Development Finance Institution

Webinar

Brief 33:2021

Pakistan Instituteof
Development Economics

PAKISTAN INSTITUTE
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ECONOMICS

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DEVELOPMENT FINANCE INSTITUTION

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Moderator
Nadeem ul Haque
VC, PIDE

PIDE and **Al-Aman Holding (Pvt) Limited**, have collaborated to conduct a series of webinar on issues surrounding the Public Sector Enterprises. This is the second webinar of the current series and will be focusing on the Development Financial Institutions.

Development Financial Institutions (DFIs), are institutions that aim to provide risk capital primarily for economic development projects. DFIs were first established in the mid-20th century. They could be in various forms, such as multilateral development banks, national development banks, bilateral development banks, microfinance institutions and development financial institutions and those for specific areas i.e. house building and agriculture etc. The financing focus of DFIs could be extremely diverse as well, from one focusing on funding development of low-income areas to large-scale projects. They play a pivotal role, especially in developing countries, in boosting industrialization processes during the early stages of economic development. In Pakistan, DFIs were playing an essential part in establishing an industrial base in pre-nationalization period. In the post-nationalization era, however, the DFIs have not been able to fully exploit their potentials and their impact has remined much lower than expected.

There is a great room to expand the DFI industry in Pakistan as the existing financial support available for high-risk development activities in Pakistan is on a lower level. This, hence, is also acting as a barrier to growth as well. To support development and growth in the country, it is important that government facilitate the establishment and working of DFIs as they can help create the industrialization eco-system that will eventually prove to be the driver of growth for Pakistan.

SPEAKERS

Saleem Raza
Former Governor
State Bank

Afaq Tiwana
Agro- based
Industry Expert

Ayesha Aziz
Pak-Brunei
Investment

Istaqbal Mehdi
CEO/ Chairman
AHL

Commentators

Tasneem Norani
Former CEO of
various SOEs

Skinder Khan
Chairman Millat
Tractor Limited

Link to Join Webinar

URL: **https://bit.ly/2Pwskh3**
Meeting ID: **986 3023 1695** Passcode: **381153**

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Key Messages

- Pakistan has given up the kind of planning that is necessary to get the optimal growth that the economy needs to be on a sustainable growth path. Over the last thirty years, Pakistan has managed to achieve a growth of 4 % while investment remained below 15% except in 2005 -2006 where it reached 20% of GDP.

- Historically, joint ventures were meant to identify profit-earning industries and enterprises in host countries. Besides, these joint ventures are also meant to get maximum returns by utilizing the resources and comparative advantage of both countries.

- In Pakistan, approximately 60-80% of economic activities take place in the agriculture sector and the labor employed in agriculture-related SME's remains outside the sphere of commercial banking. Furthermore, it is crucial to recognize that nearly ***80 percent of the population has insufficient access to sustainable finance or no access at all***. Therefore, it is important to provide an impetus for integrating the economy by bringing a large underserved population into the pyramid of development through development finance.

- ***Pakistan has an unusual banking system*** among the leading emerging markets with a predominantly private sector owned commercial banking system. Compared with the growth trajectory of Japan, during its growth phase instead of privatizing banks, they were allocated to particular conglomerates. Similarly, Germany has 55% public banking which finances SMEs, agriculture, and development. Many emerging economies such as China and India have government-owned banking systems with 74% and 94 % share respectively. There is evidence from other countries such as Brazil and Turkey where development finance banks are publicly owned, and they fund development projects.

- ***In Pakistan, there is a lack of coordination between the economy and finance institutions*** creating a huge financial gap. Also, there are no financial institutions to finance small farmers, SMEs, or any other profitable project. It is a common practice around the world that the government steps in to improve market efficiency where the private sector cannot intervene due to its obligations to stakeholders. Although commercial banks provide short-term finances to agriculture and SMEs what is needed for long-term asset creation is advice, direction, and technology. The government seriously needs to tackle the market failure in Pakistan.

- ***There is market failure in development finance*** and the role of commercial banks is marginal because they are not fully developed finance institutions. The role of government is crucial and without its support, Pakistan is not going to get the kind of institutions that can lead the track of development. Financial institutions can develop either by building and capitalizing existing commercial banks or merging some of the leading banks and make a development finance institution.

- ***The history of Development Finance Institutions (DFIs) has remained quite ambiguous*** throughout history. We cannot have a credible public bank system considering the current exploitations of institutions for political purposes. Therefore, the prevailing situation in Pakistan can be referred to as government failure rather than market failure.

- ***In Pakistan, investment banks are usually mistaken for DFIs.*** Investment banks are well-capitalized, but they are structured and regulated in a way that they have no recourse to long-term finances. These entities are not banking therefore, they should not be regulated like banks, and allow them to invest in joint ventures and long-term financing to perform better. These entities are not doing investment banking because they are structured, monitored, and regulated as banks by the State Bank of Pakistan and are restricted to do lending. If the regulatory framework is changed, allowing these companies to invest in operating leases and capital ventures then these can perform better.

- Multilaterals companies are interested in investing in agriculture and related enterprises but there is growing skepticism about the capacity of the public sector to take on and execute these projects. Due to these kinds of ***multilateral DFI mismanagement*** in the public sector, the farmer feels the need to strengthen the private sector as a service provider. A successful partnership is ongoing with HBL to develop service providers for the agriculture sector by linking them directly and eliminating the role of the informal sector as middlemen. The role of the informal sector as middlemen is very strong in the agriculture sector on both ends, supply of seeds and pesticides to farmers and buying from the farmer.

- In Pakistan, ***a new entrepreneur has almost no or significantly lower chances of entering*** the industrial sector or initiating an industrial project except few established families. There is no industrialization because a genuine entrepreneur who is willing to initiate a project and make profits is excluded. After all, commercial banks are not ready to finance such projects. Commercial banks are making easy money by lending to the government.

- DFIs are drivers of industrialization therefore, ***the presence of state-owned DFIs is essential for growing economies***. In Pakistan arm's the length between state-owned enterprises and the core government is not good. Pakistan needs to find viable solutions to save or insulate DFIs from political exploitation as chances of corruption are higher when money is involved.

- Joint ventures like Pak-Brunei are interested in investing in agriculture infrastructures such as warehouses or operating leases in Pakistan. All we need is to give some attention and make some arrangements with these DFIs for a particular capital venture. For instance, Pak -Brunei experimented with a few dead projects and attempted to revive them. Under the SECP framework, specialized vehicles for private equity can be set up for agro-finance, leasing, and SMEs because SECP has an area that allows for private equity.

- ***Finance is not important in setting your industries, rather finance follows ideas.*** We are devoid of ideas and that model was set up in the 60s, giving cheap credit and protecting those industries. NBFC and IDBP left the government with bad debt.
- The role of finance in promoting development is undeniable, therefore we have to alter the philosophy of public sector management. Development is a legitimate task that the market alone will not take for a variety of reasons. To promote development, ***there is a need for coordination between the government and the market.*** The framework of law and justice has never been established, and the infrastructure of government is not available for markets to function well. We need to devise a solution by looking at the problems and realities of our home instead of comparing with others.

- We can only have credible DFIs if the boards of DFIs are autonomous and spirited enough to make decisions without the influence of politics and politicians. Usually, the presence of MNCs and other foreign institutions onboard enables them to keep their distance from political exploitation and protect the interest of DFIs.

- Those development years of Pakistan were formative years despite rent-seeking DFIs were able to drive growth through industrialization. A system was in place and the economy was working better because of better bureaucracy. We can see the evidence of ZTBL which turned into a ghost institution. The public sector has entangled itself in political dominance, accountability, and media trials. ***Pakistan is in a strange era where the government or opposition are politicizing institutions*** and it is not helping to improve the status of the countries.

Prepared by
Nazia Hassan
PhD Scholar, PIDE

Edited by
Hafsa Hina

Design by
Afzal Balti

www.pide.org.pk
policy@pide.org.pk.
92-51-924 8051
92-51-942 8065