ASIAN DEVELOPMENT BANK

Pakistan: Prioritizing Interventions for Financial Sector Development in Pakistan

Project Name	Prioritizing Interventions for Financial Sector Development in Pakistan
Project Number	48327-001
Country	Pakistan
Project Status	Active
Project Type / Modality of Assistance	Technical Assistance
Source of Funding / Amount	**TA 8832-PAK: Prioritizing Interventions for Financial Sector Development in Pakistan** Technical Assistance Special Fund — US$ 225,000.00
Strategic Agendas	Environmentally sustainable growth Inclusive economic growth Regional integration
Drivers of Change	Governance and capacity development
Sector / Subsector	**Finance** - Finance sector development
Gender Equity and Mainstreaming	No gender elements
Description	Impact and Outcome The expected impact of the proposed S-PATA is informed decision making by government for reform of the financial sector. The expected outcome of the proposed S-PATA will be the identification and prioritization of key steps to expand and deepen private sector financing in Pakistan. B.Methodology and Key Activities The proposed S-PATA will have three outputs. 1) Identification of key financial sector constraints. This output will be delivered by completing a review of the current constraints facing the financial sector and its ability to allocate capital and provide financial intermediation. Attention will be paid to (i) the growing level of public debt, (ii) need for development of the conventional bond and sukuk markets to supply long-term capital for infrastructure investments, and (iii)) financial inclusion for export led growth integration of SMEs cluster in the exporters being facilitated. 2) Action plan and prioritization of outputs and activities that address financial sector constraints. This output will be delivered by: (i) mapping and prioritizing the proposed outputs and activities of technical assistance so that they address those constraints in a holistic manner, meet the current needs of the GOP, are achievable, and include potential options for the proposed Project; (ii) coordinate with other donors to agree on a resource allocation plan for the proposed Project and other technical assistance acceptable to the GOP; and (iii) convene a consultative group consisting of experienced policy makers, economists, commercial banking experts, capital market professionals and other key stakeholders who will provide feedback, review, and validation of the identified constraints and proposed action plan and its implementation. 3) Identification and coordination of funding and preparation of implementation plan for future ADB assistance. This output will be delivered by: (i) completing an implementation plan for the delivery of future ADB assistance, , and (ii) preparing terms of reference for a larger technical team of international and national financial sector specialists under the more detailed and longer-term technical assistance to be provided.

Project Rationale and Linkage to Country/Regional Strategy	The new government is keen to support further financial market reform, strengthening, diversification and growth, to facilitate better allocation of capital for infrastructure and other investment and provide more inclusive financial services. The S-PATA will (i) help the GOP map out and prioritize the steps that need to be taken to achieve further financial sector growth, and (ii) identify and structure technical assistance that may be provided by ADB, other donors and or the government to support such steps. This will ensure that the technical assistance provided addresses real constraints in a holistic manner, meet current sector needs and government priorities, and can realistically be achieved within the time and resources available. Public debt management. Pakistan's public debt has increased significantly in recent years due to high fiscal deficit levels, which peaked to about 8% of GDP for the fiscal year (FY) ended 30 June 2013 and expected to be around 4.9% as projected in the budget for FY2014-15. For FY2014 public debt totaled PRs16,321 billion or 64.3% of GDP, compared to PRs6,044 billion or 56.8% of GDP in FY2008 . To fund this increase government relied heavily on domestic debt, which was 66.8% of total public debt for FY2013 compared to 54% in FY2008. Domestic government debt was mainly generated from the banking market, through the issuance of short term government securities, and the National Savings Schemes (NSS), which provided a variety of attractive retail savings instruments. These NSS instruments are a source of vulnerability, liquidity risk and market distortion because of the put-options that NSS investors can exercise at any time of the instruments' life. The GOP's debt management function is spread across a number of agencies under the MOF. This fragmentation makes policy coordination, implementation and reforms very difficult, and recruitment of qualified staff from the market is problematic. It can result in (i) mixed signals to the capital markets about the government's short, medium and long-term domestic and external debt requirements; (ii) contingent liabilities missed or not properly accounted for; and (iii) the overall cost of public debt to be higher than needed. To address this, in April 2014 the GOP announced the Medium Term Debt Management Strategy (FY 2014-18) (MTDS). The MTDS contains a new policy on an appropriate mix of funding, and provides a framework that enables the government to take informed decisions based on cost-risk tradeoffs. It also calls for the centralization of the debt management functions to achieve greater clarity and accountability. In Pakistan the corporate debt market is underdeveloped and the private sector is dependent on the banking sector for finance. Pakistan is relatively under-leveraged as an economy, with total private sector debt at about 20% of GDP. One of the reasons for underdeveloped debt capital markets is lack of interest of institutional and retail investor for such instruments. The average maturity of domestic public debt is 1.8 years, which means that the risk-free yield curve is not developed, and benchmarking for the cost of long term capital is very difficult. Lack of infrastructure finance. It is estimated that priority infrastructure projects in the power sector alone need long-term financing equal to $9.7 billion from the public sector and $14.9 billion from the private sector. Availability of financing for energy, transport and other infrastructure projects from capital markets is extremely limited. Infrastructure finance from banks has been static for many years for a number of reasons, including (i) concerns about the circular debt , (ii) a strong bias towards asset-backed corporate loans and risk-free public debt, and (iii) banks' internal portfolio preferences. To help address this gap, the SBP has issued guidelines on infrastructure project financing, and developed proposals for an infrastructure financing veh
Impact	

Project Outcome

Description of Outcome	
Progress Toward Outcome	Two International Consultants and one national consultant hired.
Implementation Progress	
Description of Project Outputs	
Status of Implementation Progress (Outputs, Activities, and Issues)	Five consultants were hired for the assignment, which included very senior bankers, one of whom was a former governor of SBP. The team of consultants met all the important stakeholders including domestic and international banks, mutual funds, capital market companies, housing finance company, stock exchanges, Pakistan Mercantile Exchange, private equity funds, leading corporate conglomerates, SBP and SECP. During the process, consultants identified major constraints of the financial sector which are impeding the deepening of financial sector intermediation and access to finance. It was assessed that access for infrastructure finance, SMEs, export credit, agriculture financing, financial inclusion at large and housing finance are major gaps. The team noted that DFID, World Bank and IFC are supporting the Government of Pakistan (the government) through SBP and SECP for the development of SMEs, agriculture financing, and financial inclusion. Another major impediment to the development of financial markets is weak public debt management. To address and improve this area, the Ministry of Finance, at the request of the IMF, has agreed to work with the World Bank and DFID. USAID has also allocated around $20 million to support the government in improving its debt management and also to strengthen the private debt capital markets. The consultants have submitted two reports on housing finance and a proposed infrastructure financing vehicle as potential areas for ADB support. For effective interventions on infrastructure financing, it is imperative that the support is aligned with government's initiatives.
Geographical Location	

Summary of Environmental and Social Aspects

Environmental Aspects	
Involuntary Resettlement	
Indigenous Peoples	
Stakeholder Communication, Participation, and Consultation	
During Project Design	The 2014-16 Country Operations Business Plan allocated $0.5 million for a technical assistance grant and a $10 million for a loan from Asian Development Fund resources to support the development of the financial sector and improve public debt management in 2014. In May 2014 an ADB consultation mission met with the government of Pakistan (GOP) and agreed to delink the technical assistance grant from the loan, process the technical assistance grant as a Small-Scale Policy and Advisory Technical Assistance (S-PATA) on a standalone basis and shift the loan to 2015. This change was made in light of considerable grant assistance being offered by a number of donors to support financial sector development and related areas and the need for clarify and prioritize these interventions . A follow-up mission in October 2014 reconfirmed this approach with the Ministry of Finance (MOF), State Bank of Pakistan (SBP), Securities and Exchange Commission of Pakistan (SECP) and selected stakeholders. ADB has a long history of supporting Pakistan's financial sector development through its sovereign and non-sovereign operations. Support for financial sector development is expected to remain a priority in the Country Partnership Strategy (CPS) 2015-19 currently being finalized. The $260 million Financial (Nonbank) Markets and Governance Program in 2002 supported capacity building of the Securities and Exchange Commission of Pakistan (SECP), establishment of regulatory frameworks for money and futures markets, strengthening of disclosure and governance requirements, and establishment of professional standards. The $400 million Second Generation of Capital Market Reform Program in 2007 supported the development of institutional investors to facilitate long-term capital formation, improved the efficiency of securities and strengthened market governance to protect investors. Yet, there is an un-finished agenda as Pakistani financial and capital markets don't adequately respond to the needs of economy. In recent years ADB's involvement in the financial sector through its sovereign operations has been limited as priority was given to energy and transport development, and carried out mainly through its non-sovereign operations to eleven banks participating in the Trade Finance Program as well as Rural Financial Inclusion and Diary Growth project.
During Project Implementation	The Ministry of Finance has since requested ADB assistance to capitalize and operationalize the Pakistan Development Fund Limited (PDFL). PDFL will support the financing of infrastructure projects in Pakistan. Moreover, the SBP has also requested ADB to assist in the operationalization of the recently established Export Import Bank of Pakistan (EXIMBP) to promote financial inclusion for export led growth integration SMEs cluster in the exporters being facilitated. The EXIMBP will support expansion and diversification of the export base of the country by providing short term export credit, medium, long term financing facilities, guarantees, export credit insurance and other supporting services to the exporters. An additional consultants have been hired for this.

Business Opportunities

Consulting Services	The individual consultants will be recruited in accordance with ADB's Guidelines on the Use of Consultants (2013, as amended from time to time). Disbursements under the TA will be made in accordance with ADB's Technical Assistance Disbursement Handbook (2010, as amended from time to time). Indicative Consulting Services Inputs Financial Sector Specialist and Team Leader_ 3.0 months input Financial Sector/Capital Market Specialist_ 3.0 months input Financial Sector/Capital Market Expert-Local_ 4.0 months input Infrastructure Financing Expert-Local 88 WD over a period of seven months Financial & Capital Market Expert-Local 66 WD over a period of seven months Financial Sector/EXIM bank Expert -Intl 40 WD input spread over 5 months

Responsible Staff

Responsible ADB Officer	Ali, Shauzab
Responsible ADB Department	Central and West Asia Department
Responsible ADB Division	Pakistan Resident Mission
Executing Agencies	*Ministry of Finance* *Economic Affairs Div.* *Rm. 308 Block "C" Secretariat Bldg* *Islamabad, Pakistan*

Timetable

Concept Clearance	-
Fact Finding	-
MRM	-
Approval	15 Dec 2014
Last Review Mission	-
Last PDS Update	31 Mar 2017

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Milestones					
Approval	Signing Date	Effectivity Date	Closing		
			Original	Revised	Actual
15 Dec 2014	-	15 Dec 2014	30 Nov 2015	31 Dec 2017	-

Financing Plan/TA Utilization							Cumulative Disbursements	
ADB	Cofinancing	Counterpart				Total	Date	Amount
		Gov	Beneficiaries	Project Sponsor	Others			
225,000.00	0.00	0.00	0.00	0.00	0.00	225,000.00	15 Dec 2014	133,269.38

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