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The ODA Loan to Banking Sector Adjustment Programin Pakistan

The OECF (the Overseas Economic Cooperation Fund, Japan : President, Chairman of the Board, Akira Nishigaki) is providing the Islamic Republic of Pakistan with a loan for the Banking Sector Adjustment Program amounting to 32,030 million yen.
The related Loan Agreement was signed today at the Economic Affairs Division in Islamabad, Pakistan by Mr. Ikuro Sato, Chief Representative, Islamabad Office, and Mr. Aftab Ahmad Khan, Secretary, Economic Affairs Division, Government of Pakistan.
The cumulative total of ODA loan commitments to Pakistan stands at 644.66 billion yen for 68 commitments.
The amount and conditions of the loan, with a description of the program, are as follows.

1. Loan Amount and Conditions

Project	Amount (Mil. Yen)	Interest Rate (% p.a.)	Repayment Period /Grace Period (years)	Tying Status
Banking Sector Adjustment Program	32,030	1.8	30(10)	General-Untied

2. Outline of the Program

Banking Sector Adjustment Program

(1) Economic Situation in Pakistan

Pakistan's economy is heavily dependent on agricultural sector, which account for approximately 27 % of GDP and 50% of total employment. As a result, Pakistan has a typical trade pattern in which primary agricultural products and cotton based manufactured products, usually low value added, are exported, and, in return fossil fuels and industrial commodities are imported.
Despite temporary improvement, external current account has been consistently negative for these years, and this trade imbalance has been compensated by capital transfers from foreign countries and remittances from overseas Pakistani workers.
Most recently, foreign reserve declined to approximately US$500 million (equivalent for 2 weeks of imports) at the end of 1996, and recovered and stood at about US$1,000 million to 1,500 million after then due to depression of the whole Pakistani economy and the decline of foreign private investment. Although the former government of Mrs. Benajir Bhutto eagerly pursued structural adjustment programs, including privatization of some state owned companies and restructuring of budgetary expenditures, weak revenue collection and poor export performance resulted in the expansion of fiscal and current account deficits, mainly because frequent floods have brought a serious damage on agricultural output. Failure in economic policies of the government as well as continuous terrorism triggered anti-government movement. On November, 1996, the President Leghari removed the Prime Minister from her position and a caretaker cabinet was organized. As a result of the general election called on February, 1997, Mr. Nawaz Sharif returned to the power since 1993.
The new government announced "the Prime Minister's Economic Revival Programme" in order to realize sustainable economic development through restraint of inflation, decrease of budgetary and current account deficit and promotion of the domestic industries. Many multinational and bilateral organizations are supporting to the new government's policies, for example International Monetary Fund's ESAF/EFF Program, the World Bank's Banking Sector Adjustment Loan and Asian Development Bank's Capital Market Development Program Loan.

(2) Background of the Program

The Banks Nationalization Act was enacted in 1974 to nationalize all financial institutions in Pakistan. After 1990, some of the nationalized commercial banks (NCBs) and development finance institutions have been partially privatized. However, the largest three NCBs, Habib Bank Limited, United Bank Limited and National Bank of Pakistan, which account for about 60 percent of all loans and deposits in Pakistan, have remained completely state owned. The oligopolistic banking market structure together with regulation of interest rate, huge overstuffing and inefficient branch network, political interference upon determination of providing loans and insufficient capability for credit approvals have resulted in Rs 128 billion non-performing loans (or 4 percent of GDP) as of June 1997.
The State Bank of Pakistan (SBP), the central bank of Pakistan, does not have enough qualified staffs to conduct appropriate on-site and off-site audit on financial institutions. So far guidelines for disclosure of financial information, capital adequacy of BIS standard and loan loss provisions based on the international accounting standards, have not been sufficiently adopted in Pakistan. As a result, the trust on Pakistani Rupee and financial institutions have not been improved. In fact, its national savings ratio sharply deteriorated from 15.8 percent in 93/94 to 11.8 percent in 96/97, ending in restriction of national investments and increase of eternal current account deficit. At the same time, mandatory and concessional credit scheme used by the government through state owned financial institutions, resulted in huge budgetary deficit, double digit inflation and crowded out private sectors.

(3)Purpose and Outline of the Program

This structural adjustment loan is co-financed with the International Bank of Reconstruction and Development. One of the purposes of this program is macro-economic stabilization through balance of payment support. Another is to support the current government's efforts to reform the banking sector more efficient.
The program consists of: i) preventing further increase of bad loans, ii) recovery of non-performing loans through the "Incentive Scheme," invented by the SBP, iii) retrenchment of surplus staffs through "Golden Handshake Scheme" and closure of over-existing branches, iv) preparation of privatizing three NCBs and two development financial institutions, v) introduction of international accounting standards and strengthening prudential regulations, vi) establishment of banking courts for enhancement of solution of disputes related to non-performing loans through legal procedures. These measures are to be accomplished or already accomplished. The loan will be disbursed for expenditures made for purchases of eligible imported goods and services. Both Japanese and Pakistani government agreed that the counterpart fund, generated by the loan, shall be used to cover local currency requirement of high priority projects, mainly in social sector.