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Acronyms and Abbreviations

ACP	Agreement at Completion Point
ADBP	Agricultural Development Bank of Pakistan
AJK	Azad Jammu and Kashmir
AJK CDP	Azad Jammu and Kashmir Community Development Project
ANR	Agriculture and Natural Resources
APS	Asia-Pacific Strategy
ARRI	Annual Report on Results and Impact
AsDB	Asian Development Bank
BADP	NWFP Barani Area Development Project
BVDP	Barani Village Development Project
CCP	Community Credit Pool
CGAP	Consultative Group to Assist the Poor
CI	Cooperating Institution
CLP	Core Learning Partnership
CO	Community Organization
COSOP	Country Strategic Opportunities Paper
CPA	Country Programme Analysis
CPE	Country Programme Evaluation
CPIS	Country Programme Issues Sheet
CPM	Country Programme Manager
CWP	Country Working Paper
DASP	Dir Area Support Project
ENRAP	Electronic Networking for Rural Asia/Pacific project
EVEREST	Evaluation of IFAD's Regional Strategy for Asia and the Pacific
FAO	Food and Agricultural Organization
FATA	Federally Administered Tribal Areas
GOP	Government of Pakistan
IEE	Independent External Evaluation of IFAD
IFAD	International Fund for Agricultural Development
IFI	International Financial Institution
LGO	Local Government Ordinance 2001
M&E	Monitoring and Evaluation
MFB	Microfinance Bank
MFP	Microfinance Provider
MIOP	Microfinance Innovation and Outreach Programme
MTDF	Medium Term Development Framework
MTR	Mid Term Review
MVSP	Mansehra Village Support Project
NRM	Natural Resource Management
NGO	Non-Governmental Organization
NADP	Northern Areas Development Project
NJVCDP	Neelum and Jhelum Valleys Community Development Project
NWFP	North West Frontier Province
NRSP	National Rural Support Programme
OE	Office of Evaluation
OSS	Operational Self Sufficiency
PBAS	Performance Based Allocation System
PCU	Project Coordination Unit
PCR	Project Completion Report
PFCADP	Pat Feeder Command Area Development Project
PI	Regional Division for Asia and the Pacific

PKR	Pakistan Rupees
PMU	Project Management Unit
PMN	Pakistan Microfinance Network
PPAF	Pakistan Poverty Alleviation Fund
PPO	Pakistan Post Office
PRSP	Poverty Reduction Strategy Paper
PSC	Project Steering Committee
PSR	Project Status Report
RDSF	Rural Development Sector Framework
RSPs	Rural Support Programmes
SBP	State Bank of Pakistan
SBADP	Second Barani Area Development Project
SECP	Securities and Exchange Commission of Pakistan
SRSP	Sarhad Rural Support Programme
SWRCP	Smallholders and Women's Rural Credit Project
TAG	Technical Assistance Grant
UNDP	United Nations Development Programme
UNOPS	United Nations Office for Project Services
USD	United States Dollars
TOR	Terms of Reference
WFP	World Food Programme
WHAM	Widening Harmonized Access to Microfinance Project
ZTBL	Zaraee Taraqqiati Bank Limited

1. COUNTRY CONTEXT AND SECTOR ISSUES

1.1 IFAD in the Context of Rural Finance in Pakistan: Introduction

1. For much of the period between the 1970s and 1990s rural finance in Pakistan was dominated by the government-owned Agricultural Development Bank of Pakistan (ADBP), which was subsequently restructured and renamed the Zaraee Taraqqiati Bank Limited (ZTBL). The ADBP provided loans for almost every kind of investment in agriculture, including working capital, tractors, threshers, tubewells and agro-industry. It accepted security in the form of 12 kinds of assets and guarantees, including some which, in theory, could also be provided by small farmers and the landless[1]. Although the Bank's system of supervised credit—based on Mobile Credit Officers and the Mobile Female Credit Officers added later—was supposed to provide extensive outreach, the disbursement targets provided to bank staff served to focus them on a small number of large loans. In practice, therefore, very few small farmers, the landless and women benefited from the ADBP.

2. In the mid-1980s, the ADBP, with funds from the leading International Financial Institutions (IFIs), started lending for milk plants and other agro-industrial enterprises. All too many of these initiatives were approved for political reasons and soon started failing. The civilian government installed under military patronage in 1985, and the ones that followed, wrote off large amounts of ADBP loans. Although the bank was not yet in an alarming position, the basis for its insolvency had been laid by the time IFAD approved a major project for the ADBP in 1990[2]. This was the USD 25 million Smallholders and Women's Rural Credit Project (SWRCP), cofinanced by the World Bank for USD 150 million, a pioneering initiative which envisaged the use of social collateral but was abandoned prematurely in 1994, about two years after the project was declared effective. This also affected the Neelum and Jhelum Valleys Community Development Project (NJVCDP), approved in 1991, which was supposed to receive a line of credit through the SWRCP but did not. Moreover, the credit line intended to go through the ADBP to the Mansehra Village Support Programme (MVSP), approved in 1993, also did not materialize as such and was transferred to another institution[3].

3. In addition to the ADBP, the government required and encouraged the Nationalized Commercial Banks (NCBs) to lend in agriculture[4]. All banks had targets for interest-free agricultural loans mandated by the State Bank of Pakistan (SBP), which paid the banks 10% interest for such loans. What little activity took place through the NCBs was aimed at the large farmers. In many parts of the country, the NCBs did not lend for agriculture at all. Not surprisingly, IFAD projects never involved the NCBs. In NWFP, however, IFAD approved lines of credit through the Bank of Khyber, a commercial bank established by the Government of NWFP in the early-1990s. This was done for the Dir Area Support Project (DASP), approved in 1996; Southern Federally Administered Tribal Areas (FATA) Development Project (South FATA), approved in 2000; and the North West Frontier Province (NWFP) Barani Area Development Project (BADP), approved in 2001 and cofinanced by the Asian Development Bank (AsDB)[5]. In all three projects, the commercial lines of credit were abandoned during 2004-2007 due to the inability of the Bank of Khyber to operate them at a profit, and the inability of the donors to find an acceptable alternative.

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[1] For example, appraised value of crops, new machinery and milch animals purchased under the loan.

[2] An earlier project, the Second Barani Area Development Project (SBADP) in the Punjab (approved 1990), also had a credit line through the ADBP.

[3] According to the Mid-Term Review (MTR) of the MVSP, "The source of funds assumed to be available at the start of the project were [*sic*] part of an IFAD line of credit to ADBP which was subsequently cancelled." This presumably refers to the SWRCP. According to the MTR, ADBP was to supply 67% of the credit component, with 33% coming from the Government through the Sarhad Rural Support Programme (SRSP), but this is not mentioned in the President's Report.

[4] All Pakistani commercial banks had been nationalized in the early-1970s. Until the start of privatization in the 1990s, only a handful of foreign banks represented the private sector in banking.

[5] In the BADP, however, the Bank of Khyber was supposed to channel 80% of the credit through non-governmental organizations (NGOs) to community organizations.

4. Thus, seven of the 10 IFAD projects approved during 1990-2001 were tied at the time of design to credit lines through government-owned banks, and in at least six of them this arrangement did not work out as expected[6]. Four projects approved during the 1990s, including two mentioned above that also engaged a bank, allowed credit to be disbursed through non-governmental organizations (NGOs) or Rural Support Programmes (RSPs); these were the BADP, MVSP, the Pat Feeder Command Area Development Project (PFCADP) in Balochistan (approved 1994)[7] and the Barani Village Development Project in Punjab (approved 1998)[8]. These arrangements reflected the arrival of NGOs and RSPs in the field of rural finance. The first such initiative in the rural areas was taken in 1983 by the Aga Khan Rural Support Programme (AKRSP), which was the first of the RSPs[9] and operated in the Northern Areas and the Chitral District of NWFP.

5. During the period under review, several donor-assisted rural development projects also experimented with approaches that did not depend on banks and NGOs. These relied on individually recruited social mobilizers who organized credit and savings programmes under the overall supervision of a Project Management Unit (PMU). As mentioned later, a number of IFAD-assisted projects ultimately followed this approach, but only two of them built in this mechanism as the only channel for credit at the design stage; these were the Northern Areas Development Project (NADP), approved in 1997, and the Azad Jammu and Kashmir (AJK) Community Development Project (CDP), approved in 2003 as the second phase of the NJVCDP. The President's Report for AJK CDP says that the project would build on the same structure that was promoted by the NJVCDP, namely, the Community Credit Pool (CCP). Similar PMU-organized revolving funds at the community level were also established in MVSP, DASP and South FATA, in all cases with small amounts of funds.

6. Financial sector reform initiated during the late-1990s progressed rapidly with the privatization of NCBs and the restructuring of the ADBP. Around the same time, a number of NGOs had begun to establish what eventually came to be known as the Pakistan Microfinance Network (PMN). In 1998, following a new poverty alleviation strategy (outlined below), the Government sponsored, and the World Bank assisted, the establishment of the Pakistan Poverty Alleviation Fund (PPAF), an autonomous apex organization for the provision of microfinance and grant funds to NGOs on a wholesale basis[10]. The PPAF disbursed its first loans to Microfinance Providers (MFPs) in 2000. This, together with a number of other developments described below, signalled the emergence of microfinance in Pakistan during 2000-2001. In 2005, IFAD approved the USD 26.5 million Microfinance Innovation and Outreach Programme (MIOP), which is channelled through the PPAF for on-lending by the partner NGOs of the PPAF. Thus, over a 15-year period, IFAD completed the same transition from the ADBP to the PPAF which the Government itself went through in terms of the overall implementation approach to credit delivery for the rural poor. But it followed the World Bank to the PPAF with a lag of six years.

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[6] The fate of the credit line in the SBADP cannot be determined from available documentation, as the document provided under the name of the Mid-Term Review is actually a survey report that says nothing about the progress of the credit component. Other information suggests, however, that credit was disbursed.

[7] The credit component was entrusted to the Balochistan Rural Support Programme (BRSP), which was then a new RSP. Its performance was considered unsatisfactory and the component transferred after the MTR to the Taraqee Foundation, which had little experience and also struggled to make things work.

[8] The project design called for an NGO to be engaged, and the National Rural Support Programme (NRSP) was selected after project implementation started.

[9] There are now 10 RSPs in the country. They are: (a) incorporated under the Companies Ordinance as private companies limited by guarantee and not having a share capital; (b) governed by Boards of Directors in which representatives from civil society rather than government agencies hold the majority; and (c) staffed by individuals recruited from the open market. Thus, the RSPs are autonomous of the government in respect of legal status, governance and management. In respect of funding, however, the RSPs depend mainly on funds provided by donors and the government for projects and general support.

[10] The PPAF has the same autonomous status in terms of the law, governance and management as the RSPs.

1.2 Macro Level Context of Microfinance[11]

7. As indicated above, Pakistan is a relative late-comer to microfinance. The decisive change in this direction came with "*Overcoming Poverty*, Report of the Task Force on Poverty Eradication" (1997). This report recommended a number of macro-economic policies for changing the structure of the growth process so as to enhance its potential for reducing poverty. It also recommended five programmes for establishing the institutional basis for eradicating poverty within ten years. The proposed programmes included two, in particular, that were eventually supported through the PPAF and its NGO partners, namely:

(a) participatory development at the village and *mohalla* (city neighbourhood) levels through support organizations for social mobilization; and,
(b) micro-credit for the urban and rural poor through the PPAF.

8. The autonomous status of the PPAF was a major departure from government control of banks. This was ensured by Mr Sartaj Aziz, a former senior official of IFAD who was a member of the Federal Cabinet in the 1980s and 1990s. He states that the political leadership learned some lessons from the politicized decision making that dominated social sector programmes in the 1990s. He observes that there was a conscious decision in 1998-1999 to insulate poverty alleviation initiatives from local politics[12]. The support extended by the Government for the autonomy of the PPAF is mentioned by Mr Aziz as an example of this thinking.

9. Since 2000, however, the record in terms of direct government intervention in microfinance has been more mixed. According to an extensive review of the sector conducted by the Consultative Group to Assist the Poor (CGAP 2007)[13]:

(a) "the government-owned ZTBL lends at 9 percent (or 8 percent, net of the rebate), which is below market rates, and it has huge [Non-Performing Loans]. Despite numerous restructuring plans with donors' assistance, ZTBL continues to make a large number of subsidized small loans in rural and agriculture finance (336,000 micro-loans last year);"
(b) the Khushhali Bank, established by a special ordinance of the Government in 2001 and supported by the AsDB, is viewed to be under government control rather than autonomous. "The new government-led Rozgar Scheme, which targets 2 million young people with business loans at subsidized interest rates, is a clear illustration of ***increased activity of [the Government] in retail credit delivery***;" and,
(c) "One of the few remaining provincial-owned financial institutions, Bank of Khyber, started by the North West Frontier Province government, was forced to restructure several times because of loan losses, then moved into microfinance, but its board members did not allow cost-covering interest rates."

10. At the same time, the Government has put in place a solid legal and regulatory framework for microfinance, starting with the Microfinance Institutions Ordinance in 2001, "which is respected worldwide" (CGAP 2007). According to CGAP 2007, "The law does not affect NGO MFPs that do not engage in retail deposit taking, and they are permitted to accept compulsory savings, provided these are held in trust for customers in a licensed bank." And the Securities and Exchange Commission of Pakistan (SECP) prudentially regulates non-banking finance companies and insurance companies.

[11] Analysis of the macro, meso and micro level aspects of rural finance is required by the consultant's Terms of Reference reproduced in Annex I.
[12] Speech reproduced in NRSP 1997.
[13] This was called the "Country-Level Effectiveness and Accountability Review (CLEAR) with a Policy Diagnostic."

11. At the policy level, the Government sees microfinance as an increasingly important but not exclusive instrument for poverty alleviation. In particular:

(a) The first Poverty Reduction Strategy Paper (PRSP I), finalized in 2003, makes microfinance one of the main vehicles for targeting the poor and vulnerable.
(b) The Government's Medium Term Development Framework 2005-2010 (MTDF) highlights credit-based self-employment (livelihood) programmes that aim at micro-credit for the poor in agriculture, micro-credit for small and medium enterprises, and micro-credit for housing.

12. The overall Government approach to poverty alleviation remains multi-faceted and does not generate excessively ambitious expectations for microfinance as an instrument for poverty alleviation. This is clear, in particular, from the MTDF (GOP 2005: Chapter 5), in which a wide range of poverty alleviation policies and programmes have been identified. It is not clear, therefore, why the CGAP review of 2007 considers "overstated expectations of microfinance as an instrumental poverty alleviation tool" to be a major challenge for Pakistan at the macro level. Indeed, the list of poverty alleviation measures provided in the MTDF is even more comprehensive than what CGAP 2007 recognizes in the second of the following sentences: "There is indeed good evidence that access to a range of financial services can play a strong role in alleviating poverty, but microfinance is by no means a magic bullet. Many other services, such as health, education and infrastructure, may have more direct impact on poverty alleviation."

1.3 Meso Level Context of Microfinance

13. There are a large number of stakeholders in rural finance, and the institutional landscape is best described *in toto* by CGAP 2007, in words that are reproduced in Annex II. Donor commitments for microfinance during 2000-2005 are estimated to have been USD 527 million, with disbursements of USD 400 million (Annex III, taken from CGAP 2007[14]). Not all the donor assistance is for lending through MFPs: a large amount, particularly from the AsDB, seems to be for budget support, and there is a hint to this effect in footnote 18 of Annex III. The largest MFPs, including NRSP, note that they do not have adequate access to funds for meeting their expanding needs.

14. Among the MFPs, the PMN has 18 members that account for 99.5% of the market, and a total of 27 that report their data to it. The MFPs include six relatively new MFBs, multi-sectoral NGOs and the 10 RSPs, which are integrated rural development programmes, and specialized (credit-only) NGOs. Some commercial financial institutions such as leasing companies are also present in the field, and several commercial banks also provide microfinance services. The State Bank of Pakistan (SBP) is now encouraging alliances between MFPs and the Pakistan Post Office (PPO), which has a network of more than 12,000 offices throughout the country and four million savings accounts. And finally, some of the cellular phone companies are also actively considering entering the sector.

15. The PPAF is by far the largest wholesaler of microfinance in Pakistan, providing funds to partner NGOs that reach about one-half of the one million-plus borrowers in the country. Among retailers, MFBs are the largest peer group in the sector, followed closely by the RSPs, with specialized NGOs[15] a distant third. Within these peer groups:

(a) Khushhali Bank accounts for 92% of the market share among the MFBs. It works mainly in urban and peri-urban areas and is the largest MFP in the country, reaching about 300,000-350,000 microborrowers. It does not get any of its funds from the PPAF.
(b) NRSP accounts for 59% of the market share among the RSPs and is the largest MFP in rural areas. NRSP as well as the other RSPs depend for their funds mainly on the PPAF.

[14] Curiously, however, this annex, which CGAP notes is based on self-reporting, reports zero microfinance commitments and disbursement by IFAD during 2000-2005.
[15] The PMN refers to specialized NGOs as "specialized MFIs" in its reports.

(c) Kashf Foundation, which works mainly with women in urban areas using the Grameen approach, holds 73% of the market share among specialized NGOs. According to a 2006 survey by Microfinance Information Exchange (MIX 2006), Kashf is one of only two of the 27 MFPs reporting to the PMN that are sustainable[16].

16. An authoritative survey (MIX 2006) observes that average operational self-sufficiency (OSS) in Pakistan was 80%, compared with 106% across South Asia, and all except five MFPs reporting to PMN were running losses. Based on the PMN's Performance Indicators Report (PIR) for 2005 (PMN 2006),[17] the financial status of MFPs that have worked in IFAD-assisted projects in recent years may be described with the following key indicators:

(a) The OSS for NRSP is 85% and its adjusted return on assets is -4.4%.
(b) For the Bank of Khyber the OSS is 41% and the adjusted return on assets is -27.3%.
(c) The SRSP reports OSS of only 15% and adjusted return to assets of -29.5%. SRSP's proposal for an experimental approach in BADP was not accepted by AsDB and IFAD at the time of the MTR, when they were considering an alternative to the Bank of Khyber.
(d) The ratio of portfolio at risk > 30 days to gross loan portfolio is 1.3% for NRSP, 0% for SRSP and 21.1% for the Bank of Khyber.

17. The PIR concludes that, "the microfinance sector in Pakistan has one of the lowest profitability ratios globally." The problem has been diagnosed in the following terms:

(a) Working with low-cost delivery mechanisms, Pakistan's MFPs are globally competitive in terms of credit delivery costs (USAID Widening Harmonized Access to Microfinance Project (WHAM) 2006 and others). According to CGAP 2007, "the average operating expense ratios of PMN members are basically in line with the region's overall low ratios (PMN is at 22.4% and total Asia is 22.8%)."
(b) On the other hand, MFPs in Pakistan charge prices that do not cover total costs. CGAP 2007 notes that "revenues generated from the loan portfolio (e.g., the yield on portfolio) are low at 18.8% for PMN members (compared with 30.7% in Asia on average)."

18. Thus, as outlined in USAID WHAM 2006, reaching the potential clientele and sustaining operations thereafter would require subsidies in perpetuity. The scenario differs between urban and rural areas, and also within rural areas. One relevant insight comes from an evaluation by the International Fund for Agricultural Development (IFAD 2007): microfinance coverage varies directly with population density and proximity to roads. While Bangladesh, with a population density of about 1,100 persons per km^2, is well-served, very low-density rural areas (10-15 persons per km^2) where the road system is inadequate get very little or no coverage. The evaluation observes, "IFAD's core innovation contribution has focused on medium density [rural] areas and replicating successful urban pro-poor models. Consistent with the industry at large, however, IFAD has made much less progress in innovating for micro agricultural financial products and services (i.e., on-farm financing) and for reaching very low density populations." Thus, a standard sustainable model of rural (particularly agricultural) finance has not emerged.

19. Outcomes such as these reflect differences in the prevailing demand and supply conditions, particularly between urban and rural areas. This may be illustrated with specific reference to NRSP, which has been IFAD's partner in the BVDP: 82% of its rural portfolio consists of loans for agriculture and livestock, and only 18% for enterprise development; in its urban portfolio, however, 89% of the loans are for enterprise development, and only 11% for livestock. The unit cost of service delivery is lowest in urban areas and highest in the sparsely-populated rural areas[18]. Moreover,

[16] The other sustainable MFP is the Orangi Charitable Trust, which also works in urban areas.
[17] The PIR for 2006 is expected to be published some time during September 2007.
[18] According to the PPAF, its experience suggests that a new urban branch of an MFP breaks even in 1.5 years and a new rural one in three-to-four years (meeting with evaluation mission, 12 July 2007).

demand in rural areas originates mainly in agriculture, where returns are low and somewhat unpredictable, and cash inflows are seasonal rather than daily or monthly. These demand-and-supply factors could explain low outreach as well as the unsustainability of rural finance operations in the kind of remote sparsely-populated areas that have been selected by most of the IFAD projects.

20. However, the return to borrowers of microfinance loans is estimated to be high. A survey-based study commissioned by the PPAF in 2005 estimated the return on investment for loans averaging PKR 11,445 to be 70% after deducting the estimated cost of borrowing (PPAF 2007). Feasibility studies for microfinance projects also estimate such high rates of return. This is consistent with the fact that borrowing from the informal sector at very high rates of interest is large and extensive throughout the country. But, as pointed out by CGAP and others, MFPs in Pakistan are reluctant to charge interest rates that are necessary for sustainability. For example, NRSP charges 20% per annum on a declining basis, which amounts to about 12% on a flat basis. IFAD's erstwhile partner ADBP/ZTBL also lends at subsidized rates. In the IFAD-assisted projects in NWFP (refer to Annex IV), SRSP as well as the Bank of Khyber have been unwilling to charge interest rates that would reflect the costs of lending in rural areas. Most recently, the Bank of Khyber cited the low population density and high lending costs in rural areas as a factor behind its withdrawal from BADP, but an observation made in CGAP 2007 and reproduced above in paragraph 9(c) says that the bank's "board members did not allow cost-covering interest rates."

21. CGAP suggests that most MFPs, and particularly the multi-sectoral programmes, view microfinance as a social service rather than a financial service. "The main preoccupation is to transfer funds to specified target groups and, if the funds rotate, all the better" (CGAP 2007). But there is no long-term vision of sustainability, and the personnel (social mobilizers and community activists) are recruited and motivated more for helping solve the problems of the community as social workers than for establishing the foundations of sustainable operations as hard-nosed bankers. In addition, raising the interest rate could, at least in the short run, reduce the number of borrowers, which may be construed to reflect adversely on the performance of managers and directors.

22. This is a picture that could describe not only most of the rural MFPs but also IFAD-assisted projects in which community-level revolving funds (or credit pools) have been established, with the additional qualification, however, that projects designed for only 7-8 years would have even less of a vision of sustainability than institutions that are expected to be permanent. Not surprisingly, field work for this evaluation suggests that community-level mechanisms facilitated by project management charge a much lower rate of interest than rural MFPs. CGAP is of the view that these problems of vision, values and incentives are not present among the specialized (credit-only) MFPs, which offer, therefore, much better prospects of sustainability. In operational terms, according to CGAP 2007, "The reason is simple: the delivery of financial services to the poor requires banking skills and specific systems and operating procedures that are different from social mobilization and development (e.g., MIS, loan analysis and recovery)."

1.4 Micro Level Context of Microfinance

23. Field work suggests that IFAD-assisted projects, like most others engaged in rural finance, are extremely flexible in lending for various purposes. Typically, loans of PKR 5,000-10,000 are available for agricultural inputs, poultry and small assets (e.g., sewing machines). Larger loans in the range of PKR 10,000-20,000 are used for purchase of livestock, transport and investment in enterprises (e.g., building a store, improving a barber shop, etc.). By all accounts, however (e.g., PPAF 2007), the average loan size for rural MFPs has remained in the range of PKR 10,000-12,000 for the last few years. Indeed, the sector as a whole, relative to other countries, appears to be unduly conservative and shy of innovation and product development. CGAP 2007 concluded as follows:

> The range and nature of product offerings by MFPs leaves much to be desired. The Pakistan credit market is dominated by one financial service—credit—and many MFPs [but not the

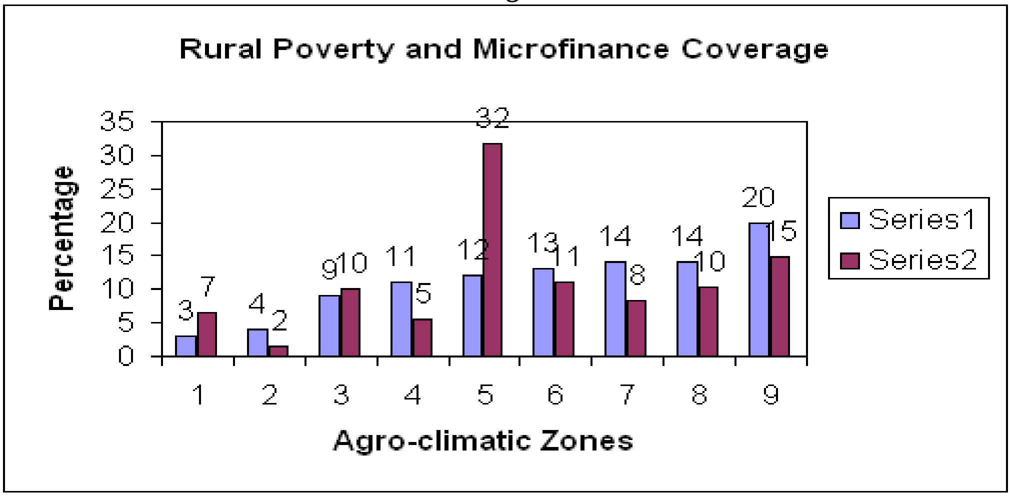
RSPs] use a methodology inspired by the Grameen model. Clients make do with institutions that nearly all offer the identical product, typically a small loan with six- or twelve-month tenure, group guarantees, and bi-weekly payments [except in rural finance].

24. There are some exceptions to the overall picture, however, and NRSP is perhaps the most important one. From 2007 it has introduced "health insurance" for its borrowers in cooperation with an established insurance company. Like other RSPs and most NGOs, it also promotes the mobilization of savings in bank accounts maintained in the name of community organizations. The RSPs account for 77% of all microsavers in the country (PMN MicroWatch 2007). The savings accumulated by RSP-supported community organizations exceed one billion rupees, but they cannot be used by the RSPs for lending purposes. Some of the IFAD-assisted projects, mentioned above, get around this constraint by promoting CCPs in which the project and the communities put in matching amounts, which are then revolved as loans among community members. IFAD-assisted projects have also been diligent about providing training in credit management and enterprise development in tandem with microfinance.

25. Overall, savers outnumber borrowers in the sectors: at the end of 2005, the number of savers was about twice the number of borrowers (PMN 2006), though growth was faster during 2003-2005 in the number of borrowers. The most recent data show the number of borrowers at 1.13 million (PMN MicroWatch 2007); it barely exceeded 100,000 in 2002. The pattern of growth, however, has been uneven across the country, and not necessarily focused on areas with a high incidence of rural poverty. More specifically:

(a) Outreach is particularly weak in AJK, Balochistan and NWFP, and also parts of Punjab and Sindh. As indicated above, it is in Balochistan and NWFP that IFAD-assisted projects have faced the most serious problems in rural credit delivery, and it is in AJK and NWFP that these projects have improvised with community-level revolving funds and credit pools.
(b) The proportion of microcredit clients in particular agro-climatic zones (Series 2 in Figure 1) is weakly correlated with their shares among the rural poor (Series 1). For example, 39% of the borrowers live in two zones of Punjab, which account for only 15% of the rural poor. And NWFP accounted for 14% of the rural poor but only 8% of the microcredit clients. Detailed supporting data and the sources for Figure 1 are provided in Annex V[19].

Figure 1:



[19] The number of borrowers is taken from the PMN MicroWATCH December 2006 issue, and zone-by-zone estimates of poverty from Malik 2005, who used the 2002 official survey data.

1.5 Major Problems and Issues

26. Almost all observers of microfinance in Pakistan comment on two basic problems, namely, low outreach and lack of sustainability, that confront the sector. Outreach is considered to be low in comparison with the estimated clientele of about 10 million borrowers. This estimate has been circulated by the USAID WHAM project and is being used uncritically by almost everyone in the sector, including IFAD. Discussion with the originators of the estimate reveals that it is based on the assumption that outreach in Bangladesh is an appropriate benchmark for estimating outreach in Pakistan. At the same time, leading MFP practitioners in Pakistan, as well as the IFAD evaluation of its rural finance policy, caution that Bangladesh is unique and cannot be the most relevant benchmark under the very different conditions prevailing in rural Pakistan.

27. Annex VI reviews the basis for the estimate made by USAID WHAM and supports the contention that the 10-million estimate is on the high side and lacks justification. It observes that the USAID WHAM estimate means that "1.4 adults from every poor and vulnerable household in the country would be microfinance borrowers all the time." This means that "every single household among the poor and vulnerable of the country is a microfinance borrower, and that 40% of all such households have more than one borrower in the microfinance sector, at all times." Using a household-based model of decision making, Annex VI suggests that this is a highly unrealistic scenario. It concludes: "Assuming that only 70% of the poor and vulnerable households would be willing to borrow from MFPs at any given time, the potential clientele would be 5.1 million individuals (including 3.3 million in rural areas), and the projected burden of unsustainable microfinance operations would be reduced by about one-half." This does not mean, however, that low outreach and unsustainability are not real problems, but careful analysis of micro-level factors suggests that they have been overstated.

28. The fact that Pakistan is a relatively new entrant in the field of microfinance is one of the major reasons for the low outreach of the sector. The growth, however, has been phenomenal and no slackening of interest on the part of the government or the private sector is evident thus far. Indeed, discussion is ongoing among policy making circles for ways and means to reach three million borrowers in the near future. The initiatives under discussion would almost certainly entail subsidies by the government, particularly for rural areas, which may increase outreach but also the extent of unsustainability. As in the past, the impulse for populism remains strong, and subsidies are not likely to go away any time soon, particularly if the bill is smaller than what is being currently projected[20]. This kind of public policy has a direct impact on the incentives, vision and policies of MFPs, international best practices notwithstanding. This macro-level context qualifies what donors such as IFAD can realistically aim to do at the meso level.

29. Even with public subsidies, however, and also because of the subsidies, as argued later on, MFPs working or aiming to work in rural areas face a number of challenges. Perhaps the foremost among these is the uncertainty of demand from the agriculture sector. In most parts of the country, growth in agriculture affects the entire rural economy. This is particularly the case in areas, such as the cotton/wheat zones of Punjab and Sindh, in which little diversification has taken place and the agricultural cycle dominates the business cycle. In the cotton/wheat zones, two-thirds of agricultural income comes from agriculture (Annex V). In the rainfed areas of Punjab, however, only 14% of household income depends on agriculture, while the relevant share of household income in NWFP (24%) also shows a diversified economic base that should be conducive to sustainability in the long term.

30. In most parts of the country, however, the ups and downs in agriculture remain daunting challenges to MFPs aiming at expanding outreach through sustainable operations. Coupled with this

[20] USAID WHAM 2006 estimates that in order to reach 10 million customers (by 2014/15), MFPs would incur a shortfall of USD 900 million (at constant 2005 prices), while sustaining services to this clientele "beyond 2014 would incur a shortfall of revenues against costs of about USD 200 million each year in perpetuity."

is the apprehension that subsidized, supply-driven MFPs would have little incentive to respond to conditions on the ground with a range of relevant microfinance products, supported by cost-effective alliances. The interplay between the effect of subsidies and responsive to client needs as well as concerns for sustainability may be illustrated with reference to four possible outcomes, described as follows:

(a) The absence of insurance for agricultural activities and microfinance operations means that uncertain demand from agriculture would continue to undermine plans for greater microfinance outreach. NRSP is the only rural MFP which has introduced insurance as part of its microfinance operations, and that too only in 2007. This is a path-breaking development but none of the other rural MFPs has followed suit. By providing an alternative form of insurance to the MFPs, the continuation and enhancement of public subsidies would reduce the incentive for MFPs to introduce appropriate ***insurance products***.

(b) As noted above, there is little variation in the standard loan product that is on offer, which means that MFPs are not responding to the variations in living conditions and sources of income across the country. Product development is one way of increasing outreach as well as the prospects for sustainability, but subsidies present an alternative source of income for MFPs that undermines their incentive to grow and sustain through ***new loan products***.

(c) As noted in paragraph 14, a large infrastructure for mobilizing savings and introducing new products is available through the PPO, and the SBP is encouraging alliances between MFPs and the PPO. Cellular telephone companies are also eyeing the microfinance market, and at least one UNDP project, working with two MFPs, is engaging them actively. MFP ***alliances with PPO and cellular phone companies*** could help reduce the cost of credit delivery, particularly in remote and low population density areas, but subsidies would reduce the incentive for MFPs to seek cost-cutting measures by entering into such alliances.

31. The fourth possible consequence of subsidy is one that needs to be addressed in conjunction with the way microfinance issues have been analyzed in recent years by CGAP and those following the CGAP approach. The approach adopted by CGAP and its donors, as explained in CGAP 2007, has a view of aid effectiveness that says nothing about poverty and poverty alleviation. This view is summarized in what CGAP calls the Aid Effectiveness Star, which looks at five elements, namely, strategic clarity, appropriate instruments, staff capacity, relevant knowledge management and accountability for results, none of which apparently is elaborated in terms of clear poverty objectives. The entire framework is actually addressed in terms of financial management rather than socio-economic analysis, and one result of this is the complete absence of a poverty analytic (e.g., the relationship between outreach and the incidence of poverty, as illustrated in Annex V) from sector reports and analyses such as CGAP 2007, PMN 2006 and USAID WHAM 2006.

32. Another result of following an exclusively financial management approach is that CGAP 2007 conveys the impression that MFPs pass on subsidies to the eventual borrower instead of using them for their own institutional development. This is a counter-intuitive conclusion, if it is recognized that the bottom line for all MFPs is either retained earnings (in the case of for-profit organizations) or surpluses (for non profits). If this is correct, then it follows that MFPs would be using part of the subsidy for their own institutional interests, perverse as they may be in view of what is socially optimal. Indeed, Annex V shows that MFP operations have been concentrated in agro-climatic zones in which the incidence of poverty is low—because the cost of operation in these high-population-density and good-access areas is also low and, as a result, the possibility of generating profits and surpluses is high. With continuing and enhanced subsidies, there is a ***high probability that MFPs would tend to concentrate in areas with a low incidence of poverty***, where the cost of operation is low, rather than passing on the subsidy to poor people across the country. As is well known in economics, the economic incidence of the subsidy would be different from its legal or administrative incidence.

2. IFAD'S APPROACH AND OUTREACH IN RURAL FINANCE

2.1 Implementation Approach

33. As described in Chapter 1 of this paper, IFAD's approach to rural finance has evolved in line with the sector as whole, and this is summarized in Table 1. It has been particularly problematic in Balochistan and NWFP, tentative in AJK and the Northern Areas, and more sure-footed in the Punjab. This is consistent with the state of the sector as it has evolved during 1990-2005. IFAD has not been slow in engaging NGOs to deliver the rural credit components of IFAD-assisted projects. It has, however, lagged behind the World Bank in moving from government-controlled banks (ADBP and Bank of Khyber) to the autonomous PPAF.

Table 1: Mechanisms for Rural Credit Delivery in IFAD-assisted Projects, 1990-2005

Date of Approval	Project	Mechanism for Credit Delivery Adopted at the Design Stage	Fate of Mechanism and Eventual Arrangement
Apr 1990	SBADP	Credit line through ADBP	***Credit was provided***
Oct 1990	SWRCP	Credit line to ADBP with 3 pilot projects; policy dialogue in cooperation with World Bank	***Project was closed within 2 years*** of effectiveness on account of problems with ADBP
Sep 1991	NJVCDP	Credit line through ADBP/SWRCP	SWRCP and its ***credit line were abandoned***; CCPs established through project management
Dec 1992	MVSP	67% of the total was to come through a credit line through ADBP/SWRCP, and 33% through SRSP	SWRCP and its ***credit line were abandoned***; credit component was transferred to SRSP
Apr 1994	PFCADP	Revolving fund through BRSP	BRSP did not perform; ***component was transferred*** to the Taraqee Foundation
Sep 1996	DASP	Credit line through Bank of Khyber for enterprise development, plus community-based revolving fund for income generation	***Bank of Khyber withdrew*** from the project in 2004; ***other lending reached an impasse*** on account of religious objections
Sep 1997	NADP	Revolving credit fund for income generation	***As per design***
Dec 1998	BVDP	Revolving fund through an NGO	NRSP was the NGO selected and has ***worked out sustainability of operations*** with the Government
Dec 2000	South FATA	Credit line through Bank of Khyber for enterprise development, plus community-based revolving fund for income generation	***Bank of Khyber withdrew*** from the project; CCPs established through project management
Apr 2001	NWFP BADP	Credit line through Bank of Khyber, 80% of it for disbursement through NGOs to communities, and 20% for direct disbursement by bank for larger loans	***Bank of Khyber withdrew*** from the project, and donors did not find an acceptable alternative; resources were reallocated
Dec 2003	AJK CDP	Same structure as promoted under NJVCDP, namely, CCPs established through project management	***As per design***
Dec 2005	MIOP	Lending to and capacity building of NGOs through the PPAF	***As per design***

34. Like other donors and the government, IFAD has also struggled to increase outreach and deal with sustainability issues. This is most evident in IFAD-assisted projects in Balochistan and NWFP, the latter highlighted in Annex IV with reference to two MTRs, one Project Completion Report (PCR) and one Completion Evaluation. It cannot be said that this has been a successful struggle in most

cases, but there is at least one success story in the making, and that is the BVDP, where the government has agreed with NRSP for the latter to retain the revolving fund at the completion of the project and extend credit to project beneficiaries on a continuing basis. Other aspects of the IFAD approach are discussed below in relation to specific evaluation criteria.

2.2 Investment and Outreach

35. It is not easy to estimate the investment made by and outreach achieved by IFAD-assisted projects: even the Country Programme Results Management Framework for Pakistan, June 2007, reports the amounts and number of beneficiaries from the design stage, rather than on an actual basis. By any definition, the results management framework is supposed to report on and assist with implementation and feedback, rather than design. The fact that in IFAD the data in this framework are taken from design parameters is but one indication that there is no real feedback loop based on reliable monitoring and evaluation[21].

36. A second indication to this effect is that even design data are not consulted and interpreted correctly: the results framework reported design data on only four of the seven projects that were ongoing in June 2007, and in one of these cases (refer to Note 8 of Table 2) grossly over-estimated the target number of beneficiaries at design by ignoring the contribution of the larger cofinancier. At the same time, there is no mention in the results framework that in BVDP IFAD has helped provide USD 4.65 million in credit through more than 25,000 small loans (Note 6 of Table 2). A third indication is that in Annex III, in which donors have self-reported their microfinance commitments and disbursements during 2000-2005, the corresponding figures for IFAD are zero, which is a complete absurdity when compared with the actual position during these years. Clearly, IFAD's results management framework is in disarray, and the institution does not have any reliable data available to present a correct picture of its microfinance operations in Pakistan.

37. Except for the SWCRP (approved 1990) and MIOP (approved 2005), all of IFAD's credit operations during a 15-year period have been in the context of multi-sectoral projects. While the first of these loans was cancelled, the second has yet to proceed into implementation in the way it was designed. Moreover, the AJK CDP (approved 2003 and affected by the earthquake in October 2005) is yet to initiate its credit component on any significant scale. In addition, the credit component in NWFP BADP was cancelled at the stage of the MTR in 2007. Thus, IFAD's investment and outreach up to this point in time has to be assessed in relation to the rural finance components of the remaining eight multi-sectoral projects.

38. These eight projects had a total budget for microfinance amounting to USD 14.96 million (Table 2), out of which USD 7.65 million was for SBADP (approved in 1990). The remaining seven projects averaged a budget of USD 1.04 million per project, out of which BVDP, the only apparently sustainable credit intervention by IFAD, accounted for USD 2.70 million. The remaining six projects approved during 1991-2000 had an average budget of only USD 0.77 million, or USD 0.11 million (less than PKR 5 million, at an exchange rate of USD 1 = PKR 45) per year for a seven-year project, which is small even by the standards of most of the small NGOs active in microfinance in Pakistan. Clearly, except for BVDP and the recently approved MIOP, IFAD in Pakistan has only been tinkering with rural finance for about 15 years. This is consistent with the stated strategy of IFAD in Pakistan, which is discussed later.

39. Compared with the donor community as a whole (for which data are reported in Annex III):

(a) The IFAD-assisted projects that were ongoing in 2005 had a budget of USD 10.5 million, which represents about 2.5% of all donor disbursements during 2000-2005.

[21] It is incomprehensible that projects are required to report regularly on long lists of financial and physical indicators but the results management framework presented within IFAD does not utilize this information.

(b) Projects that are ongoing in 2007, including BVDP on account of its continuing operations, have a budget of USD 29.2 million, which is about 3.5% of donor commitments for 2000-2010.

(c) Referring to the percentage in (a) and the number of borrowers in Table 2 and its notes, even with generous assumptions, it is unlikely that ongoing IFAD-assisted projects are currently reaching more than 40,000-50,000 microfinance borrowers in the country. This may be a large number in its own right, but it is certainly much less than the total of 240,809 beneficiaries reported in the IFAD Country Programme Results Management Framework for Pakistan, June 2007.

Table 2: Provision of Credit through IFAD-assisted Projects, 1990-2005

Project	Amount at Time of Design (mn USD)	Explanatory Note	Target number of beneficiaries	Target for female beneficiaries
SBADP	7.65			
SWRCP	22.4	1	122,000	
NJVCDP	0.31	2	5,886	
MVSP	1.08	2		
PFCADP	0.17	3		
DASP	1.70	4		
NADP*	0.20	5		
BVDP	2.70	6		
South FATA*	1.15	7	3,809	
NWFP BADP*	1.99	8	4,600	30% of loans
AJK CDP*	4.50	9	34,000	
MIOP*	18.70	9	180,000	50% of borrowers

Explanatory Notes:

*	Indicates ongoing project
1	This project was cancelled, apparently without starting lending at any significant scale. The target number of beneficiaries is the number associated with the IFAD credit only.
2	For these two projects, the line of credit was to come from the cancelled SWRCP. For NJVCDP, the PCR reports an expenditure of PKR 12.55 million, which is converted in the table above at the rate of USD 1 = PKR 40 as stated in the PCR. For MVSP, the PCR reports that the budget at the time of design was PKR 27 million. This has been converted at the exchange rate of USD 1 = PKR 25 at design.
3	The PCR reports that the budget at the time of design was PKR 5.2 million. This has been converted at the exchange rate of USD 1 = PKR 30 at design.
4	This includes USD 1.5 million for a credit line through the Bank of Khyber and USD 0.20 million for a community-level revolving fund.
5	This is for a community-level revolving fund.
6	According to IFAD's Country Programme Issues Sheet for Pakistan, June 2007, NRSP has disbursed a cumulative PKR 279 million (USD 4.65 million) through 25,147 loans.
7	The target number of beneficiaries is taken from the IFAD Country Programme Results Management Framework for Pakistan, June 2007.
8	The target number of beneficiaries reported in the IFAD Country Programme Results Management Framework for Pakistan, June 2007, is 23,000, which corresponds to the entire line of credit, including the contribution of the AsDB. The number reported here is proportional to IFAD's share in the total (USD 1.99 million out of USD 10.00 million).
9	The target number of beneficiaries is taken from the IFAD Country Programme Results Management Framework for Pakistan, June 2007.

2.3 Country Strategy and Corporate Policy

40. Two country strategy documents are available for Pakistan, one prepared in 1991 (IFAD 1991) and the other, a Country Strategic Opportunities Paper (COSOP) approved by the Executive Board of IFAD in 2003 (IFAD 2003a). The first document acknowledges the need for "credit to expand the economic base and prospects of the target groups, along with other pertinent interventions (such as technology, training, extension and marketing assistance) as required." This is one of 12 elements of future strategy summarized in this document. There is no mention of policy dialogue, although innovative approaches emerging at that time from the NGO community are recognized in the discussion.

41. The second document—the COSOP of 2003—continues more or less in the same vein. More specifically:

(a) The COSOP mentions rural finance, in association with enterprise development, as one of a large number of interventions required in support of rural development and access to resources by the poor.
(b) Curiously, it highlights the need for rural finance product development exclusively in the context of empowering women through participation in the non-farm economy.
(c) It makes no mention of rural finance as a topic for policy dialogue.
(d) The IFAD Rural Finance Policy, approved by the Executive Board in 2003, also gets no mention in the COSOP.

42. The COSOP is consistent with the Rural Finance Policy (IFAD 2003b) insofar as it calls for the use of rural finance for generating income and employment. The COSOP as well as the projects are also consistent with corporate policy in the sense that IFAD in Pakistan has been providing resources for liquidity as well as institutional development. There are three important areas of corporate policy, however, in which IFAD strategy and projects in Pakistan have been less than fully compliant with or supportive of corporate policy. These are discussed as follows:

(a) A range of options is given in the corporate policy for providing equity, including credit lines, equity participation in apex institutions and rural financial institutions, credit guarantees, and start-up capital for micro-insurance, micro-leasing or other schemes. In Pakistan, IFAD has concentrated only on credit lines and ignored the other options for providing resources. It has followed its established approach and not adapted to the 2003 corporate policy.
(b) The corporate policy says, "Wherever feasible, liquidity is to be provided only to regulated and properly supervised financial institutions as wholesalers or retailers. Among the performance criteria for their selection, which may be reinforced through IFAD support, are professional management and commercial orientation, autonomy from political interference, orientation towards self-reliance and sustainability as short- or longer-term goals." Credit operations undertaken through project management units cannot qualify in terms of most of these requirements. It may be pointed out, however, that credit operations by project management are the only option available in most of the cases in which IFAD has exercised this option.
(c) The corporate policy says, "Interest rate subsidies … are to be rigorously avoided." In Pakistan, however, as the earlier discussion has indicated, IFAD operates in the midst of interest rate subsidies and has co-existed with them in all its projects.

3. PERFORMANCE AND IMPACTS

3.1 Performance Assessment: Relevance, Effectiveness and Efficiency

43. For much of the review period, IFAD in Pakistan has been diligent in aligning its country strategy and project design with national as well as corporate priorities and strategies, with particular attention to the needs of women and the poor. That it has had the misfortune of having to depend on badly-managed government banks in seven of the 12 projects under review is more a reflection of the state of rural finance in the country than IFAD. IFAD has endeavoured to maintain its relevance, particularly for reaching the rural poor, by engaging NGOs, including the vaunted RSPs, for its community organization and credit operations. To date, however, only one of these NGOs, namely, NRSP, has come close to the potential that attracted IFAD and others in the first instance; but this is a lesson learned in hindsight rather than a matter of relevance at the design stage.

44. IFAD has been less than nimble, however, in keeping pace with the changes that have taken place rapidly in the national and corporate environments for rural finance during 2000-2005. It has been lacking, in particular, in making the right choices at the right time at the institutional and policy levels. More specifically:

(a) It was only in 2005, six years after the World Bank, that IFAD started assisting PPAF, the largest wholesaler of microfinance in the country and a forceful voice for policy dialogue and good practices in the sector.
(b) The options formalized in the 2003 corporate policy on rural finance for providing liquidity in a number of ways have been around for several years globally as well as in the countries of region. These are essentially options for strengthening meso level development, but IFAD in Pakistan seems to have progressed little in this direction over the years.
(c) IFAD is not a participant in the wide-ranging policy dialogue that is taking place in the country on issues of microfinance outreach and sustainability, and ways in which microfinance could contribute to poverty alleviation.

45. Keeping in view the CPE guidelines used by OE for assessing relevance:

(a) The relevance of projects has been high (which means a score of 6) in relation to the country strategies of 1991 and 2003 as well as national priorities.
(b) Non-project interventions at the meso and macro levels have not been consistent with the changing requirements of the sector and corporate policy, particularly during 2000-2005, but the CPE methodology does not allow for this to be considered negatively: these are also factors that were overlooked in the country strategy, so the projects have to be considered relevant (score of 5) or highly relevant in relation to strategy.
(c) In the column under “highly irrelevant” the CPE guideline says, “Choice and combination of project and non-project activities, and individual project objectives do not fit with country strategy objectives and have missed opportunities for rural poverty reduction.” It would be fair to say in this connection that IFAD-assisted projects have missed opportunities for rural poverty reduction by not moving faster in terms of meso and macro level initiatives.
(d) Given the importance of rural poverty reduction in the country strategies, an overall score of 4 (partly relevant) or 5 (relevant) may be appropriate.

46. In relation to effectiveness, reference is made to Table 1, supported by the discussion in Section 1.1, which suggests that there have been more failures than successes in the 15-year history of IFAD’s involvement in rural finance in Pakistan. This point is also brought out in paragraph 43 with reference to the lack of performance of government-owned banks and NGOs which were engaged by IFAD for credit delivery. With reference to targets of the kind that Table 2 attempted to capture, it may well be true that some of the projects managed to exceed targets, but this possible gain cannot outweigh the loss in numbers and objectives that is associated with the virtual abandonment of the

credit component in several projects, and of one complete credit-only project (the SWCRP). Accordingly, and in view of the guidelines given in the CPE methodology, an overall rating of 3 (partly ineffective) is considered appropriate.

47. In relation to efficiency, it has to be recognized that the overall operating environment in Pakistan suffers from a high degree of inefficiency, and the rural finance sector has not been an outstanding exception in this regard during the review period. In following the CPE guidelines, however, an assessment has to be made in relation to comparators, presumably comparators available within the country. If viewed in these terms, it would be hard to find comparators in the relevant project areas and provinces who might have been significantly more efficient than the mechanisms selected for credit delivery in IFAD-assisted projects. At the same time, it can hardly be said that "the choice and combination of projects and non-project activities maximized IFAD's poverty reduction impact for the given resources," which is how the CPE methodology describes the requirement for "highly efficient" arrangements. Thus, a rating of 5 (efficient) is considered appropriate in the circumstances.

3.2 Rural Poverty Reduction Impacts and Sustainability

48. A comparison of various sources of information available for this evaluation suggests that impact is always stated highly by project beneficiaries (as in the field work undertaken for this evaluation) and project reports, including PCRs, that are based on beneficiary responses. Indeed, the PCRs and studies by IFAD and the projects based on the PCRs provide a hugely optimistic assessment of the impact of microfinance on incomes and assets. Impact is also assessed to be wide-ranging in a number of statistical studies conducted in the region. This is also true of two reports commissioned by the PPAF, which raise questions of the kind that are described in Annex VII. The problem, in brief, is that the reported benefits in terms of expenditures and the acquisition of assets exceed in rupee terms the reported increases in incomes. It is impossible to conclude, therefore, that microfinance imparts all or even most of the benefits claimed in such studies.

49. Unlike most other organizations in the sector, the PPAF has been cautious in attributing benefits to microfinance. In its presentation to the evaluation mission, and using the findings from its sample survey, the PPAF estimated that household incomes would have increased by at most 12% in a year on account of microfinance loans extended by its partner NGOs. This may appear to be a large increase, but inflation during the year may be at least 7-8%, while the population growth rate may be close to 3% per annum. The net result would be only a marginal improvement in the incomes of the beneficiaries, if that.

50. The extent of benefits is also not as considerable as that projected at the time of project design. This should be evident from the number of credit components that were either cancelled or re-designed in a major way and basically limped to conclusion. In addition, a cross-check has been presented in paragraph 39, estimating the outreach of IFAD-assisted projects in relation to donor disbursements in the microfinance. By putting together all these considerations, it would be appropriate to assign a rating of 3 (partly unsuccessful) to the microfinance operations of IFAD in Pakistan. This rating is defined in the CPE guidelines as follows: "Project and non-project activities attained only some of their individual goals and few of the goals set out in the country strategy."

51. A detailed analysis of sustainability has been presented earlier in this report, and paragraphs 20-22 sum up some of the most relevant aspects of this issue. In brief, with the possible exception of BVDP, it is considered unlikely that IFAD-assisted rural credit operations would turn out to be sustainable. The relevant overall rating, therefore, would be 3 (sustainability probably unlikely), elaborated in the CPE guidelines as follows: "Some supporting factors are in place, but they are not sufficient to ensure sustainability of projects, non-project activities, and country-level impacts."

3.3 Innovation, Replicability and Scaling up

52. As indicated earlier in this report, the SWRCP was a pioneering attempt at extending credit to rural women and the poor, and it could not make any headway. Currently, MIOP is unfolding with positive expectations but the results remain to be seen. In between these two projects, IFAD has improvised mainly by charging project management to organize community-level revolving funds and credit pools. It is not quite clear how well this mechanism is performing. Clearly, it represents an idea that is still unique to IFAD-assisted projects, without any signs of replication.

3.4 Policy Dialogue

53. As mentioned above, policy dialogue in the area of rural finance has not been addressed in the two country strategies adopted by IFAD for Pakistan. Moreover, it is also missing from the list of policy issues that is included in the Country Programme Issues Sheet, which is based on the analysis of the rural development sector framework of the country and used to flag policy issues in discussion with the government. Having said that, it should be acknowledged that the failed SWRCP represented, to date, IFAD's most ambitious attempt at policy dialogue, and this was initiated in cooperation with the World Bank. The recently-approved MIOP, which has engaged the World Bank as a cooperating institution, also opens up possibilities for policy dialogue.

3.5 Operational Performance of IFAD and its Partners

54. The operational performance of IFAD has been less inspiring than what it might have been in countries where the operating environment for rural finance is more favourable. Unsupportive public policy has been the main constraint faced by IFAD during most of the review period. The responsibility for this rests on the government, which has practiced a blend of populism and administrative control over retailing credit that continues to influence the shape of the sector and of IFAD-assisted projects to this day. While there have been some positive changes in the operating environment for microfinance in recent years, major impediments remain in the way of finding partners who could expand outreach in a sustainable manner; this is highlighted, in particular, in paragraphs 28-32 above.

55. Under the circumstances, it is not surprising that the performance shown by IFAD and its implementing partners has been one of desperate adjustment from time to time in order to find the "right approach" in an unfavourable environment. It seems appropriate to conclude, therefore, that:

(a) IFAD and the institutions charged with credit delivery have by-and-large fulfilled their roles; but:
(b) The government, particularly the Federal Government and the Government of NWFP (the owner of the Bank of Khyber), has not been reacting in time to the need for change.

4. CONCLUSIONS AND RECOMMENDATIONS

4.1 Development Effectiveness and Strategic Gaps

56. For reasons having to do mainly with the operating environment, the development effectiveness of IFAD in the area of microfinance has been low. For much of the period under review, the environment has been characterized by administrative control of retail institutions coupled with a populist belief in subsidized credit. The result is a sector dominated by vision, values and incentives that have inhibited pro-poor expansion in outreach and sustainable delivery of financial services. IFAD has had no choice but to look for one option after another in its long search for appropriate partners.

57. Having said that, the biggest strategic gap in IFAD's rural finance work in Pakistan is that there is no rural finance strategy. The 1991 strategy document and the 2003 COSOP merely put down as strategy what IFAD-assisted projects were actually doing. Between 2005 and now, IFAD has approved one major microfinance project and initiated work on another, with very little justification in terms of the COSOP approved by the Executive Board in 2003. Thus, the next COSOP in relation to microfinance is also likely to be an extension of the design of existing microfinance projects, rather than a strategy for the future.

58. As a matter of strategy, IFAD has opted to work in the remote, less favoured areas of AJK, FATA and NWFP. These are areas in which reliable MFPs are neither available at present nor likely to emerge in the near future because of the high cost of service delivery. Thus, IFAD's microfinance portfolio in four of the five ongoing projects faces an uncertain future. New projects, no matter how innovative, will not solve the problem of older projects. IFAD has not yet articulated a strategy for enhancing the impact and sustainability of the four older ongoing projects.

59. Moreover, as outlined in paragraph 42, the gap between IFAD's Rural Finance Policy and operations in Pakistan is also quite evident. This is a cause for concern because the corporate policy shows a number of directions for investing in institutional development which may be particularly relevant for Pakistan but have evidently not been explored systematically. Attention to the kind of meso and macro level issues that are flagged in the corporate policy could be a key to progress in an unfavourable operating environment.

4.2 Key Issues for the Future

60. As discussed in detail in Chapter 1, most discussion of the key issues facing the rural finance sector emanates with concerns for enhancing outreach and sustainability. As the discussion in Section 1.5 suggests, however, neither outreach nor sustainability may be as big a problem as some of the contemporary discourse aims to demonstrate. A wide range of issues that require the attention of donors and the government is discussed in CGAP 2007. In Section 1.5 of this report, however, the focus is on the interplay between a smaller set of issues and the possible effects of subsidized credit. It is suggested that the continuation and likely enhancement of subsidy, mainly by the government, is likely to:

(a) reduce the incentive for MFPs to introduce appropriate insurance products;
(b) undermine their incentive to grow and sustain through new loan products;
(c) reduce the incentive for MFPs to seek cost-cutting measures by entering into alliances with PPO and cellular phone companies; and,
(d) tend to concentrate MFPs in areas with a low incidence of poverty, where the cost of operation is low, rather than passing on the subsidy to poor people across the country.

61. There can always, however, be a nuanced distinction between public policy and the corporate policies of the MFPs. This is already emerging in a number of multi-sectoral MFPs, including NRSP, that have decided to separate the costs of credit delivery from those of other services. There is a recognition among these MFPs of a duality in rural finance, namely:

(a) Some of the areas of operation have high population densities and good access. These offer early prospects of increasing outreach and attaining sustainability without subsidy.
(b) Many rural areas, however, have low population densities and poor road access; here, rural MFPs need subsidies to enter and expand the market.

4.3 Recommendations

62. In view of the findings presented above, there is clearly a need for clearer strategic thinking in order to:

(a) develop future projects in line with a microfinance strategy, rather than letting existing projects dictate the future course of action;
(b) enhance the impact and sustainability of the four ongoing multi-sectoral projects which do not, at present, have the benefit of being served by reliable MFPs; and,
(c) devise approaches that are consistent with the letter and spirit of the corporate Rural Finance Policy of IFAD.

63. Greater resources as well as dialogue need to be aimed at the institutional and policy levels in pursuit of the above-mentioned. The main focus of dialogue, clearly, would be subsidy (and its effects), and this needs to be pursued at two levels, namely, at the corporate level with interested MFPs, and at the macro level with the government (including the Government of NWFP). It is recognized that populist subsidies do not fade away for a long time. The quest for corporate sustainability, however, gives hopes that some or even many MFPs would, in the years to come, embrace a dual rather than monolithic approach in their use of subsidies, as indicated above.

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Annex I:
Terms of Reference

BACKGROUND

The Pakistan Country Programme Evaluation (CPE) will be undertaken by IFAD's Office of Evaluation (OE) during 2007. The overarching objectives of the CPE will be to:

i) assess the performance and impact of IFAD's overall country programme in Pakistan; and
ii) develop a series of findings and recommendations that will serve as building blocks for the preparation of the new IFAD COSOP for Pakistan.

RESPONSIBILITY

The consultant will carry out the work within the framework defined by IFAD Evaluation policy- in particular the section on Country Programme Evaluations, the Guidance for CPEs of OE, and in accordance to the guidance contained in the Approach Paper and this TORs.

The objective of the work assigned to the RFS specialist is to evaluate how well IFAD's country program strategy addressed rural finance issues and applied the strategy in the operationalization of the program within the practical constraints of the limited funding available. The work will assess the contribution of the IFAD country program to IFAD's corporate objectives and its impact on rural finance and make recommendations for improvement for consideration in the prospective COSOP. The analytical contribution will encompass three level of analysis (macro, meso, micro).

Macro
Briefly review Pakistan's rural finance policy and regulatory framework and provide a short description of the microfinance market (demand and supply). Assess whether there was a supportive enabling policy and institutional environment for rural finance, whether the design RFS components would fit into it and whether it evolved following context-related changes.

Meso (Institutional and supply-side dimension)

Analysis of: a) the performance of the microfinance institutions involved in the country programme; and b) of the relevance and effectiveness of the support provided to them by the programme. This will include:

(i) Short description of the microfinance institutions involved in the country strategy through the projects and of the services offered by them;
(ii) Description of the support mechanisms (refinancing, training, technical assistance) provided by the projects to the participating rural financing institutions;
(ii) Credit discipline and performance of the loan portfolio (indicators may include: repayment rate, PAR, portfolio analysis etc.);
(iii) Profitability and operational/financial self-sufficiency using standardized CGAP indicators;
(iv) Productivity and efficiency (number/values of loans per staff member, ratio of operating costs to outstanding portfolio, calculation of effective interest rate).
(v) Analysis of the sustainability of the financial institutions supported by the project and of their potential for replicability and scaling up within the country.
(vi) Analysis of the project's human resources arrangements to implement and develop the component.

Micro – Household client dimension (Demand-side)

(i) Outreach: breadth (number of clients), gender focus (% women), poverty depth;

(ii) Type of economic activities/enterprises financed through the RF components and their economic viability

(iii) Discussion of the variety and relevance of financial products offered and their benefits to the final clients (terms, maturity, interest rate, transaction costs, collateral, etc.).

Within this framework, the Consultant will:

a. review all available background documentation related to IFAD operations in Pakistan as they relate to ANR

b. review the OE evaluation methodology and participate in a mission planning meeting to develop a common understanding of methodology and individual roles and responsibilities;

c. participate in meetings with Federal, provincial and project authorities, relevant donors and NGOs, and groups of project beneficiaries

d. visit projects in the field

e. participate in end-of-mission team meetings at which mission members would collectively discuss the CPE ratings.

The outputs of the assignment will include:

i. A problem tree analysis of rural finance issues as they affect rural development, distinguishing between problems and their consequences (ideally at a base level of 1990) and a report of the impact of the IFAD country program on the problems with particular attention being given to the very poor and vulnerable and to questions of sustainability, innovation and replicability;

ii. Evaluations and ratings of projects visited for relevance, effectiveness and efficiency; innovation and replicability, sustainability;

iii. A discussion -in view of various levels of government- about IFAD's most appropriate role regarding rural financial services with particular consideration being given to an appropriate niche for IFAD and the potential benefits of working more closely with other UN organisations

iv. An assessment of the adequacy (including timeliness) of M&E reporting systems in use to provide management information on both the performance of the strategy and individual projects and the degree to which managers acted on the information;

v. An assessment of compliance with IFAD's policy on Rural Finance

vi. description of policy dialogue undertaken compared with what was required for the country program to achieve its rural finance objectives and an assessment of IFAD's impact on this area;

vii. description of innovations attempted in the country program, how well they were managed and how well the effective innovations were replicated. In this regard, particular attention should be paid to any Technical Assistance Grants (TAGs) and the research projects they funded,;

viii. An assessment of the management of IFAD's knowledge of its own experience in successful rural finance development and communication to the appropriate stakeholders;

ix. An assessment of how realistic time frames were for the achieving of project objectives and resources allocated and time frames for effective policy dialogue;

x. A presentation of findings to interested stakeholders;

xi. An assessment of the overall impact of the country program on rural finance with recommendations for improvement which should be considered in the prospective COSOP;

xii. An examination of any other issues which might come to light in the course of the evaluation.

The assessment of the above will be presented in <u>one single working paper</u> approximately 20-25 pages long.

PROFILE

The Rural Finance Specialist should have the following qualifications:

- Consultant with at least 15 years experience in rural development, particularly in issues related to rural finance.
- Education in Economics, Finance or related field.
- Previous experience in South Asia, particularly Pakistan, is highly desirable.
- Excellent English writing skills

SUPERVISION

The expert will work under the overall supervision of the Team leader and the IFAD lead evaluator.

WORK PLAN

The consultant will be hired for a total xx days within the period 1st July to 15 August 2007. For carrying out her tasks the expert will participate in the field mission from 9th to 31st July 2007. Once the field mission is finalized the consultant will prepare within two weeks a report with the findings in the area under her/his responsibility.

Annex II:
Microfinance Stakeholders[22]

Microfinance Practitioners Network

PMN was created following a series of informal meetings among Pakistani delegates to the 1997 Microcredit Summit in Washington, D.C. These delegates recognized the benefits of having an industry association. In 1999, the Microfinance Group Pakistan (MGP) was incorporated with funding from the Aga Khan Foundation and the Asia Foundation. It later became PMN, a legal entity under the 1984 Companies Ordinance. PMN's mission and vision is to help foster the emergence of strong retail MFPs that are able to provide quality and diverse financial services on a large scale on a sustainable basis. To pursue this goal, PMN advocates for an enabling policy environment, encourages the acceptance of good practices throughout the sector, promotes the use of performance standards, and supports financial transparency.

As of December 2005, PMN had 18 members and 27 MFPs reporting to its *MicroWatch* bulletin. PMN produces detailed statistics on members' performance.

Financial service providers

A multitude of institutions provide microfinance services in Pakistan, ranging from government-owned institutions, MFBs, and cooperatives. Most of them are not specialized in financial services, but rather combine microfinance with other development or welfare programs, including health, education, community infrastructure, and human resource development. The main categories of MFPs are the following:

- **MFBs.** MFBs are licensed by SBP, and they are subject to SBP oversight. There are six MFBs: Khushhali Bank (KB), Network Microfinance Bank, Pakistan-Oman Microfinance Bank, Rozgar Microfinance Bank, Tameer Microfinance Bank, and the First Microfinance Bank.
- **Multisectoral NGOs.** Some NGOs run microfinance operations as part of their integrated development programs. Many are PMN members, including Sungi Development Foundation, Development Action for Mobilization and Emancipation (DAMEN), Save the Poor, Taraqee Foundation, and Community Support Concerns.
- **Specialized NGOs.**[23] Other NGOs specialize in microfinance or have microfinance as a major focus. Specialized NGOs that are part of PMN include Asasah, Kashf Foundation, OPP, Sindh Agricultural and Forestry Workers, SAFWCO, and Thardeep Rural Development Programme (TRDP).
- **RSPs.** RSPs consist of programs that run microfinance operations as part of their integrated development programs. RSPs that are members of PMN include the National Rural Support Program, the Punjab Rural Support Program, and the Sarhad Rural Support Program.
- **Commercial Financial Institutions (CFIs).** The core business of CFIs is not microfinance, but they have a separate microfinance department or division. ORIX Leasing Pakistan is part of this group.
- **Commercial Banks.** Many commercial banks provide microfinance services— although probably not in large quantities. Only a few track microfinance as a distinct product category. These banks include First Women Bank, Bank of Khyber, and SME Bank

[22] Source: CGAP 2007.
[23] PMN usually calls specialized NGOs "specialized MFIs" in its reports.

- **Government-owned Institutions**. Beyond certain government-owned commercial banks like the Bank of Khyber, several government-owned institutions that reach poor clients are often overlooked in discussions on MFPs. There are several major examples: NBP provides a range of services to microentrepreneurs, including credit and savings; Pak Post Saving Bank (often called Post Bank) is the main supplier of savings and money transfer services through 7,500 branches across Pakistan[24]; ZTBL, supported by AsDB, provides credit and savings services through its 343 branches; and the Central Directorate of National Savings (CDNS), attached to the MoF, borrows funds from seven National Savings Schemes (NSS). CDNS operates through 12 regional directorates and 366 savings centers, servicing over 4 million accounts.[25] Based on preliminary CGAP estimates that do not include NSS, Pak Post and ZTBL account for more than two-thirds of the small-balance savings accounts. A recent government project, named the Rozgar Scheme, also provides credit facilities. It targets young people with loans of up to 100,000 PRs (about US$ 1,646) on highly subsidized terms through NBP.
- **Cooperatives.** The cooperative societies used to have about 53,000 outlets, a secondary structure of provincial cooperative banks, and a federal bank of cooperatives as an apex institution. However, the entire cooperative movement went through a series of crises.[26] Although the review team did not conduct a thorough research on cooperatives, it appears that cooperatives play a limited role in microfinance today. Most cooperative banks, as well as second tier institutions, have closed down. It is not clear how many of the cooperative societies are still operating or how many of them offer financial services.
- **Informal Providers.** As is common in most countries, there is a wide network of informal lending mechanisms throughout Pakistan. These include "committees" (rotating savings and credit associations), family and friends, landlords, input providers, traders, and moneylenders. Although it is difficult to quantify the monetary amount of services provided through these mechanisms (particularly credit), it is likely to be widespread. Clients interviewed by the CLEAR team during field visits highlighted the importance of such providers. According to clients, effective interest rates charged by money lenders are usually around 300 percent per year.

Wholesale facilities (apexes)

PPAF is the main provider of wholesale refinancing to MFPs. It was launched with World Bank support in 1999 to address a range of development challenges, including the lack of access to funding by nearly all unregulated MFPs. Today, it refinances about 56 percent of the micro-loans disbursed by retail providers that are members of PMN. PPAF's Microcredit Loan Fund has 10,513 million PRs (US$ 175.2 million), and its current outstanding portfolio to MFPs is 4,013 million PRs (US$ 66.9 million). For more information on PPAF see Annex 5.

Beside PPAF, the Orangi Charitable Trust (OCT)/OPP also offers wholesale financing on a limited scale to a number of rather small MFPs in the provinces of Sindh and Punjab.

Policy makers and supervisors

SBP is the supervisor of the formal banking sector, which includes the six MFBs. Commercial banks abide by the 1962 Banking Companies Ordinance, while MFBs fall under the 2001 Microfinance Ordinance. The Securities and Exchange Commission of Pakistan (SECP) prudentially regulates non-banking finance companies and insurance companies. NGOs and RSPs are registered by the SECP as not-for-profit companies under Section 42 of the 1984 Companies Ordinance or by provincial

[24] Out of about 13,000 post office branches, 7,500 offer financial services.
[25] Source: World Bank, Islamabad.
[26] Source: ZTBL at a Glance Brochure.

registration authorities either as societies under the 1860 Societies Registration Act or as trusts under the 1882 Trusts Act.[27] The degree of regulatory oversight by these provincial registration authorities is negligible. See Annex 4 for a description of the legal framework for each type of institution that provides microfinance services.

Microfinance Funders

At least 11 bilateral and multilateral donor agencies fund microfinance in Pakistan, along with several international NGOs and private funders. The two largest funders are AsDB and the World Bank, with commitments for microfinance between 2000 and 2005 of about US$ 330 million from the AsDB and US$ 169 million from the World Bank (the two largest recipients being Khushhali Bank and PPAF, respectively).[28] The Department for International Development (DFID) is now coming in as the third largest funder in the market, with future commitments of at least US$ 80 million until 2010.

Box: 2 Funders of Microfinance in Pakistan

International:
Multilateral agencies: ADB, EC, IFAD, IFC, ILO, UNDP, World Bank
Bilateral agencies: AECI, DFID, JBIC, SDC, USAID
International NGOs: PLAN, ACTED, Save the Children US, Islamic Relief
International Private Investors: Citigroup, Deutsche Bank (Global Commercial Microfinance Consortium), Shore Bank Int., Aga Khan Agency for Microfinance (AKAM)
Domestic funders:
NGOs: Orangi Charitable Trust
Government: Ministry of Finance

[27] MFBs are licensed under SBP. Banks and MFBs are also registered as companies under SECP, yet the prudential regulation by SBP is by far more important.
[28] See Annex 8 on donor funding in microfinance [reproduced in Annex III of this paper].

Annex III:
Microfinance Donors in Pakistan

Microfinance Funding by Donors (in USD) (Stand-alone microfinance projects and microfinance components of integrated projects)[1]				
	Commitments for microfinance 2000-2005[2]	**Microfinance disbursements 2000-2005**[3]	**Disbursed funding for microfinance in fiscal year 2005**[4]	**Projected Microfinance commitments 2006-2010**[5] **(approved or not)**[6]
WB	169,000,000	148,000,000	24,000,000	45,000,000
IFAD	0	0	0	13,200,000
UNDP	1,680,100	1,344,000	170,600	396,000
DFID	7,125,600	7,109,200[7]	442,900[8]	80,385,900[9]
EC	1,501,600[10]	174,100	174,100[11]	1,619,200[12]
IFC	4,353,000	4,353,000	1,453,000	8,800,000-13,800,000[13]
SDC	4,166,400	4,020,300[14]	1,427,400[15]	3,966,100[16]
AsDB	330,000,000[17]	223,000,000[18]	5,373,000	82,000,000
USAID	9,000,000	8,600,000	3,800,000	13,300,000
Total	526,826,700	396,600,600	36,841,000	248,667,200-253,667,200
All data are self-reported				

Notes:

1. All figures are rounded to the next hundred.
2. All the money budgeted for microfinance for this period of time (2000-2005).
3. The average exchange rate for six years was used (2000-2005).
4. Average exchange rate 2005.
5. That is: “How much money does your agency plan to spend after 31 December 2005 for microfinance?”
6. Current exchange rate (February 2007).
7. US$ 1 = 0.662 GBP.
8. US$ 1 = 0.550 GBP.
9. US$ 1 = 0.513 GBP, amount depending on Access to Finance Programme (£30-40 million).
10. US$ 1 = 0.959 EUR (average exchange rate 2000-2005).
11. Exchange rate for 2005 (all disbursements in 2005): US$ 1 = 0.804 EUR.
12. EC has an upcoming programming exercise in 2007. US$ 1 = 0.786 EUR.
13. US$ 3,700,000 have already been disbursed in 2006.
14. US$ 1 = 1.460 CH.
15. US$ 1 = 1.245 CHF.
16. Future commitments depend on the outcome of planned external reviews of all projects in 2007. US$ 1 = 1.236 CHF.
17. 1.23 billion PRs for Area Development Programmes in NWFP not included in this figure.
18. This is money disbursed by AsDB to the government, but much of it is still sitting somewhere (i.e., no disbursements yet from New Bank Fund).

Annex IV:
Challenges and Changes in Rural Finance in NWFP

A. From the MTR of MVSP, 1996

36. To finance their credit needs, the "target group" (COs/WOs) is largely dependent on the informal sectors. SRSP has credit as the pivot for its institutional strengthening at the grassroots. The ADBP is not readily accessible to the small farmers.

37. Out of Rs. 27 million allocated to the credit programme, SRSP was to receive 33% (Rs. 8.91 million) from GONWFP while ADBP was to supply 66% (Rs. 18.09 million) of the allocation to extend credit facilities under MVSP to intensify and diversify crop and livestock production, sericulture and small-scale non-farm enterprises. To date the use of credit has not occurred for two reasons. Firstly, SRSP credit policies have only recently been established. Secondly, the ADBP has not been able to finance project farmers due to a liquidity crisis. The source of funds assumed to be available at the start of the project were part of an IFAD line of credit to ADBP which was subsequently cancelled. As a result it is now necessary to make provision for the credit component from IFAD loan resources. To date SRSP has been financing the initial credit operations using its own resources and the IFAD ECP grant.

38. Up to February 1996, the amount disbursed by the SRSP for credit, through a long procedure was Rs. 0.732 million in favour of 164 beneficiaries (84% for COs) with an interest rate of 8.5%. In the meanwhile, Rs. 1.122 million have been mobilised from COs' savings and Rs. 0.465 million from WOs' savings.

39. On the other hand, although it has 4 branches (Mansehra-Balakot-Battagram-Oghi) covering the whole district of Mansehra, ADBP, which has a lot of constraints to be effective in the project area, has been extending credit independently, with a rate of interest of 12.5%, recently adjusted to 14%. This has not been directed to project farmers.

40. Many issues can be drawn from the current situation:

- the service of charge (8.5%) used by the SRSP is not related to the situation on the financial market. On the same trend, the SRSP might have a tight liquidity position in the future with a sharp drop in the provision of its fund if it does not immediately move to positive interest rates;
- the lack of coordination between the ADBP and the SRSP is not contributing towards the formation of WOs or enhancing credit delivery under the MVSP. Nor is the length of the loan procedure which is discouraging for the target groups;
- on the basis of field visits, its seems that the link between training and credit requests is not evident. The lack of savings and the identification of appropriate themes of training, could be related to this situation;
- investments in marketing and small processing businesses appear to be profitable for the community.

41. The Mission makes the following recommendations:

(a) the SRSP proposed a credit demand of Rs 11.9 million. After review with the Mission and taking into account the need to emphasise the development of processing and marketing on a commercial basis it was agreed to increase this to just over Rs 16 million. Such opportunities should be promoted, especially in marketing of milk, fruit, vegetables and also in seed business;
(b) it is recommended that the service of charge for SRSP credits should be assessed according to the economic cost of money which presently exceeds 12% a year;
(c) in addition, in order to limit the risk for unpaid credits, an interest spread should be charged of about 1 to 2%. The implementation of this guarantee fund and charging an adequate service of

charge will protect credit funds from monitory erosion and contribute to a sustainable credit system;

(d) under this scope, savings community should get incentives through an appropriate rate of interest. Presently, the rate used by ADBP and the commercial banks is about 8 to 9%. These rates should at least be matched in CO/WO savings programmes;

(e) on the basis of the social infrastructure being implemented by the SRSP and in view of the need to develop an adequate and sustainable credit system, it is recommended to create a "Community Credit Fund Pool" for mobilising "community savings" and injecting productive funds on credit by the project;

(f) the community would be fully involved in this credit process with its own credit committee and the entire responsibility for recovering credits. This is effectively a credit union approach.

42. However many points have to be clarified: the contribution of SRSP for identifying needs and credit packages, the enhancement of the financial managerial skills of the Loan Committee, the impact of this new structure on employment and on non-farm income-generating activities. In line with these issues it is necessary for SRSP to retain an experienced “small loans” person, possibly a retired banker, to guide its credit operations.

B. From the PCR of MVSP, 2001

43. The Project provided a revolving credit line to the tune of PKR 17.534 million to the beneficiaries through SRSP. The Project design had selected the Agricultural Development Bank of Pakistan (ADBP) as the disbursing bank of the credit fund, but at MTR the decision to transfer the fund to SRSP was taken due to ADBP’s rigidity on collateral and other procedural norms. The Subsidiary Loan Agreement (SLA) between the SRSP and the Government was subsequently signed in January 1998. Since then by end-December 2001, the credit revolving fund has grown to PKR 46 million.

44. By the time of the PCR Mission’s visit, a total of PKR 59.88 million was disbursed by SRSP to 3 058 clients with an average loan size of PKR 19 581 per borrower. About 70% of these loans were accessed by the male CO members, and the remainder by the WO members. As reported by SRSP, the MVSP area by the time of PCR Mission’s visit had 2 620 active clients in its borrowers’ list. The cumulative, overall recovery at the time stood at 89%.

45. Of the total loan portfolio, about 70% was comprised of livestock loans, 21% small enterprise loans and the remaining 9% agriculture loans. Livestock is considered one of the major activities for income generation by the resource-poor communities. Owing to the great demand in the area for milk and its by-products, investment in this sector has a potential to bring quick returns.

46. The communities have been trained by SRSP in management of their credit records. The repayment rates have been satisfactory almost throughout the period of the portfolio operation to date except for a brief period following the closing of the Project.

47. The phasing out of MVSP in June 2000 brought about a decline in the recovery rate for the MVSP loans. A wrong impression about winding up of SRSP from the project area after the closure of MVSP discouraged the borrowers to pay back the due installments. The withdrawal of project vehicles from SRSP by the Government added credence to the impression, in addition to hampering staff mobility that was needed for sustaining the recovery drive. Another factor that acted negatively on the recovery rate was non-issuance of completion certificates of the MVSP PIs by the Government. The prolonged spell of drought continuing for two years in the project area, most of which is barani (rain-fed), shrunk the income level of the most of the borrows for their landholdings remaining fallow for very long time. The recovery situation started improving drastically with the arrival of the PPAF loan portfolio.

48. The SRSP also established linkage between the Bank of Khyber (BOK) and the beneficiaries, and thus the beneficiaries' access to institutional credit was further widened. But it is apprehended that the bulk of the BOK credit would go to the male beneficiaries due to the mobility factor and procedures involved. This can be resolved by adopting a system of wholesaling credit to WOs or/and their clusters. Further expansion of credit opportunities for the CO/WO members has taken place recently through the availability of PPAF credit in the project area.

49. One drawback of the MVSP credit program was (and will remain to be so if the group structures are not altered) the lack of access of the poorest villagers to both the IFAD credit fund and the BOK fund as a large number of them did not join the groups formed under the Project. SRSP did not stop the diversion, to men, of loans issued to women. The Government PCR report also blamed SRSP's slack supervision of loans which has resulted in loan misuse (used for undeclared, unproductive purposes). The enterprise development related activities including skill development, production and marketing in support of women's groups were not paid the due attention by SRSP for its lack of expertise. At the time of PCR, an amount of PKR 18.36 million had been generated by the communities as group savings. Most of this amount was being recycled within groups for internal lending. SRSP took a neutral stand on this activity and did not issue any guideline to regulate it.

50. SRSP had been charging a rate of interest of 20% from the borrowers instead of 15% agreed in the SLA. The issue remained unresolved during the implementation period, but still can be resolved with the willingness of the SRSP and the Government to do so.

51. *The SRSP performance in operating Project credit had been* ***satisfactory.*** *The beneficiaries of credit had satisfaction over the implementation of the component. The recovery rate had been very good except during a brief lull at the time of Project closing. The organization needs to further streamline the operations of the MVSP credit fund which will lie with the NGO for at least eight post-project years. SDU will need to establish, on the basis of a dialogue with SRSP, a credit monitoring system for this period.*

C. From the MTR of South FATA, August 2005

127. As already explained, the rural financial services component has hardly started for two reasons. First there are qualifying criteria for COs/WOs to become eligible for matching grants to kick start their internal lending through the Community Credit Pool (CCP). At the time of the Mission's visit, 13 COs had just been approved for matching grants and some small internal loans had been made using savings prior to this. However there is no indication yet of how these loans are going to be used, whether they will be repaid and how beneficial the system will be. The second reason for limited progress is obviously the withdrawal of Bank of Khyber. The mission identified no obvious replacement and proposes that the commercial credit line be dropped from the project.

128. The mission is however of the view that the absence of a commercial credit line may not be too damaging to achieving the project purpose. In the economic analysis, little benefit was taken from off-farm income. Clearly the encouragement of value-added activities such as food processing is important but it is likely that the best returns will come from the marketing of fresh produce, which does not require much capital if hire vehicles are used initially. It is important that graduates of the skill training programme have access to start up funds but lifting the maximum individual loan from the CCP will assist with that. In addition, at least in Kurram agency, an NGO is planning to set up a rural finance programme[29]. The management headaches likely to come from a commercial credit line through a bank would be considerable and the NGO approach is precluded while the project establishes its image as a government programme.

129. The mission recommends:

[29] Should this get off the ground, then at a later stage, the project may provide some additional liquidity.

- The CCP is enhanced through raising the maximum matching grant from Rs 50,000 to Rs 100,000 and the maximum individual loan from Rs 10,000 to Rs 30,000.
- The appointment of small loan officers in the PMU in each agency to train, supervise and monitor the COs in their CCP management.
- An increase in the funds set aside for CCP.
- Preparation of a credit management manual.

D. From the Completion Evaluation of DASP, 2007

76. **Bank of Khyber (BOK)**. The collaboration with BOK has been terminated by December 2004. The credit line availed by the DASP has never reached 10% of VO members, compared to the on-lending volume, and no WO member was given access to a BOK sponsored loan. In hindsight, BOK involvement under the specific circumstances of the DASP proved to be a mission impossible, due to the following facts[30]: (i) BOK rules and regulations do not permit operations outside a given district while there is only one agency in Timergara, (ii) BOK is a GONWFP undertaking with current refinancing costs of 9% (7.5% in 2004), (iii) on-lending at 14% to groups and 16% to individuals is deemed insufficient for generating sufficient spread, with the consequence that it now stands at 18% for the latter. In June 2007, BOK had an outstanding micro-credit portfolio of PKR 220 million at 18% interest, of which 70% were rural borrowers by numbers and 50% by value. More than 90% of these loans are under PKR 50 000, with an average of PKR 20 000. Cumulative recovery amounts to 93% but the assessment of the currently outstanding loans infers a possible default rate of 25%. Not surprisingly, GONWFP is at an impasse over the micro-credit policy and strategies to be evolved in all rural support projects in the province, and would welcome promising conceptual inputs. BOK performance, strictly in relation with the DASP, is rated 2.

[30] Interview with Mr. Nasim Khan, Head, Microfinance Department, BOK, on 22 June 2007.

Annex V:
Rural Poverty and Micro-credit Outreach by Agro-climatic Zone

	Agro-climatic Zone	Household Income Derived from: Livestock	Crops	Both	Poverty Headcount	Share in Rural Poor	Microcredit Clients: Total	Share
		(Percent) FY 2002			*(Percent) FY 2002*		*(in '000)* *Dec. 2006*	*(Percent)*
						Series 1		***Series 2***
1	Punjab *Barani* (Rainfed)	0.7	13.0	14	26	3	45	7
2	Other Balochistan	2.5	39.3	42	39	4	11	2
3	Sindh Rice/Other	0.9	59.6	61	53	9	68	10
4	Punjab Low-Intensity	2.7	55.4	58	54	11	37	5
5	Punjab Rice/Wheat	1.7	44.5	46	38	12	214	32
6	Sindh Cotton/Wheat	1.2	67.3	69	57	13	75	11
7	Other NWFP	1.4	21.4	23	47	14	57	8
8	Punjab Mixed	3.2	41.6	45	49	14	70	10
9	Punjab Cotton/Wheat	2.3	64.3	67	56	20	100	15
	Rural Pakistan	1.8	49.5	51		100	677	100

Source for Series 1: Malik 2005.
Source for Series 2: PMN MicroWATCH, , Issue II: 4th Quarter, 2006. The reported numbers do not include the Khushhali Bank, which operates mainly in urban and peri-urban areas.

	Agro-climatic Zone	**Districts**
1	Punjab *Barani* (Rainfed)	Attock, Jhelum, Rawalpindi, Islamabad, Chakwal
2	Other Balochistan	All Balochistan
3	Sindh Rice/Other	Jacobabad, Larkana, Dadu, Thatta, Badin, Shikarpur, Karachi
4	Punjab Low-Intensity	Dera Ghazi Khan/Rajanpur, Muzaffargarh/Layyah, Mianwali, Bhakkar, and Dera Ismail Khan in NWFP
5	Punjab Rice/Wheat	Sialkot, Gujrat, Gujranwala, Sheikhupura, Lahore, Kasur, Narowal, Mandi Bahauddin, Hafizabad
6	Sindh Cotton/Wheat	Sukkur, Khairpur, Nawabshah, Hyderabad, Tharparkar, Nowshero Feroz, Ghotki, Umerkot, Mirpur Khas, Sanghar
7	Other NWFP	All NWFP except Dera Ismail Khan
8	Punjab Mixed	Sargodha, Khushab, Jhang, Faisalabad/Toba Tek Singh, Okara
9	Punjab Cotton/Wheat	Sahiwal, Bahawalnagar, Bahawalpur, Rahimyar Khan, Multan, Vehari, Lodhran, Khanewal, Pakpattan

Source: Information compiled by author from references mentioned above.

Annex VI: Estimating the Market for Microfinance Services in Pakistan[31]

Most organizations working in Pakistan, including PMN, USAID and IFAD, estimate that about 10 million individuals in the country need microfinance services. The assumptions leading up to this estimate are explained in *Microfinance Performance in Pakistan 1999-2005: Growth—but a Structural Flaw Persists*, published in 2006 by the USAID WHAM project. The "structural flaw" is that "revenues from interest rates, service charges, and loan fees are too low to cover costs." WHAM estimates that in order to reach 10 million customers (by 2014 or 2015), MFPs would incur a shortfall of USD 900 million (at constant 2005 prices), while sustaining services to this clientele "beyond 2014 would incur a shortfall of revenues against costs of about USD 200 million each year in perpetuity."

The 10-million estimate is based on a number of assumptions, the starting point being that microfinance would focus on that 40% of the country's population which the Government in its *Medium Term Development Framework 2005-2010* (MTDF) calls the transitorily poor. This term covers two categories, each accounting for more than 20% of the population, namely, the poor who live just below the official poverty line, and the vulnerable, who live just above it[32]. The chronically poor, representing 12% of the population according to the MTDF, are evidently excluded from WHAM's estimate of the potential clientele for microfinance.

WHAM observes that the Government's 2001 Household Income and Expenditure Survey estimated that there were 28 million adults in the 7.3 million households in the two categories mentioned above[33]. "Assuming not all individuals borrow all the time, the 10 million individuals was assumed as the low end of the range and was further cross-checked against estimates used elsewhere." Thus, the 10-million estimate is, by now, the standard estimate of potential clientele used by various organizations. The following discussion subjects this estimate to a sensitivity analysis of the demand for micro credit based on a household model of decision making.

The estimate is based on the assumption that (10 out of 28 million, or) 36% of all adults in the poor and vulnerable categories would borrow from MFPs at any one time. In other words, 1.4 adults[34] from every poor and vulnerable household in the country would be microfinance borrowers all the time. This translates into about one-half of the 2.7 adults per household who may be considered to be the earning decision makers[35]. An average of 1.4 adults per household means that every single household among the poor and vulnerable of the country is a microfinance borrower, and that 40% of all such households have more than one borrower in the microfinance sector, at all times.

Viewed in terms of household decision making, having two microfinance borrowers in the same household may not be consistent with the prudent and risk averse behaviour that is generally observed among the poor and vulnerable. Moreover, given that a typical household would be served by only one MFP at a time, it is unlikely that the same MFP would lend to two individuals from the same household at one and the same time, for all times. Thus, an average of one borrower per household appears more realistic than an average of 1.4. This would reduce the potential clientele to 7.3 million

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[31] This note has been prepared by the author. The PPAF is among those who share the author's perception that current estimates of the demand for microcredit are overstated.

[32] According to the MTDF, five-year panel data show that only 3% of the population was poor in all the five years, but one-half of the population was poor in at least one out of five years. In a predominantly rural country, this could be a reflection of a five-year cycle in the returns to farming, especially in the large cotton/wheat zone.

[33] The official *Pakistan Economic Survey 2005-06* reports that the proportion of poor and vulnerable in the population has fallen from 45% in 2001 to 36.9% in 2005. At the same time, the estimated population has increased by 7.8%, but the net result is a reduction in the absolute number of poor and vulnerable.

[34] 10 million adults divided by 7.3 million households.

[35] This excludes young adults (say, ages 19-24) who tend not to borrow if their elders are the decision makers, and the elderly (say, 65 and above), who would not borrow if their children have taken over the responsibility of earning from them.

individuals, including 4.7 million in rural areas (assuming that 65% of the poor and vulnerable live in rural areas).

There are, however, many among the poor and vulnerable households who may not want to borrow all the time, or even once. For example, there are families whose religious beliefs prohibit payment of explicit interest charges, and others for whom available microfinance loan products may not be attractive. Among the latter would be the large number of rural households who depend mainly on farming that is risky as well as low-return, and households headed by entrepreneurs whose credit requirements are either greater than the typical microfinance loan (of around USD 200) or tied into business processes such as the purchase of inputs and the marketing of products. Assuming that only 70% of the poor and vulnerable households would be willing to borrow from MFPs at any given time[36], the potential clientele would be 5.1 million individuals (including 3.3 million in rural areas), and the projected burden of unsustainable microfinance operations would be reduced by about one-half[37].

[36] This assumption is consistent with 100% of the urban and 54% of the rural poor and vulnerable households borrowing from MFPs at any one time, assuming that 65% of all such households live in rural areas.
[37] Clearly, a decline in the absolute number of poor and vulnerable persons, as reported for 2001-2005, would also reduce the potential clientele for microfinance as well as the projected burden of unsustainability.

Annex VII:
Comments and Questions on PPAF Impact Assessment Study[38]

1. The PPAF was established to help reduce poverty throughout the country by providing loans and grants for a variety of interventions. Its target groups are the poor and the disadvantaged, especially the women among them. The PPAF is an apex entity that became operational in 2000 and works through partner organizations (POs) in the non-governmental sector. It commissioned GALLUP Pakistan to carry out an impact assessment study, which was published as a summary document called "Assessment of Outcomes."

2. The study is based mainly on quantitative data collected during August-September 2002 from 1,700 households, including borrowers served by the POs as well as a control group of "comparable" non-borrowers. The sample was drawn from 140 community organizations spread over 17 districts in all four provinces of the country. According to the study, the average loan size at that time was PKR 9,050 (approximately USD 150). The official poverty line at that time (not mentioned in the study) was PKR 748.6 (USD 12.5) per adult, per month, or USD 150 per year.

3. The published summary is a user-friendly document that reports on the 17 hypotheses tested during the study. Towards the end, it also reports on the return to investment, the size of loan, the borrower's personal assessment of benefits and his/her views on borrowing again from the same community organization. The Foreword by the Chief Executive of the PPAF observes that the study led to "interesting in-house learning" within the organization. The Foreword mentions, in particular, a new enterprise development facility in which eligible clients would not be bound by a ceiling of PKR 30,000 (PKR 500) for enterprise loans.

4. The positive findings of the study in relation to income and consumption are summarized as follows:

(a) Participation in a PPAF-assisted micro-credit programme leads to ***increases in income***, specifically, personal income, household income and income from each of three key sectors (namely, agriculture, livestock and enterprise).
(b) It also leads to ***increases in household consumption and the consumption of key food items*** (such as chicken, beef, eggs, ghee/oil and milk).

5. In relation to changes in assets, the study reports the following positive impacts (with rupee values reported only in one case, as mentioned below):

(a) Participation in a PPAF-assisted micro-credit programme leads to ***increases in expensive household consumer durables*** (such as VCR/VCP, iron, fan, washing machines and bicycles) as well as ***better household facilities*** (such as latrine, water connection, electricity, gas and telephone).
(b) It also leads to an ***increase in the expenditure on house repairs***. The borrowers increased their expenditure from PKR 878 per year to PKR 1,844 per year, an increase of PKR 966 (USD 16). The corresponding increase for non-borrowers was less than USD 4.
(c) And finally, the programme also leads to an ***increase in the operating surplus*** of the enterprises operated by the household.

6. The study reports that as opposed to the average loan of about USD 150, the amount preferred by the borrowers was just under USD 300. And it estimates the mean return on investment for the USD 150 loan at approximately 30%. ***The study does not say whether this is the return that accrues to the borrower before or after payment of the cost of borrowing, including the interest, which is at***

[38] With some modifications, the same comments and questions apply to the second such study commissioned by the PPAF and published in 2005.

least 12-20% per annum (on a flat basis) among the POs of the PPAF. If this is the return net of costs, then the average gross return must be in excess of 40-50%, which may be possible in some trading activities but perhaps not in a largely agriculture-based portfolio of loans.

7. Assuming that the return reported in the study is net of the cost of borrowing, the rupee equivalent would be about USD 45 per year per borrower. From this, according to the study, USD 16 went on house repairs, leaving USD 29 for all the other positive changes reported in paragraphs 4 and 5 above. Even under optimistic assumptions, such as those summarized in paragraph 6, ***it is hard to imagine how all the reported increases in expenditures could have been accommodated within USD 29 during a year***. Moreover, given that the study collected data on income and expenditures, ***it is hard to understand why no rupee values have been given, except in the case of house repairs***, while reporting the results for as many as 17 hypotheses.

8. The only reported rupee values—those pertaining to house repairs—show that the borrowers were spending 163% more on house repairs than the non-borrowers. Although data have not been reported on the socio-economic status of borrowers and non-borrowers, this statistic suggests that the borrowers and non-borrowers were not as comparable as they might have been. Or, put differently, ***the borrowers appear to be drawn from a more fortunate segment of society than the non-borrowers***. Data to the contrary is required to refute this tentative conclusion.

9. Although the study appears to have collected data in terms of rupees for income and expenditure, ***it has reported rupee values only for one hypothesis and, surprisingly, omitted sharing similar information which it seems to possess for most of the other 16 hypotheses.*** It does not tell us, for example:

(a) What was the mean level of income of borrowers and non-borrowers?
(b) What was the distribution of respondent households in terms that are used by the Government (see below) in analyzing poverty levels?
(c) How much was the change in personal, household and sector-wise incomes, all of which are reported to have increased?
(d) How much was the increase in spending on the relatively expensive items associated with consumer durables and household facilities?
(e) What was the increase in the operating surplus of the business enterprises that benefited from the PPAF-assisted programme?

10. Although PPAF's vision, mission and objectives are associated strongly with the poor, the disadvantaged and poor women:

(a) Women are mentioned only once in the findings of the study, and ***there is no gender-based analysis in any of the 17 hypotheses***.
(b) The term ***"poverty" is not defined in the study, no hypotheses related to poverty were formulated***, no data are presented to show what proportion of the borrowers and non-borrowers were poor, either according to the official poverty line or any other measure, and how many of the well-defined poor benefited from the PPAF-assisted programme.

11. The PPAF is mentioned in Government documents (including the *Pakistan Economic Survey 2006-07*) as a leading instrument in the country's strategy for poverty reduction. The Government has been analyzing poverty in official documents in ways such as those reflected in the following table. A similar table appeared in the Government's Medium Term Development Frameowork (MTDF), which was prepared during 2004-05, around the same time that the GALLUP study was being finalized for publication. The GALLUP study seems to have the kind of expenditure data which the Government has used to focus on different categories of the poor and vulnerable in the following table. For purposes of establishing a baseline as well as reporting impact, ***it would have been natural for a PPAF-commissioned study to use the same kind of categories to describe the sample as the Government has defined in its basic documents***. At a minimum, the GALLUP study could have

used the official poverty line to describe the main characteristics of the sample and sub-samples, and analyzed impact according to household socio-economic status.

The Incidence of Poverty in 2000-2001 and 2004-05

Category of Poor	Definition in Relation to Adult Equivalent Poverty Line			Percent of Population in Category	
	In Percent Terms	In Rupee Terms[1]			
		2000-2001	2004-2005	2000-2001	2004-2005
Extremely poor	< 50%	< Rs 361.7	< Rs 439.3	1.1%	1.0%
Ultra poor	> 50%, < 75%	Rs 361.7 – 542.6	Rs 439.3 – 659.0	10.8%	6.5%
Poor	> 75%, < 100%	Rs 542.6 – 723.4	Rs 659.0 – 878.6	22.5%	16.4%
Vulnerable	> 100%, < 125%	Rs 723.4 – 904.3	Rs 878.6 – 1098.3	22.5%	20.5%
Quasi non-poor	> 125%, < 200%	Rs 904.3 – 1446.8	Rs 1098.3 – 1757.3	30.1%	35.0%
Non-poor	> 200%	> Rs 1446.8	> Rs 1757.3	13.0%	20.5%

Notes:
[1] The adult equivalent poverty line was Rs 723.4 in 2000-2001 and Rs 878.6 in 2004-05.

Source: Pakistan Economic Survey 2006-07.
Islamabad: Government of Pakistan, Finance Division, Economic Adviser's Wing.