



1. Project Data :
OEDID: L4257
Project ID: P049448
Project Name: Banking Sector Adjustment Loan
Country: Pakistan
Sector: Financial Adjustment
L/C Number: L4257
Partners involved : OECF
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2. Project Objectives, Financing, Costs and Components :
The BSAL was a single tranche operation of US\$ 250 million, approved in December 1997. The main objectives were to support short-term reforms in the banking sector designed to: arrest the flow of bad loans, curtail loss-making, and restore liquidity to the public sector banks (commercial and development); improve prudential regulations and disclosure requirements of banks; remove market segmentation to increase the efficiency of financial intermediation; and strengthen the legal and judicial processes. These objectives were seen as necessary precursors to a medium term reform program that aims to improve governance through privatization, strengthen banking supervision, and improve the legal and judicial system for loan recovery.

3. Achievement of Relevant Objectives :
The short term objectives were achieved. The measures taken to stem the flow of bad loans and increase loan recovery were effective; new managers recruited from the private sector were installed in the public commercial banks with a mandate to prepare them for privatization; significant downsizing has occurred; new prudential regulations consistent with international norms were announced. Some measures were taken to reduce market segmentation; and several laws were passed or amended and the court system for loan recovery amended to make loan recovery more efficient.

4. Significant Achievements :
The reforms being carried out in the banking sector stand out as being particularly ambitious. The wholesale replacement of the management with qualified, experienced nationals from the outside may be the single most important part of the reforms. The banks have already shed a significant amount of staff and recovered some of the bad loans, which are notable achievements; if the banks continue to be streamlined and strengthened and ultimately privatized, the reform program will have been truly outstanding.

5. Significant Shortcomings :
In terms of implementation, the one area that appears to have the weakest commitment by Government is removing market segmentation: the Government took no measures as of the writing of the ICR to reduce the effective interest rates on the NSS; it only stated a commitment to do so; although mandatory liquidity reserve requirements have been reduced, it is not clear why they should remain even as high as 15%; and the reductions in the special credit schemes had all occurred prior to the appraisal of the BSAL, so there seems to be no incremental measures taken.

In terms of loan design, the one weakness of the BSAL is the absence of monitoring indicators. The BSAL is supposed to be one in a series of single tranche operations, so it would have been useful and appropriate to put in place indicators by which the results of the reforms could be measured. For example, on increasing financial sector efficiency by decreasing segmentation, a number of measures (such as spreads) could be used to monitor over time whether the reforms undertaken are having the desired effect. Similarly for the new prudential regulations, it would have been useful to establish baseline figures against which progress could have been tracked on the banks' compliance with the regulations, recognizing that full compliance would take a number of years. On improving the legal framework for loan recoveries, indicators could have been proposed for measuring whether the efficiency (in terms of time and cost to the banks) of loan recoveries through the court system was showing any discernible

progress over time. This would have shown a serious interest in results .

6. Ratings :	ICR	OED Review	Reason for Disagreement /Comments
Outcome :	Highly Satisfactory	Highly Satisfactory	
Institutional Dev .:	Substantial	Substantial	
Sustainability :	Likely	Uncertain	As the ICR notes, sustainability of reforms will depend on the Government's willingness to take difficult decisions and bold actions; on substantial external financing; and on other exogenous factors, such as internal political animosities, that could derail the process .
Bank Performance :	Highly Satisfactory	Satisfactory	Absence of M+E indicators (see para. 5)
Borrower Perf .:	Highly Satisfactory	Highly Satisfactory	
Quality of ICR :		Satisfactory	

7. Lessons of Broad Applicability :

The ES agrees with the ICR that full government ownership is critical to success, that dealing with the underlying governance and corruption issues is a bold and necessary approach to addressing the root causes of problems in the financial sector, and that sequencing reforms is important .

8. Audit Recommended? Yes No

9. Comments on Quality of ICR :

The ICR is satisfactory; it gives a good account of the problems confronting the banking sector and the measures taken by the Government to address them; and it is clearly written . But the ICR would have benefited from providing clarification of what the conditions were for this loan . Reference was made in several places to conditions of Board presentation, but they are not described anywhere . In addition, most of the reforms mentioned had been put in place or were underway at the time of appraisal of the BSAL in May 97; it is not clear whether or not the Bank was providing support for additional reforms or for past reforms . A description of Board conditions could have clarified this point. In addition, it would have been useful for readers to understand the unusual loan acceleration clause, which is mentioned several times, but never explained . Finally, the ICR mentions in passing (para. 48) that the loan was co-financed by Japan's OECF, but there is no information on the amount or timing of this co -financing.