DFIs for Economic Development in Pakistan
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ARTICLE (December 21 2008): Besides high balance of payments deficit, the country is at present facing a number of challenges, such as:

(a) low foreign exchange reserves; (b) impending huge debt servicing; (c) shortfall in power generation capacity, resultantly electricity loadshedding; (d) poor physical infrastructure in terms of ports, railways and roads; (e) heavy dependence on imported industrial raw materials, consumer durables and plant and machinery; (f) fast rising population, urbanisation, poverty and unemployment; (g) deplorable conditions in health and education sector; (h) severe supply gap in housing availability; and (i) lack of properly-funded and functional development financial institutions (DFIs).

To ease foreign exchange availability and reserves situation, the government has already obtained from IMF $7.60 billion stand-by loan (of which $3.10 billion has been already disbursed) while more funds are from the Friends of Pakistan (FOP).

The government is in the process of preparing a dossier on projects for consideration by the FOP. Besides, a number of public sector enterprises, including privatisation of SME Bank etc are under consideration. It is not considered imperative that the plans are first discussed among the stakeholders including the provincial governments and the local DFIs.

Like other developing countries in the region, DFIs were established in Pakistan during l950s and 1960s for fostering economic development with assistance from international Financial Institutions (IFIs) as well as a number of friendly countries particularly, the USA.

These DFIs were major channels for routing development funds to the private manufacturing sector and achieving the desired socio-economic objectives, such as encouraging new entrepreneurs, promoting industries in less developed areas and wider diffusion of industrial ownership.

The DFIs were also assisting the Government in screening new development projects, framing economic development plans or policies, rehabilitating sick or problem projects, administering or supervising special loans provided by the government or foreign institutions and participating in the promotion of other DFIs for achieving related socio-economic objectives.

Besides promoting establishment of import-substitution industries, the DFIs encouraged capital formation by directly investing or underwriting shares and debentures issued by the local companies. They also assisted Pakistani entrepreneurs in obtaining suitable foreign investment, attracting foreign investors in formation of joint ventures with local partners and assisting in obtaining technical / managerial advice for businesses and industries. Many industries were made operational, enormous jobs were created both in the operational and service sectors and the country was on the road to economic and social progress.

In the 1980s and 1990s many DFIs ran into problems stemming basically from poor management, excessive had loans, withdrawal of incentives or resource constraints. The stakeholders did not opt to) get problems of DFIs probed or their functions reoriented to the then prevalent realities with the help of reputed independent experts. Unlike the cases of certain commercial banks, neither there were efforts to inject fresh equity or soft loans into problem DFIs, nor there was a serious attempt to restructure them.

The problem DFIs, under, presumably, a faulty approach, were merged into other DFIs/commercial banks or were liquidated. The Youth Investment Promotion Society (YIPS) was merged into) Regional Development Finance Corporation (RDFC) which in turn was merged into Small Business Finance Corporation (SBFC), subsequently renamed as SME Bank Limited.

PICIC, the premier DFI was merged with NIB Bank. Before that NDFC was merged into NBP and Bankers Equity (BE) liquidated. IDBP and SME Bank - both DFIs holding commercial banking license, are reportedly on the privatisation list.

The people's government is committed to provide jobs to the millions of jobless and poor. Jobs can help reduce poverty and stop migration from interior to the cities. More jobs can be created through promotion of economic activities, particularly in less-developed areas of Balochistan, FATA, Waziristan, NWFP Sindh and the Southern Punjab.

Promotion of agriculture, agro-based industries, export-oriented handicrafts, provision of housing, construction of health and education infrastructure, development of mining and mineral based industries etc can provide jobs besides improving import-exports trade balance.

Implementation of these measures can be facilitated with appropriate financing by the DFIs such as SME Bank, ZTBL, HBFC and IDBP, SME Bank and IDBP, when restructured are considered to have the potential for rejuvenating business and industry at this critical juncture. These need to he taken off the privatisation list.

The task ahead is larger than the capabilities or scope of existing DFIs. Therefore apart from strengthening existing DFIs; the government should look into the proposition of creating new sector-specific DFIs. Malaysia, economically and technologically more advanced than Pakistan, still has operative a number of development finance institutions (DFIs), set up under the Development Financial Institution Act 2002.

DFIA defines a DFI as: "an institution which carries on any activity, whether for profit or otherwise, with or without any Government funding, with the purpose of promoting development in the industrial, agricultural, commercial or other economic sector, including the provision of capital or other credit facility.

For the purposes of this definition, "development" includes the commencement of any new industrial, agricultural, commercial or other economic venture or the expansion or improvement of any such existing venture.

Moreover in Malaysia, the DFIs roles as outlined under the Financial Sector Master Plan (2001-2010) are: (a) develop and promote strategic sectors of the economy and achieve social goals as mandated by the Government; (b) to fill the gaps in the supply of financial services that are not normally provided by banking institutions; and (c) offer value added advisory services and technical assistance supported by strong research capabilities.

DFI's role in changing economic situations in Malaysia is acknowledged for: (a) continued support as financier; (b) assistance for business development; (c) enhance effectiveness of role as implementer of developmental programs; and (d) role to facilitate development. (Source: Presentations in a recent ADFIAP Seminar in Malaysia).

Pakistan, still a low income, developing country, badly needs the services and facilities offered by the DFIs for achieving socio-economic objectives and well-being of the people, particularly in the underdeveloped areas, also on political consideration.

Unlike private institutions or commercial banks that are motivated solely by profit, the public-sector DFIs are tuned to finance socio-economic projects also. Their basic motive is the welfare of the people. In every developing country, as a minimum there are DFIs for financing of Small and Medium Enterprises (SMEs), housing, municipal services, effluent and waste disposal, physical infrastructure and export promotion.

There are DFIs even in. the developed countries eg Germany, Canada, European Union, etc. Growth and stability in a country, like Pakistan, can come through financing by the local DFIs and not through profit-centred activities of the foreign controlled commercial banks, is the view widely held in Pakistan, particularly after the recent debacles in the financial sectors of Europe and USA.

In India, IDBI and ICICI were two premier DFIs at a time when we in Pakistan had DFIs like PICIC and NDFC. Unlike Pakistan, the role of these two institutions have been substantially enlarged over the period. In order to further enforce their role, to supplement their low cost funding sources and enhance their profitability they were granted licenses for commercial banking business.

Both the institutions were restructured to keep them in line with changing market conditions. IDBI Bank and ICICI Bank are profitably financing infrastructure and other development projects in India whereas we have allowed PICIC and NDFC to whither away.

In this context, we may also borrow a leaf from the history of the World Bank, which has been restructured many times over the years. Conceived during World War II at Bretton Woods, New Hampshire, the World Bank initially helped rebuild Europe after the war. Its first loan of $250 million was to France in 1947 for post-war reconstruction.

Reconstruction has remained an important focus of the Bank's work - given the natural disasters, humanitarian emergencies, and post-conflict rehabilitation needs that affect developing and transition economies. The Bank borrows at low cost and offers clients good borrowing terms.

Today it has sharpened its focus on poverty reduction in middle-income and creditworthy poorer countries by promoting sustainable development through loans, guarantees, risk management products, and analytical and advisory services.

The World Bank today has a multidisciplinary and diverse staff, including economists, public policy experts, sectoral experts, and social scientists. Forty percent of staff is now based in its country offices. The Bank has become a Financial Sector Group, encompassing five closely associated development institutions: the IBRD, the IDA, the IFC, the MIGA, and the ICSID. (Source World Bank's web site)

With new developments, new areas of interest are appearing on the economic scene. For profitable exploitation of which the country needs services and support from the DFIs, which may also be encouraged to adapt to face the emerging situations. Effluent disposal and solid waste management are assuming importance for health and export exigencies and such projects may be financed on priority basis.

It may be appreciated that the DFIs in Pakistan are relevant for financing such projects. These DFIs are badly needed at least until the country is dependent on the IFIs for finances, technical assistance and advice on its various socio-economic development projects.

The local DFIs would be catering the requirements of relatively smaller customers or projects for finances and technical services now provided by the IFIs to the government-sponsored large projects or institutions. DFIs would also be needed for the specialised 'think tanks' offering suggestions to the government on different policy issues and options. As such, the government may reactivate its policy of economic development through promotion and funding of local DFIs.

Long Term Credit Fund (LTCF), established by the Government for financing private sector power generation projects, for the last many years has remained, almost dormant as for as financing of new power generation capacity is concerned although throughout this period the country has suffered power shortages and has been seen no increase in power generation capacity.

LTCF, originally known as Private Sector Energy Development Fund (PSEDF), was administered by NDFC on behalf of the government. It has played an important role in promotion of Independent Power Producers (IPPs) - such as Hub Power project in the private sector in Pakistan.

LTFC now administered by NBP, with suitable revamp and upgrading, has the potential to play a much bigger role for the establishment of additional power generation capacity and infrastructure projects in the country, through finances mobilised locally as well as foreign credit lines from friendly foreign countries and IFIs.

Infrastructure and municipal projects need specialised DFIs as the existing financial sector (with the exception of LTCF) generally lacks the expertise to appraise, finance and monitor such projects. The LTCF, can play a decisive role in overcoming power shortages, may be allowed full service commercial banking licence with a view to facilitate mobilisation of local savings and thus have the flexibility for sustaining ifs operations without support from the Government.

Economic growth and stabilisation with a human face is possible only through local DFIs, which need to he nurtured. In the past, the DFIs had played substantial role along with the commercial banks' in the consortia for project financing. Once the local DFIs are strengthened, they can play even bigger role in the financing of large infrastructure projects.

There is talk of relocation of existing industries away from the cities and built up areas. In the corning days when the provincial governments are better aware of environment pollution problems due to industries operating within populated areas The movement is expected to) gain momentum. The DFIs only would be able to satisfactorily handle the industrial relocation process as well as the setting up and financing of effluent treatment plants in various parts of the country.

Food security is of tremendous importance for a country. Development of agriculture on modern lines cannot only help achieve food self-sufficiency but also) yield exportable surplus to eat-n foreign exchange. The operations of ZTBL (earlier ADBP) thus need to be strengthened.

In Pakistan, large infrastructure or other socio-economic projects are financed by the IFIs like the World Bank, ADB, IFC or the Islamic Development Bank. Properly revamped local DFIs may appropriately collaborate with the IFIs in financing as well as monitoring of such projects or program.

Moreover, relatively smaller projects in these very sectors are presently not catered by the IFI by way of technical assistance or loan funds. This gap in tile provision of technical advice, research studies and financial Support could easily he filled by the local DFIs.

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