revenues of such project or the proceeds of insurance thereon as the principal source of repayments of such Public External Indebtedness and (B) the property over which such Security is granted consists solely of such assets and revenues.

The State Bank of Pakistan holds International Monetary Assets (as defined in Condition 10.2), including gold and foreign exchange. Because the State Bank of Pakistan is a juridical entity separate from the Issuer, the Issuer believes that the Notes' negative pledge covenant does not apply to the International Monetary Assets held by the State Bank of Pakistan. The State Bank of Pakistan could therefore incur Public External Indebtedness secured by International Monetary Assets without securing amounts payable under the Notes equally and rateably.

5. INTEREST

5.1 Interest Rate and Interest Payment Dates

The Notes bear interest from and including March 30, 2006 to but excluding the Maturity Date (as defined in Condition 7.1) at the rate of 7.125% per annum, payable semi-annually in arrear on March 30 and September 30 in each year (each an **Interest Payment Date**). The first payment (representing six months' interest) shall be made on September 30, 2006. The final interest payment will be in respect of the period from and including September 30, 2015 to but excluding the Maturity Date and shall be made on the Maturity Date.

5.2 Interest Accrual

Each Note will cease to bear interest from and including its due date for redemption unless, upon due presentation, payment of the principal in respect of the Note is improperly withheld or refused or unless default is otherwise made in respect of payment. In such event, interest will continue to accrue until whichever is the earlier of:

(a) the date on which all amounts due in respect of such Note have been paid; and

(b) five days after the date on which the full amount of the moneys payable in respect of such Notes has been received by the Fiscal Agent and notice to that effect has been given to the Noteholders in accordance with Condition 12.

5.3 Calculation of Broken Interest

When interest is required to be calculated in respect of a period other than for a six month period, it shall be calculated on the basis of a 360-day year consisting of 12 months of 30 days each and, in the case of an incomplete month, the number of days elapsed on the basis of a month of 30 days.

6. PAYMENTS

6.1 Payments in respect of Notes

Payment of principal and interest will be made by transfer to the registered account of the Noteholder or by a check in U.S. dollars drawn on a bank that processes payments in U.S. dollars mailed to the registered address of the Noteholder if it does not have a registered account. Payment of principal will only be made against presentation and surrender of the relevant Certificate at the specified office of any of the Agents. Interest on Notes due on an Interest Payment Date will be paid to the holder shown on the register of Noteholders at the close of business on the date (the **record date**) being the fifteenth day before the due date for the payment of interest.

For the purposes of this Condition, a Noteholder's **registered account** means the U.S. dollar account maintained by or on behalf of it with a bank that processes payments in U.S. dollars, details of which appear on the register of Noteholders at the close of business, in the case of principal, on the second

Business Day (as defined below) before the due date for payment and, in the case of interest, on the relevant record date, and a Noteholder's **registered address** means its address appearing on the register of Noteholders at that time.

6.2 Payments subject to Applicable Laws

Payments in respect of principal and interest on Notes are subject in all cases to any fiscal or other laws and regulations applicable in the place of payment, but without prejudice to the provisions of Condition 8.

6.4 No commissions

No commissions or expenses shall be charged to the Noteholders in respect of any payments made in accordance with this Condition.

6.4 Payment on Business Days

Where payment is to be made by transfer to a registered account, payment instructions (for value the due date or, if that is not a Business Day, for value the first following day which is a Business Day) will be initiated and, where payment is to be made by check, the check will be mailed, on the Business Day preceding the due date for payment or, in the case of a payment of principal, if later, on the Business Day on which the relevant Certificate is surrendered at the specified office of an Agent.

Noteholders will not be entitled to any interest or other payment for any delay after the due date in receiving the amount due if the due date is not a Business Day, if the Noteholder is late in surrendering its Certificate (if required to do so) or if a check mailed in accordance with this Condition arrives after the due date for payment.

In this Condition **Business Day** means a day (other than a Saturday or Sunday) on which commercial banks are open for general business in London, New York City and, in the case of presentation of a Certificate, in the place in which the Certificate is presented.

6.5 Partial Payments

If the amount of principal or interest which is due on the Notes is not paid in full, the Registrar will annotate the register of Noteholders with a record of the amount of principal or interest in fact paid.

6.6 Agents

The names of the initial Agents and their initial specified offices are set out at the end of these Conditions. The Issuer reserves the right at any time to vary or terminate the appointment of any Agent and to appoint additional or other Agents provided that there will at all times be:

(a) a Fiscal Agent, a Registrar, a Paying Agent and a Transfer Agent;

(b) so long as the Notes are admitted to listing on the Official List of the Luxembourg Stock Exchange and to trading on the Euro MTF market of the Luxembourg Stock Exchange, and the rules of that exchange so require, a Paying Agent and a Transfer Agent in Luxembourg; and

(c) a Paying Agent in a Member State of the European Union (if any) that is not obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive.

Notice of any termination or appointment and of any changes in specified offices will be given to the Noteholders promptly by the Issuer in accordance with Condition 12.

7. REDEMPTION AND PURCHASE

7.1 Redemption at Maturity

Unless previously redeemed or purchased and cancelled as provided below, the Issuer will redeem the Notes at their principal amount on March 31, 2016 (the **Maturity Date**).

7.2 Purchases

The Issuer may at any time purchase Notes in the open market or otherwise at any price.

7.3 Cancellations

All Notes so purchased shall be cancelled and may not be held, reissued or resold.

8. TAXATION

8.1 Payment without Withholding

All payments in respect of the Notes by or on behalf of the Issuer shall be made without withholding or deduction for, or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature (**Taxes**) imposed or levied by or on behalf of the Relevant Jurisdiction, unless the withholding or deduction of the Taxes is required by law. In that event, the Issuer will pay such additional amounts as may be necessary in order that the net amounts received by the Noteholders after the withholding or deduction shall equal the respective amounts which would have been receivable in respect of the Notes in the absence of the withholding or deduction; except that no additional amounts shall be payable in relation to any payment in respect of any Note:

(a) presented for payment by or on behalf of a holder who is liable to the Taxes in respect of the Note by reason of his having some connection with the Relevant Jurisdiction other than the mere holding of the Note; or

(b) presented for payment more than 30 days after the Relevant Date (as defined below), except to the extent that the relevant holder would have been entitled to such additional amounts if it had presented such Note for payment on the last day of such period of 30 days assuming, whether or not such is in fact the case, that day to have been a Business Day (as defined in Condition 6); or

(c) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive; or

(d) presented for payment by or on behalf of a holder who would have been able to avoid such withholding or deduction by presenting the relevant Note to another Paying Agent in a Member State of the European Union.

8.2 Interpretation

In these Conditions:

(a) **Relevant Date** means the date on which the payment first becomes due but, if the full amount of the money payable has not been received by the Fiscal Agent on or before the due date, it means the date on which, the full amount of the money having been so received, notice to that effect has been duly given to the Noteholders by the Issuer in accordance with Condition 12; and

(b) **Relevant Jurisdiction** means the Islamic Republic of Pakistan (**Pakistan**) or any political subdivision or any authority thereof or therein having power to tax in respect of payments made by it of principal and interest on the Notes.

8.3 **Additional Amounts**

Any reference in these Conditions to any amounts in respect of the Notes shall be deemed also to refer to any additional amounts which may be payable under this Condition.

9. PRESCRIPTION

Claims in respect of principal and interest will become prescribed unless made within 10 years (in the case of principal) and five years (in the case of interest) from the Relevant Date, as defined in Condition 8.

10. EVENTS OF DEFAULT

10.1 Events of Default

If any of the following events (**Events of Default**) shall have occurred and be continuing:

(a) (i) the Issuer fails to pay any principal on any of the Notes when due and payable; or

(ii) the Issuer fails to pay any interest on any of the Notes or any amount due under Condition 8 when due and payable and such failure continues for a period of 10 days; or

(b) the Issuer does not perform or comply with any one or more of its other obligations in the Notes, which default is incapable of remedy or is not remedied within 30 days following the service by any Noteholder on the Issuer of notice requiring the same to be remedied; or

(c) (i) the acceleration of the maturity (other than by optional or mandatory prepayment or redemption) of any External Indebtedness of the Issuer; or

(ii) any default in the payment of principal of, or premium or prepayment charge (if any) or interest on, any External Indebtedness of the Issuer shall occur when and as the same shall become due and payable if such default shall continue for more than the period of grace, if any, applicable thereto; or

(iii) any default in the payment when due and called upon (after the expiry of any applicable grace period) of any Guarantee of the Issuer in respect of any External Indebtedness of any other person,

provided that the aggregate amount of the relevant External Indebtedness in respect of which one or more of the events mentioned in this paragraph (c) have occurred equals or exceeds U.S.$25,000,000 or its equivalent; or

(d) a moratorium on the payment of principal of, or interest on, the External Indebtedness of the Issuer shall be declared by the Issuer; or

(e) the Issuer shall cease to be a member of the International Monetary Fund (IMF) or shall cease to be eligible to use the general resources of the IMF; or

(f) (i) the validity of the Notes shall be contested by the Issuer; or

(ii) the Issuer shall deny any of its obligations under the Notes (whether by a general suspension of payments or a moratorium on the payment of debt or otherwise); or

(iii) it shall be or become unlawful for the Issuer to perform or comply with all or any of its obligations set out in the Notes, including, without limitation, the payment of interest on the Notes, as a result of any change in law or regulation in Pakistan or any ruling of any court in Pakistan whose decision is final and unappealable or for any reason such obligations cease to be in full force and effect; or

(g) any regulation, decree, consent, approval, license or other authority necessary to enable the Issuer to make or perform its obligations under the Notes, or for the validity or enforceability thereof, shall expire, be withheld, revoked, terminated or otherwise cease to remain in full force and effect, or shall be modified in a manner which adversely affects any rights or claims of any of the Noteholders; or

(h) the Issuer or the State Bank of Pakistan shall not at all times exercise full ownership, power and control over any of their respective International Monetary Assets as they exist from time to time unless, prior to the occurrence of such an event, a public sector entity that has substantially all of the powers and assets of the State Bank of Pakistan (including, without limitation, all of its International Monetary Assets) and performs the functions of the central bank shall assume and acquire such assets, powers and functions,

then upon the occurrence of any such Event of Default the holder of any Note may give notice to the Issuer, through the Fiscal Agent, that the Note is, and it shall accordingly forthwith become, immediately due and repayable at its principal amount, together with interest accrued to the date of repayment, unless prior to receipt of such demand by the Issuer all such Events of Default shall have been cured, provided, however, that any notice declaring any Note due and repayable shall become effective only when the Fiscal Agent has received such notice from holders of not less than 25% in aggregate principal amount of the Notes then outstanding. If any Event of Default shall give rise to a declaration which shall be effective and all Events of Default shall cease to continue following such declaration, then such declaration may be rescinded and annulled by the adoption of an Extraordinary Resolution in accordance with the procedures set forth in Condition 13 below or of a written resolution of the holders of not less than two thirds in aggregate principal amount of the Notes then outstanding.

10.2 Interpretation

As used herein:

External Indebtedness means Indebtedness expressed or denominated or payable or which, at the option of the relevant creditor, may be payable in a currency other than Pakistani Rupees; and

International Monetary Assets means all (i) gold, (ii) Special Drawing Rights, (iii) Reserve Positions in the Fund and (iv) Foreign Exchange, and the terms **Special Drawing Rights, Reserve Positions in the Fund** and **Foreign Exchange** have, as to the types of assets included, the meanings given to them in the IMF's publication entitled "International Financial Statistics" or such other meanings as shall be formally adopted by the IMF from time to time.

11. REPLACEMENT OF CERTIFICATES

If any Certificate is lost, stolen, mutilated, defaced or destroyed it may be replaced at the specified office of the Registrar upon payment by the claimant of the expenses incurred in connection with the replacement and on such terms as to evidence and indemnity as the Issuer may reasonably require. Mutilated or defaced Certificates must be surrendered before replacements will be issued.

12. NOTICES

All notices to the Noteholders will be valid if mailed to them at their respective addresses in the register of Noteholders maintained by the Registrar. So long as the Notes are admitted to listing on the Official List of the Luxembourg Stock Exchange and to trading on the Euro MTF market of the Luxembourg Stock Exchange and the rules of that exchange so require, the Issuer will also publish notices to the holders of the Notes in a leading newspaper having general circulation in Luxembourg (which is expected to be the *d'Wort*) or in a daily newspaper of international circulation including Luxembourg (which is expected to be the *Financial Times*) or arrange to make such notices available on the website of the Luxembourg Stock Exchange at http://www.bourse.lu. Any notice shall be deemed to have been given on the first day to occur of (i) the day after being so mailed or (ii) the date of publication or, if so published more than once or on different dates, on the date of the first publication.

13. MEETINGS OF NOTEHOLDERS AND MODIFICATION

13.1 Meetings of Noteholders

The Agency Agreement contains provisions for convening meetings of the Noteholders to consider any matter affecting their interests, including the modification or abrogation by Extraordinary Resolution of any of these Conditions or any of the provisions of the Agency Agreement. The quorum at any meeting for passing an Extraordinary Resolution will be one or more persons present holding or representing more than 50% in principal amount of the Notes for the time being outstanding, or at any adjourned meeting one or more persons present whatever the principal amount of the Notes held or represented by him or them, except that at any meeting the business of which includes the modification or abrogation of certain of these Conditions or certain of the provisions of the Agency Agreement the necessary quorum for passing an Extraordinary Resolution will be one or more persons present holding or representing not less than two-thirds, or at any adjourned meeting not less than one-third, of the principal amount of the Notes for the time being outstanding. An Extraordinary Resolution passed at any meeting of the Noteholders will be binding on all Noteholders, whether or not they are present at the meeting.

In addition, a resolution in writing signed by or on behalf of Noteholders of at least 90% in aggregate principal amount of Notes for the time being outstanding who for the time being are entitled to receive notice of a meeting of Noteholders will take effect as if it were an Extraordinary Resolution. Such a resolution in writing may be contained in one document or several documents in the same form, each signed by or on behalf of one or more Noteholders.

13.2 Modification

The Fiscal Agent may agree, without the consent of the Noteholders, to any modification of any of these Conditions or any of the provisions of the Agency Agreement either (i) for the purpose of curing any ambiguity or of curing, correcting or supplementing any manifest or proven error or any other defective provision contained herein or therein or (ii) in any other manner which is, in the sole opinion of the Issuer, not materially prejudicial to the interests of the Noteholders. Any modification shall be binding on the Noteholders and, unless the Fiscal Agent agrees otherwise, any modification shall be notified by the Issuer to the Noteholders as soon as practicable thereafter in accordance with Condition 12.

14. FURTHER ISSUES

The Issuer may from time to time without the consent of the Noteholders create and issue further notes, having terms and conditions the same as those of the Notes, or the same except for the amount of the first payment of interest, which may be consolidated and form a single series with the outstanding Notes, provided that either (i) such additional notes do not have, for purposes of U.S. federal income taxation (regardless of whether any holders of such notes are subject to the U.S. federal income tax laws), a greater amount of original issue discount than the Notes as of the date of issuance of such additional notes, or (ii) such additional securities are issued in a "qualified reopening" for U.S. federal income tax purposes).

15. GOVERNING LAW AND SUBMISSION TO JURISDICTION

15.1 Governing Law

The Agency Agreement and the Notes are governed by, and will be construed in accordance with, English law.

15.2 Jurisdiction

The Issuer irrevocably submits to the jurisdiction of the courts of England sitting in London, England and the courts of Pakistan (the **Specified Courts**) over any suit, action or proceeding against it or its properties, assets or revenues with respect to the Notes (a **Related Proceeding**). The Issuer hereby waives any objection to Related Proceedings in such courts whether on the grounds of venue, residence or domicile or on the ground that the Related Proceedings have been brought in an inconvenient forum. The Issuer hereby agrees that a final non-appealable judgment obtained in any such Related Proceeding (a **Related Judgment**) shall be conclusive and binding upon it and may be enforced in any Specified Court or in any other courts to the jurisdiction of which the Issuer is or may be subject (the **Other Courts**), by a suit upon such judgment or appropriate enforcement proceedings in Pakistan.

15.3 Appointment of Process Agent

The Issuer has appointed the High Commissioner of the Islamic Republic of Pakistan in London, presently located at 35 Lowndes Square, London SW1 9JN as its agent for service of process and hereby undertakes that, in the event of the High Commissioner of the Islamic Republic of Pakistan ceasing so to act or ceasing to be located in England, it will appoint another person as its agent for service of process in England in respect of any Related Proceedings. Nothing herein shall affect the right to serve proceedings in any other manner permitted by law.

15.4 Waiver of Immunity

To the extent that the Issuer or any of its revenues, assets or properties are entitled, in any jurisdiction in which any Specified Court is located, in which any Related Proceeding may at any time be brought against it or any of its revenues, assets or properties, or in any jurisdiction in which any Specified Court or Other Court is located in which any suit, action or proceeding may at any time be brought solely for the purpose of enforcing or executing any Related Judgment, to any immunity from suit, from the jurisdiction of any such court, from setoff, from attachment prior to judgment, from attachment in aid of execution of a judgment, from execution of a judgment or from any other legal or judicial process or remedy, and to the extent that in any such jurisdiction there shall be attributed such an immunity, the Issuer hereby irrevocably agrees not to claim and hereby irrevocably waives such immunity to the fullest extent permitted by the laws of such jurisdiction (and hereby consents generally for the purposes of the State Immunity Act 1978 to the giving of any relief or the issue of any process in connection with any Related Proceeding or Related Judgment) provided that such agreement and waiver, insofar as it relates to any jurisdictions other than a jurisdiction in which any Specified Court is located, is given solely for the purposes of enabling a Noteholder to enforce or execute a Related Judgment. The waiver of immunities given above constitutes only a limited and specific waiver for the purposes of the Notes and under no circumstances shall it be interpreted as a general waiver by the Issuer or a waiver with respect to proceedings unrelated to the Notes. The Issuer does not hereby waive such immunity in respect of property which is (i) used by a diplomatic or consular mission of the Issuer (except as may be necessary to effect service of process), (ii) property of a military character and under the control of a military authority or defense agency or (iii) located in Pakistan and dedicated to a public or governmental use (as distinct from patrimonial property or property dedicated to a commercial use).

16. RIGHTS OF THIRD PARTIES

No rights are conferred on any person under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of this Note, but this does not affect any right or remedy of any person which exists or is available apart from that Act.

TERMS AND CONDITIONS OF THE 2036 NOTES

The following is the text of the Terms and Conditions of the 2036 Notes which (subject to modification and except for the paragraphs in italics) will be endorsed on the Certificates issued in respect of the 2036 Notes:

The U.S.$300,000,000 7.875% Notes due 2036 (the **Notes**, which expression shall in these Conditions, unless the context otherwise requires, include any further notes issued pursuant to Condition 14 and forming a single series with the Notes) of The President of the Islamic Republic of Pakistan for and on behalf of the Islamic Republic of Pakistan (the **Issuer**) are issued subject to and with the benefit of a Fiscal Agency Agreement dated March 30, 2006 (such agreement as amended and/or supplemented and/or restated from time to time, the **Agency Agreement**) made between the Issuer, Citigroup Global Markets Deutschland AG & Co. KGaA as registrar (the **Registrar**), Citibank, N.A., London Branch as fiscal agent and principal paying agent (the **Fiscal Agent**) and the other initial paying agents named in the Agency Agreement (together with the Fiscal Agent, the **Paying Agents**) and the other agents named in it (together with the Fiscal Agent, the Registrar and the other Paying Agents, the **Agents**).

The statements in these Conditions include summaries of, and are subject to, the detailed provisions of and definitions in the Agency Agreement. Copies of the Agency Agreement are available for inspection during normal business hours by the holders of the Notes (the **Noteholders**) at the specified office of each of the Paying Agents. The Noteholders are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Agency Agreement applicable to them. References in these Conditions to the Fiscal Agent, the Registrar, the Paying Agents and the Agents shall include any successor appointed under the Agency Agreement.

*Euroclear Bank S.A./N.V. (**Euroclear**) and Clearstream Banking, société anonyme (**Clearstream, Luxembourg**) will initially hold Notes represented by the Unrestricted Global Certificate on behalf of their participants through their respective depositaries, which are participants in DTC. Transfers within DTC, Euroclear and Clearstream, Luxembourg will be in accordance with the usual rules and operating procedures of the relevant system. Cross-market transfers between investors who hold or who will hold Notes through DTC and investors who hold or will hold Notes through Euroclear and Clearstream, Luxembourg will be effected in DTC through the respective depositaries of Euroclear and Clearstream, Luxembourg, subject to certain restrictions. The owners shown in the records of Euroclear, Clearstream, Luxembourg, and DTC of book-entry interests in Notes are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Agency Agreement applicable to them.*

1. Form, Denomination and Title

1.1 Form and Denomination

The Notes are issued in registered form in amounts of U.S.$100,000 and integral multiples of U.S.$1,000 in excess thereof (referred to as the **principal amount** of a Note). A note certificate (each a **Certificate**) will be issued to each Noteholder in respect of its registered holding of Notes. Each Certificate will be numbered serially with an identifying number which will be recorded on the relevant Certificate and in the register of Noteholders which the Issuer will procure to be kept by the Registrar.

The Notes are not issuable in bearer form. Except in the limited circumstances described herein (see "The Global Certificates - Registration of Title"), owners of interests in the Notes will not be entitled to receive physical delivery of Certificates.

1.2 Title

Title to the Notes passes only by registration in the register of Noteholders. The holder of any Note will (except as otherwise required by law) be treated as its absolute owner for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any interest or any writing on, or the theft or loss of, the Certificate issued in respect of it) and no person will be liable for so treating the holder. In these Conditions **Noteholder** and (in relation to a Note) **holder** means the person in whose name a Note is registered in the register of Noteholders.

For a description of the procedures for transferring title to book-entry interests in the Notes, see "Clearing and Settlement Arrangements".

2. TRANSFERS OF NOTES AND ISSUE OF CERTIFICATES

2.1 Transfers

A Note may be transferred by depositing the Certificate issued in respect of that Note, with the form of transfer on the back duly completed and signed, at the specified office of the Registrar or any of the Agents.

For a description of certain restrictions on transfers of interests in the Notes, see "Transfer Restrictions".

2.2 Delivery of new Certificates

Notes represented by Certificates issued in exchange for interests in the Restricted Global Certificate shall be **Restricted Notes**. Notes represented by Certificates issued in exchange for the Unrestricted Global Certificate shall be **Unrestricted Notes**. Each new Certificate to be issued upon transfer or exchange of Notes will, within five business days of receipt by the Registrar or the relevant Agent of the duly completed form of transfer endorsed on the relevant Certificate, be mailed by uninsured mail at the risk of the holder entitled to the Note to the address specified in the form of transfer. For the purposes of this Condition, **business day** shall mean a day on which banks are open for business in the city in which the specified office of the Agent with whom a Certificate is deposited in connection with a transfer is located.

The issue of Certificates upon transfer of Notes is subject to compliance by the transferor and transferee with the certification procedures described above and in the Agency Agreement and, in the case of Restricted Notes, compliance with the Securities Act Legend.

Where some but not all of the Notes in respect of which a Certificate is issued are to be transferred a new Certificate in respect of the Notes not so transferred will, within five business days of receipt by the Registrar or the relevant Agent of the original Certificate, be mailed by uninsured mail at the risk of the holder of the Notes not so transferred to the address of such holder appearing on the register of Noteholders or as specified in the form of transfer.

2.3 Formalities free of charge

Registration of transfer of Notes will be effected without charge by or on behalf of the Issuer or any Agent but upon payment (or the giving of such indemnity as the Issuer or any Agent may reasonably require) in respect of any tax or other governmental charges which may be imposed in relation to such transfer.

2.4 Closed Periods

No Noteholder may require the transfer of a Note to be registered during the period of 15 days ending on the due date for any payment of principal or interest on that Note.

2.5 Regulations

All transfers of Notes and entries on the register of Noteholders will be made subject to the detailed regulations concerning transfer of Notes scheduled to the Agency Agreement. The regulations may be changed by the Issuer with the prior written approval of the Registrar. A copy of the current regulations will be mailed (free of charge) by the Registrar to any Noteholder who requests one.

3. STATUS

The Notes are direct, unconditional and (subject to the provisions of Condition 4) unsecured obligations of the Issuer and (subject as provided above) rank and will rank *pari passu*, without any preference among themselves, with all other present and future unsecured and unsubordinated External Indebtedness (as defined in Condition 10) of the Issuer. The due and punctual payment of the Notes and the performance of the obligations of the Issuer with respect thereto are backed by the full faith and credit of the Issuer.

4. NEGATIVE PLEDGE

4.1 Negative Pledge

So long as any Note remains outstanding (as defined in the Agency Agreement) the Issuer will not, save for the exceptions set out below in Condition 4.3 create, incur, assume or permit to subsist any Security upon the whole or any part of its assets or revenues to secure (i) any of its Public External Indebtedness; (ii) any of its Guarantees in respect of Public External Indebtedness; or (iii) the Public External Indebtedness of any other person; without at the same time or prior thereto securing the Notes equally and rateably therewith or providing such other arrangement (whether or not comprising Security) as shall be approved by an Extraordinary Resolution (as defined in the Agency Agreement) of Noteholders.

4.2 Interpretation

In these Conditions:

(a) **Guarantee** means any obligation of a person to pay the Indebtedness of another person including without limitation:

  (i) an obligation to pay or purchase such Indebtedness;

  (ii) an obligation to lend money or to purchase or subscribe shares or other securities or to purchase assets or services in order to provide funds for the payment of such Indebtedness;

  (iii) an indemnity against the consequences of a default in the payment of such Indebtedness; or

  (iv) any other agreement to be responsible for such Indebtedness;

(b) **Indebtedness** means any obligation (whether present or future) for the payment or repayment of money which has been borrowed or raised (including money raised by acceptances and leasing);

(c) **person** means any individual, company, corporation, firm, partnership, joint venture, association, organization, state or agency of a state or other entity, whether or not having a separate legal personality;

(d) **Public External Indebtedness** means any Indebtedness which (i) is payable, or at the option of the relevant creditor may be payable, in any currency other than Pakistani Rupees, and (ii) is in the form of, or is represented by, bonds, notes or other securities with a stated maturity of more than one year from the date of issue which may be quoted, listed or ordinarily purchased or sold on any stock exchange, automated trading system, over the counter or other securities market; and

(e) **Security** means any mortgage, pledge, lien, hypothecation, security interest or other charge or encumbrance or preferential arrangement which has the practical effect of constituting a security interest (which, for the avoidance of doubt, does not include Islamic sale and leaseback (*sukuk alijara*) financing) whether in effect on the date of the Agency Agreement or thereafter.

4.3 Exceptions

The following exceptions apply to the Issuer's obligations under paragraph 4.1 of this Condition:

(a) any Security upon property to secure Public External Indebtedness of the Issuer incurred for the purpose of financing the acquisition of such property and any renewal and extension of such Security which is limited to the original property covered thereby and which (in either case) secures any renewal or extension of the original secured financing;

(b) any Security existing on property at the time of its acquisition to secure Public External Indebtedness of the Issuer and any renewal or extension of any such Security which is limited to the original property covered thereby and which secures any renewal or extension of the original secured financing;

(c) any Security arising by operation of law (or pursuant to any agreement establishing a Security equivalent to one which would otherwise exist under relevant local law) in connection with Public External Indebtedness; and

(d) any Security securing Public External Indebtedness of the Issuer or any Guarantee by the Issuer of Public External Indebtedness of any other person incurred for the purpose of financing all or part of the costs of the acquisition, construction or development of a project; provided that (A) the holders of such Public External Indebtedness or Guarantee expressly agree to limit their recourse to the assets and revenues of such project or the proceeds of insurance thereon as the principal source of repayments of such Public External Indebtedness and (B) the property over which such Security is granted consists solely of such assets and revenues.

The State Bank of Pakistan holds International Monetary Assets (as defined in Condition 10.2), including gold and foreign exchange. Because the State Bank of Pakistan is a juridical entity separate from the Issuer, the Issuer believes that the Notes' negative pledge covenant does not apply to the International Monetary Assets held by the State Bank of Pakistan. The State Bank of Pakistan could therefore incur Public External Indebtedness secured by International Monetary Assets without securing amounts payable under the Notes equally and rateably.

5. INTEREST

5.1 Interest Rate and Interest Payment Dates

The Notes bear interest from and including March 30 2006 to but excluding the Maturity Date (as defined in Condition 7.1) at the rate of 7.875% per annum, payable semi-annually in arrear on March 30 and September 30 in each year (each an **Interest Payment Date**). The first payment (representing six months' interest) shall be made on September 30, 2006. The final interest payment will be in respect of the period from and including September 30, 2035 to but excluding the Maturity Date and shall be made on the Maturity Date.

5.2 Interest Accrual

Each Note will cease to bear interest from and including its due date for redemption unless, upon due presentation, payment of the principal in respect of the Note is improperly withheld or refused or unless default is otherwise made in respect of payment. In such event, interest will continue to accrue until whichever is the earlier of:

(a) the date on which all amounts due in respect of such Note have been paid; and

(b) five days after the date on which the full amount of the moneys payable in respect of such Notes has been received by the Fiscal Agent and notice to that effect has been given to the Noteholders in accordance with Condition 12.

5.3 Calculation of Broken Interest

When interest is required to be calculated in respect of a period other than for a six month period, it shall be calculated on the basis of a 360-day year consisting of 12 months of 30 days each and, in the case of an incomplete month, the number of days elapsed on the basis of a month of 30 days.

6. PAYMENTS

6.1 Payments in respect of Notes

Payment of principal and interest will be made by transfer to the registered account of the Noteholder or by a check in U.S. dollars drawn on a bank that processes payments in U.S. dollars mailed to the registered address of the Noteholder if it does not have a registered account. Payment of principal will only be made against presentation and surrender of the relevant Certificate at the specified office of any of the Agents. Interest on Notes due on an Interest Payment Date will be paid to the holder shown on the register of Noteholders at the close of business on the date (the **record date**) being the fifteenth day before the due date for the payment of interest.

For the purposes of this Condition, a Noteholder's **registered account** means the U.S. dollar account maintained by or on behalf of it with a bank that processes payments in U.S. dollars, details of which appear on the register of Noteholders at the close of business, in the case of principal, on the second

Business Day (as defined below) before the due date for payment and, in the case of interest, on the relevant record date, and a Noteholder's **registered address** means its address appearing on the register of Noteholders at that time.

6.2 Payments subject to Applicable Laws

Payments in respect of principal and interest on Notes are subject in all cases to any fiscal or other laws and regulations applicable in the place of payment, but without prejudice to the provisions of Condition 8.

6.4 No commissions

No commissions or expenses shall be charged to the Noteholders in respect of any payments made in accordance with this Condition.

6.4 Payment on Business Days

Where payment is to be made by transfer to a registered account, payment instructions (for value the due date or, if that is not a Business Day, for value the first following day which is a Business Day) will be initiated and, where payment is to be made by check, the check will be mailed, on the Business Day preceding the due date for payment or, in the case of a payment of principal, if later, on the Business Day on which the relevant Certificate is surrendered at the specified office of an Agent.

Noteholders will not be entitled to any interest or other payment for any delay after the due date in receiving the amount due if the due date is not a Business Day, if the Noteholder is late in surrendering its Certificate (if required to do so) or if a check mailed in accordance with this Condition arrives after the due date for payment.

In this Condition **Business Day** means a day (other than a Saturday or Sunday) on which commercial banks are open for general business in London, New York City and, in the case of presentation of a Certificate, in the place in which the Certificate is presented.

6.5 Partial Payments

If the amount of principal or interest which is due on the Notes is not paid in full, the Registrar will annotate the register of Noteholders with a record of the amount of principal or interest in fact paid.

6.6 Agents

The names of the initial Agents and their initial specified offices are set out at the end of these Conditions. The Issuer reserves the right at any time to vary or terminate the appointment of any Agent and to appoint additional or other Agents provided that there will at all times be:

(a) a Fiscal Agent, a Registrar, a Paying Agent and a Transfer Agent;

(b) so long as the Notes are admitted to listing on the Official List of the Luxembourg Stock Exchange and to trading on the Euro MTF market of the Luxembourg Stock Exchange, and the rules of that exchange so require, a Paying Agent and a Transfer Agent in Luxembourg; and

(c) a Paying Agent in a Member State of the European Union (if any) that is not obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive.

Notice of any termination or appointment and of any changes in specified offices will be given to the Noteholders promptly by the Issuer in accordance with Condition 12.

7. REDEMPTION AND PURCHASE

7.1 Redemption at Maturity

Unless previously redeemed or purchased and cancelled as provided below, the Issuer will redeem the Notes at their principal amount on March 31, 2036 (the **Maturity Date**).

7.2 Purchases

The Issuer may at any time purchase Notes in the open market or otherwise at any price.

7.3 Cancellations

All Notes so purchased shall be cancelled and may not be held, reissued or resold.

8. TAXATION

8.1 Payment without Withholding

All payments in respect of the Notes by or on behalf of the Issuer shall be made without withholding or deduction for, or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature (**Taxes**) imposed or levied by or on behalf of the Relevant Jurisdiction, unless the withholding or deduction of the Taxes is required by law. In that event, the Issuer will pay such additional amounts as may be necessary in order that the net amounts received by the Noteholders after the withholding or deduction shall equal the respective amounts which would have been receivable in respect of the Notes in the absence of the withholding or deduction; except that no additional amounts shall be payable in relation to any payment in respect of any Note:

(a) presented for payment by or on behalf of a holder who is liable to the Taxes in respect of the Note by reason of his having some connection with the Relevant Jurisdiction other than the mere holding of the Note; or

(b) presented for payment more than 30 days after the Relevant Date (as defined below), except to the extent that the relevant holder would have been entitled to such additional amounts if it had presented such Note for payment on the last day of such period of 30 days assuming, whether or not such is in fact the case, that day to have been a Business Day (as defined in Condition 6); or

(c) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive; or

(d) presented for payment by or on behalf of a holder who would have been able to avoid such withholding or deduction by presenting the relevant Note to another Paying Agent in a Member State of the European Union.

8.2 Interpretation

In these Conditions:

(a) **Relevant Date** means the date on which the payment first becomes due but, if the full amount of the money payable has not been received by the Fiscal Agent on or before the due date, it means the date on which, the full amount of the money having been so received, notice to that effect has been duly given to the Noteholders by the Issuer in accordance with Condition 12; and

(b) **Relevant Jurisdiction** means the Islamic Republic of Pakistan (**Pakistan**) or any political subdivision or any authority thereof or therein having power to tax in respect of payments made by it of principal and interest on the Notes.

8.3 Additional Amounts

Any reference in these Conditions to any amounts in respect of the Notes shall be deemed also to refer to any additional amounts which may be payable under this Condition.

9. PRESCRIPTION

Claims in respect of principal and interest will become prescribed unless made within 10 years (in the case of principal) and five years (in the case of interest) from the Relevant Date, as defined in Condition 8.

10. EVENTS OF DEFAULT

10.1 Events of Default

If any of the following events (**Events of Default**) shall have occurred and be continuing:

(a) (i) the Issuer fails to pay any principal on any of the Notes when due and payable; or

(ii) the Issuer fails to pay any interest on any of the Notes or any amount due under Condition 8 when due and payable and such failure continues for a period of 10 days; or

(b) the Issuer does not perform or comply with any one or more of its other obligations in the Notes, which default is incapable of remedy or is not remedied within 30 days following the service by any Noteholder on the Issuer of notice requiring the same to be remedied; or

(c) (i) the acceleration of the maturity (other than by optional or mandatory prepayment or redemption) of any External Indebtedness of the Issuer; or

(ii) any default in the payment of principal of, or premium or prepayment charge (if any) or interest on, any External Indebtedness of the Issuer shall occur when and as the same shall become due and payable if such default shall continue for more than the period of grace, if any, applicable thereto; or

(iii) any default in the payment when due and called upon (after the expiry of any applicable grace period) of any Guarantee of the Issuer in respect of any External Indebtedness of any other person,

provided that the aggregate amount of the relevant External Indebtedness in respect of which one or more of the events mentioned in this paragraph (c) have occurred equals or exceeds U.S.$25,000,000 or its equivalent; or

(d) a moratorium on the payment of principal of, or interest on, the External Indebtedness of the Issuer shall be declared by the Issuer; or

(e) the Issuer shall cease to be a member of the International Monetary Fund (IMF) or shall cease to be eligible to use the general resources of the IMF; or

(f) (i) the validity of the Notes shall be contested by the Issuer; or

(ii) the Issuer shall deny any of its obligations under the Notes (whether by a general suspension of payments or a moratorium on the payment of debt or otherwise); or

(iii) it shall be or become unlawful for the Issuer to perform or comply with all or any of its obligations set out in the Notes, including, without limitation, the payment of interest on the Notes, as a result of any change in law or regulation in Pakistan or any ruling of any court in Pakistan whose decision is final and unappealable or for any reason such obligations cease to be in full force and effect; or

(g) any regulation, decree, consent, approval, license or other authority necessary to enable the Issuer to make or perform its obligations under the Notes, or for the validity or enforceability thereof, shall expire, be withheld, revoked, terminated or otherwise cease to remain in full force and effect, or shall be modified in a manner which adversely affects any rights or claims of any of the Noteholders; or

(h) the Issuer or the State Bank of Pakistan shall not at all times exercise full ownership, power and control over any of their respective International Monetary Assets as they exist from time to time unless, prior to the occurrence of such an event, a public sector entity that has substantially all of the powers and assets of the State Bank of Pakistan (including, without limitation, all of its International Monetary Assets) and performs the functions of the central bank shall assume and acquire such assets, powers and functions,

then upon the occurrence of any such Event of Default the holder of any Note may give notice to the Issuer, through the Fiscal Agent, that the Note is, and it shall accordingly forthwith become, immediately due and repayable at its principal amount, together with interest accrued to the date of repayment, unless prior to receipt of such demand by the Issuer all such Events of Default shall have been cured, provided, however, that any notice declaring any Note due and repayable shall become effective only when the Fiscal Agent has received such notice from holders of not less than 25% in aggregate principal amount of the Notes then outstanding. If any Event of Default shall give rise to a declaration which shall be effective and all Events of Default shall cease to continue following such declaration, then such declaration may be rescinded and annulled by the adoption of an Extraordinary Resolution in accordance with the procedures set forth in Condition 13 below or of a written resolution of the holders of not less than two thirds in aggregate principal amount of the Notes then outstanding.

10.2 Interpretation

As used herein:

External Indebtedness means Indebtedness expressed or denominated or payable or which, at the option of the relevant creditor, may be payable in a currency other than Pakistani Rupees; and

International Monetary Assets means all (i) gold, (ii) Special Drawing Rights, (iii) Reserve Positions in the Fund and (iv) Foreign Exchange, and the terms **Special Drawing Rights, Reserve Positions in the Fund** and **Foreign Exchange** have, as to the types of assets included, the meanings given to them in the IMF's publication entitled "International Financial Statistics" or such other meanings as shall be formally adopted by the IMF from time to time.

11. REPLACEMENT OF CERTIFICATES

If any Certificate is lost, stolen, mutilated, defaced or destroyed it may be replaced at the specified office of the Registrar upon payment by the claimant of the expenses incurred in connection with the replacement and on such terms as to evidence and indemnity as the Issuer may reasonably require. Mutilated or defaced Certificates must be surrendered before replacements will be issued.

12. NOTICES

All notices to the Noteholders will be valid if mailed to them at their respective addresses in the register of Noteholders maintained by the Registrar. So long as the Notes are admitted to listing on the Official List of the Luxembourg Stock Exchange and to trading on the Euro MTF market of the Luxembourg Stock Exchange and the rules of that exchange so require, the Issuer will also publish notices to the holders of the Notes in a leading newspaper having general circulation in Luxembourg (which is expected to be the *d'Wort*) or in a daily newspaper of international circulation including Luxembourg (which is expected to be the *Financial Times*) or arrange to make such notices available on the website of the Luxembourg Stock Exchange at http://www.bourse.lu. Any notice shall be deemed to have been given on the first day to occur of (i) the day after being so mailed or (ii) the date of publication or, if so published more than once or on different dates, on the date of the first publication.

13. MEETINGS OF NOTEHOLDERS AND MODIFICATION

13.1 Meetings of Noteholders

The Agency Agreement contains provisions for convening meetings of the Noteholders to consider any matter affecting their interests, including the modification or abrogation by Extraordinary Resolution of any of these Conditions or any of the provisions of the Agency Agreement. The quorum at any meeting for passing an Extraordinary Resolution will be one or more persons present holding or representing more than 50% in principal amount of the Notes for the time being outstanding, or at any adjourned meeting one or more persons present whatever the principal amount of the Notes held or represented by him or them, except that at any meeting the business of which includes the modification or abrogation of certain of these Conditions or certain of the provisions of the Agency Agreement the necessary quorum for passing an Extraordinary Resolution will be one or more persons present holding or representing not less than two-thirds, or at any adjourned meeting not less than one-third, of the principal amount of the Notes for the time being outstanding. An Extraordinary Resolution passed at any meeting of the Noteholders will be binding on all Noteholders, whether or not they are present at the meeting.

In addition, a resolution in writing signed by or on behalf of Noteholders of at least 90% in aggregate principal amount of Notes for the time being outstanding who for the time being are entitled to receive notice of a meeting of Noteholders will take effect as if it were an Extraordinary Resolution. Such a resolution in writing may be contained in one document or several documents in the same form, each signed by or on behalf of one or more Noteholders.

13.2 Modification

The Fiscal Agent may agree, without the consent of the Noteholders, to any modification of any of these Conditions or any of the provisions of the Agency Agreement either (i) for the purpose of curing any ambiguity or of curing, correcting or supplementing any manifest or proven error or any other defective provision contained herein or therein or (ii) in any other manner which is, in the sole opinion of the Issuer, not materially prejudicial to the interests of the Noteholders. Any modification shall be binding on the Noteholders and, unless the Fiscal Agent agrees otherwise, any modification shall be notified by the Issuer to the Noteholders as soon as practicable thereafter in accordance with Condition 12.

14. FURTHER ISSUES

The Issuer may from time to time without the consent of the Noteholders create and issue further notes, having terms and conditions the same as those of the Notes, or the same except for the amount of the first payment of interest, which may be consolidated and form a single series with the outstanding Notes, provided that either (i) such additional notes do not have, for purposes of U.S. federal income taxation (regardless of whether any holders of such notes are subject to the U.S. federal income tax laws), a greater amount of original issue discount than the Notes as of the date of issuance of such additional notes, or (ii) such additional securities are issued in a "qualified reopening" for U.S. federal income tax purposes).

15. GOVERNING LAW AND SUBMISSION TO JURISDICTION

15.1 Governing Law

The Agency Agreement and the Notes are governed by, and will be construed in accordance with, English law.

15.2 Jurisdiction

The Issuer irrevocably submits to the jurisdiction of the courts of England sitting in London, England and the courts of Pakistan (the **Specified Courts**) over any suit, action or proceeding against it or its properties, assets or revenues with respect to the Notes (a **Related Proceeding**). The Issuer hereby waives any objection to Related Proceedings in such courts whether on the grounds of venue, residence or domicile or on the ground that the Related Proceedings have been brought in an inconvenient forum. The Issuer hereby agrees that a final non-appealable judgment obtained in any such Related Proceeding (a **Related Judgment**) shall be conclusive and binding upon it and may be enforced in any Specified Court or in any other courts to the jurisdiction of which the Issuer is or may be subject (the **Other Courts**), by a suit upon such judgment or appropriate enforcement proceedings in Pakistan.

15.3 Appointment of Process Agent

The Issuer has appointed the High Commissioner of the Islamic Republic of Pakistan in London, presently located at 35 Lowndes Square, London SW1 9JN as its agent for service of process and hereby undertakes that, in the event of the High Commissioner of the Islamic Republic of Pakistan ceasing so to act or ceasing to be located in England, it will appoint another person as its agent for service of process in England in respect of any Related Proceedings. Nothing herein shall affect the right to serve proceedings in any other manner permitted by law.

15.4 Waiver of Immunity

To the extent that the Issuer or any of its revenues, assets or properties are entitled, in any jurisdiction in which any Specified Court is located, in which any Related Proceeding may at any time be brought against it or any of its revenues, assets or properties, or in any jurisdiction in which any Specified Court or Other Court is located in which any suit, action or proceeding may at any time be brought solely for the purpose of enforcing or executing any Related Judgment, to any immunity from suit, from the jurisdiction of any such court, from setoff, from attachment prior to judgment, from attachment in aid of execution of a judgment, from execution of a judgment or from any other legal or judicial process or remedy, and to the extent that in any such jurisdiction there shall be attributed such an immunity, the Issuer hereby irrevocably agrees not to claim and hereby irrevocably waives such immunity to the fullest extent permitted by the laws of such jurisdiction (and hereby consents generally for the purposes of the State Immunity Act 1978 to the giving of any relief or the issue of any process in connection with any Related Proceeding or Related Judgment) provided that such agreement and waiver, insofar as it relates to any jurisdictions other than a jurisdiction in which any Specified Court is located, is given solely for the purposes of enabling a Noteholder to enforce or execute a Related Judgment. The waiver of immunities given above constitutes only a limited and specific waiver for the purposes of the Notes and under no circumstances shall it be interpreted as a general waiver by the Issuer or a waiver with respect to proceedings unrelated to the Notes. The Issuer does not hereby waive such immunity in respect of property which is (i) used by a diplomatic or consular mission of the Issuer (except as may be necessary to effect service of process), (ii) property of a military character and under the control of a military authority or defense agency or (iii) located in Pakistan and dedicated to a public or governmental use (as distinct from patrimonial property or property dedicated to a commercial use).

16. RIGHTS OF THIRD PARTIES

No rights are conferred on any person under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of this Note, but this does not affect any right or remedy of any person which exists or is available apart from that Act.

THE GLOBAL CERTIFICATES

The Global Certificates contain the following provisions which apply to the Notes in respect of which they are issued whilst they are represented by the Global Certificates, some of which modify the effect of the Conditions. Terms defined in the Conditions have the same meaning in paragraphs 1 to 6 below. This section should be construed as applying separately to each of the 2016 Notes and the 2036 Notes.

1. ACCOUNTHOLDERS

For so long as any of the Notes are represented by one or more Global Certificates, each person (other than another clearing system) who is for the time being shown in the records of DTC or Euroclear or Clearstream, Luxembourg (as the case may be) as the holder of a particular aggregate principal amount of such Notes (each an **Accountholder**) (in which regard any certificate or other document issued by DTC or Euroclear or Clearstream, Luxembourg (as the case may be) as to the aggregate principal amount of such Notes standing to the account of any person shall be conclusive and binding for all purposes) shall be treated as the holder of such aggregate principal amount of such Notes (and the expression **Noteholders** and references to **holding of Notes** and to **holder of Notes** shall be construed accordingly) for all purposes other than with respect to payments on such Notes, the right to which shall be vested, as against the Issuer, solely in the nominee for the relevant clearing system (the **Relevant Nominee**) in accordance with and subject to the terms of the Global Certificates. Each Accountholder must look solely to DTC or Euroclear or Clearstream, Luxembourg, as the case may be, for its share of each payment made to the Relevant Nominee.

2. CANCELLATION

Cancellation of any Note following its purchase by the Issuer will be effected by reduction in the aggregate principal amount of the Notes in the register of Noteholders.

3. PAYMENTS

Payments of principal and interest in respect of Notes represented by a Global Certificate will be made, in the case of payment of principal, against presentation and surrender of such Global Certificate to or to the order of the Fiscal Agent or such other Agent as shall have been notified to the holders of one or more Global Certificates for such purpose.

Holders of book-entry interests in the Notes held through DTC will receive, to the extent received by the Fiscal Agent, all distributions of amounts with respect to book-entry interests in such Notes from the Fiscal Agent through DTC. Distributions in the United States will be subject to relevant U.S. tax laws and regulations.

A record of each payment made will be entered in the register of Noteholders by or on behalf of the Fiscal Agent and shall be *prima facie* evidence that payment has been made.

4. NOTICES

So long as the Notes are represented by a Global Certificate and such Global Certificate is held on behalf of a clearing system, notices to Noteholders may be given by delivery of the relevant notice to that clearing system for communication by it to entitled Accountholders in substitution for notification as required by Condition 12. Any such notice shall be deemed to have been given to the Noteholders on the day after the day on which such notice is delivered to DTC.

Whilst any of the Notes held by a Noteholder are represented by a Global Certificate, notices to be given by such Noteholder may be given by such Noteholder (where applicable) through DTC and otherwise in such manner as the Fiscal Agent and DTC may approve for this purpose.

So long as the Notes are admitted to listing on the Official List of the Luxembourg Stock Exchange and to trading on the Euro MTF market of the Luxembourg Stock Exchange and the rules of that exchange so require, the Issuer will also publish notices to the holders of the Notes in a leading newspaper having general circulation in Luxembourg (which is expected to be the *d'Wort*) or in a daily newspaper of international circulation including Luxembourg (which is expected to be the *Financial Times*) or arrange to make such notices available on the website of the Luxembourg Stock Exchange at http://www.bourse.lu.

5. REGISTRATION OF TITLE

Registration of title to Notes in a name other than that of the Relevant Nominee will not be permitted unless DTC notifies the Issuer that it is unwilling or unable to continue as a clearing system in connection with a Global Certificate or DTC ceases to be a clearing agency registered under the U.S. Securities Exchange Act of 1934, and in each case a successor clearing system is not appointed by the Issuer within 90 days after receiving such notice from DTC or becoming aware that DTC is no longer so registered. In these circumstances, title to a Note may be transferred into the names of holders notified by the Relevant Nominee in accordance with the Conditions, except that Certificates in respect of Notes so transferred may not be available until 21 days after the request for transfer is duly made.

The Registrar will not register title to the Notes in a name other than that of the Relevant Nominee for a period of 15 calendar days preceding the due date for any payment of principal, or interest in respect of the Notes.

6. TRANSFERS

Transfers of book-entry interests in the notes will be effected through the records of Euroclear, Clearstream, Luxembourg and DTC and their respective participants in accordance with the rules and procedures of Euroclear, Clearstream, Luxembourg and DTC and their respective direct and indirect participants, as more fully described under "*Clearing and Settlement Arrangements*".

TAXATION

Pakistan Taxation

General

This summary of the principal Pakistan tax consequences of holding the Notes is only included as guidance and does not constitute tax advice. Prospective investors should consult their own advisers with regard to their potential tax liabilities resulting from an investment in the Notes.

In addition, this summary only addresses the tax consequences to non-residents holding the Notes as capital assets, and does not address the tax consequences which may be relevant to other classes of non-resident holders.

The summary is based on present Pakistan tax laws and practices.

Tax on interest payments

Clause 75 of the Second Schedule to the Income Tax Ordinance (2001) exempts from income tax any income of an agency of a foreign Government, a foreign national (company, firm or association of persons), or any other non-resident person approved by the federal Government for the purposes of this clause, from profit on moneys borrowed under a loan agreement or in respect of a foreign currency instrument approved by the federal Government.

The Notes have been approved on March 16, 2006 by the Finance Division of the Federal Government for purposes of Clause 75 of the Second Schedule of the Income Tax Ordinance.

Stamp Duty

The Issuer has undertaken to bear the liability for stamp duty in respect of the Notes, *inter alia*, in Pakistan. Under the Stamp Act 1899, where the Issuer assumes liability for stamp duty, the instrument to which such assumption relates is exempt from duty.

United States Taxation

Any U.S. federal tax discussion in this Offering Circular was not intended or written to be used, and cannot be used, by any taxpayer for purposes of avoiding U.S. federal tax penalties that may be imposed on the taxpayer. Any such tax discussion was written to support the promotion or marketing of the Notes to be issued or sold pursuant to this Offering Circular. Each taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax adviser.

The following is a general summary of the principal U.S. federal income tax consequences that may be relevant with respect to the purchase, ownership and disposition of the Notes. In general, this summary assumes that holders acquire the Notes at original issuance and will hold the Notes as capital assets. It does not purport to be a comprehensive description of all the tax considerations that may be relevant to a decision to purchase Notes. In particular, it does not discuss special tax considerations that may apply to certain types of taxpayers, including, without limitation, the following: (i) financial institutions; (ii) insurance companies; (iii) dealers or traders in stocks, securities, notional principal contracts or currencies; (iv) tax-exempt entities; (v) real estate investment trusts; (vi) regulated investment companies; (vii) persons that will hold Notes as part of a "hedging" or "conversion" transaction or as a position in a "straddle" or as part of a "synthetic security" or other integrated transaction for U.S. federal income tax purposes; and (viii) U.S. Holders that have a "functional currency" other than the U.S. dollar. In addition, this summary does not address alternative minimum tax consequences or the indirect effects on the holders of interests in a holder of Notes. This summary also does not describe any tax consequences arising under the laws of any taxing jurisdiction other than the U.S. federal government.

Each prospective investor should consult its own tax adviser with respect to the U.S. federal, state, local and foreign tax consequences of acquiring, owning or disposing of the Notes.

This summary is based on the U.S. Internal Revenue Code of 1986, as amended (the "Code"), U.S. Treasury regulations and judicial and administrative interpretations thereof, in each case as in effect or available on the date of this Offering Circular. All of the foregoing is subject to change, and any such change may apply retroactively and could affect the tax consequences described below.

As used in this section, the term U.S. Holder means a beneficial owner of Notes that is for U.S. federal income tax purposes: (i) a citizen or resident of the United States; (ii) a corporation created or organized in or under the laws of the United States or any state thereof (including the District of Columbia); (iii) any estate the income of which is subject to U.S. federal income tax regardless of its source; or (iv) any trust if a court within the United States is able to exercise primary supervision over its administration and one or more U.S. persons have the authority to control all substantial decisions of the trust. If a partnership (including for this purpose any entity treated as a partnership for U.S. federal income tax purposes) holds Notes, the tax treatment of a partner generally will depend upon the status of the partner and upon the activities of the partnership. Partners of partnerships holding Notes should consult their own tax advisers.

INVESTORS SHOULD CONSULT THEIR OWN TAX ADVISORS IN DETERMINING THE TAX CONSEQUENCES TO THEM OF HOLDING NOTES, INCLUDING THE APPLICATION TO THEIR PARTICULAR SITUATION OF THE U.S. FEDERAL INCOME TAX CONSIDERATIONS DISCUSSED BELOW, AS WELL AS THE APPLICATION OF STATE, LOCAL, FOREIGN OR OTHER TAX LAWS AND POSSIBLE CHANGES IN TAX LAW.

Taxation of Interest and Additional Amounts

U.S. Holders will be taxed on the gross amount of interest and any additional amounts (without reduction for any Pakistani withholding taxes) as ordinary interest income in accordance with their method of tax accounting. Any Pakistani withholding taxes paid generally will be treated as foreign income taxes eligible for credit against a U.S. Holder's U.S. federal income tax liability, subject to generally applicable limitations and conditions, or, at the election of such U.S. Holder, for deduction in computing the Holder's taxable income. Interest and additional amounts, if any, will constitute foreign source income for U.S. foreign tax credit purposes.

Taxation of Capital Gains

Upon the sale, exchange or retirement of a Note, a U.S. Holder will generally recognize capital gain or loss equal to the difference between the amount realized on the sale, exchange or retirement and the U.S. Holder's adjusted tax basis in the Note. For these purposes, the amount realized does not include any amount attributable to accrued interest, except to the extent previously included in income. Amounts attributable to accrued interest are treated as interest as described under "Taxation of Interest and Additional Amounts" above. Gain or loss realized by an individual U.S. Holder generally will be long-term capital gain or loss subject to taxation at reduced rates if, at the time of the disposition, the Note has been held for more than one year. The ability of a U.S. Holder to offset capital losses against ordinary income is limited. Gain or loss realized by a U.S. Holder generally will be treated as from sources within the United States for U.S. foreign tax credit purposes.

Information Reporting and Backup Withholding

Payments of principal and interest on the Notes, and payments of the proceeds of a sale of Notes, that are paid within the United States or through certain U.S.-related financial intermediaries are subject to information reporting and may be subject to backup withholding unless the holder (1) is a corporation or other exempt recipient or (2) provides a taxpayer identification number and certifies that no loss of exemption has occurred. The amount of any backup withholding from a payment to a U.S. Holder will be allowed as a credit against such U.S. Holder's U.S. federal income tax liability and may entitle such U.S. Holder to a refund, provided that the required information is timely furnished to the U.S. Internal Revenue Service.

EU Savings Directive

Under EC Council Directive 2003/48/EC on the taxation of savings income, Member States are required, from July 1, 2005, to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to an individual resident in that other Member State. However, for a transitional period, Belgium, Luxembourg and Austria are instead required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries). A number of non-EU countries and territories including Switzerland have agreed to adopt similar measures (a withholding system in the case of Switzerland) with effect from the same date.

If, following implementation of this Directive, a payment were to be made or collected through a Member State which has opted for a withholding system and an amount of, or in respect of tax were to be withheld from that payment, neither the Issuer nor any Paying Agent nor any other person would be obliged to pay additional amounts with respect to any Note as a result of the imposition of such withholding tax. If a withholding tax is imposed on payment made by a Paying Agent following implementation of this Directive, the Issuer will be required to maintain a Paying Agent in a Member State (if any) that will not be obliged to withhold or deduct tax pursuant to the Directive. Holders of the Notes should consult their own tax advisors regarding the implications of the Directive in their particular circumstances.

CLEARING AND SETTLEMENT ARRANGEMENTS

The Issuer has obtained the information in this section from sources it believes to be reliable, including from DTC, Euroclear and Clearstream Luxembourg. The Issuer takes no responsibility, however, for the accuracy of this information. Although DTC, Euroclear and Clearstream, Luxembourg have agreed to the following procedures in order to facilitate transfers of interests in the 2016 Unrestricted Global Certificate and the 2036 Unrestricted Global Certificate (together, the ***Unrestricted Global Certificates****) and in the 2016 Restricted Global Certificate and the 2036 Restricted Global Certificate (together, the* ***Unrestricted Global Certificates****) among participants of DTC, Euroclear and Clearstream, Luxembourg, they are under no obligation to perform or continue to perform such procedures, and such procedures may be discontinued at any time. Neither the Issuer nor the Fiscal Agent will have any responsibility for the performance by DTC, Euroclear or Clearstream, Luxembourg or their respective participants or indirect participants of their respective obligations under the rules and procedures governing their operations.*

DTC

DTC is a limited-purpose trust company organised under the New York Banking Law, a "banking organisation" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code and a "clearing agency" registered pursuant to the provisions of Section 17A of the Exchange Act of 1934, as amended (the **Exchange Act**). DTC was created to hold securities for its participating organisations (**DTC Participants**) and to facilitate the clearance and settlement of securities transactions between DTC Participants through electronic book-entry changes in accounts of its DTC Participants, thereby eliminating the need for physical movement of certificates. DTC Participants include securities brokers and dealers, brokers, banks, trust companies and clearing corporations and may include certain other organisations. Indirect access to the DTC system also is available to others such as banks, brokers, dealers and trust companies that clear through or maintain a custodial relationship with a DTC Participant, either directly or indirectly (**Indirect DTC Participants**).

Because DTC can only act on behalf of DTC Participants, who in turn act on behalf of Indirect DTC Participants and certain banks, the ability of a person having a beneficial interest in a Note to pledge such interest to persons or entities that do not participate in the DTC system, or otherwise take actions in respect of such interest, may be affected by the lack of a physical certificate of such interest. The Rules applicable to DTC and its Participants are on file with the United States Securities and Exchange Commission.

Euroclear and Clearstream, Luxembourg

Euroclear and Clearstream, Luxembourg hold securities for participating organisations, and facilitate the clearance and settlement of securities transactions between their respective participants, through electronic book-entry changes in accounts of such participants. Euroclear and Clearstream, Luxembourg provide to their participants, among other things, services for safekeeping, administration, clearance and settlement of internationally traded securities and securities lending and borrowing. Euroclear and Clearstream, Luxembourg interface with domestic securities markets. Euroclear and Clearstream, Luxembourg participants are recognised financial institutions such as underwriters, securities brokers and dealers, banks, trust companies and certain other organisations and include the Managers. Indirect access to Euroclear or Clearstream, Luxembourg is also available to others such as banks, brokers, dealers and trust companies that clear through or maintain a custodian relationship with a Euroclear or Clearstream, Luxembourg participant, either directly or indirectly.

Initial Settlement

Upon issuance of the Unrestricted Global Certificates and the Restricted Global Certificates, DTC or its custodian will credit, on its book-entry system, the respective principal amount of the individual beneficial interests in a Note to the accounts of DTC Participants. Ownership of beneficial interests in a Note will be limited to persons who have accounts with DTC, including Euroclear and Clearstream, Luxembourg, or Indirect DTC Participants. Ownership of beneficial interests in the Notes will be shown on, and the transfer of that ownership will be effected only through, records maintained by DTC or its nominee (with respect to interests of DTC Participants) and the records of DTC Participants (with respect to interests of Indirect DTC Participants).

Euroclear and Clearstream, Luxembourg will hold omnibus positions on behalf of their participants through customers' securities accounts for Euroclear and Clearstream, Luxembourg on the books of their respective depositaries, which in turn will hold such positions in customers' securities accounts in such depositaries' names on the books of DTC. JPMorgan Chase Bank, N.A. will act as depositary for Euroclear, and Citibank will act as depositary for Clearstream, Luxembourg.

Investors that hold their interests in the Notes through DTC will follow the settlement practices applicable to global bond issues. Investors' securities custody accounts will be credited with their holdings against payment in same-day funds on the settlement date.

Investors that hold their interests in the Notes through Clearstream, Luxembourg or Euroclear accounts will follow the settlement procedures applicable to conventional Eurobonds in registered form. The interests will be credited to the securities custody accounts on the settlement date against payment in same-day funds.

Secondary Market Trading

Since the purchaser determines the place of delivery, it is important to establish at the time of trade where both the purchaser's and seller's accounts are located to ensure that settlement can be made on the desired value date.

Trading between DTC Participants

Secondary market trading between DTC Participants will be settled using the procedures applicable to global bond issues in same-day funds.

Trading between Euroclear and/or Clearstream, Luxembourg participants

Secondary market trading between Euroclear participants and/or Clearstream, Luxembourg participants will be settled using the procedures applicable to conventional Eurobonds in same-day funds.

Trading between DTC seller and Euroclear or Clearstream, Luxembourg purchaser

When Notes are to be transferred from the account of a DTC Participant to the account of a Clearstream, Luxembourg or Euroclear participant, the purchaser will send instructions to Clearstream, Luxembourg or Euroclear through a Clearstream, Luxembourg or Euroclear participant, as the case may be, at least one business day prior to settlement. Clearstream, Luxembourg or the Euroclear operator will instruct its respective depositary to receive the Notes against payment. Payment will include interest accrued on such beneficial interest on the Note from and including the last interest payment date to and excluding the settlement date. Payment will then be made by the depositary to the DTC Participant's account against delivery of Notes. After settlement has been completed, the Notes will be credited to the respective clearing system, and by the clearing system, in accordance with its usual procedures, to the Clearstream, Luxembourg or Euroclear participant's account. The securities credit will appear the next day (European time) and the cash debit will be back-valued to, and the interest on the Note will accrue from, the value date (which would be the preceding day when settlement occurred in New York). If settlement is not completed on the intended value date (i.e., the trade fails), the Clearstream, Luxembourg or Euroclear cash debit will be valued instead as of the actual settlement date.

Euroclear and Clearstream, Luxembourg participants will need to make available to the respective clearing system the funds necessary to process same-day funds settlement. The most direct means of doing so is to preposition funds for settlement, either from cash on-hand or existing lines of credit. Under this approach, participants may take on credit exposure to the Euroclear operator or Clearstream, Luxembourg until the interests in the Note are credited to their accounts one day later.

As an alternative, if Clearstream, Luxembourg or Euroclear has extended a line of credit to a Clearstream, Luxembourg or Euroclear participant, as the case may be, such participant may elect not to pre-position funds and may allow that credit line to be drawn upon to finance settlement. Under this procedure, Clearstream, Luxembourg participants or Euroclear participants purchasing interests in a Note would incur overdraft charges for one day, assuming they cleared the overdraft when the interest in the Note were credited to their accounts. However, interest on the Note would accrue from the value date. Therefore, in many cases, the investment income on the interest in the Note would accrue from the value date. Therefore, in many cases, the investment income on the interest in the Note earned during that one-day period may substantially reduce or offset the amount of such overdraft charges, although this result will depend on each participant's particular cost of funds.

Since the settlement is taking place during New York business hours, DTC Participants can employ their usual procedures for transferring the Global Certificates to the respective depositaries of Clearstream, Luxembourg or Euroclear for the benefit of Clearstream, Luxembourg participants or Euroclear participants. The sale proceeds will be available to the DTC seller on the settlement date. Thus, to the DTC Participants, a cross-market sale transaction will settle no differently than a trade between two DTC Participants.

Trading between Clearstream, Luxembourg or Euroclear seller and DTC purchaser

Due to time zones differences in their favour, Clearstream, Luxembourg and Euroclear participants may employ their customary procedures for transactions in which interests in a Note are to be transferred by their respective clearing system, through its respective depositary, to a DTC Participant, as the case may be, at least one business day prior to settlement. In these cases, Clearstream, Luxembourg or Euroclear will instruct its respective depositary to deliver the interest in the Note to the DTC Participant's account against payment. Payment will include interest accrued on such beneficial interest in the Note from and including the interest payment date to and excluding the settlement date. The payment will then be reflected in the account of the Clearstream, Luxembourg participant or Euroclear participant the following day, and receipt of the cash proceeds in the Clearstream, Luxembourg or Euroclear participant's account would be back-valued to the value date (which would be the preceding day, when settlement occurred in New York). Should the Clearstream, Luxembourg or Euroclear participant have a line of credit in its respective clearing system and elect to be in debit in anticipation of receipt of the sale proceeds in its account, the back-valuation will extinguish any overdraft charges occurred over that one-day period. If settlement is not completed on the intended value date (i.e., the trade fails), receipt of the cash proceeds in the Clearstream, Luxembourg or Euroclear participant's account would instead be valued as of the actual settlement date.

Finally, day traders that use Clearstream, Luxembourg or Euroclear to purchase interests in a Note from DTC Participants for delivery to Clearstream, Luxembourg participants or Euroclear participants should note that these trades will automatically fail on the sale side unless affirmative action is taken. At least three techniques should be readily available to eliminate this potential problem:

- borrowing through Clearstream, Luxembourg or Euroclear for one day (until the purchase side of the day trade is reflected in their Clearstream, Luxembourg or Euroclear accounts) in accordance with the clearing system's customary procedures;

- borrowing the interests in the United States from a DTC Participant no later than one day prior to settlement, which would give the interests sufficient time to be reflected in their Clearstream, Luxembourg or Euroclear account in order to settle the sale side of the trade; or

- staggering the value date for the buy and sell sides of the trade so that the value date for the purchase from the DTC Participant is at least one day prior to the value date for the sale to the Clearstream, Luxembourg participant or Euroclear participant.

PLAN OF DISTRIBUTION

Each of the managers named in the table below (the **Managers**) has, pursuant to a Subscription Agreement (the **Subscription Agreement**) 23 March 2006, severally agreed to subscribe or procure subscribers for the principal amount of Notes set out opposite its name in the table below at the issue price of 100.00% of the principal amount of the 2016 Notes and at the issue price of 100.00% of the principal amount of the 2036 Notes, subject to the provisions of the Subscription Agreement.

Manager	**Underwriting commitment**	
	2016 Notes U.S.$	**2036 Notes U.S.$**
Citigroup Global Markets Limited	166,666,667	100,000,000
Deutsche Bank Securities Inc.	166,666,667	100,000,000
J.P. Morgan Securities Ltd.	166,666,666	100,000,000
Total	U.S.$500,000,000	U.S.$300,000,000

The Issuer will pay to the Managers a combined management and underwriting commission, will reimburse the Managers in respect of certain of their expenses, and has agreed to indemnify the Managers against certain liabilities (including liabilities under the Securities Act), incurred in connection with the issue of the Notes. The Subscription Agreement may be terminated in certain circumstances prior to payment of the net subscription money in respect of the Notes to the Issuer.

United States

The Notes have not been and will not be registered under the Securities Act and, subject to certain exceptions, may not be offered or sold within the United States or to or for the account or benefit of a U.S. person except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Accordingly, the Notes are being offered and sold only (a) outside the United States to persons other than U.S. persons as defined in Regulation S under the Securities Act in offshore transactions in reliance on, and in compliance with, Regulation S and (b) in the United States to a limited number of QIBs as defined in Rule 144A under the Securities Act in connection with resales by the Managers, in reliance on, and in compliance with, Rule 144A.

In addition, until 40 days after the commencement of the offering, an offer or sale of Notes within the United States by any dealer (whether or not participating in the offering of the Notes) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A.

Each Manager has represented and agreed that except as permitted by the Subscription Agreement and set forth in "*Transfer Restrictions*" it has offered and sold, and will offer and sell, the Notes within the United States or to, or for the account or benefit of, U.S. persons (a) as part of their distribution at any time and (b) otherwise until 40 days after the later of the commencement of the offering and the Closing Date, only in accordance with Rule 903 of Regulation S or Rule 144A. Accordingly, neither such Manager nor its affiliates, nor any persons acting on its or their behalf, have engaged or will engage in any directed selling efforts (as defined in Regulation S) with respect to the Notes, and such Manager, its affiliates and all persons acting on its or their behalf have complied and will comply with the offering restrictions requirement of Regulation S. Each Manager has agreed that, at or prior to confirmation of sale of the Notes (other than a sale pursuant to Rule 144A), it will have sent to each distributor, dealer or person receiving a selling concession, fee or other remuneration that purchases the Notes from it during the restricted period a confirmation or notice to substantially the foregoing effect.

Each purchaser of a Note, by its acceptance thereof, will be deemed to have acknowledged, represented to and agreed with the Issuer and the Managers as follows:

(a) It understands and acknowledges that the Notes have not been registered under the Securities Act or any other applicable securities law, and that the Notes are being offered for sale in transactions not requiring registration under the Securities Act or any other securities laws, including sales pursuant to Rule 144A and Regulation S and, unless so registered, may not be offered, sold or otherwise transferred except in compliance with the registration requirements of the Securities Act or any other applicable securities laws, pursuant to an exemption therefrom or pursuant to a transaction not subject thereto.

(b) It is either (i) a QIB and is aware that any sale of the Notes to it will be made in reliance on Rule 144A and it is acquiring the Notes for its own account or for the account of another QIB with respect to which it exercises full investment discretion, or (ii) it is not a U.S. person (as defined in Regulation S) or purchasing for the account or benefit of a U.S. person and is purchasing the Notes in an offshore transaction (as defined in Regulation S) in accordance with Regulation S.

(c) It is purchasing the Notes for its own account or for the account of investors meeting the requirements of paragraph (b) for which it is acting as a fiduciary or agent and with respect to which it has the authority to make these acknowledgements, representations and agreements, in each case not with a view to, or for offer or sale in connection with, any distribution thereof in violation of the Securities Act.

(d) If it is a QIB purchasing the Notes pursuant to Rule 144A, it will not offer, sell, pledge or otherwise transfer the Notes except (i) (A) to the Issuer, (B) to a person whom the purchaser reasonably believes is a QIB in a transaction meeting the requirements of Rule 144A, (C) in an offshore transaction complying with Rule 903 or Rule 904 of Regulation S or (D) in a transaction that is otherwise exempt from the registration requirements of the Securities Act but only upon delivery to the Issuer of an opinion of counsel in form and scope satisfactory to the Issuer and (ii) in accordance with all applicable securities laws of the States of the United States. It acknowledges that certificates in respect of Notes, unless otherwise agreed by the Issuer, will bear a legend to the following effect:

THE NOTES REPRESENTED HEREBY HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE SECURITIES ACT OF 1933 (THE SECURITIES ACT), OR ANY SECURITIES LAW OF ANY STATE IN THE UNITED STATES OF AMERICA, AND MAY NOT BE REOFFERED, RESOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT AS PERMITTED BY THE FOLLOWING SENTENCES. THE HOLDER HEREOF, BY PURCHASING THE NOTES IN RESPECT OF WHICH THIS CERTIFICATE IS ISSUED, ACKNOWLEDGES AND AGREES, FOR THE BENEFIT OF THE ISSUER, THAT SUCH NOTES MAY BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED ONLY (A)(1) TO THE ISSUER, (2) IN COMPLIANCE WITH RULE 144A UNDER THE SECURITIES ACT TO A PERSON THAT THE HOLDER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A UNDER THE SECURITIES ACT PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER WHOM THE HOLDER HAS INFORMED, IN EACH CASE, THAT THE OFFER, SALE, PLEDGE OR OTHER TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A, (3) IN AN OFFSHORE TRANSACTION COMPLYING WITH RULE 903 OR 904 OF REGULATION S UNDER THE SECURITIES ACT, OR (4) IN A TRANSACTION THAT IS OTHERWISE EXEMPT FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT BUT ONLY IF AVAILABLE AND UPON DELIVERY TO THE ISSUER OF AN OPINION OF COUNSEL IN FORM AND SCOPE SATISFACTORY TO THE ISSUER; AND (B) IN EACH CASE IN COMPLIANCE WITH ALL APPLICABLE SECURITIES LAWS OF THE STATES OF THE UNITED STATES.

Each purchaser further acknowledges that the Managers and their affiliates will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements. If it is acquiring any Restricted Notes for the account of one or more QIBs, the purchaser thereof represents that it has sole investment discretion with respect to each such account and that it has full power to make the foregoing acknowledgements, representations and agreements on behalf of each such account.

United Kingdom

Each Manager has represented and agreed that it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Notes in, from or otherwise involving the United Kingdom.

Pakistan

Each Manager has represented and agreed that the Notes or interests therein will not be offered or sold directly or indirectly in Pakistan, to residents of Pakistan, or to, or for the account or benefit of, such persons. The State Bank of Pakistan has confirmed that non-resident Pakistani citizens are free to purchase the Notes and to transfer the Notes to other non-resident persons, subject, in each case, to the condition that the purchase price is paid in convertible foreign currency outside Pakistan.

Hong Kong

Each of the Managers has represented and agreed that:

(a) it has not offered or sold and will not offer or sell in Hong Kong, by means of any document, the Notes other than (i) to persons whose ordinary business is to buy or sell shares or debentures (whether as principal or agent); or (ii) in other circumstances which do not result in the document being an offer to the public within the meaning of the Companies Ordinance (Cap. 32) (the **CO**); or (iii) to "professional investors" within the meaning of the Securities and Futures Ordinance (Cap. 571) (the **SFO**) and any rules made under the SFO; or (iv) in other circumstances which do not result in the document being a "prospectus" which do not constitute an offer to the public within the meaning of the CO; and

(b) it has not issued or had in its possession for the purposes of issue, and will not issue or have in its possession for the purposes of issue (in each case whether in Hong Kong or elsewhere), any advertisement, invitation or document relating to the Notes, which is directed at, or the contents of which are likely to be accessed or read by, the public in Hong Kong (except if permitted to do so under the laws of Hong Kong) other than with respect to the Notes which are or are intended to be disposed of only to persons outside Hong Kong or only to "professional investors" within the meaning of the SFO and any rules made under the SFO.

Singapore

The Offering Circular has not been registered as a prospectus with the Monetary Authority of Singapore (the **MAS**) under the Securities and Futures Act (Cap. 289) (the **Securities and Futures Act**). Accordingly, the Notes may not be offered or sold or made the subject of an invitation for subscription or purchase nor may the Offering Circular or any other document or material in connection with the offer or sale, or invitation for subscription or purchase of the Notes be circulated or distributed, whether directly or indirectly, to the public or any member of the public in Singapore other than: (i) to an institutional investor or other person falling within Section 274 of the Securities and Futures Act; (ii) to a sophisticated investor as defined, and in accordance with the conditions specified, in Section 275 of the Securities and Futures Act; or (iii) pursuant to, and in accordance with the conditions of, any other applicable exemption under the Securities and Futures Act.

Where the Notes are subscribed or purchased under Section 275 by a relevant person which is:

(i) a corporation (which is not an accredited investor) the sole business of which is to hold investments and the entire share capital of which is owned by one or more individuals, each of whom is an accredited investor; or

(ii) a trust (where the trustee is not an accredited investor) whose sole purpose is to hold investments and each beneficiary is an accredited investor, shares, debentures and units of shares and debentures of that corporation or the beneficiaries' rights and interest in that trust shall not be transferable for six months after that corporation or that trust has acquired the Notes under Section 275 except: (1) to an institutional investor under Section 274 of the SFA or to a relevant person, or any person pursuant to Section 275(1A), and in accordance with the conditions specified in Section 275 of the SFA; (2) where no consideration is given for the transfer; or (3) by operation of law.

Republic of Italy

Each Manager has represented that it has not offered, sold or delivered any Notes or distributed copies of this Offering Circular or any other document relating to the Notes in the Republic of Italy and will not offer, sell or deliver any Notes or distribute copies of this Offering Circular or any other document relating to the Notes in the Republic of Italy other than to professional investors (*operatori qualificati*), as defined in Article 31, second paragraph, of CONSOB Regulation No. 11522 of 1st July, 1998, as amended. Any offer, sale or delivery of the Notes or distribution of copies of this Offering Circular or any other document relating to the Notes in the Republic of Italy must be (a) made by an investment firm, bank or financial intermediary permitted to conduct such activities in the Republic of Italy in accordance with the Legislative Decree No. 58 of 24th February, 1998 (**Financial Services Act**) and Legislative Decree No. 385 of 1st September, 1993 (the **Banking Act**); (b) in compliance with Article 129 of the Banking Act and the implementing guidelines of the Bank of Italy; and (c) in compliance with any other applicable laws and regulations.

In any case the Notes shall not be placed, sold or offered either in the primary or the secondary market to individuals residing in Italy.

General

No action has been taken by the Issuer or any of the Managers that would, or is intended to, permit a public offer of the Notes or possession or distribution of the Offering Circular or any other offering or publicity material relating to the Notes in any country or jurisdiction where any such action for that purpose is required. Accordingly, each Manager has undertaken that it will not, directly or indirectly, offer or sell any Notes or distribute or publish any offering circular, prospectus, form of application, advertisement or other document or information in any country or jurisdiction except under circumstances that will, to the best of its knowledge and belief, result in compliance with any applicable laws and regulations and all offers and sales of Notes by it will be made on the same terms.

TRANSFER RESTRICTIONS

Due to the following significant transfer restrictions applicable to the Notes, investors are advised to consult legal counsel prior to making any reoffer, resale, pledge, transfer or disposal of Notes.

The Notes have not been registered under the Securities Act, and may not be offered or sold in the United States or to, or for the account or benefit of, U.S. persons (as defined in Regulation S under the Securities Act) except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Accordingly, the Notes are being offered and sold (1) in the United States only to persons reasonably believed to be "qualified institutional buyers," which are referred to as QIBs, as defined in Rule 144A under the Securities Act in compliance with Rule 144A and (2) to persons outside the United States (**foreign purchasers**) in offshore transactions pursuant to Regulation S under the Securities Act.

By its purchase of Notes, each purchaser of Notes will be deemed to:

(1) represent that it is purchasing the Notes for its own account or an account with respect to which it exercises sole investment discretion and that it and any such account is (a) a QIB, and is aware that the sale to it is being made in reliance on Rule 144A or (b) a foreign purchaser that is outside the United States;

(2) acknowledge that the Notes have not been registered under the Securities Act and may not be offered or sold within the United States except as set forth below;

(3) if it is a person other than a foreign purchaser outside the United States after the expiration of the distribution compliance period, agree that if it should resell or otherwise transfer the Notes within the time period referred to in Rule 144(k) under the Securities Act after the original issuance of the Notes, it will do so only (a) to the Issuer, (b) to a QIB in compliance with Rule 144A, (c) outside the United States in an offshore transaction in compliance with Rule 903 or 904 of Regulation S under the Securities Act, (d) pursuant to the exemption from registration provided by Rule 144 under the Securities Act (if available) but only upon delivery to the Issuer of an opinion of counsel in form and scope satisfactory to the Issuer or (e) pursuant to an effective registration statement under the Securities Act. Subject to the procedures set forth in the Agency Agreement, prior to any proposed transfer of the Notes (other than pursuant to an effective registration statement) within the time period referred to in Rule 144(k) under the Securities Act after the original issuance of the Notes, the holder thereof must check the appropriate box set forth on the reverse of its Notes relating to the manner of such transfer and submit the Notes to the Fiscal Agent;

(4) agree that it will deliver to each person to whom it transfers Notes notice of any restriction on transfer of such Notes;

(5) understand and agree that Notes initially offered in the United States to QIBs will be represented by one or more Restricted Global Certificates and that Notes offered outside the United States in offshore transactions pursuant to Regulation S will be represented by one or more Unrestricted Global Certificates;

(6) understand that unless registered under the Securities Act, the Notes (other than those issued to foreign purchasers after expiration of the distribution compliance period) will bear a legend to the following effect, unless otherwise agreed by the Issuer and the holder thereof:

THE NOTES REPRESENTED HEREBY HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE SECURITIES ACT OF 1933 (THE SECURITIES ACT), OR ANY SECURITIES LAW OF ANY STATE IN THE UNITED STATES OF AMERICA, AND MAY NOT BE REOFFERED, RESOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT AS PERMITTED BY THE FOLLOWING SENTENCES. THE HOLDER HEREOF, BY PURCHASING THE NOTES IN RESPECT OF WHICH THIS CERTIFICATE IS ISSUED, ACKNOWLEDGES AND AGREES, FOR THE BENEFIT OF THE ISSUER, THAT SUCH NOTES MAY BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED ONLY (A)(1) TO THE ISSUER, (2) IN COMPLIANCE WITH RULE 144A UNDER THE SECURITIES ACT TO A PERSON THAT THE HOLDER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A UNDER THE SECURITIES ACT PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER WHOM THE HOLDER HAS INFORMED, IN EACH CASE, THAT THE OFFER, SALE, PLEDGE OR OTHER TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A, (3) IN AN OFFSHORE TRANSACTION COMPLYING WITH RULE 903 OR 904 OF

REGULATION S UNDER THE SECURITIES ACT, OR (4) IN A TRANSACTION THAT IS OTHERWISE EXEMPT FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT BUT ONLY IF AVAILABLE AND UPON DELIVERY TO THE ISSUER OF AN OPINION OF COUNSEL IN FORM AND SCOPE SATISFACTORY TO THE ISSUER; AND (B) IN EACH CASE IN COMPLIANCE WITH ALL APPLICABLE SECURITIES LAWS OF THE STATES OF THE UNITED STATES.

(7) understand that unless registered under the Securities Act, the Notes sold to foreign purchasers in reliance on Regulation S prior to the expiration of the distribution compliance period will bear an additional legend to the following effect, unless otherwise agreed by us and the holder thereof:

> UPON THE EXPIRATION OF THE PERIOD 40 DAYS AFTER THE LATER OF THE COMMENCEMENT OF THE OFFERING OF NOTES IN RELIANCE ON REGULATION S UNDER THE SECURITIES ACT AND THE ORIGINAL ISSUE DATE OF SUCH NOTES, THIS NOTE SHALL NO LONGER BE SUBJECT TO THE RESTRICTIONS ON TRANSFER PROVIDED IN THIS LEGEND;

(8) acknowledge that the Issuer and the Managers will rely upon the truth and accuracy of the foregoing acknowledgments, representations and agreements, and agree that if any of the acknowledgments, representations or warranties deemed to have been made by it by its purchase of Notes are no longer accurate, it shall promptly notify the Issuer and the Managers; and

(9) if it is acquiring Notes as a fiduciary or agent for one or more investor accounts, represent that it has sole investment discretion with respect to each such account and it has full power to make the foregoing acknowledgments, representations and agreements on behalf of each such account.

VALIDITY OF NOTES

The validity of the Notes will be passed upon for the Issuer by Arnold & Porter LLP, English and United States counsel to the Issuer, and by the Joint Secretary to the Ministry of Law, Justice and Human Rights of the Government of Pakistan, and for the Managers by Allen & Overy LLP, English and United States counsel to the Managers, and by Kabraji and Talibuddin. As to all matters of Pakistani law, Arnold & Porter LLP may rely on the opinion of the Joint Secretary to the Ministry of Law, Justice and Human Rights of the Government of Pakistan, and Allen & Overy LLP may rely upon the opinion of Kabraji & Talibuddin. As to all matters of English law, the Joint Secretary to the Ministry of Law, Justice and Human Rights of the Government of Pakistan may rely upon the opinion of Arnold & Porter LLP, and Kabraji & Talibuddin may rely upon the opinion of Allen & Overy LLP.

GENERAL INFORMATION

Authorization

The Issuer has obtained all necessary consents, approvals and authorizations under the laws of the Islamic Republic of Pakistan in connection with the issue and performance of the Notes. The issue of the Notes was approved on February 13, 2006 by the Prime Minister of the Islamic Republic of Pakistan, pursuant to Rule 16(2) of the Rules of Business of the Government of Pakistan 1973 (as amended). The Notes have been approved on March 16, 2006 by the Finance Division of the Federal Government for purposes of Clause 75 of the Second Schedule of the Income Tax Ordinance.

Listing

Application has been made to admit the Notes to listing on the Official List of the Luxembourg Stock Exchange and to trading on the Euro MTF market of the Luxembourg Stock Exchange. The Luxembourg listing agent is Dexia Banque Internationale à Luxembourg, société anonyme.

So long as any of the Notes are listed on the Luxembourg Stock Exchange and the rules of the Luxembourg Stock Exchange so require, the Issuer will maintain a paying agent and a transfer agent in Luxembourg.

Clearing Systems

The Notes have been accepted for clearance through DTC, Euroclear and Clearstream, Luxembourg.

The ISIN for the 2016 Unrestricted Notes is USY8793YAK83 and for the 2016 Restricted Notes is US695847AA10. The Common Code for the 2016 Unrestricted Notes is 024962717 and for the 2016 Restricted Notes is 024972534. The CUSIP number for the 2016 Unrestricted Notes is Y8793Y AK 8 and for the 2016 Restricted Notes is 695847 AA 1.

The ISIN for the 2036 Unrestricted Notes is USY8793YAL66 and for the 2036 Restricted Notes is US695847AB92. The Common Code for the 2036 Unrestricted Notes is 024962741 and for the 2036 Restricted Notes is 024972640. The CUSIP number for the 2036 Unrestricted Notes is Y8793Y AL 6 and for the 2036 Restricted Notes is 695847 AB 9.

Application has been made for acceptance of the Notes into DTC's book-entry settlement system and for trading in PORTAL.

Litigation

The Issuer is not involved in any litigation or arbitration proceedings relating to claims or amounts which are material in the context of the issue of the Notes nor so far as the Issuer is aware is any such litigation or arbitration pending or threatened.

Economic Survey

Copies of the 2004-2005 Economic Survey and all future Economic Surveys and Statistical Supplements may be obtained at the specified office of the Paying Agent in Luxembourg during normal business hours, so long as any of the Notes are listed on the Luxembourg Stock Exchange. The aforementioned 2004-2005 Economic Survey contains certain summary information regarding the annual budget of the Government.

Documents

Copies of the Agency Agreement containing the forms of the Note Certificates will be available for inspection, at the specified offices of each of the Paying Agents during normal business hours, so long as any of the Notes are outstanding. A copy of the Agency Agreement and the Constitution of Pakistan will be available for inspection at the specified office of the Paying Agent in Luxembourg during normal business hours so long as the Notes are listed on the Luxembourg Stock Exchange.

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THE ISSUER

The President of the Islamic Republic of Pakistan
for and on behalf of the Islamic Republic of Pakistan
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Pak Secretariat
Ministry of Finance
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Pakistan

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Printed by RR Donnelley, 86019