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END OF CONTRACT REPORT

February 1994

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DEVELOPMENT: Where do we go from here?

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I. SUMMARY

Project Overview.
I've enjoyed serving as the principal technical advisor to the Government of Pakistan (GOP) for the development of a market-oriented housing finance system, under the Shelter Resource Mobilization Program (USAID Project Nos. 391-HG-001 and 391-0507). I have worked directly with private sector housing finance companies to assist them in starting their operations and becoming viable housing finance institutions. There are two such companies operating currently with a third due to commence operations on March 15, 1994. I have also worked closely with the GOP Ministry of Finance and State Bank of Pakistan to help define public and private sector roles, procedures, and regulatory and supervisory mechanisms.

My major activity has been the continuing analysis of the critical bottlenecks in the way of the development of a healthy housing finance industry in Pakistan. I supervised studies of the financial system in Pakistan - one on Capital Markets and the other a general study of Commercial Banks and their appropriate role in housing finance. I worked closely with the SRMP Chief Technical Advisor to develop our overall Action Plan and modify it from time to time as changing circumstances warranted. I pulled the seven housing finance applicants together into a group for discussion of mutual problems and concerns. Over time the group has become more formal and has recently organized itself into a Trade Group. It will later become a Trade Association once it has seven licensed members in the group. We have held four national seminars on problems surrounding the development of a housing finance industry. I contributed major portions of the reports produced by the SRMP and served as the Keynote speaker at the last seminar on Urban Development and Land Policy in Pakistan. I have worked closely with individual HFC's to help them get through the licensing process; get their operational problems solved and to begin to develop a standard MIS system for mortgage lending application, disbursement and recovery.

My work has also required direct and continuous contact with the State Bank of Pakistan and the Ministry of Finance to assist in the resolution of problems that have arisen from time to time at the Ministry and to discuss the regulatory and supervisory framework being put in place at the State Bank to monitor and regulate the housing finance industry. I have also worked extensively with the Association of Builders and Developers (ABAD) in Karachi to better understand the problems of the building industry in Pakistan and how those problems relate to housing finance. I have written several papers on this subject which can be found in the SRMP document library.

There are still many bottlenecks remaining. Land transfer is still very expensive in Pakistan and is avoided by most people creating a monumental mess in the land records system. The urban land development process does not work well in Pakistan. The government dominates the development process and is the major developer of serviced plots in most urban areas. This has been a major constraint on the development of private sector housing in Pakistan. We still need to provide access to lower cost capital if the housing finance industry is to prosper in Pakistan. Presently it costs 20 to 22% for a home mortgage loan. Transaction costs add another 20%. This has limited the market to upper middle class and wealthy families. We have gotten State Bank of Pakistan to agree to operate a "refinance Window" at State Bank which should help the new HFC's recapitalize and if structured properly could also bring down the cost of funds by 2 or 3%. Generally the problems are larger than the housing sector and cannot be addressed in that limited context. Below I have tried to outline my views on how multi national agencies should approach development in third world countries.

Where do we go from here?

USAID, World Bank, Asian Development Bank and other major donor supported urban development in the 1970's concentrated on sites and services projects. These provided physical development on a small scale but were not replicable because policy reform and institution building were not addressed in a coordinated fashion. According to World Bank's lastest Urban Policy Report, the same thing happened with municipal development projects and housing finance programs in the 1980's. The lesson learned is that programs that do not provide sustainable policy reform and institutional development limit their impact to a few people directly affected by the projects. Without reform of the development structure itself real growth and development cannot be sustained.

In Pakistan there has not been a clear understanding of the macroeconomic impacts of development at the national level. There are a dozen federal agencies involved in development regulation but they seldom talk to each other. National policy needs to cut across functional lines of authority and provide a coordinated framework for land use and transportation development. At the regional and municipal level there has been even less coordination of development activities across functional lines which would allow for the systematic improvement of the urban environment. And no one has seriously addressed how this lack of coordination at all levels of government has adversely impacted the national macroeconomy.

The new Benazir Bhutto government is proposing 118 new District Governments in Pakistan. No one has said if these new institutions will replace existing Cantonment Boards, Municipal Corporations and Development Authorities or if they will be another layer of government on top of the existing layers. What authority will the new Districts have to raise their own revenue? What will be of composition of their policy bodies? Will the policy body be elected? What term will it serve? How will the new government interface with the existing District Commissioner system? It seems clear that the Government of Pakistan will need a great deal of technical assistance to help answers these and many other questions which will arise from this new initiative. I personally would like to be involved in such an effort.

In a speech I gave recently (attached) at a national seminar on Urban Policy questions in Pakistan I suggested the need for a strong autonomous municipal or local district body with powers to control land use and transportation development. Critical to the success of this body will be its ability to raise its own revenues and to have final authority over functional agencies involved in development such as WAPDA, KESC, CDA, KDA, Cantonment Boards, Municipal Corporations, etc.. If structured properly the Benazir Bhutto initiative on District Government bodies could provide the vehicle to stimulate, control and coordinate development at the local level.

With an elected policy body this new District Government would be directly responsible to the people who elects it. Accountability and real decision making powers are the keys to the success of such a new government body. However, if it is to be just another layer of local government with a small amount of money to distribute among its elected members it will further complicate the existing process which does not work.

As the USAID Housing Finance Advisor to the Government of Pakistan, I have tried to take a macro approach to the development of a housing finance industry in Pakistan. This approach has focused primarily on policy reform and institution building. With a small $4 million program grant from USAID Mission in Pakistan we have been able to provide hands-on resident advisor technical assistance to the government and the emerging housing finance companies. An additional $40 million in U.S. Housing Guarantee Loan funding has been used to leverage policy reform at the national level. In addition, we have worked to strengthen capital markets; encouraged the privatization of commercial banks; developed recommendations for strengthening the stock exchanges in Pakistan; and, assisted the State Bank in strengthening its regulatory and supervisory capabilities.

While we have assisted the Government of Pakistan to create a private sector housing finance industry; from the start we have been aware of the weakness in the municipal infrastructure development process, and the difficulties in delivering land and housing in the urban centers in an efficient and cost effective manner. Urban centers without centralized authority over land use and transportation development will continue to suffer from poorly planned and poorly regulated housing development.

Housing is not the central issue. Making urban centers efficient and productive is what needs to be pursued. Jobs and education for the urban poor along with removal of constraints on private sector development will be keys to the success of future urban development programs. Unfortunately, the Asian Development and World Bank continue to focus their efforts on physical projects and leave the technical assistance portion of their loans to the discretion of the borrowing nation. Most countries want to put all of their loan money into projects and technical assistance suffers. It is the resident technical person who is needed to promote and push the implementation of policy and institutional reforms. Asian Development Bank and World Bank need to insist that a portion of their loans go to technical assistance so that the problems of policy and institutional reform can be addressed head on.

mnm Th0ere also must be a better understanding and functioning of the country's financial sector as a whole. Ad hocism must stop. For example, government offering high yield, income tax and zakat free profit for savings deposits creates disintermediation for the commercial banking system. At the same time government borrowing and directed credit does not allow the commercial banking system to meet the credit needs of the private sector. Macro financial sector policy must be coordinated and its impacts understood. Taking away the authority of the State Bank to regulate the financial sector, constrain monetary expansion, and cap provincial government deficit spending is a very bad signal coming from the new Benazir Bhutto government. Financial stability is of prime importance if foreign investment is to grow and help stimulate the economy. A strong State Bank is needed to resist political pressures from politicians more interested in their own futures than that of their country.

Policy reform is needed at all levels of government in Pakistan. Institutional reform is most needed at the municipal or metropolitan level. Municipal institutions with authority to coordinate actions of a multitude of functional development agencies and their programs must be created. Municipal elected officials closest to the problems of the people they represent need the power and financial resources to be responsive to their peoples needs. Unfortunately, you cannot build strong institutions at the municipal level, controlled by local elected officials, without somehow eliminating the massive elements of corruption present in the current governance system.

By the year 2000 most people in less developed countries will live in urban centers. As a result urban centers will be creating the majority of GDP in goods and services. Making urban centers productive and efficient is the key to better living standards and health for the urban poor. The macro approach to development issues that addresses weaknesses in the structural framework through both policy and institutional reform is the right approach. But I'm afraid the World Bank Urban Policy falls short and will fail as its policies in the 1970's and 1980's have failed. It will fail because it does not address the key problem in policy and institutional reform in developing countries - the problem of corruption.

Corruption sucks the productivity out of the economy of a developing country and produces nothing in return. It stifles growth, it creates substandard development and it kills private enterprise and investment. As long as newspapers in Pakistan openly report disputes between government officials and local contractors over the size of kickbacks on contracts (currently publicly known to be 18%) without punitive action by the legal system - policy reform, institution building and urban initiatives will be no more successful than programs and projects in the 1970's and 1980's. When police can openly take monthly bribes from truck drivers along the highways; when WAPDA workers demand bribes to install a meter; or, when Capitol Development Authority workers refuse to clean a sewer line without a bribe, there is little or no chance for countries like Pakistan to stay even, much less make progress in addressing their growing urban problems.

If eighteen percent of all contracted public development work in Pakistan is skimmed off the top by corrupt government officials how can public sector dominated development add to the positive growth of the economy. Government must remove itself from physical development and at the same time remove the constraints on private sector development which currently restrict the productivity of urban centers in the country.

Recently there have been articles in the local newspapers criticizing the IMF structural adjustment program. The articles ask, "where have such programs worked throughout the world", they then answer the question by saying structural adjustment has not worked in any country to date. If this is true, why has structural adjustment (which Pakistan is currently agreeing to undertake) not worked. Structural adjustment policies at the macro level are intended over the longer term to create an enabling policy environment for more productive urban economies. This new environment is supposed to increase the efficiency of firms and households and support macroeconomic adjustment and stimulate the resumption of economic growth. However, corruption adversely effects the production of goods and services and dampens the climate for investment, savings, resource mobilization, and capital formation in the urban areas. Has anyone considered that the high level of corruption in developing countries may be the root cause of the failure of the IMF structural adjustment programs.

I understand the Ford Foundation is undertaking a major initiative to promote urban research in developing countries. I believe that is an excellent approach and one that can bring substantial benefits from better understand of the impacts of urban level investment on the macroeconomy of a country. The research should take into account the national macro economic impacts as well as the local impacts if it is to result in sustainable improvements in the development structural framework.

Housing finance and urban development are inseparable. The SRMP would need an additional three or four years to be able to affect necessary policy and institutional changes required to provide a sound basis for housing finance in Pakistan. We would need to provide a broad based foundation for all types of urban development not just housing finance. Please reference my Keynote Address at the SRMP National Seminar on "Urban Institutions and Land Policy." Policy reform and institution building are the keys to more efficient and effective urban development in Pakistan and other third world countries. The SRMP has laid the groundwork upon which a broader urban develop effort could be undertaken. Hopefully World Bank and Asian Development Bank will take up the effort and move the agenda forward.

II. JOB DESCRIPTION

What my contract says:

Attachment to Contract No. 391-0507-S-00-2408-00

Scope of Work for Housing Finance Advisor

The Advisor will serve as the principal technical advisor to the Government of Pakistan (GOP) for the development of a market-oriented housing finance system, under the Shelter Resource Mobilization program (USAID Project nos. 391-HG-001 and 391-0507). The technical advisor will work directly with private and joint sector housing finance companies to assist them to start operating and to develop as viable housing finance institutions, and with the GOP to assist with the development of a market-based housing finance system with clearly defined public and private sector roles, procedures and support mechanisms. The advisor will be based in Islamabad and will be expected to travel extensively to cities where housing finance companies are being formed. As appropriate, the advisor may also work with the State Bank of Pakistan (SBP) in regard to the SBP's monitoring and regulating of housing finance companies.

The advisor will work with designated representatives of the Ministry of Finance, particularly the Internal Finance Wing. the advisor will supervise short-term technical assistance, research, and training consultants funded under the Shelter Resource Mobilization Program and advise the GOP. RHUDO/Asia, and USAID/Pakistan on program-related shelter and housing finance technical issues. The advisor will receive overall policy supervision from RHUDO/Asia in coordination with USAID/Pakistan. Day to day supervision of the advisor will be provided by the SRMP Project Officer and the advisor will work in cooperation with the Chief Technical Advisor (Senior Housing Finance Policy Advisor), based in Islamabad.

Specifically, the advisor will:

1. Serve as the principal technical advisor to the GOP to operationalize the SRMP Policy Action Plan. This will include:

    o assisting the Ministry of Finance and other GOP agencies to prepare documents and analyses as needed to implement the Policy Action Plan;

    o monitoring, evaluating, and reporting on the implementation of the Policy Action Plan, and recommending revisions to the plan as necessary.

2. Analyze on a continuing basis the development of Pakistan's housing finance system. Identify critical bottlenecks to the development of the system in terms of financial markets, administrative and legal issues, and institutional development. Recommend ways to mitigate constraints to development of the housing finance system, calling on specialist consultants, researchers, and trainers as needed.

3. Prepare specific technical advice for new housing finance companies and for the GOP on topics such as:

   - structuring and starting-up housing finance companies;
   - the development of appropriate mortgage documents and other documentation required for the operation of housing finance companies;
   - mortgage underwriting standards;
   - mortgage portfolio management;
   - special shelter lending programs for low-income households;
   - developing human resource training plans for housing finance companies, including identifying training needs and making specific training recommendations'
   - inspection and regulation of housing finance companies;
   - regulating the housing finance system; etc..

4. Assist the GOP and other agencies to promote and facilitate the creation of the market-based housing finance system with the capacity to continue to expand to meet shelter needs. Work with private investors to identify and overcome obstacles and constraints to starting and operating viable housing finance institutions.

5. As called upon by the GOP, assist with the establishment and development of the units or agencies which license, regulate, and supervise housing finance companies.

6. Assist the GOP develop an information system which tracks resource mobilization and investment, both public and private, in the shelter sector.

7. Prepare scopes of work and terms of reference for studies and consultancies, and work with consultants, trainers, and the SRMP IQC contractor to carry out such work.

8. Document the work by submitting to the GOP. RHUDO/Asia, and USAID/Pakistan regular trip reports and Quarterly Progress Reports, or other reports as may be requested, including documentation of experiences and conclusions from activities undertaken, providing a program record for monitoring and evaluating program progress.

III. Project and Job Performance

A. Achievements and Shortfalls.

It was during Benazir Bhutto's first government that a project was launched with the assistance of USAID to develop a private sector, market oriented housing finance system in Pakistan. Many in the private sector were enthusiastic about this new initiative and as the program developed, they formed groups of investors to take advantage of what was seen as a huge demand for housing credit in the country.

About three years ago USAID Pakistan set up the Shelter Resource Mobilization Program to work through the Internal Finance Wing of the Ministry of Finance to establish a new housing finance industry. S.R.O.'s were issued setting forth requirements for licensing companies and the State Bank issued new prudential regulations for all Non-Bank Financial Institutions which included the new housing finance industry.

No one in Pakistan had engaged in this business previously and private sector firms started out without a clear understanding of the problems that would be encounter as private sector companies. Access to capital at a reasonable rate would provide a huge housing finance market and a good return on investment for sponsors. Unfortunately, government has continued to view housing as a social welfare activity and as a drain on the economy rather than as the robust economic sector it is in many countries and could be in Pakistan. No one in government has understood that a strong housing finance industry can provide significant economic, social and political benefits at little or no cost to the government. In fact, in the United States it is a 400 billion dollar a year industry and provides 4% of GDP. It is a well documented fact that for every dollar you spend on housing there are three more dollars added to your GDP.

Viewing housing finance as a social welfare area has been a political failure as well as an economic failure. The public sector Housing Building Finance Corporation is currently bankrupt and it has a huge percentage of non-performing loans in its portfolio. HBFC can still provide a small amount of political patronage but is currently booking very few loans. Its subsidized credit from State Bank is to end in 1994 and its future is less than promising. As a result the governments one major long term initiative in housing finance has failed. Government does not have the resources to provide a "Yellow House" to every poor person in Pakistan. Governments more recent attempts to initiate a private sector, market oriented approach to housing finance will also fail unless the government bureaucracy shows some real commitment to making the new housing finance system work.

The fact of the matter is, private companies have been asked by the government to commit 100 million rupees of equity capital to a venture which at present has no chance of success. There is a huge market for mortgage credit in Pakistan but the government has not given the housing finance companies access to that market. Citibank and International Housing Finance Ltd are making a few loans to upper middle income and high income individuals at interest rates of 20 to 24%. Transaction costs are another 20%. Even the middle income group in Pakistan is excluded from this very limited market. Without lower cost capital the system cannot succeed. Lower cost capital does not mean subsidies, it means access to capital at par with commercial banks and investment banks.

B. Challenges and Constraints.

The key to the success of this new industry will be its ability over time to mobilize private savings. Unfortunately, the weak condition of the financial sector in most developing countries, and particularly difficulty in mobilizing private savings, has left most of the financing of urban investments to the public sector. Unless housing finance companies are allowed to mobilize private savings for housing the only alternative the government has is to provide large public subsidies for housing. First, government has to stop competing for savings with the private sector. The recent National Saving Centre's offer of 13.73% income tax and zakat free profit on special three years savings accounts is creating a disturbingly large disintermediation for the commercial banking system as large amounts of funds are flowing out of the banks into these government sponsored schemes. It is creating an even larger problem for housing finance companies who cannot raise funds at any rate in a market where government is offering income tax and zakat free profit.

Government needs to decrease its own development activities and concentrate on policy reform which removes constraints on private sector development. Key constraints such as infrastructure deficiencies, the regulatory framework governing market for land and housing, weak municipal institutions, and inadequate financial services for urban development all limit the productivity of private firms and private households in producing and consuming goods and services.

The two housing finance companies in operation are faced with immediate capital problems. Citibank invested $4 million dollars in Citihome. According to the Manager of Citihome they will be running out of this initial capital in two months. They have no immediate source of funds with which to continue operations. If they borrow from Citibank Pakistan it will be charged against the Citibank ceilings and would harm the bank's existing business. So even a bank as strong as Citibank will find it difficult to continue its housing finance operations without access to passbook savings deposits and foreign exchange deposits.

Access to passbook savings is available to almost all Housing finance companies throughout the world. Such access is not available in Pakistan. The industry cannot succeed without this access. Foreign exchange deposits are less critical but would provide a very good market for attracting offshore Pakistani remittances tied to housing finance loans. These policy changes can be made by the government immediately, without any new legislation or new regulations. Over time access to deposits will bring down the costs of funds for housing finance companies. The industry will readily agree to pass those lower costs on to their clients.

I would ask, "why are Investment Banks allowed to take foreign exchange deposits from clients in the Middle East tied to housing finance loans at 10% interest while housing finance companies are forced to charge 20% interest because they do not have access to the foreign exchange deposits and other lower cost capital."

The State Bank is arguing that it is losing money on the foreign exchange cover (3.5%) for deposits taken by commercial banks and investment banks. It indicates that it is making money on cover (8.5%) for foreign currency loan transactions. If this is so, why doesn't State Bank charge one cover rate for all foreign currency deposits - say 5% or 6%. Whatever rate allows it to provide the cover without incurring a loss. That would remove its major objection to having housing finance companies serve as foreign exchange agents.

Access to passbook savings deposits is just as critical for housing finance companies. Savings schemes can be linked to housing finance loans. Saving by customers over time can provide a record of a families ability to repay a loan. Savings can provide a broader based financial sector by pulling black money into the formal sector. It seems the only reason for not allowing access to passbook savings deposits is the governments fear of another cooperative society scandal. Well, that fear, is groundless. Housing Finance Companies and their directors have been vetted by the government. The State Bank has Prudential regulations in place for the regulation and supervision of the industry. The non-bank financial institution division is currently fully staffed and being trained to regulate and supervise the operations of housing finance companies on the same basis as they do commercial banks. There should be no question of a cooperative society type scandal taking place in this new industry if State Bank does its job.

Access to savings combined with a recent State Bank commitment to open a "Refinance Window" for housing finance will allow the housing finance market to grow and reach a much broader market. Admittedly that market will only reach down to the middle class and some lower middle class family to begin with but as it strengthens and broadens its financial base, the economic activity itself will provide more and more customers from the jobs created among the poorer labor classes in our country. This is not a perfect solution but a strong housing finance industry will create thousands and thousands of new jobs for people who need jobs as much, or often times more, than they need shelter.

People in Pakistan are thought to be spenders not savers. Given the opportunity to save in the form of equity in their own home may very well dispel the impression that Pakistani's are not savers at par with Indians and others.

There are many political benefits to be derived from active government support for this industry. A growing middle class with growing political power needs to know that the government is concerned about its problems as well as those of the poor in the country. Education and jobs will help the poorer classes. Access to credit, for a home of their own, will greatly strengthen the middle class and expand the store of wealth in this sector.

Jobs created by a strong housing finance industry will greatly benefit the laboring class in Pakistan. As the industry grows and matures it will be able to provide more and more access to credit to the laboring classes. Government housing schemes for the poor have been failures in the past and will continue to fail due to lack of funds, government bureaucratic incompetence, corruption and lack of purpose. A "Yellow House" for every family in Pakistan is not something the government can afford. It must concentrate on those things it can do. Housing finance is an area where government can make significant strides forward without straining the government budget.

Continued support of HBFC subsidized lending will continue to be a failure and a drain on government resources. Support of a market oriented, private sector housing finance industry will provide the rapidly growing middle class in Pakistan an opportunity for home ownership. It will provide thousands of new jobs. And it will provide new revenue to government rather than a drain on its scarce resources. I believe education and jobs for the poor, and homes for the middle classes can provide great political as well as social benefits for Pakistan.

In summary, the new industry will need help from the government in two major areas.

(1) State Bank has agreed to set up a housing finance mortgage "refinance window". It is critical that State Bank and the Ministry of Finance also agree to give full access to local currency pass book savings deposits. It would be helpful if they also agreed to allow HFC's to take foreign currency deposits.

(2) The federal government must provide a strong signal that it is committed to alleviating the housing shortage and supports the new housing finance industry. This support could take the form of incentives to the new industry.

   a. Tax deduction to homeowners on mortgage interest: The cost of taking out a home mortgage loan is very high. 20% interest rates have been dictated by the market. One way to make these transactions more affordable to the HFC customers is to allow the homebuyer to deduct interest paid on his home mortgage from his taxable income. This will will only benefit good citizens currently paying taxes and could bring more people under the income tax umbrella. This facility is available to homeowners who have rented their property in Pakistan. It should be available to homeowners who reside in the mortgaged property.

   b. Tax Incentive for Capital Accumulation: Housing Finance Companies need to broaden their capital base if the industry is to expand and reach the maximum number of people in the country. It is suggested that the government allow HFC's to transfer 40% of their gross earnings to general reserves prior to computation of their tax liability. Any funds removed from the general reserves would become subject to taxation. This is a positive incentive which would benefit the industry at little cost to the government. We believe this type of incentive is much more productive than a Tax Holiday as it allows the industry to broaden its capital base and helps strengthen the overall savings in the economy.

c. Elimination of Excise Tax for all types of housing finance: Finance for construction (new or additions/alterations) is exempt from excise tax; financing for purchase of completed property is still subject to 1% excise levy. The wording of the relevant SRO needs to be amended and for the sake of clarity (construction, additions, alterations and financing for purchase of residential property only) should be exempted from the 1% excise levy. This could lower customer transaction costs and make housing finance more affordable to a greater number of customers.

d. Lowering of Transactions Costs of Land Transfer: Stamp duty tax levied by the Provinces ranges from 9% to 10%. This has forced the majority of transactions outside the formal registration process. Powers of Attorney and Allotment Letters have created a terrible mess in title documentation and land transfers. To bring the transactions back into the formal process the fees must be rationalized. I suggest a standard maximum registration/transfer fee of 1% to help resolve this major nation-wide problem. While the Provinces levy the high stamp duty fees they in turn are creating a legal title mess nationwide which is costing the country many billions of rupees in lost development and increased legal fees. The current high fees adversely impact all areas of development not just that of housing.

   Given the high costs of legal title and transfer it is no wonder that the government is the major developer in the country. No one else can penetrate the legal maze or afford the transaction costs. This is a national issue that needs to be resolved as quickly as possible.

As mentioned earlier their are only two housing finance companies in operation in Pakistan at this time (Citihome and International). No other companies will enter the field until policy changes are made which provide access to capital for the companies and some reasonable assurance that the government supports the industry over the long term. Housing finance can provide many benefits to Pakistan if given a "level playing field" upon which to operate. It cannot operate without access to savings deposits. It will not expand quickly without some form of incentives from the government.

IV. Learning from the experience.

Introduction.

The major lesson learned from my twenty seven months in Pakistan working to develop a Housing Finance Industry is that the program approach was faulty to begin with. The project paper outlined a process which was aimed at developing new non-bank financial institutions in Pakistan, i.e. housing finance companies. SRO's were issued to outline requirements for organization, equity capital, and licensing. Prudential regulations were developed to regulate and supervise the proposed new industry. No one thought to look at the existing financial system and ask the question, "Why should we go to the trouble of setting up a new industry when we have 6,000 branches of commercial banks already in existence in the country." The program should have been directed at getting the commercial banks actively involved in home mortgage lending. You need look no further than to Malaysia which is probably the most economically successful Muslim country in Asia to see the impact housing finance can have on the general economy. Malaysia has a booming economy. It has a booming housing finance industry. And it has a requirement that commercial banks invest five percent of total assets in the housing sector. If the government of Pakistan required the active participation of commercial banks in housing finance we would not need housing finance companies in Pakistan.

Commercial banks have thousands of branches which cover the country from end to end. The commercial banks have the majority of the capital in the country. The commercial banks have a bank of last resort and full access to capital markets, interbank funds, and savings deposits. they also have special rates for registration and stamp duty tax on mortgaged property transactions.

It would have made more sense to concentrate USAID efforts towards getting the active participation of commercial banks in the business of housing finance than to try and set up a whole new system. Housing finance would be much further along in Pakistan if it had been integrated into the existing financial system.

A. Tactics.

As reported above the main strategy was faulty in promoting a new industry rather than integrating housing finance into the commercial banking system. As for tactics I believe the SRMP from the start has been in a very good tactical position to implement whatever program it wanted to undertake. First, it concentrated on policy reform and institution building which seems to be the direction most multi nationals are heading in the 1990's. Second, we had the HG money ($40 million) in guaranteed loans which we have used to leverage the policy reform and institution building. And thirdly, we were a low cost highly personalized resident technical advisor oriented program which allowed us over time to identify and solve major problems involved in developing a housing finance industry in Pakistan. I believe our tactical approach has been sound and would recommend it for other programs. The HG loan guarantee money has been critical to the tactical success and isn't normally available to other types of programs.

B. Conclusions and Recommendations.

Housing Finance can work in Pakistan. But it will fail as the programs in South America failed many years ago because projects did not have the foresight to take a macro approach to housing finance. Setting up a few companies to provide loans for a small number of upper middle income people is not the goal of any housing finance program. But that is what has occurred in South America and what could be the fate of the housing finance industry in Pakistan. Housing finance cannot be separated from other areas of urban development. Problems of land transfer effect commercial and industrial development as well as housing. Inadequate infrastructure has the same broad negative effect in the urban environment. What is needed is a macro approach to urban environment which focuses on policy reform, land reform and institution building. Above I have talked briefly about all of these areas and would refer the reader to the appendices for further discussion on how I believe urban development should be tackled. In summary, I believe it will be necessary to build strong metropolitan development agencies with the ability to raise their own development funds through issuance of Municipal bonds or other financial instruments and collection of property taxes. The new Districts proposed by the Benazir Bhutto government could serve this purpose if structured carefully. Conflicting roles among Municipal Corporations, Cantonment Boards and Development Authorities must be removed. One agency with elected officials as its policy board should have the overall authority for development throughout the urban area it serves.

Everyone in Pakistan knows that the tax system needs to be normalized and restructured so that reasonable levels of revenue can be collected on income and wealth. The government is too active in the area of development and is funding public sector development almost entirely from deficit funding. This in turn sucks up the liquidity in the capital markets leaving very little for private sector development. Financial sector reform must be continued and accelerated wherever possible. Foreign exchange cover needs to be rationalized by State Bank. Housing finance companies need to be given access to passbook savings, interbank funds at par with commercial banks, and refinance from State Bank of Pakistan.

Land transfer fees must be lowered to make mortgage loans financial viable for the average Pakistani. Twenty percent interest rates with an additional twenty percent transaction costs have limited the housing finance market.

The key to success for housing finance companies will be in their ability to attract lower cost capital and their ability to get government to make key policy changes in the fees charges for related land and document transactions. Finally the government must take some positive steps to bring the huge commercial banking sector into the field of housing finance. This can be done as in malaysia where the government requires 5% of banks total assets be invested in the housing sector or it can be accomplished by fiscal incentives discussed above. Pakistan could have a very successful housing finance industry and the industry could provide for a large segment of the demand if policy reform and institution building continue. It will take several more years before the needed reform can be implemented. Unfortunately, the SRMP and USAID are departing shortly and will not be available to lead the effort. And that it what is critically needed in a program such as ours. There is no substitute for resident advisor technical assistance which can focus the issues and bring together the parties needed to resolve the issues. If nothing else we have strongly advertise housing finance in Pakistan and raised the level of awareness on the sector greatly. We will leave many Pakistani's dedicated to pursuing a viable housing finance industry. That in itself is a great success because in the long run it is the Pakistani's who will have to take the leadership needed to move the development process forward in the country.

It has been a very educational and stimulating twenty seven months for me. I believe we have had a positive role in the development of housing finance in Pakistan. Sustainability will depend on how well the Pakistani's can take up the reins and continue the development process.