ICR Review
Operations Evaluation Department

Report Number : ICRR11471

1. Project Data:		Date Posted :	03/25/2003	
PROJ ID :	P010470		Appraisal	Actual
Project Name :	Financial Sector Deepening And Intermediation Project (FSDIP)	Project Costs (US$M)	1016	18.9
Country :	Pakistan	Loan/Credit (US$M)	216	18.9
Sector(s):	Board: FSP - Banking (98%), Law and justice (2%)	Cofinancing (US$M)	800	
L/C Number :	L3808			
		Board Approval (FY)		95
Partners involved :	ADB, Participating banks, sub-project sponsors	Closing Date	12/31/1999	06/30/2002

Prepared by :	Reviewed by :	Group Manager :	Group :	
S. Ramachandran	Alice C. Galenson	Kyle Peters	OEDCR	

2. Project Objectives and Components

a. Objectives

The Financial Sector Deepening and Intermediation Project (FSDIP), prepared in 18 months and approved in 1994 (FY95), was to support reforms begun under the 1989 Financial Sector Adjustment Loan. The FSDIP's initial objectives were to (1) support the private sector by providing non-subsidized resources for investments, (2) deepen the financial system, (3) promote new financial instruments and (4) strengthen the State Bank of Pakistan (SBP, the central bank) and other financial institutions (FI).

The FSDIP sought to do this by (1) strengthening the regulatory framework for FIs through improved procedures, monitoring and enforcement; (2) improving the legal framework for loan recovery; (3) strengthening banking and non-bank institutions; (4) reducing concessional finance extended by the SBP; (5) developing a private market in foreign exchange cover; (6) improving the management of monetary instruments and eliminating inter-sectoral and inter-institutional distortions; (7) strengthening of the payments system; (8) enhancing the capacity of regulatory institutions of the securities and insurance markets; and (9) privatizing, restructuring and institutional development of banks, development finance institutions and insurance companies.

The project encountered problems during the first two years and the objectives were revised. The $200m credit component was cancelled in three stages (with the final cancellation in December 1998) and the FSDIP was restructured into a technical assistance (TA) project to (1) strengthen the regulatory framework for banks and non-banks to improve procedures and enforcement including foreign exchange operations; (2) strengthen and improve the process for privatizing financial institutions and (3) improve the regulation of securities and insurance markets. These revisions made the FSDIP consistent with the reform agenda that the Banking Sector Adjustment Loan (BSAL), approved in 1997 for $250m, supported.

b. Components

The FSDIP originally had two components: (1) a $200 m line of credit for long term investment projects through eligible banks and (2) a $16 m TA component for (a) improving SBP's operating systems and regulatory functions (b) institutional building of the Corporate Law Authority and Controllers of Insurance; (c) establishing an administrative unit for Bankers' Equity Limited and implement various studies and enforce environmental standards; and (d) for the Privatization Commission to restructure and prepare several FIs for privatization and valuation of the State Life Insurance Companies.

The revised components focused the project on technical assistance for (a) and (d).

The project lists many areas needing improvement, and viewed the banking problems as the lack of technical abilities (that TA could remedy) rather than of incentives. The 1997 BSAL appears to have changed the approach to emphasizing bank privatization, and the TA was directed mainly to the SBP. Even so, some components (like automating the central bank's library) appear peripheral to the main issues in the banking system.

c. Comments on Project Cost, Financing and Dates

The project was approved shortly after the Fund ESAF (Pakistan has many aborted Fund programs). The $200 m credit line was poorly justified (not just poorly designed as the ICR states) and its subsequent cancellation in 1998 was appropriate. The TA was augmented to $28 m; but although the project was extended by two years, only $ 18.9 m was utilized (the ICR ascribes this to post-Sep.11 effects, although the borrower's comments suggest Bank delays in approval). The Asian Development Bank pulled out of the cofinancing arrangement for the FSDIP and approved a separate $125m loan for capital market development and funded the related technical assistance .

3. Achievement of Relevant Objectives:

As few of the project objectives were quantified, their achievements cannot be measured . It does appear, however, that the FSDIP helped improve SBP's capabilities (organization, automation etc.). SBP's greater legal independence, supported by the FSDIP and other policy loans, is an improvement that remains untested .

The ICR lists many improvements including: (1) improved SBP's capacity as regulator, raising the minimum capital required of banks and liberalizing the opening of branches; (2) the promulgation of a Privatization Law and the preparation of banks for sale (although the ICR states that the process has been slow); and (3) improvements in the regulation of non-bank institutions.

4. Significant Outcomes/Impacts:

Pakistan's banks and the SBP seem to have improved, but the BSAL ICR suggests that the gains came from restoring incentives in banks by their privatization . The FSDIP, especially after the objectives and components were revised in 1998, supported these policy reforms.

5. Significant Shortcomings (including non-compliance with safeguard policies):

The Bank deemed the original project unsatisfactory (QAG did not exist at the time) soon after it was approved. The credit component did not disburse because the sub-borrowers were averse to bearing the exchange risk and few banks were deemed eligible because their large non-performing loans had wiped out much of their equity.

The credit line was subsequently cancelled, and these shortcomings became moot .

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Moderately Satisfactory	The FSDIP contributed to the improvements in the sector because it was amended to reinforce the policy reforms that were supported by the later BSAL. The FSDIP was poorly designed at the outset, and the amendments only partially corrected this. Some components, however, addressed peripheral issues.
Institutional Dev .:	Substantial	Modest	While the SBP's technical abilities have improved, its independence from the government and enforcement of its regulations are more important. While the law now allows such independence, it is not clear whether these will be enforced when needed.
Sustainability :	Highly Likely	Likely	The current SBP governor is likely to ensure that the improvements continue, but this could change with a new governor; so the highly likely rating may be unwarranted.
Bank Performance :	Satisfactory	Satisfactory	
Borrower Perf .:	Satisfactory	Satisfactory	
Quality of ICR :		Satisfactory	

NOTE: ICR rating values flagged with ' * ' don't comply with OP/BP 13.55, but are listed for completeness.

7. Lessons of Broad Applicability:

1. Loans (credit lines) to banks are not an effective inducement to reform . The cancellation of the project's credit line and the privatization (supported by the subsequent BSAL) led to improvements that were vainly sought through the FSDIP and earlier projects.

2. The limitations that TA could remedy, while undoubtedly prevalent, are often the excuse but rarely the impediment to policy reform, especially in countries like Pakistan which has excellent commercial bankers . Any skills that the central bank lacks could have been purchased domestically (with revenues from seigniorage). The ICR of the BSAL emphasized the importance of "political will" to reform, not technical capabilities.

8. Assessment Recommended? ● Yes ○ No

Why? Pakistan's banking reforms have long been in coming despite extended Bank support (the 1989 FSAL, a later BSAL etc.). This project should be audited as one of the cluster of loans to the sector, each of which appears to have had a different approach.

9. Comments on Quality of ICR:

The ICR adequately described the project's implementation and the difficulties encountered, but the rather sanguine ratings suggest that the vulnerability of the gains to individuals rather than to institutions were not adequately considered.