SUMMARY OF FINANCIAL MARKETS IN PAKISTAN: SECONDARY SOURCE SURVEY

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NOTE

This document was prepared by Arthur Young and summarizes existing literature describing the country. Secondary sources were obtained from the International Monetary Fund, the World Bank, the Inter-American Development Bank, the African Development Bank, the Asian Development Bank, the United Nations, and other relevant commercial sources.

PAKISTAN

SUMMARY OF FINANCIAL MARKETS SURVEY

A. ENVIRONMENT

1. Unstable political history
   The civil unrest experienced in the past few years was reduced with the imposition of martial law. Pakistan is in the process of rebuilding democratic institutions. Martial Law has recently been lifted.

2. Stable economic history
   Performance in the agricultural sector of the economy is subject to considerable annual fluctuation, although the proportion of Gross Domestic Product(GDP) attributed to the agricultural sector has declined dramatically in recent years. Pakistan exports a wide range of manufactured goods.

3. Stable social system
   a) Predominately Moslem (97% of the population).
      The citizens are composed of four major ethnic groups: Punjabi(65%), Sindi(11%), Baluchi(9%) and the Pathan(8%). Pakistan also supports a large population of Afghani refugees.

   b) National language
      Many languages are spoken throughout Pakistan due to the diversity of ethic groups and the lack of similarity among dialects within a single language. However, the majority of the educated population speaks English. Urdu, spoken by 7% of the population, is the overnment's official language. Punjabi is spoken by 64% of the people, while Sindhi and Pushtu are spoken by 12% and 8% of the population respectively. The remaining 9% speak a variety of other languages and dialects.

4. Substantial international assistance

a) International donors:
- OPEC
- World Bank
- International Monetary Fund
- Asian Development Bank
- Islamic Development Bank

b) Bilateral donors:
- Japan
- United States
- United Kingdom

B. ECONOMY

1. Predominance of public sector:

   a) Pakistan has a mixed economy, with the public sector dominant.

   b) Recently, the government has taken actions to strengthen the private sector. Public sector investment in fixed assets has decreased from nearly three quarters of total gross domestic investment to just slightly over one half. The capacity of parapublics to finance their own investment has also increased from 10% of their total investment to 20% of their total.

2. Government expenditure has averaged 23% percent of the GDP in the last five years. The portion spent on development has dropped, though, from 40% to 30% reflecting the GOP's policy of reduced public investment. GOP has also managed to reduce the public sector's dependence on domestic bank funds by improving tax collection and mobilization of domestic resources, chiefly through the NSS.

3. The industrial sector has assumed the leading role in Pakistan's economic development. It has averaged a growth rate of 6.9% annually, over twice that of agriculture, and it has become increasingly diversified. The cotton textile sector is no longer the major sector with other industries, such as the steel and steel-based industries, and the chemical and petrochemical industries, having assumed greater prominence. Even small scale firms have shown great bouyancy and have directed their attention torward fast growing sectors such as carpets, surgical instruments and sporting goods.

4. The government plans to continue its present industrial growth rate by greatly expanding the role of the private sector. Although the government expects to retain its presence in the heavy industries (steel, petroleum refining, etc.) it will not be increasing its level of activity. New public investment will be directed torward balancing and modernizing existing parastatals.

5. Balance of Payments

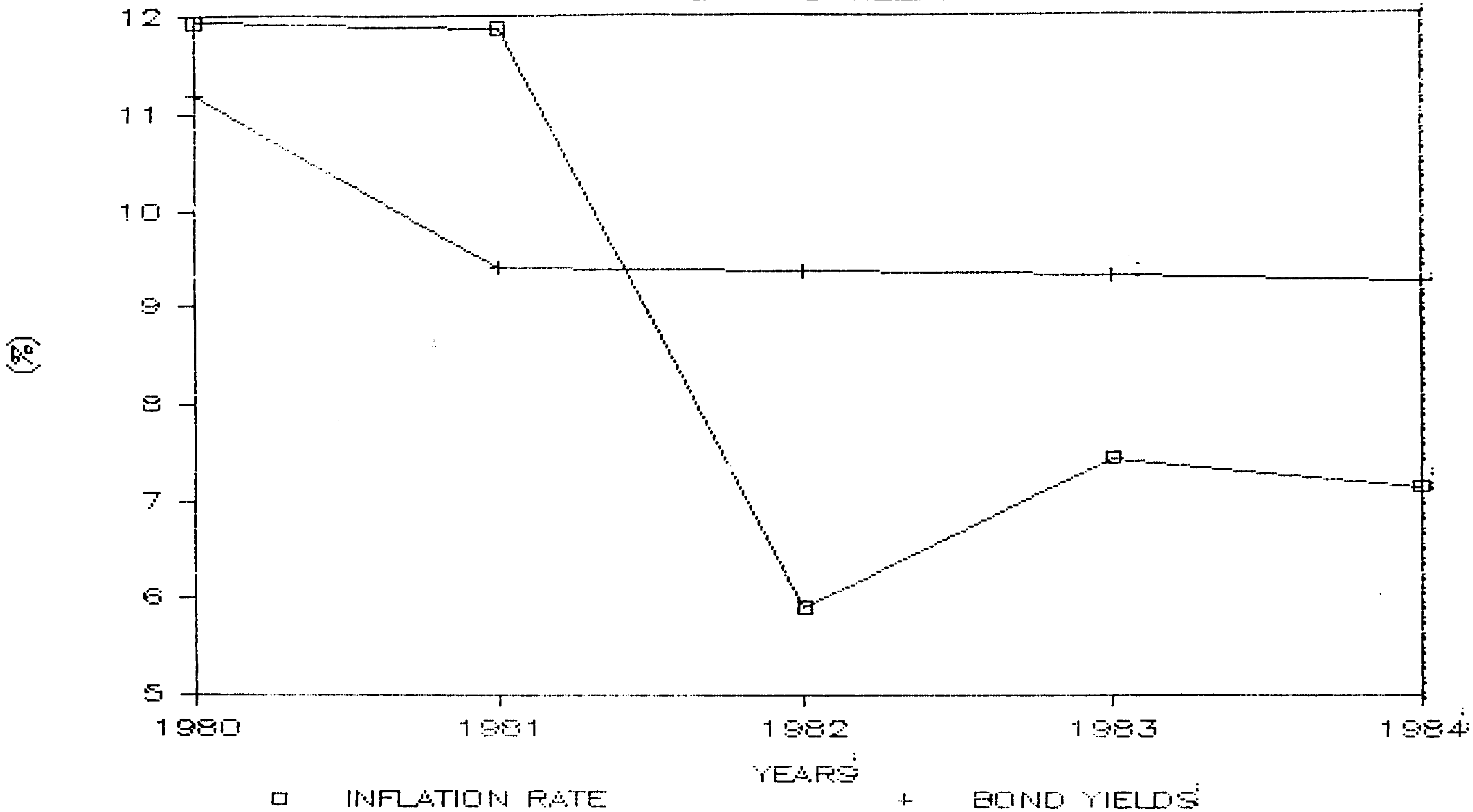
Pakistan has maintained a trade deficit equaling 10% of GNP for the last six years. Although imports have doubled in cost during the past four years the current account deficit has been kept constant through the remittances of overseas Pakistanis, an import substitution policy, and a devaluation of the rupee (1982). The current account deficit has been financed mostly through funds provided by multilateral and bilateral agencies, and the use of IMF credit.

4. Labor force analysis

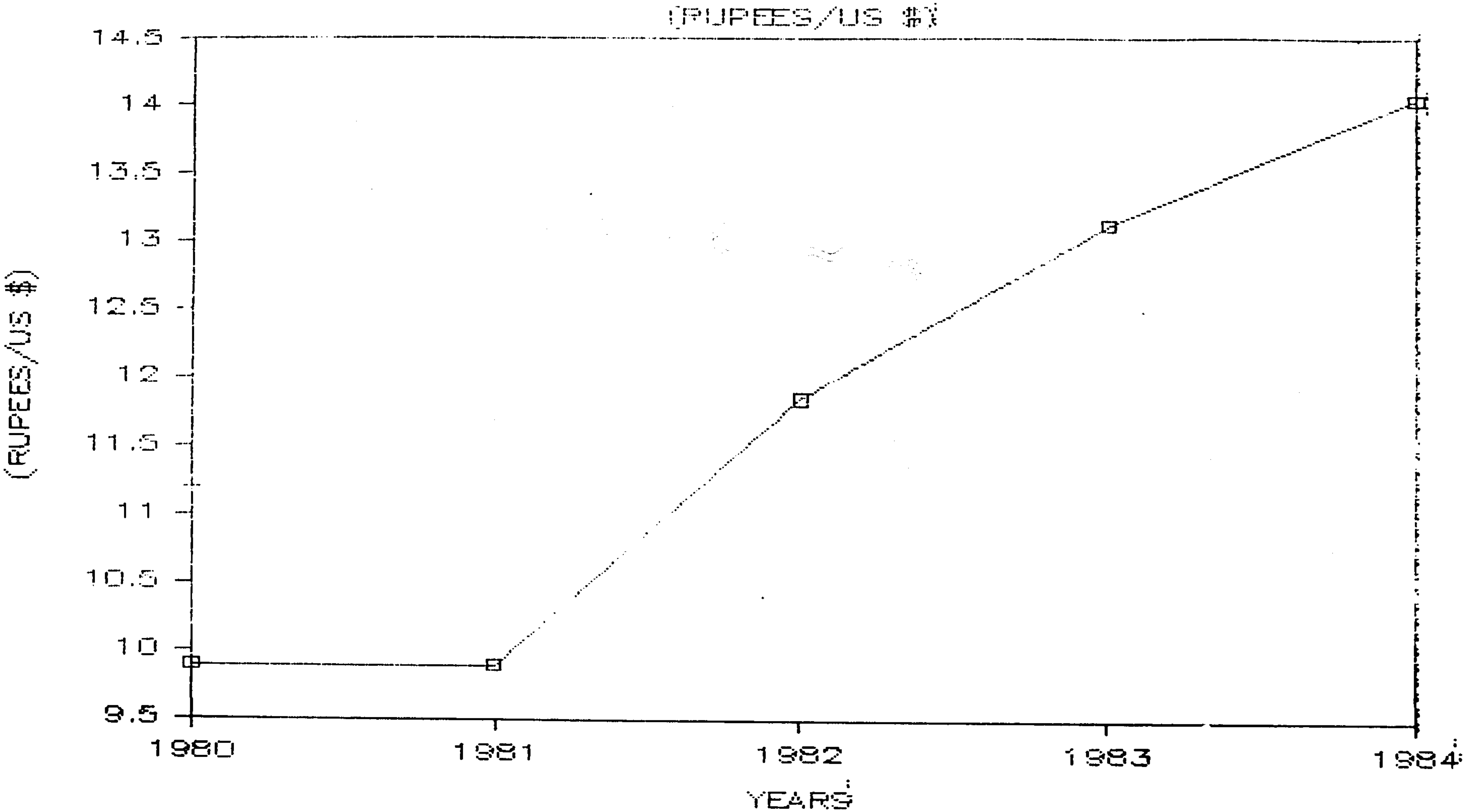
total population: exceeds 90 million
no. under age 15: nearly four out of every nine persons
total labor force: 28 million
no. employed in agricultural sector: over 50%
literacy rate: 26%

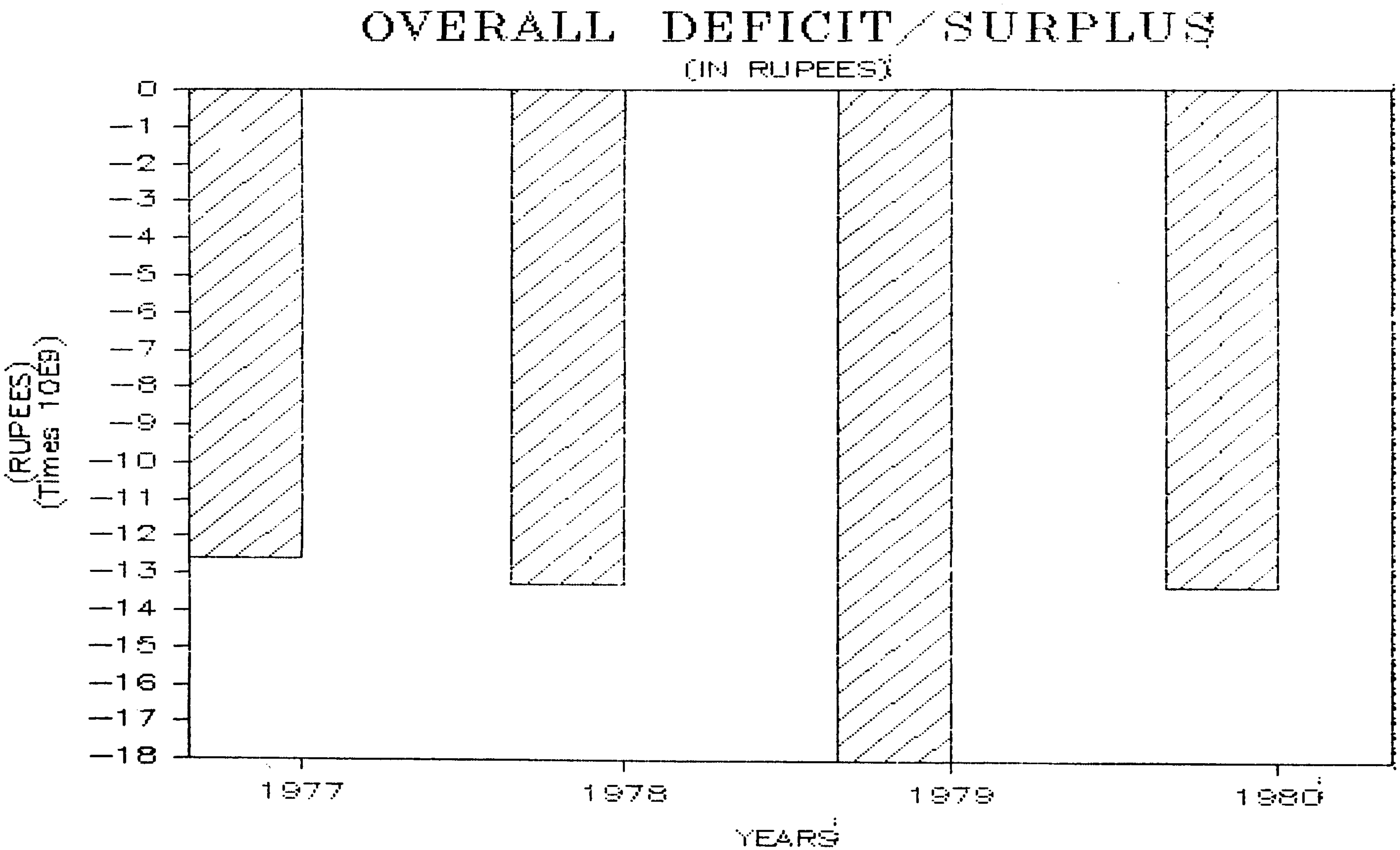
PAKISTAN'S INFLATION RATE

AND BOND YIELDS



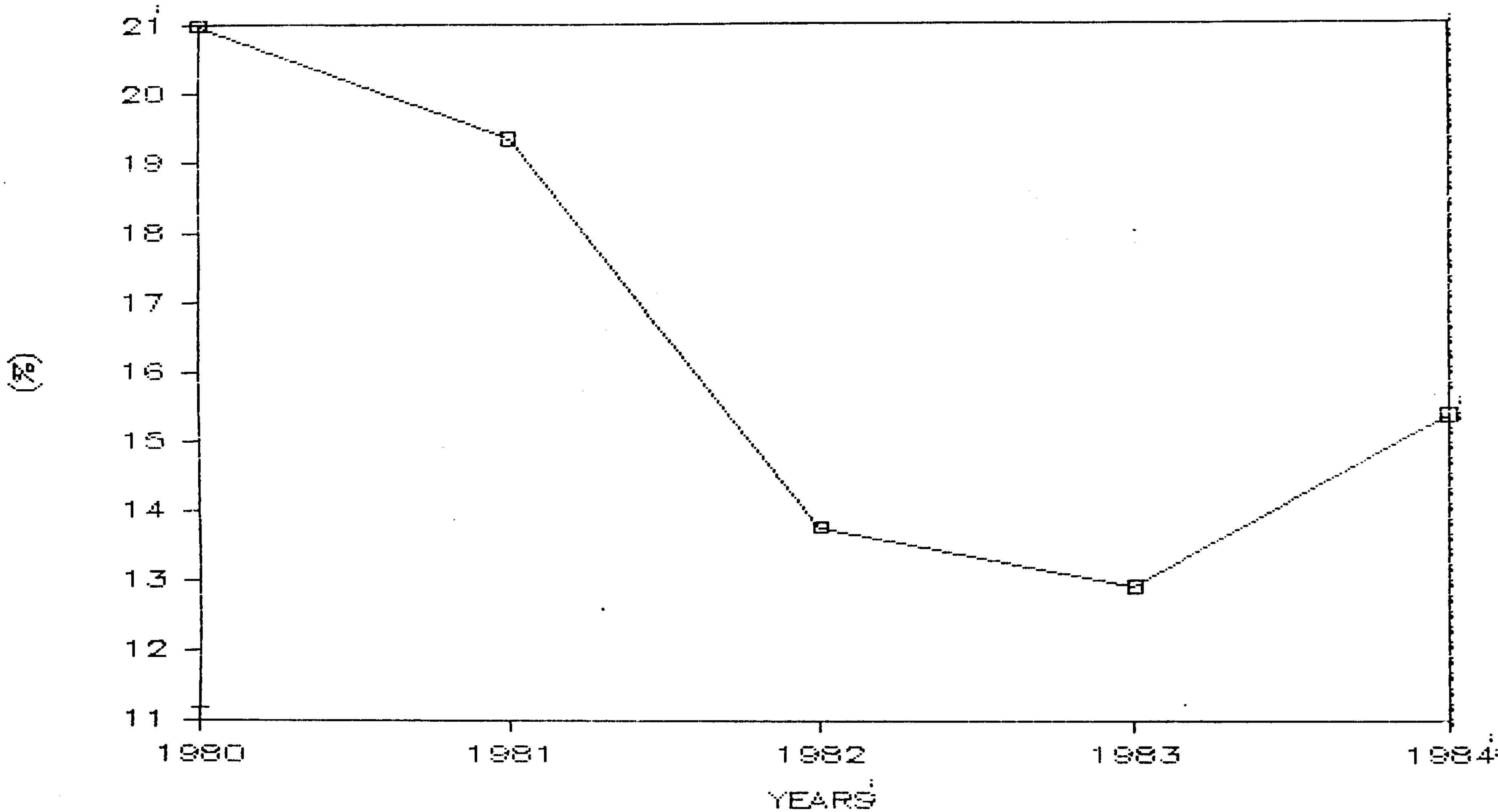
MARKET EXCHANGE RATE

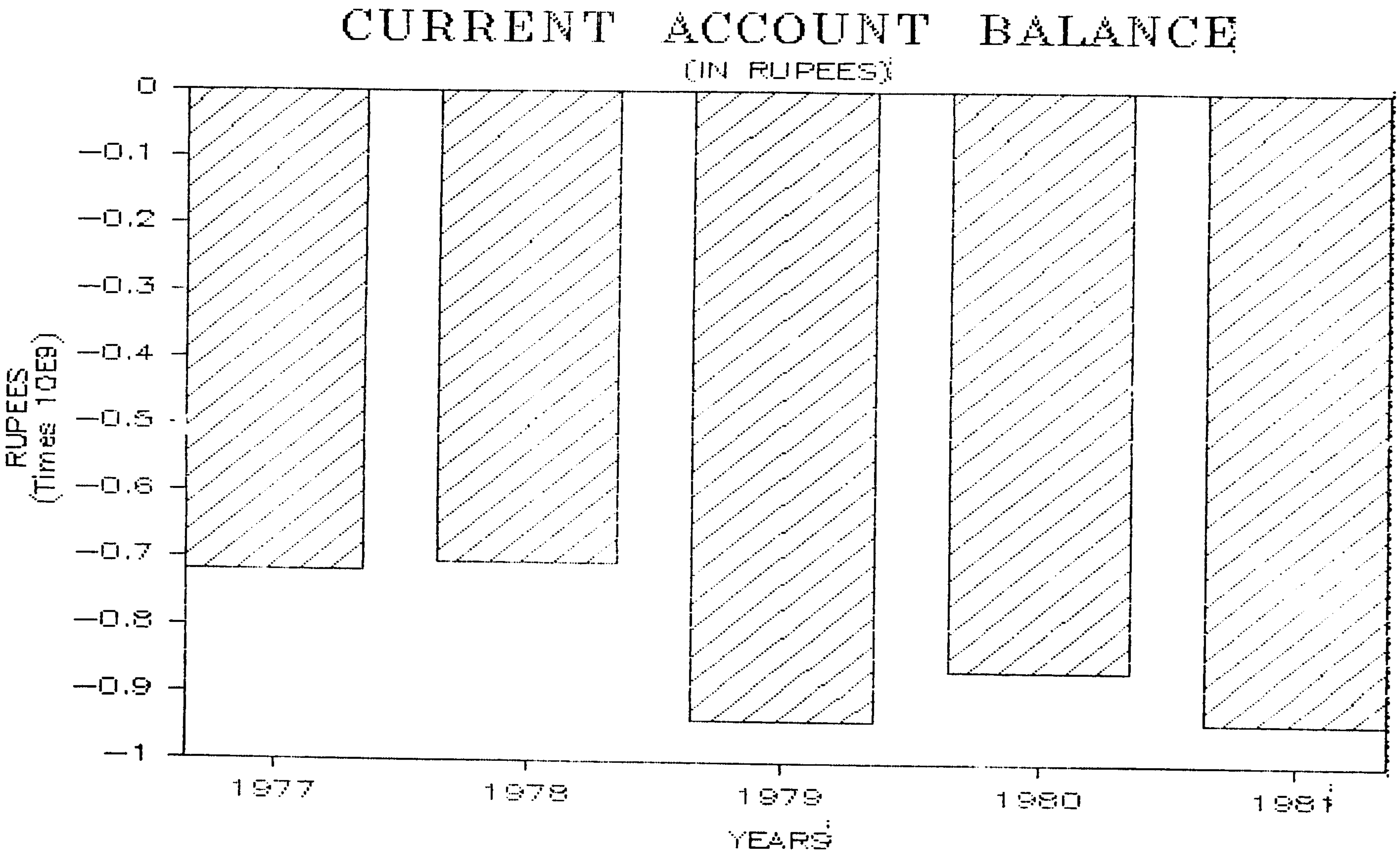



OVERALL DEFICIT/SURPLUS
(IN RUPEES)
(RUPEES)
(Times 10E9)
0
−1
−2
−3
−4
−5
−6
−7
−8
−9
−10
−11
−12
−13
−14
−15
−16
−17
−18
1977
1978
1979
1980
YEARS


GROSS DOMESTIC PRODUCT
(IN RUPEES)
GDP IN RUPEES
(Times 10E12)
2.8
2.6
2.4
2.2
2
1.8
1.6
1.4
1.2
1
0.8
0.6
0.4
0.2
0
1977
1978
1979
1980
1981
YEARS

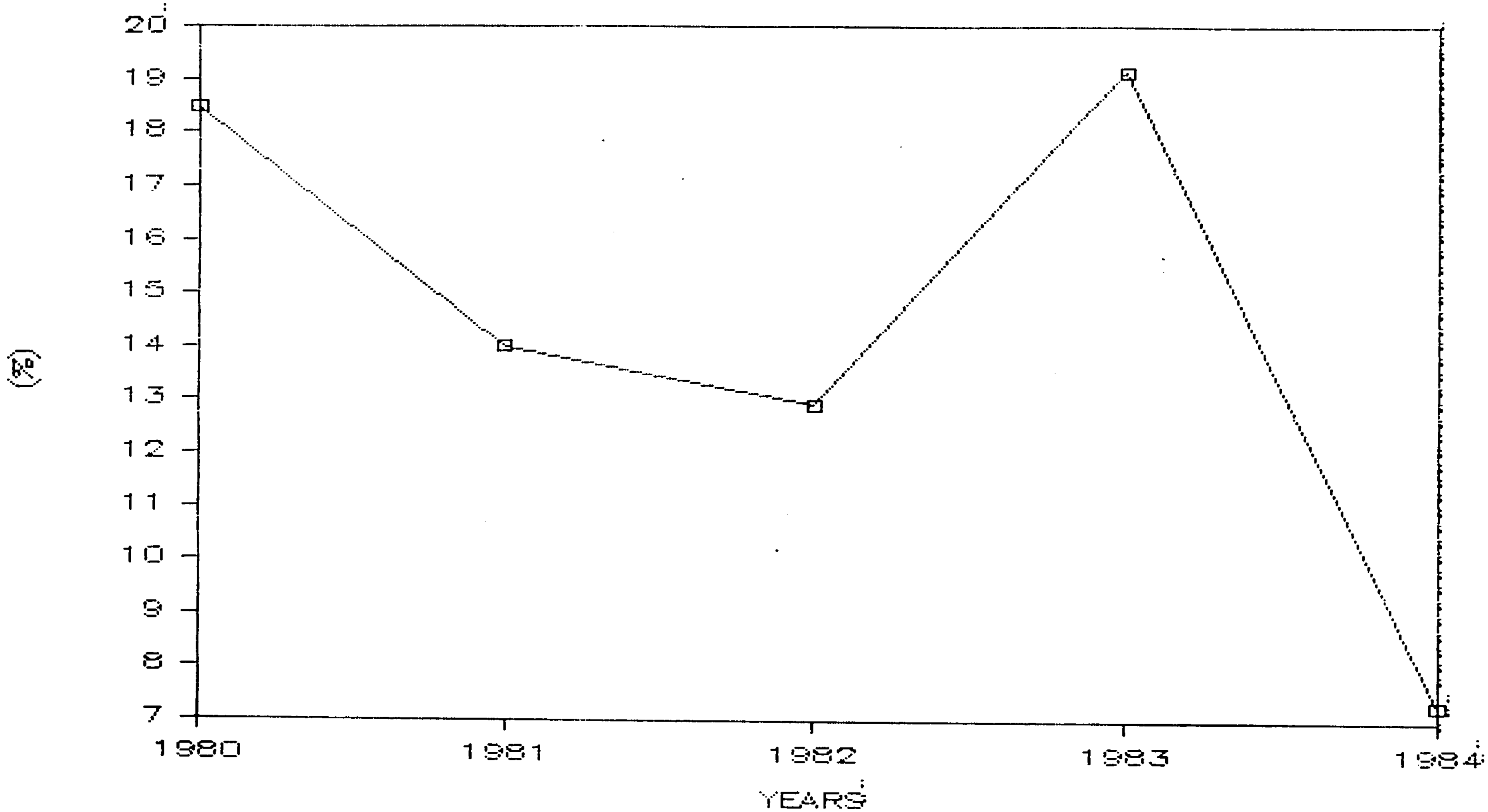
GROSS DOMESTIC PRODUCT GROWTH RATE

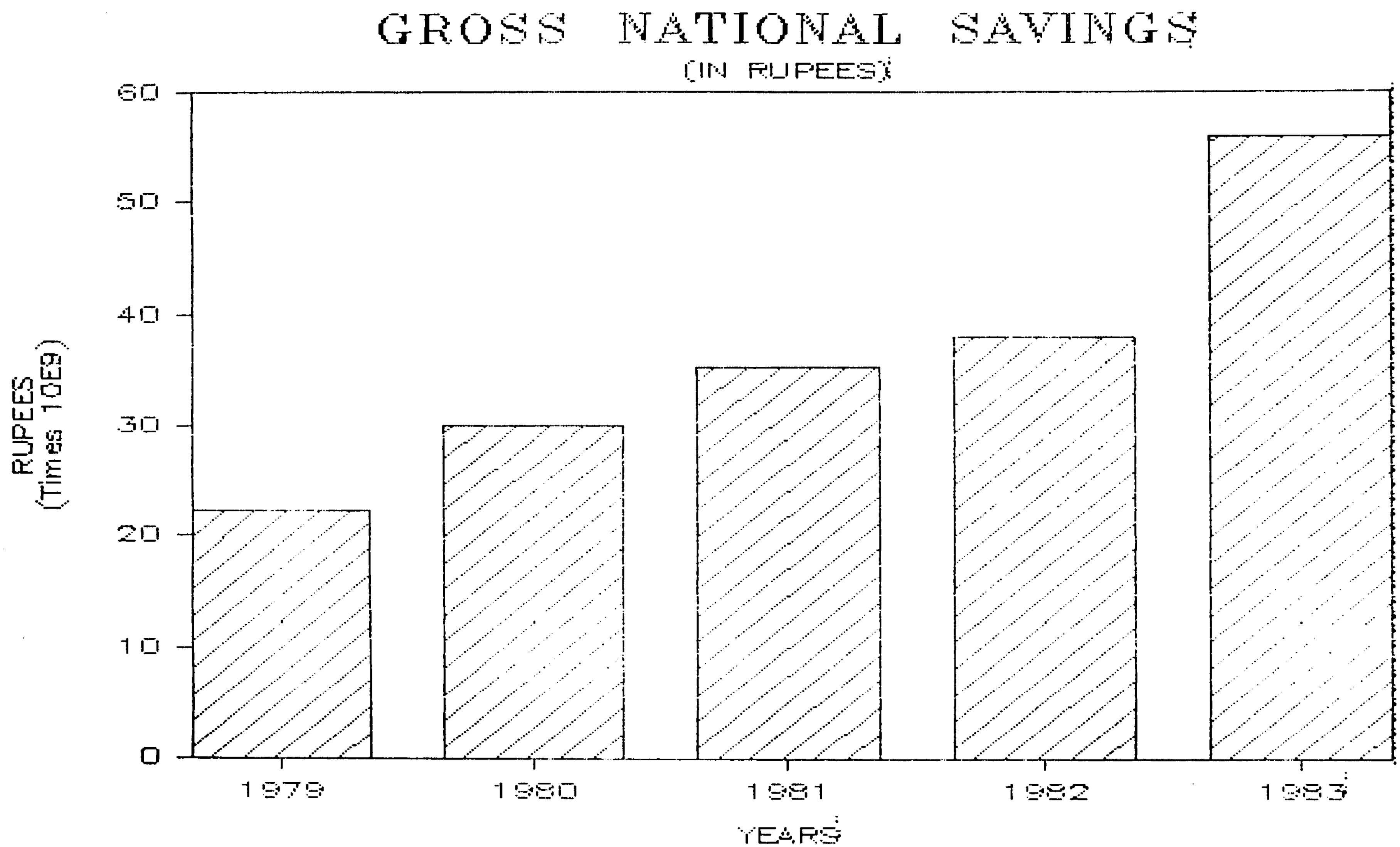



CURRENT ACCOUNT BALANCE
(IN RUPEES)
RUPEES
(Times 10E9)
0
−0.1
−0.2
−0.3
−0.4
−0.5
−0.6
−0.7
−0.8
−0.9
−1
1977
1978
1979
1980
1981
YEARS

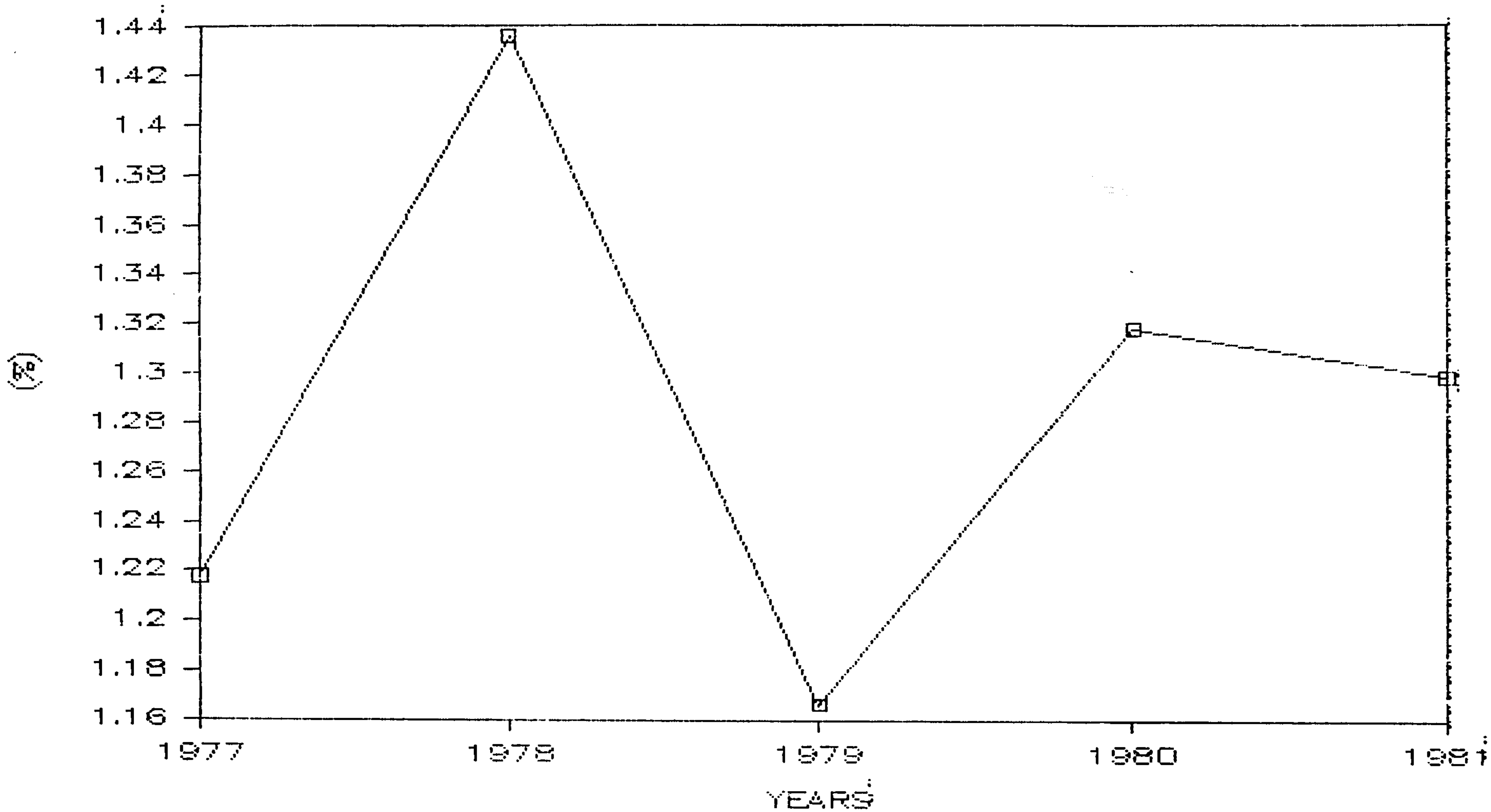
10

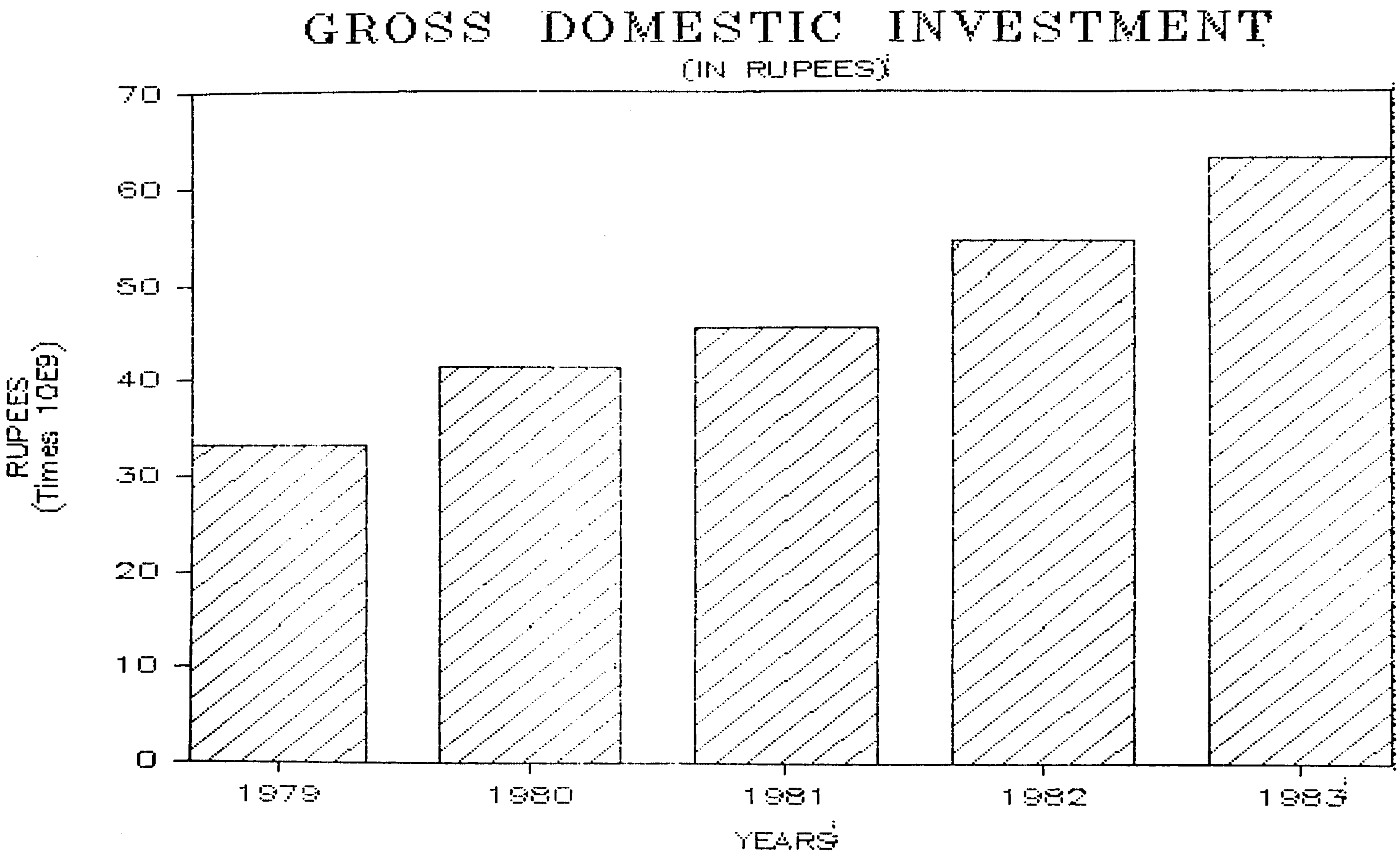
PERCENT CHANGE IN MONEY SUPPLY



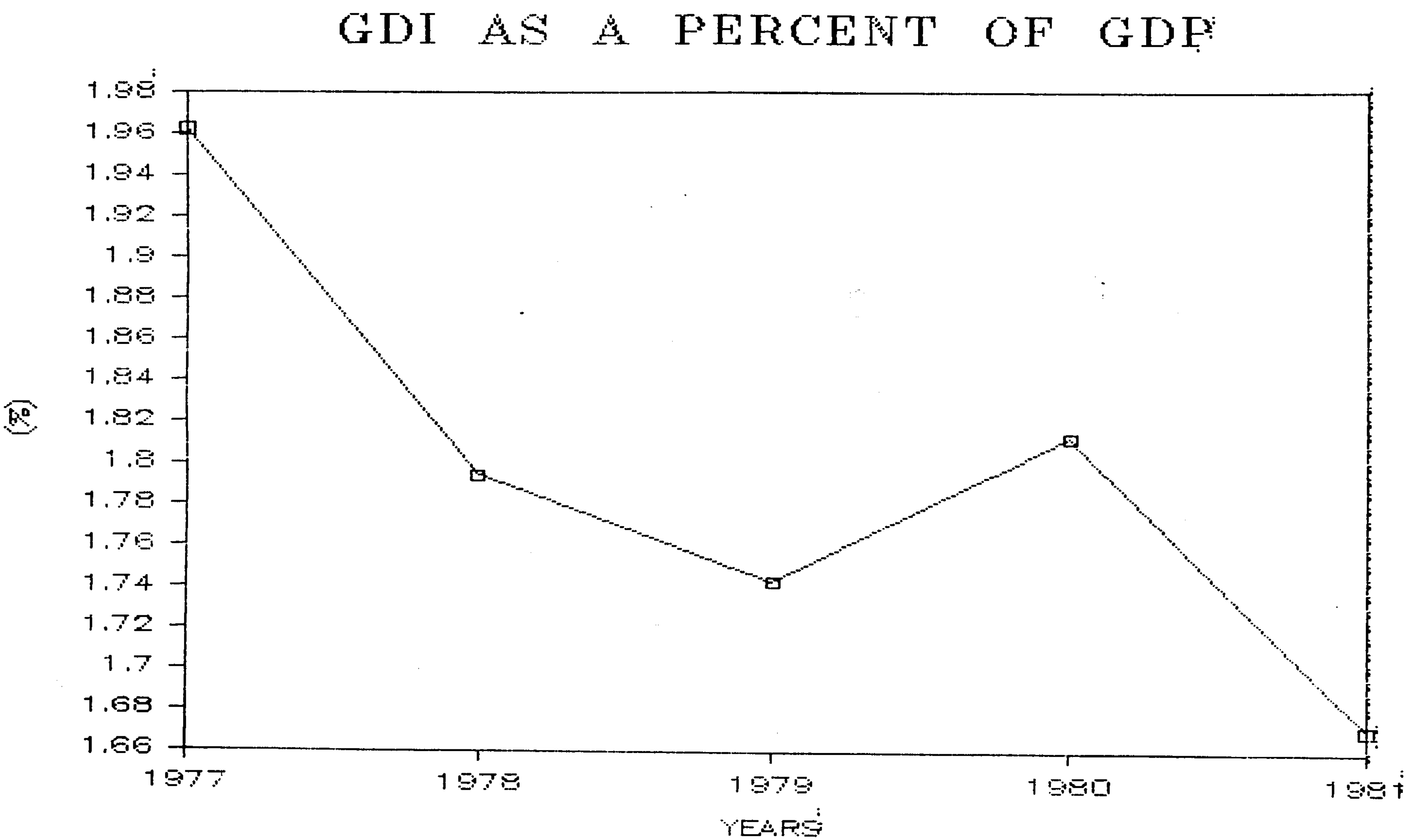

GROSS NATIONAL SAVINGS
(IN RUPEES)
RUPEES
(Times 10E9)
60
50
40
30
20
10
0
1979
1980
1981
1982
1983
YEARS

GNS AS A PERCENT OF GDP



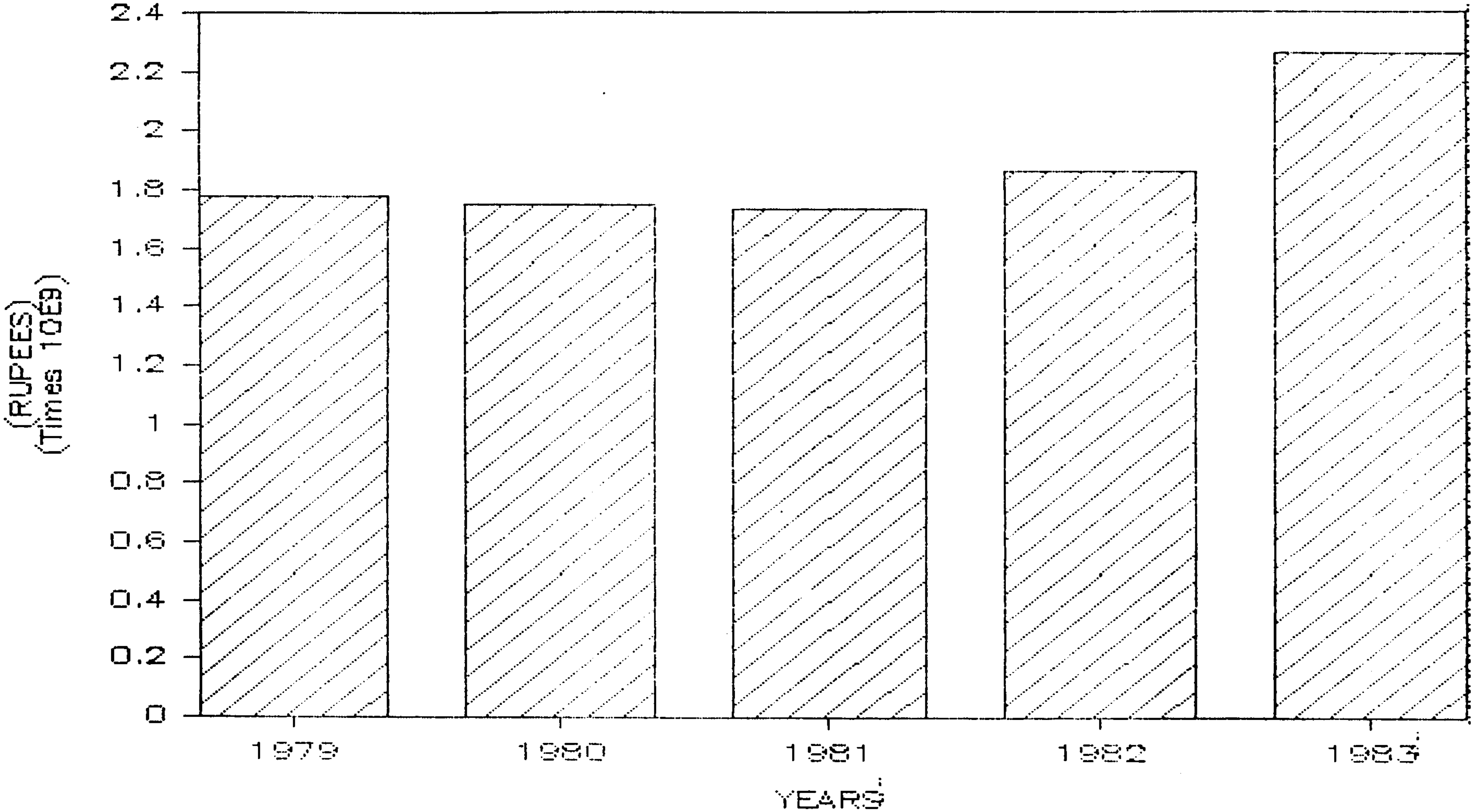

GROSS DOMESTIC INVESTMENT
(IN RUPEES)
70
60
50
40
30
20
10
0
RUPEES
(Times 10E9)
1979
1980
1981
1982
1983
YEARS

14



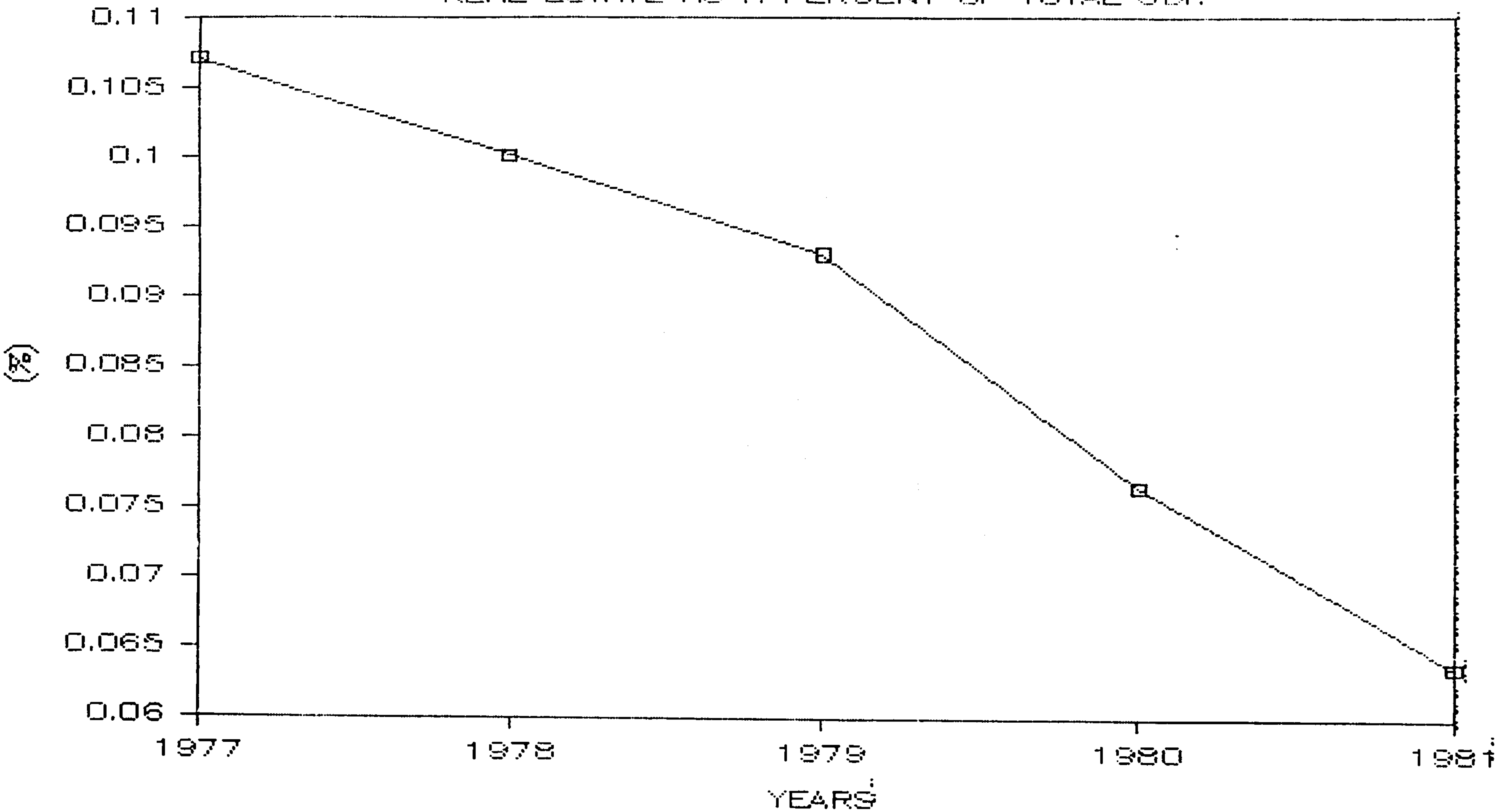
GDI AS A PERCENT OF GDP
1.98
1.96
1.94
1.92
1.9
1.88
1.86
1.84
1.82
1.8
1.78
1.76
1.74
1.72
1.7
1.68
1.66
(%)
1977
1978
1979
1980
1981
YEARS

GNP FROM BANKS, INSURANCE AND
REAL ESTATE



GNP FROM BANKS, INSURANCE AND

REAL ESTATE AS A PERCENT OF TOTAL GDP



C. GOVERNMENT ATTITUDES

1. The government of Pakistan welcomes foreign investment, particularly in the area of manufacturing. Joint equity participation with Pakistan investors is encouraged. Legislation has been passed that provides security against expropriation and adequate compensation for acquisitions. Foreign investors are guaranteed the right to repatriate funds up to the amount of the original investment, profits, and any additional amount resulting from re-invested profits or appreciation of capital investments. Liberal incentives are provided for foreign investment, but government controls, heavy taxation, and bureaucratic delays have served to discourage it. Although there is no specific condition or law requiring foreign investors to associate with local equity capital, in recent years, the government has advocated gradual action in this direction.

2. Profits
   The government of Pakistan is commited to Islamization of the economy. The Islamic tenets of equity and fairness have prompted institutional arrangements based on the principal of profit and loss sharing combined with the elimination of interest. As of July 1, 1985, only these Islamic modes of financing will be permissible.

3. Privitization
   The government does not have an explicit policy for the divestiture of existing parastatals. It has been considering a strategy of involving the private sector in some unprofitable parapublic enterprises so as to lessen its financial burden.

D. REGULATORY CLIMATE

1. Foreign Exchange Control
   Foreigners spending up to six months in Pakistan are allowed to take a sum of foreign currency out of the country not exceeding the amount which they brought in, plus 100 rupees.

2. Price Controls
   In general, prices are set through market forces. However, the prices of wheat, rice, pharmaceuticals, sugar, and several other items are controlled by the government. The scope of price contracts and their enforcement has broadened in recent years. Consequently, black market operations have been on the rise.

3. Restrictive Labor Laws
   Employment applications must be submitted for government approval prior to providing local employment to foreign nationals.

4. There are no foreign ownership limitations; however, it has been reported that several 100% foreign-owned companies are being pressured to sell equity to local investors or to the government.

E. BANKING SYSTEM

GOP is commited to the Islamization of the country's economic system. In terms of the financial system, the major point in this transformation is the elimination of interest payments of all types. In place of interest GOP has started instituting a system of profit and loss sharing, and lending without additional charge over and above the intrinsic value of the principal amount. The government has taken a gradual approach in implementing the new system to ensure a smooth transition. It has concentrated its efforts on the development of techniques and instruments congruent with the principle of profit and loss sharing. The following list includes the financing techniques that the government has identified for use in the interest-free system:

- mark-up (margin of profit agreed upon by buyer and seller in advance);
- leasing;
- hire-purchase (financial institutions provide funds for purchase of fixed assets under a joint ownership arrangement);
- stock issues;
- 'modarabas' (similar to a silent partner arrangement. the 'modarib' is the steward managing the modaraba funds);
- participation term certificates (PTCs) (redeemable equity intended to replace debentures for industrial financing);
- 'musharika' (similar to PTCs except that it is a bilateral agreement between a financial institution and the user of funds, which cannot be traded);
- 'qarz-e-hasna' (interest-free loan where the borrower is obliged to return the capital without dilution of its intrinsic value).

1. Commercial banks

a) All domestic commercial banks have seperate interest-free counters. As of March 1984, deposits at these counters (referred to as PLS deposits) accounted for 17.8% of the total demand and time deposits in the country. The use of these funds is restricted to activities in accordance with Islamic tenets. For their other accounts commercial banks pay from 5.5% for their short-term call deposits to 12.75% for their 5 years or over term deposits. The loan rates vary from 11% for fixed investments to 14% for working capitals. Some loans for supported government activities such as exportation of locally manufactured machinery are given at a rate of 2 - 3%. The major user of funds is the private sector (over 50%). The public sector uses 33% of the available domestic funds.

b) The commercial banking system consists of five nationalised banks and 18 foreign banks, most banks with several branches. All commercial banks are subject to the SBP capital, reserve and liquidity requirements.

2. The State Bank of Pakistan
The State Bank of Pakistan (SBP) is responsible for regulating the monetary and credit expansion for the country. Aside from traditonal central banking functions, the SBP is also in charge of promoting Pakistan's development finance capacity. The SBP appoints and removes the directors of the commercial banks.

3. The Banking Council
The Banking Council provides recommendations to the SBP on the appointment of the commercial bank directors and the bank auditors. It also conducts the evaluations of banks.

4. The Credit Consultative Committee
The Credit Consultative Committee reviews and advises the SBP on credit policies.

5. The Agricultural Development Bank of Pakistan (ADBP)
The Agricultural Development Bank of Pakistan provides not only medium and long term funds to the agricultural sector, but also an increasing amount of seasonal financing.

6. The Federal Bank for Co-operatives (FBC)
The Federal Bank for Co-operatives extends credit to, and takes an equity share in, the provincial Co-operative banks and the multi-Co-operative societies. The FBC is also a regulatory agency with inspection duties. The FBC is not involved with the actual mobilization of deposits. Instead, the Federal and Provincial governments raise the funds to match the resources raised from co-operatives.

Assets of Banking Institutions

Institution		% of total national assets
State Bank of Pakistan		17.3
Nationalized Commercial Banks		
- Allied Bank of Pakistan		2.7
- Habib Bank		20.9
- Muslim Comercial Bank		6.4
- National Bank of Pakistan		13.6
- United Bank		12.7
	sub-total	56.6
Foreign Banks		7.9
Specialized National Banks		
- Agricultural Bank of Pakistan		2.2
- Federal Bank for Co-operatives		0.4
- Industrial Development Bank of Pakistan		1.2
	sub-total	3.8
Banking System	TOTAL	67.7

F. NON-BANKING FINANCIAL INSTITUTIONS

1. Government non-banking financial institutions

a) The National Savings Schemes (NSS) - a department of the Federal Government, mobilizes private sector savings to finance the Government's overall budgetary deficit. NSS has centers in different parts of the country. In addition, NSS financial instruments can be obtained through the post offices and all of the branches of the domestic commercial banks. The NSS instruments have been quite popular because their rates of return have been higher than those offered by the commercial banks. The profits from these schemes are, unlike the commercial banks' interest, totally tax-free. The choices offered by NSS include:

- Post Office Deposits;
- NSS Deposits;
- NSS Certificates;
- Khas Deposit Certificates (offer free convertibility of both prinicipal and interest if originally obtained in foreign currency);
- Prize Bonds (only instrument offered in bearer form. All others are registered. It is used to attract funds from the parallel market and is often used a substitute for currency).

b) Pakistan Industrial Credit and Investment Corporation Limited (PICIC) - this corporation is responsible for promoting private investment in industry. PICIC gives long and medium term loans in foreign and local currency; underwrites public stock issues and other securities; serves as a broker to match foreign investors with Pakistan investment opportunities; serves as a business advisor to finance firms; and negotiates and borrows foreign currency loans.

c) The Industrial Development Bank of Pakistan (IDBP) - This organization is similar to PICIC except that it provides medium and long term credit for development of small and medium sized industrial projects. In addition, IDBP provides certain other types of financial assistance to industries.

d) Investment Advisory Centre of Pakistan (IACP) - This institution provides industrial and management consulting services to industries both within Pakistan and abroad.

e) National Investment (Unit) Trust - is the only existing mutual fund in Pakistan.

f) Investment Corporation of Pakistan - serves as the investment bank for the capital market in Pakistan.

g) Pakistan Investment and Information Centre - This organization, located in London, England, channels the savings of overseas Pakistanis into non-repatriable investments. The center serves as a liaison between Pakistan and other countries.

h) Small Business Finance Corporation (SBFC) - offers medium and long term funds to small businesses and cottage industries for expansion of industry, trade and transport.

i) House Building Finance Corporation (HBFC) - lends to individuals for the purchase of house and flats. Repayment terms are based on the rental value of the property and HBFC's share in the capital value.

j) Equity Participation Fund - an offshoot of IDBP designed to assist small and medium sized industries in less developed regions of Pakistan through the provision of equity and bridging finance.

k) National Development Leasing Corporation (NDLC) - The government has recently set up the NDLC, which will be primarily financing equipment for the manufacturing, mining and health industries. A number of commercial banks have already financed the purchase of plant and equipment for private companies on lease arrangement. Leasing, as a form of finance, should continue developing because of its compatibility with the Islamic tenets.

l) The National Development Finance Corporation (NDFC) - provides term finance. It is a tax-exempt corporation.

m) The Bankers Equity Limited (BEL) - takes care of arranging the finance for, and lending to, major projects in the private sector. It also the national underwriter for new equities. BEL also assists companies which it has sponsored in planning their activities and monitors their operational projects.

2. Other non-banking financial institutions

a) Insurance companies - There are nine insurance companies operating in the private sector which provide accident, household and general insurance. The State Life Insurance Corporation (SLIC), which was established after the life insurance business was nationalized (1974), provides both individual and corporate life schemes.

b) Pension and provident funds - All government employees are covered by a non-contributory pension scheme. In the private sector, businesses hiring more than 9 persons must contribute to an employees' old-age benefits scheme.

Assets of Non-Banking Financial Institutions

Institution	% of total financial assets	
- Bankers Equity Limited (BEL)	0.4	**
- Equity Participation Fund (EPF)	negligible	
- Housing Building Finance Corporation (HBFC)	2.2	**
- Investment Corporation of Pakistan (ICP)	0.7	**
- National Development Finance Corporation (NDFC)	1.4	
- National Investment Trust (NIT)	0.7	**
- Pakistan Industrial Credit and Investment Corporation (PICIC)	1.2	
- Pak-Kuwait Investment Company (PKIC)	0.1	
- Pak-Libya Holding Company (PLHC)	0.4	
- Saudi-Pak Industrial and Agricultural Investment Company (SPIAIC)	0.1	
- Small Business Finance Company (SBFC)	negligible	**
State Life Insurance Corporation	1.5	
Stock Exchange Market Capitalisation of Ordinary Shares	6.4	

** - these institutions manage their financial activities following the letter of the Islamic tenets.

G. FINANCIAL MARKETS

1. Formal money market
   The only formal money market in Pakistan is the Karachi Interbank Call Market where banks discount trade bills and other bills of exchange. It is the only alternative to government securities which banks have for investing excess liquidity. The main borrowers in the market are the foreign banks and PICIC.

2. Informal money market ('the parallel market')
   The parallel market handles funds generated from illegal imports and exports, and from corporate or individual income which has not been declared to the tax authorities. A sub-market, the 'Hundi market', acts as a secondary market for short term bills. Significant sums of money have been drawn into the formal financial system from the parallel market by the issues of bearer instruments, including NSS prize bonds and NDFC certificates of deposit.

3. Capital Market

   a) Investment
      Although the overall investment level has been depressed for the past five years it has slowly started to rise again with the major source of increase coming from investment in stocks. The sluggish investment rate combined with the rising savings rate has meant that Pakistan has been able to finance a large part of its own investment. In 1983 it needed only 11.2% of its investment financed from abroad.

   b) There are two stock exchanges in Pakistan, the Karachi Stock Exchange and the Lahore Stock Exchange. The former handles the larger volume of shares and lists 432 companies. The latter lists only 235 companies and trades far less shares. Very few corporate debentures are listed since since bonds have a limited use and have traditionally been privately placed. Government securities are also traded on the exchanges, but on a very limited scale, since there is no effective market yield in their pricing.

   c) Present state of the market
      The capital market in Pakistan can be characterized as bullish for the past three years. However, informed commentators (ADB report) do not believe that the present boom can be substained because share price increases have not been closely related to earnings.

d) The secondary market
Only 150 of the 342 listed companies are regularly traded. This is a consequence of a widespread reluctance of company owners to dilute their equity interests, thus losing complete control. Of the equity held by individuals, a large portion is held by brokers in their own name. Thus, only a small number of shares is actually owned by the investing public.

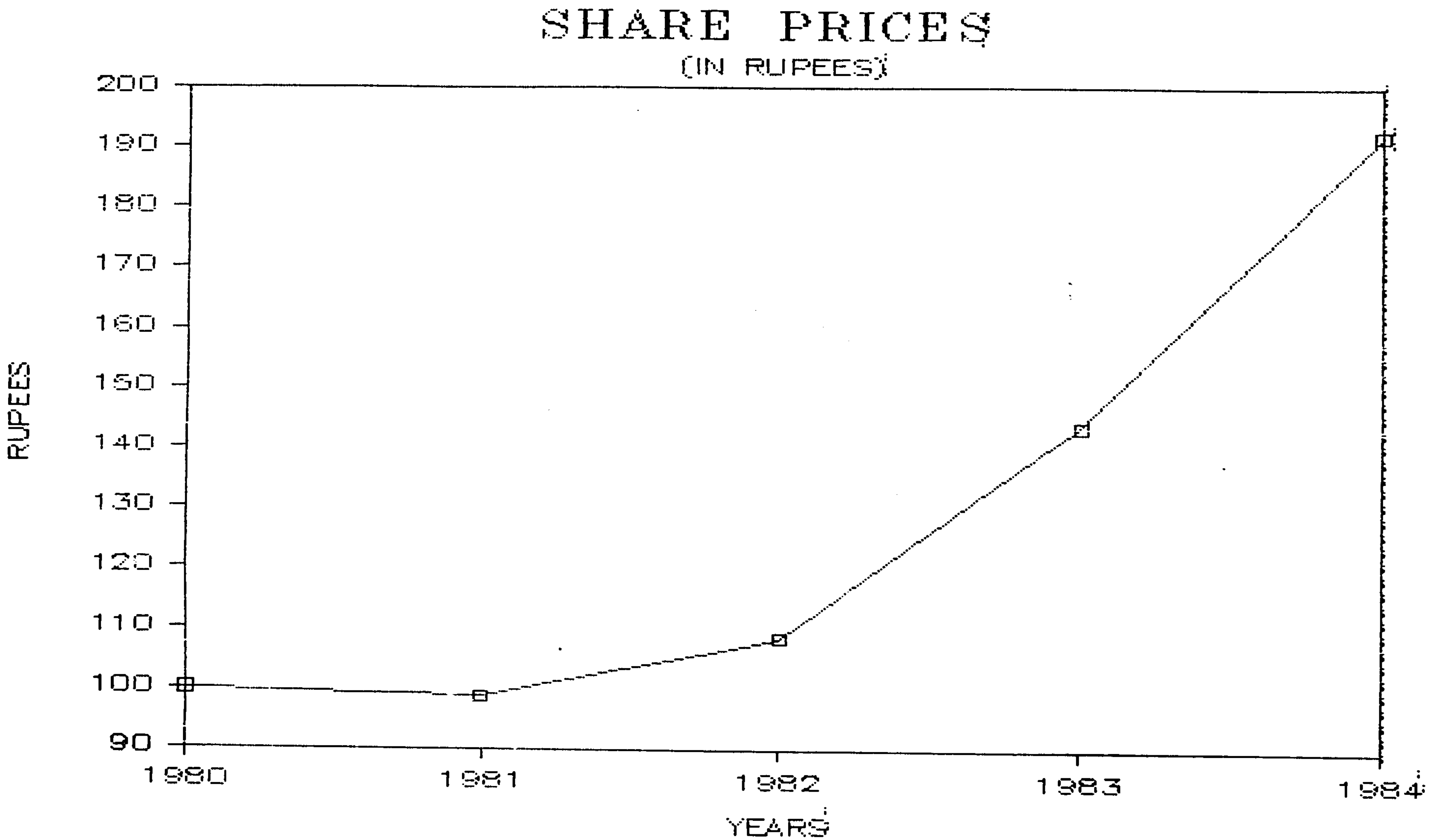
e) Dealers and brokers
On both exchanges there is a single capacity for both jobbing and broking. The Karachi membership is 200 although the trading is dominated by 30 members. The Lahore membership is 120. Members of the stock exchanges must be Pakistani citizens. Members are also expected to satisfy a minimum net worth criterion of 500,000 rupees.

f) Market regulation
The Board of the Stock Exchanges is responsible for the regulation and control of matters relating to dealing, registration and settlement. The Board also handles matters pertaining to admission, discipline and suspension of members. Regulations in terms of dealings and disclosures are not strictly enforced.

g) Commisions and fees
The commisions, which average 0.3% per transaction, are fixed according to a schedule set by the Stock Exchange.

h) Role of institutional investors/retirement funds
SLIC has invested nearly all of its assets in medium and long term government securities. SLIC plays an unimportant role in the equity market. It holds only 4.7% of the aggregate market value of all the ordinary shares quoted in the stock exchange.

i) The Trustee Savings Act
Specifies the scope of approved investments for pension funds. Currently, portfolios for these funds are dominated by deposits in NSS schemes.


SHARE PRICES
(IN RUPEES)
RUPEES
200
190
180
170
160
150
140
130
120
110
100
90
1980
1981
1982
1983
1984
YEARS

H. TAX SYSTEM

1. Tax Incentives
   Up to 1,500 rupees of dividend income is tax-free for individuals while 5,000 rupees are tax exempt for pıivate companies. Unfortunately, tax exemption on issues offered by parastatal financial insitutions are much higher (up to 15,000), negating the incentive to invest in common stocks.

2. Sources detailing Pakistan's tax structure were not found.

NOTE:

Sources obtained in researching this report were insufficient in the areas of accounting procedures and tax structure.