5

Pakistan – The Case of Karachi

This chapter sets out the context of local government finances in Pakistan and reviews the state of municipal infrastructure financing in Karachi. It describes the country's economic and local government framework in an urban context, along with the framework for decentralisation and local government finances. The section goes on to focus on the state of infrastructure finance and private sector participation in municipal service delivery in Karachi.

Macroeconomic context

Pakistan is a federal state situated in the north west of the Indian subcontinent. It has a land area of 796,095 square kilometres and a population of 162 million. The country's economic growth averaged 3.7 per cent over the period of 1995 to 2005, and has picked up considerably in the recent years with a growth rate of 7.8 per cent in 2005. An average growth rate of 6.5 per cent is expected for the period of 2005 to 2009. Pakistan's GDP per capita was estimated at US$830 in 2006, while the inflation rate was 7.9 per cent in that same year. Deregulation and privatisation, particularly in banking, telecommunications, and the oil and gas sectors are believed to have had a positive effect on the economy.[1]

Most of the recent GDP growth has come from the industrial and service sectors. The share of the agricultural sector was 24 per cent of GDP in 2004. In parallel with the shift in the country's economic structure, the level of urbanisation in Pakistan is one of the highest in South Asia. About 35 per cent of Pakistan's population lived in urban areas in 2005 and the urban population is likely to equal 50 per cent by 2030. There is a huge variation in the size of local governments, with more than half of the total urban population living in eight urban agglomerations in 2005.[2] Between 2000 and 2005, these cities grew at the rate of around 3 per cent per annum, and this growth is expected to continue over the next decade. The growth of informal settlements in the two megacities, Karachi and Lahore, has been particularly significant.[3]

At the same time, given fiscal constraints, government expenditure on infrastructure has fallen from around 5.5 per cent of GDP in 1993 to 3 per cent in 2003. Recent private sector investment in infrastructure primarily focused on the power sector. The government's constrained development budget has limited the capacity to provide adequate infrastructure services to its growing population. At least one in every three city dwellers in Pakistan lives in slums.[4]

Decentralisation framework

This section outlines the fiscal and functional framework for decentralisation that governs local government in Pakistan.

Local government legislation and organisation structure

Pakistan is a federation of the four provinces of Balochistan, North West Frontier, Punjab and Sindh. In 2000, the federal government launched a programme to restructure the administrative, functional and fiscal relations between different levels of government. The main local government legislation is the Local Government Ordinance (LGO) re-enacted by each province in 2001. This transferred a larger set of responsibilities and more autonomy to lower levels of government.[5] The devolution process was based on a number of structural changes, including the abolition of the divisional tier under provincial administration and the creation of a new, tiered structure of local governments comprising:

- districts (city districts in the four provincial capitals),
- towns (*tehsils*), and
- union administrations.

At present, the number of local governments in the country is as under (NRB 2009):

- City districts: eight, including four provincial capitals
- Districts: 102
- Towns: 68 (in city districts only)
- *Tehsils*: 334
- Union councils: 6,125

The large cities have the status of a city district to deliver 'organised urbanisation'.

Functional and fiscal devolution of powers

Under the new government structures, provinces are transformed from direct providers of largely municipal services to financiers and regulators of lower levels of local government that are expected to deliver services.[6] Consequently, the district governments have been assigned certain local functions, which were previously performed by the provincial government. Figure 5.1 sets out the split of responsibilities across different levels of local government. Since the devolution of service delivery in 2001, the current functional devolution is organised as follows:

- The four *provinces* are, inter alia, exclusively responsible for highways (inter-district roads), irrigation, and industrial and labour regulation.

Provinces further have shared responsibilities with the districts for health and education.

- The focus at the *district* level is on education, health and infrastructure development. Provinces largely devolved budgeting, planning and development of these functions.
- At the *town (tehsil)* level, the town municipal administrations take responsibility for key municipal services such as water supply, sewerage, sanitation, drainage schemes and street lights. In urban areas, however, the city districts, not the towns, undertake these responsibilities.
- Community-based services are largely dealt with at the *union* level.

In addition to the higher responsibilities and authority, decentralisation foresees a shift of financial resources to the lower levels, which is expected to strengthen participation and accountability of local governments.

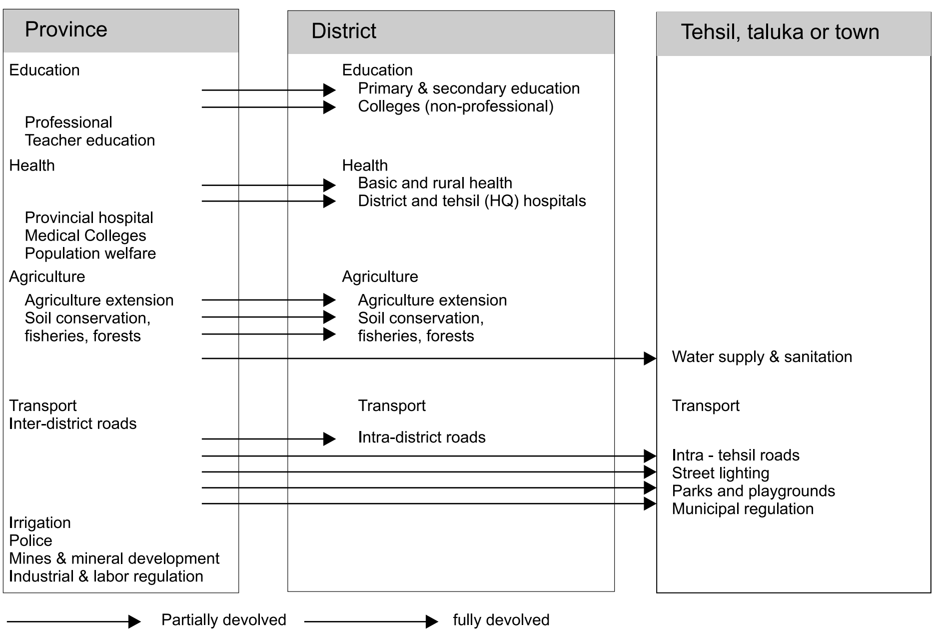

Figure 5.1. Post-devolution assignment of responsibilities to local governments
Sources: ADB/DFID/World Bank (2004); Local Government Ordinances 2001

Provision of municipal services and expenditure

Given the pressure on infrastructure facilities through rapid urbanisation and increased local government responsibilities, it remains a key challenge for local governments to deliver adequate infrastructure and public services. For example:

- Only 63 per cent of the overall population has access to potable water and as little as 42 per cent of the population has access to sanitation facilities. With the exception of a few big cities, sewerage facilities do not exist.[7]
- Only 40 per cent of solid waste is disposed of properly.
- A large proportion of provincial roads are in poor condition.[8]

Local government expenditures

Since there is no up-to-date financial data on countrywide provincial and district budgets available, we use the province of Sindh to illustrate the structure and size of sub-national budgets. Table 5.1 sets out the expenditure budget of the province of Sindh. The key points to note are:[9]

- Current expenditures amount to 120,825 million Pakistan rupees (PRs) or 69 per cent of the total budget in 2006/07. The volume of development spending, although only 31 per cent of total expenditures in 2006/07, has increased significantly over the years.
- With greater responsibilities devolved to local government at the district and town level, recurrent expenditures like salaries constitute a relatively low share of provincial budgets (16 per cent in the 2006/07 budget). In turn, a significant amount of local government transfers are allocated toward salaries at the district level. About a third of the total provincial budget is passed to lower levels of local government, in the form of transfers to city districts and towns.
- Funds for development expenditures include own provincial contributions, foreign/donor assistance and federal grants. Development expenditures include PRs8,000 million (in 2006/07), which is transferred to the district governments. Overall, as a magnitude of expenditure, transport, housing, water and education have been assigned the highest priorities in 2006/07.

Table 5.1. Province of Sindh expenditures – PRs in million

Expenditures	*2003/04*	*%*	*2004/05*	*%*	*2005/06*	*%*	*2006/07**	*%*
Current expenditures, of which	**76,093**	**80**	**85,055**	**74**	**106,620**	**71**	**120,825**	**69**
Expenditures of province	33,491	37	42,254	36	60,121	40	66,327	37
Wages	12,307	13	20,370	18	25,434	17	27,723	16
Commodities and services	4,622	5	4,877	4	13,697	9	18,420	10
Interest payments	10,110	11	9,731	8	9,060	6	9,377	5
Pension	4,393	5	4,216	4	4,825	3	5,115	3
Repairs and maintenance	1,552	2	2,553	2	2,674	2	3,476	2
Subsidies	507	1	507	0	4,431	3	2,216	1
Local government transfers	42,602	45	42,802	37	46,498	31	54,499	31
Salary to district government	20,217	21	22,894	20	24,271	16	27,749	16
Transfers to district govts	8,165	9	10,676	9	13,784	9	17,462	10
Grants to LG and others	14,220	15	9,232	8	8,443	6	9,288	5
Development expenditures, of which	**19,095**	**20**	**29,453**	**26**	**42,756**	**29**	**55,197**	**31**
Provincial ADP	10,849	11	11,074	10	20,664	14	27,000	15
District ADP	–		6,885	6	6,593	4	8,000	5
Federal/donor funding	8,246	9	11,494	10	15,499	10	20,197	11
Total expenditures	**95,188**		**114,508**		**149,376**		**176,022**	

Source: Finance Department Government of Sindh (2007)
*Estimations

Provincial and local government revenues

This section sets out details of provincial and local government revenues. It first provides an overview of total sub-national finances across the provinces of Pakistan. It then reviews in more detail the finances of the province of Sindh as an illustrative example.

Table 5.2 summarises the main sources of provincial revenues in 2002/03.[10] The key points to note are:

- The recurrent revenues in the provinces are primarily comprised of federal transfers (80 per cent in 2002/03) and only a limited amount of provincial own-source revenues.[11] Across the four provinces, Punjab is endowed with the largest budget (more than double that of Sindh, which is the second largest).
- While reliance on federal receipts varies in magnitude between 68 and 95 per cent, the overall dependence of the provinces on government transfers is apparent.
- Except for the province of Punjab, the others rely more heavily on non-tax charges for their own-source revenues. Only Punjab raises higher revenues from provincial taxes compared to non-tax receipts.

Table 5.2. Provincial consolidated revenues – in PRs million, 2002/03

Current revenues	*Balochistan*	*NWFP**	*Punjab*	*Sindh*	*Total*
Federal transfers	22,960	27,357	107,275	57,299	214,891
Provincial taxes	594	1,775	12,568	7,851	22,788
Provincial non-tax receipts	733	7,907	9,494	19,096	37,230
	%	%	%	%	%
Federal receipts	94.5	73.9	82.9	68.0	78.2
Provincial taxes	2.4	4.8	9.7	9.3	8.3
Provincial non-tax receipts	3.0	21.3	7.3	22.7	13.5

Source: ADB/DFID/World Bank (2004)
*North West Frontier Province

The following subsections provide an outline of the different revenue sources – transfers, own-source revenues and borrowing of provincial governments. This is followed by a review of the provincial budget of Sindh illustrating each revenue source.

Federal transfers[12]

Parts of the provinces' budget resources are passed on through transfers to local governments, mostly to city districts and town municipal administrations.

Provinces receive a share of federally levied and collected taxes. Federal transfers consist of the Federal Divisible Pool (FDP)[13] and straight transfers. At least every five years, the National Finance Commission decides the list of taxes comprising the FDP, the ratio of the provincial to the federal share of the pool and the formula for distribution of resources between provinces. Revenue sources from the FDP are further broken down into:

- revenue assignment,
- grant-in-aid (subvention) and
- district support grant in lieu of the abolished octroi and zila tax (OZT).[14]

Each component is governed by a specific formula for vertical distribution (between federation and the provinces) and horizontal sharing (among provinces).

Own-source revenues

Provincial own-source revenues comprise tax and non-tax receipts. Provinces are empowered to collect stamp duties on financial and property related transactions, motor vehicle taxes, agriculture income tax and land revenue, registration fees, and other user charges. Overall, the tax base and tax instruments of local governments are narrow and considered below their full potential.[15]

Borrowing and capital receipts

Capital receipts of provinces include new loans from borrowing and recoveries of loans extended by the provincial governments to their subsidiaries/autonomous organisations and government employees.

Article 167 of the constitution authorises the provincial governments to borrow. However, provincial borrowing requires the approval of the federal government.[16] Provinces, in the past, have taken on substantial amounts of debt to finance their recurrent and capital expenditures. Large overall deficits of the provinces have caused an accumulation of debt. Substantial contingent liabilities exist in terms of guarantees for loans to public sector enterprises and autonomous corporations.[17]

Finances of the provincial government of Sindh

To further illustrate the revenue structure of provincial governments, table 5.3 presents the current local government revenues (recurrent and capital) of Sindh. These statistics are more recent and include the latest budget of 2006/07. The main points to note are:

- Federal transfers, on average over the years, constitute about 78 per cent of the total provincial budget. Own-source revenues, in contrast, constitute only 13–14 per cent of the current revenues.
- Of the federal transfers, revenue assignments account for the highest (about 40 per cent) portion of the provincial budget. Its absolute growth has outstripped overall budgetary growth over recent years.
- Straight transfers, received on account of various levies on natural resources, have grown to become the second most important federal transfer in the province of Sindh, and constitute 28 per cent of the current budget.
- District support grants and grants-in-aid, received as a budgetary support to create fiscal space, are the other federal transfers.
- Of the own-source revenues, provincial tax receipts are the dominant source of Sindh's revenues. The major provincial taxes include taxes on agriculture, professional tax, stamp duty, registration tax, motor vehicle tax, hotel tax, etc.
- Sindh's borrowing is accounted for by the provinces' capital budget. The total amount of capital receipts in 2006/07 is estimated at PRs15,570 million and mainly comprises public debt.
- The provincial government has been borrowing largely from foreign lenders and the level of debt has increased manifold over the last two decades.[18] Foreign loans have largely been borrowed from multilateral development agencies. The total foreign debt liability in 2005/06 was estimated at PRs71,425 million. In addition, the province has accumulated a substantial amount of domestic debt liability, amounting to PRs24,560 million.[19]

Table 5.3. Province of Sindh, current and capital revenues – PRs in million

Revenues sources	*2003/04*	*%*	*2004/05*	*%*	*2005/06*	*%*	*2006/07**	*%*
Current revenues	**85,639**	87	**105,125**	95	**129,255**	92	**157,190**	91
Federal transfers, of which	73,054	74	89,349	80	110,102	78	135,046	78
Revenue assignments	37,578	38	49,992	45	56,683	40	64,512	37
Straight transfers	26,263	27	29,554	27	39,733	28	47,802	28
District support grants	9,213	9	9,803	9	13,686	10	16,903	10
Grant-in-aid	0	0	0	0	0	0	5,828	3
Own-source revenues, of which	12,586	13	15,776	14	19,153	14	22,145	13
Tax receipts	9,679	10	11,776	11	13,642	10	15,208	9
Non tax receipts	2,907	3	4,000	4	5,511	4	6,937	4
Capital revenues	**12,430**	13	**5,918**	5	**11,469**	8	**15,570**	9
Recoveries of loans and advances	574	1	257	0	113	0	1,693	1
Public debt	5,777	6	4,860	4	5,718	4	6,377	4
Floating debt account**	6,079	6	801	1	5,638	4	7,500	4
Total current and capital receipts	**98,069**		**111,043**		**140,724**		**172,760**	

Source: Finance Department Government of Sindh (2007)
*The figures represent revised estimates, **this debt is maintained for transactions on account of state trading

Local government revenues

To ensure that local governments can perform their functions and deliver the municipal services assigned to them, the Provincial Finance Commission (PFC) allocates financial resources to them. The PFC determines the process of conditional intergovernmental transfers from provincial to local governments by setting the 'PFC awards'.

The PFC first sets aside the so called 'priority expenditures'[20] of the province from the Provincial Divisible Pool, which consists of federal transfers and provincial own-source revenues. The remaining amount is distributed among provincial and district governments with a current vertical sharing ratio between provincial and city districts of 45:55. In addition, the provincial government transfers the entire district support grant to the local governments – district governments, town municipal administrations and union administrations – without retaining any part of it.

A recent study on the implementation progress of the 2001 LGO demonstrated that city districts continue to depend heavily on the transfer of funds from provincial and federal governments. They have not established a sustainable local revenue base.[21] With regard to the own-source revenues of local governments, city districts collect revenues from shop tax, fire tax, auction of park admission charges, sale of land and development charges, trade licence fees, car parking charges, animal tax, rent-lease money from shopping centres and market places etc. In this context, property tax was earlier collected by the provincial government and passed on to the town municipal administrations, which are now supposed to assess, levy and collect the tax.[22]

In contrast to the legislation on provincial governments (which are permitted to borrow), Section 120 of the LGO of 2001 prohibits local governments from incurring debt.

The case of Karachi

This section reviews the municipal finances and service delivery in Karachi city, the capital of Sindh province. It sets out the city context and summarises the administrative framework guiding the local government functions. The section goes on to discuss the sources of municipal revenues and expenditures respectively. It then examines the ongoing activities of private sector participation in the city's service provision and finally reviews the current state of financial markets and potential of market finance.

City context

Karachi, the major commercial centre of Pakistan situated in Sindh province, had a population of 13 million in 2007 with an annual growth rate of 4.8 per cent compared to a national growth of 3 per cent per annum. In 2009, its population is estimated to be approximately 20 million according to the City District Government of Karachi (CDGK). Sindh is the most urbanised province, with 49 per cent of the population living in urban areas. More than 60 per cent of the population of urban Sindh lives in Karachi and this concentration has increased over time. Karachi is the country's principal urban centre and is twice the size of the next largest city. Its unprecedented growth rate is mainly attributed to the large-scale migration from all rural areas of Pakistan to Karachi besides natural growth. It is estimated that approximately 200,000 people are added to the metropolis every year.

Karachi is the country's hub of trade and commerce. It accounts for 95 per cent of Pakistan's foreign trade, contributes 30 per cent to the country's industrial production and hosts about 90 per cent of head offices of financial institutions and multinational companies. The city generates about 15 per cent of the national GDP, 42 per cent of value-added in large-scale manufacturing and 25 per cent of the revenues of the federal government.[23]

City administration

The Sindh Local Government Ordinance 2001 provided for the establishment of a city district government to respond to the specific needs of Karachi and other megacities and larger urban units. Karachi has a three-tier local government system consisting of a city district council, 18 town councils and 178 union (neighbourhood) councils. In all 18 towns of the Karachi city district, there is a town municipal administration. Some of the main functions of the CDGK and the town councils are set out in Table 5.4.

Table 5.4. Responsibilities of CDGK and town councils

City District Government of Karachi	*18 town municipal administrations*
• Master plan • Land management • Education, including primary and secondary education • Health, including food and nutrition, medical services etc. • Works and services, including roads and buildings, water,[24] energy, industry, transport • Public transport, expressways, roads, streets etc. • Agriculture • Community development, including labour and social welfare	• Land use, zoning and control • Enforcement of municipal laws • Local roads • Fairs and cultural events • Water supply and sewerage systems • Solid waste collection • Street lighting • Fire fighting • Parks and recreation

Source: Local Government Ordinance 2001

Municipal revenues

This section describes the revenues of the CDGK. Table 5.5 shows the revenues of CDGK based on the actual figures for 2003–06, and the latest budget estimate for 2006/07.[25] The main observations in relation to CDGK's revenues are:

- Provincial/federal transfers constitute about 43 per cent of CDGK's budget. Own-source revenues have been about 14 per cent of the total budget. However, they are budgeted to increase significantly to about 41 per cent of local revenues in 2006/07. In that regard, please note that in the period 2003–06, the actual revenues were less than 50 per cent of the budgeted figures. Therefore, the budget estimates for the latest year are to be analysed in light of this.
- As regards transfers, PFC awards to CDGK include transfers for salary and non-salary expenses of devolved departments, which make up 23 per cent of the CDGK budget. Districts support grants in lieu of octroi charges account for 16 per cent of the CDGK budget in 2006/07. These are further

supplemented by annual development programme (ADP) grants, which are provincial transfers earmarked for capital expenditures. ADP grants have grown slower than the total budget and constitute 3.7 per cent of revenues.

- Own-source revenues are collected by the district, town and unions. They are generated from the town councils' shares of property tax, plot development charges, receipts from trade licensing fees, revenue from fire tax, rents etc.[26] The city's own-source revenues are budgeted to nearly triple in 2006/07 compared to actuals in the preceding years. The Sindh government is planning to sanction an increase in the property tax raised by towns by about 50 per cent of the current levels. Furthermore, overall user charges are also expected to increase significantly in 2006/07. In particular, the city aims to strengthen revenue collection from solid waste charges. It is yet to be seen how these plans materialise to actual revenue increases.
- The Karachi Water & Sewerage Board (KWSB) income includes special transfers and revenues accruing from water supply and conservancy charges, earmarked for KW&SB. These have typically accounted for about 20 per cent of the CDGK budget.[27] The city recognises the urgent need to reform tariff structures and improve collection of user charges, including water and sewerage.
- There has been no borrowing, since the CDGK is not empowered to access capital markets or raise loans.

Table 5.5. Karachi City District Government, revenues – PRs in million

Revenues	*2003/04*	*%*	*2004/05*	*%*	*2005/06**	*%*	*2006/07**	*%*
Transfers	**11,619**	**49.2**	**12,960**	**45.7**	**16,034**	**44.4**	**18,643**	**42.5**
Devolved dept.**	6,034	25.5	7,166	25.3	8,850	24.5	9,996	22.8
ADP	930	3.9	1,162	4.1	1,395	3.9	1,643	3.7
OZT releases	4,655	19.7	4,632	16.3	5,789	16.0	7,004	16.0
Own-source revenues	**3,508**	**14.8**	**3,728**	**13.1**	**5,084**	**14.1**	**17,777**	**40.5**
Taxation sources	2,213	9.4	2,452	8.6	2,907	8.1	6,768	15.4
User charges	1,294	5.5	1,277	4.5	2,177	6.0	11,009	25.1
Capital receipts	**3,491**	**14.8**	**5,008**	**17.7**	**7,596**	**21.1**	**2,171**	**4.9**
Water and sanitation department (KWSB)	**5,017**	**21.2**	**6,662**	**23.5**	**7,359**	**20.4**	**5,306**	**12.1**
Total revenues	**23,635**		**28,358**		**36,073**		**43,897**	

Source: City District Government Karachi (2007); Government of Sindh (2007); Karachi Megacity Development Project (2007)
*Estimated actuals in 2005/06 and budget in 2006/07 (actuals for 2003/04 and 2004/05), **transfers for devolved departments (salary/non-salary)

Municipal services and expenditures

With rapid urban growth and the corresponding pressures to deliver adequate urban infrastructure and services, Karachi faces a number of challenges:

- It is estimated that about 50 per cent of the city population lives in squatter settlements.[28]
- While 82 per cent of households have a water supply connection, water quality is poor and irregular, with high system losses.
- The sewerage network suffers from poor connectivity. Estimates reveal that only 40 per cent of all households are connected to piped sewerage lines.
- Only 60 per cent of solid waste is collected and no more than 25 per cent is transferred to landfill sites.
- The population relies almost entirely on the road network for urban transport, and there is currently no mass transit system.

Table 5.6 sets out the current expenditure budget of the CDGK. The main observations on the CDGK budgeted expenditures are:

- Development budgets increased significantly since 2003/04 to 2006/07. Estimated development expenditures outstrip the recurrent expenditures since the fiscal year 2004/05 and constitute about 50 per cent of the entire budget expenditures.
- The increase in the development budget is primarily on account of development expenditures of the city government and the Tameer-e-Karachi Programme.[29] It also includes the allocated annual development programme (ADP).
- Recurrent expenditures, at about 45 per cent of the total budget, cover expenses for responsibilities of devolved departments, mainly salaries/non-salaries for education and health. In addition, recurrent expenditures include establishment charges (allocations for salaries and allowances of officers and support staff), contingencies (consumption of utilities, expenditure on stationery, and other consumables etc.), and allocations for repair and maintenance of assets transferred to CDGK, such as roads, buildings and equipment.
- In addition, transfers to towns/unions constitute 6 per cent of budget expenditures.

Table 5.6. Karachi City District Government, expenditures – PRs in millions

Expenditures	*2003/04*		*2004/05*		*2005/06*		*2006/07*	
Recurrent expenditures, of which	**12,799**	**46**	**14,437**	**44**	**17,189**	**39**	**19,898**	**45**
Devolved departments	6,034	22	7,166	22	8,850	20	9,996	23
Establishment	2,645	10	2,802	9	3,302	8	3,990	9
Contingent	1,064	4	1,180	4	1,246	3	1,446	3
Repair and maintenance	161	1	174	1	193	0	280	1
Water and sanitation dept	2,895	10	3,115	10	3,598	8	4,186	9
Development budget, of which	**10,136**	**37**	**15,966**	**49**	**24,042**	**55**	**21,567**	**49**
Development expenditure	7,085	26	9,257	28	12,886	29	8,911	20
Tameer-e-Karachi progr.	–		2,000	6	6,000	14	9,893	22
Water and sanitation dept	2,121	8	3,547	11	3,761	9	1,120	3
ADP expenditures	930	3	1,162	4	1,395	3	1,643	4
Transfer to towns and union councils	**4,647**	**17**	**2,238**	**7**	**2,577**	**6**	**2,623**	**6**
Total expenditures	**27,582**		**32,642**		**43,807**		**44,087**	

Source: City District Government Karachi (2007)
All financial data based on budgets, not actuals.

Local PSP activities

To accelerate the pace of infrastructure development in the city, CDGK and the provincial government are making a concerted effort to promote private sector participation. The provincial government is open to receiving unsolicited bids for public–private partnerships (PPPs). At present, there is a strong private sector interest in infrastructure projects, but the procurement process remains problematic. Overall, current activities of PSP include:[30]

- *Karachi Megacity Development Project (KMDP):* The KMDP is an Asian Development Bank- (ADB-) funded infrastructure development project, which includes a technical assistance loan to enhance the government ownership of investment projects, capacity building, and institutional reforms. The technical assistance implementation started in February 2006 and is expected to last until December 2009. It is expected that the project will attract about US$800 million for Karachi, focusing on up to six sectors partly funded by PPPs at the city level. Projects will include the water and sanitation sector, the M9 motorway, traffic management/signalling etc.
- *Elevated expressway:* There are plans to build an elevated expressway with a total length of 25 kilometres, financed by Malaysian investors who approached the city government with an unsolicited proposal. The project is currently in the environmental assessment stage and the estimated cost amounts to US$350

million (PRs21 billion). If it were implemented, it is expected that the investor will recover investments by collection of tolls from all vehicles over a period of twenty years.

- *Mass transit system and public transport improvement:* A rail-based mass transit master plan has identified three corridors. It is expected that the project will be built on a 'build, operate and transfer' (BOT) basis. In addition, the induction of 8,000 environmentally friendly buses under PPP operation has been planned (2006–2010) and plans for a rapid bus transit system are under consideration.
- *Real estate developments:* A deal has been signed by a consortium of international companies for the construction of an IT Tower and call centre. The design work for the construction of the 46-story building has been completed. The tower will host a call centre with 10,000 seats, shopping, entertainment and parking facilities, as well as government offices. It will be constructed under a BOT contract with foreign investment of US$250 million.
- *Solid waste management:* CDGK has recently introduced some form of PSP for solid waste management at the town level. Many local companies are operating rubbish collection, but currently only 30 per cent of waste goes to landfills. Plans to introduce PPP for solid waste management has been under consideration for some time and negotiations with interested companies are going on, but so far no formal arrangement is in place in CDGK.
- *Markets and bazaars:* The city government has decided to lease out properties such as markets and bazaars to private operators to enhance efficiency and reduce costs.

Alternative sources of municipal financing

To improve the access to local credit markets, innovative financing schemes are being developed. As part of the Karachi Megacity Development Project (KMDP), a specialised finance vehicle is being developed with ADB assistance. It will serve as a channel for financing bankable infrastructure projects in CDGK. A registered public company will be established with the Government of Pakistan, Government of Sindh province, donor agencies and banking institutions on the governing board. The vehicle's resource base would be expanded through PPPs and pooling project credit risk through infrastructure banks and credit enhancements.[31]

This section summarises the state of the capital and credit markets in Pakistan, with respect to their potential for infrastructure financing.

State of the infrastructure finance markets

The Pakistan financial sector is growing rapidly, having reached a market capitalisation equivalent to US$40 billion in 2006. This is partially supported by growing FDI inflows and home remittances. Whilst debt markets are still underdeveloped by developed country standards, equity markets have grown steadily.[32] However, local credit is growing with an increase in banking net assets and domestic debt.

Local credit institutions

Pakistan's banking sector has experienced substantial growth and development, especially after the privatisation of a number of banks over the past few years. Islamic banking is also developing further with 2.7 per cent of the total local bank deposits, projected to increase to 10 per cent by 2010. While liquidity has increased, and thereby the provision of banking credit, there is a liquidity gap for infrastructure finance, with local credit markets being inadequate to meet project finance demands in terms of both volume and tenor. Presently, the average loan syndicate or transaction is US$250–300 million and the maximum capacity of local banks is about 4–5 projects per annum. Average loan tenor has risen from 7–8 years to 12–13 years (including grace period), but is still relatively lower than the project requirements. Islamic banks are relatively more risk averse than other local banks, as Sharia imposes certain additional risks and structuring complexities.

Local capital markets

A money market has developed following the launching of financial reforms in the early 1990s. Local capital markets have experienced some growth, more so in the equity markets than in the debt markets. However, the primary equity markets are not mature, with newly developing stock exchanges with relatively limited listings and limited trading. Despite recent growth, Pakistan's equity markets are still characterised by a low absolute level of market capitalisation.

The securities market, including the market for corporate bonds, has shown encouraging growth. An auction system to raise government debt based on two key debt instruments, treasury bills and Pakistan Investment Bonds, has been established, while a new debt instrument – the term finance certificate (TFC) – has been used by the corporate and commercial banking sectors.[33]

The local debt markets are characterised by the absence of a long-term yield curve to serve as a benchmark rate, thereby constraining debt pricing for infrastructure projects. The medium- to long-term sovereign bond market is not developed, with a yield curve being available only up to 5–10 years and with relatively low levels of liquidity. In addition, there is almost no secondary market for these securities and auctions of Pakistan Investment Bonds have been infrequent. The corporate bond market in

Pakistan is at an early stage of development (limited issue size and tenor), with total public corporate debt accounting for just over 1 per cent of GDP. Corporate bond market development is impeded by the lack of benchmark rates as well as administrative impediments stemming from their prohibitive issuing cost.

There is limited local development in derivative financial products, particularly interest rate and foreign exchange hedging instruments. Also, lack of well-developed swap and forward markets has impeded foreign exchange financing. Since 2000, some US$:PRs hedging instruments have become available through the foreign banks and financial institutions in Pakistan.

There is limited number of institutional investors in Pakistan. With pension assets at just 1.6 per cent of GDP and life insurance assets at 2.1 per cent of GDP in 2004, Pakistan has one of the smallest institutional investor bases of any of the emerging market countries. The institutional investors market in Pakistan is constrained by the predominance of the public sector, regulatory weaknesses and certain tax anomalies.

Summary

Pakistan's economy has grown strongly since 2002, and has profited from deregulation and privatisation. The rising urban population is concentrated in a few agglomerations. With decentralisation policies enacted in 2001, many responsibilities were transferred to local governments, despite the mismatch of fiscal autonomy. The provinces largely act as financiers and regulators of service provision, whilst local government, in particular (city) districts, are assigned the responsibility to deliver infrastructure and public services. Some municipal services are further devolved to the lower town level. In this context, Karachi with an estimated population of 20 million (CDGK, 2009), is the country's commercial hub and largest city.

Among sub-national governments, provinces are largely dependent on federal government transfers, with a very narrow base of own-source revenues. Almost half of the capital development budget is further transferred from the provinces to districts. City districts like Karachi are therefore equally dependent on transfers. Karachi's own-source revenues are currently limited to about 15 per cent, which underscores its limited fiscal autonomy. Also, the City District Government Karachi (CDGK) is not allowed to access any type of borrowing as of yet (although provincial governments can). On a positive note, there is a marked trend of rising budgets for development expenditures, which account for half of the city's budget. Nevertheless, with more than half of the population living in informal settlements and no existing urban mass transport system, the city faces a number of challenges in delivering adequate infrastructure.

The level of PSP at the city district level has so far been limited to private contracting of services such as solid waste and markets. A donor funded infrastructure development project, the Karachi Megacity Development Project, is expected to provide technical assistance to strengthen the institutional environment for private sector participation and to also set up a special finance vehicle to harness private sector finance. Overall the project is expected to attract US$800 million in funding for various infrastructure sectors, some of which will be funded on a PPP basis. In parallel, the banking sector has experienced significant growth, but a liquidity gap for infrastructure finance remains. The government is undertaking several initiatives to attract private financing for infrastructure projects at the national and subnational levels.

Notes

1. World Bank (2006e); IMF (2007b).
2. The eight cities are Karachi, Lahore, Faisalabad, Rawalpindi, Multan, Hyderabad, Gujranwala and Peshawar.
3. UN Population Fund (UNFPA, 2007); CLGF (2007c).
4. World Bank (2006e); UNFPA (2007).
5. Kardar (2003).
6. Ibid.
7. Shah (2003). The cost of upgrading water infrastructure alone is estimated to range between US$60 and 70 billion. The water sector largely falls under provincial jurisdiction. Provincial infrastructure regulatory authorities have been established to regulate the water sector and other areas that fall under provincial jurisdiction, such as urban transport.
8. Asian Development Bank (ADB, 2006a).
9. Government of Sindh (2007).
10. Please note that the most recent provincial finance data available is for 2002/03.
11. Kardar (2003).
12. Ibid.; Qasim (2006).
13. The FDP is sourced with proceeds from income tax, sales tax, customs duties, central excise, general sales tax on services, capital value tax and wealth tax.
14. Octroi is a local levy on goods being brought into the respective local jurisdiction.
15. Government of Sindh (2007).
16. Ibid.
17. Kardar (2003).
18. While foreign loans were initially contracted by the Government of Pakistan and passed on to the provinces, provinces now borrow directly for their capital expenditures with the consent of the federal government.
19. In 2007, the total debt liability of the government of Sindh, including contingent liabilities, amounted to PRs126,178 million or 80 per cent of the total provincial budget.
20. Priority expenditures include mainly social services such as health and education, and debt servicing of the provinces.

21. Cheema et al (2007).
22. However, the power to levy taxes has been conferred subject to the rules and instructions and approval of rates by the provincial governments. In many cases, it has been found that districts and towns are in conflict over collection of certain taxes. In Quetta, the conflict over property tax collection was decided by the High Court in favour of the district government. The case is now being filed in the Supreme Court. Similar complaints/cases have been reported in Peshawar and Lahore. Disputes on ownership of various taxes existed visibly in Karachi too, but they seem to have resolved the differences through out of court settlements.
23. Karachi City Government (2007).
24. The former Karachi Water & Sewerage Board (KWSB), which was a provincial organisation, has become the Water and Sanitary Department of the CDGK.
25. There was no consolidated financial data for CDGK available at one source. Therefore, this table has been developed based on aggregating the data (actuals and budgets, as appropriate) from multiple official sources, as presented in the sources at the end of the table. While we have attempted to confirm these figures with officials in the Karachi city government, this data should be interpreted with some caution.
26. The CDGK cannot raise new taxes without the clearance of the principal authorities, and new tax proposals have been declined in the past.
27. It is worth noting, in this context, that KWSB continues to suffer from a low rate of billing and collection and was not financially viable at the time of writing. KWSB was unable to attain the 2007 target of PRs5 billion through its revenue collection.
28. Siddiqui (2004).
29. The provincial government has initiated a plan to rehabilitate and develop the infrastructure of Karachi. The plan, under the Tameer-e-Karachi Package, has a total outlay of PRs29,600 million.
30. Interview with Karachi Megacity Development Project Manager.
31. Interview with Karachi Megacity Development Project Officer; also Shah (2003).
32. This implies that the Pakistan economy is relatively underleveraged.
33. Kardar (2003).