Monetising Patriotism, Path Unclear

A closer look at Pakistan's new diaspora financing strategy

by Sohail Khan

- The proposed certificates offer a lower return (5 - 5.5% p.a.) than existing sovereign bonds (7-8% p.a.); the goal should be diversifying funding sources, rather than seeking highly stretched patriotism premiums
- Distribution strategy remains murky e.g. bonds are unlikely to be available to the affluent US diaspora without a long drawn SEC registration process
- It is unclear how the diaspora can be efficiently reached given poor banking channel coverage of Non-Resident Pakistanis

◆On December 24th, the Government of Pakistan invited Expressions of Interest from banks to help raise USD denominated term certificates from both resident and non-resident Pakistanis with bank accounts outside Pakistan. The government seeks to raise three and five-year funds at 5.0% and 5.5% respectively through this issuance. Curiously, the EOI gives banks until December 31st to respond, a remarkably short period of time during the slowest week of the year. Such urgency would suggest that diaspora funding is now an important part of the new government's Plan A.

To put it gingerly, one hopes this is more of a thought experiment than a central part of the deficit funding strategy . The initiative faces significant challenges from a conceptual, pricing, execution, and timing perspective.

Conceptually, the raise is pillared on the assumptions that the diaspora has excess liquidity and is open to deploying such liquidity in Pakistan in term securities. This glosses over the realities facing the largest diaspora communities that account for 50%+ of total remittances. Saudi Arabia and UAE based expats have low net saving rates, are facing job insecurity associated with Arabisation, increased taxation, and a challenging macro-economic environment. In addition, much of the diaspora's savings are dedicated to providing in-country family support, with investible surpluses typically deployed in real estate: attractive for its tangibility, impressive appreciation track record (at least in rupee terms), shariah compliance, and alternative utility as a place of residence.

None of these goals are met through an interest-bearing instrument – there is fundamental incongruence between the needs and habits of the diaspora and what the government seeks to achieve through offering term investment instruments.

In addition, the unrealistically low interest rate proposed by the Government of Pakistan risks opening a credibility gap with this community. There is nothing wrong with, and certainly precedence for, offering diaspora investors a lower interest rate compared to what a foreign investor might seek. This interest rate discount reflects the beaming patriotism diaspora naturally feel towards their homeland, when under credible leadership. However, the rate differential needs to be set at a level that acknowledges this goodwill, without seeming predatory. Interest rates have risen sharply over the past year, with US banks now offering as much as 3.5% p.a. (deposits insured by the FDIC), while large Middle Eastern banks will pay 4%+ p.a. on three year deposits. In this environment, why would expat find 5 - 5.5% p.a. on these instruments, attractive, especially when they can easily earn 7 - 8% from investing in existing Pakistan sovereign bonds? While a 0.25 - 0.50% differential is understandable, 2% leaves one wondering whether the government seeks the patriotic or the naïve.

There is much to be learned on this count from the experience of the two largest issuers of

diaspora bonds – Israel and India.

Since its first issuance in 1951, Israel has taken a programmatic approach to issuing diaspora bonds across maturities and over time. Today the instruments are a key component of the nation's national debt management strategy, with diaspora bond investments symbolizing the communities commitment to the homeland. For example, twenty year maturity Israeli bonds are often given to young Jewish children at their bar / bat mitzvah's. The long track record of registration in the US allows for broad, robust distribution and a liquid secondary market.

India has been much more tactical in its issuance: limiting it to periods of external account crisis when its access to capital markets was impaired (e.g. post - 1998 nuclear test).

In both cases the patriotic discount has been small, if any. Hence, ***the primary purpose of diaspora bonds is less to benefit from lower interest rates and more to diversify funding sources, especially in challenging economic environments where access to international capital markets may be constrained.***

Execution presents its own set of challenges. There is very little precedence for expat investors investing in Pakistan sovereign bonds at issuance, with the lion's share of placements have been with global asset managers. As such, there isn't an existing retail investor base to rely upon for the inaugural issue, increasing execution risk.

In addition, the wealthiest Pakistani diaspora community is in the US, where 18% of diaspora families have incomes greater than $140,000 p.a., placing them amongst the top 10% of US households. Unfortunately, any offering to these investors would likely need to be vetted and approved by the US Securities and Exchange Commission (SEC), a time consuming and tedious process that works best only for large transactions.

Finally, a fundamental question remains: how do you actually reach the Pakistani diaspora? In the case of Israel, they have large global banks that actively build relationships and bank diaspora clients around the world. Where India lacks truly global banks, it benefits from local and international financial institutions having a long history of banking Non-Resident Indians (NRIs) through specialized business units. There is a limited equivalent distribution channel for the Pakistani diaspora, making placement a difficult and uncertain process.

The diaspora has a significant role to play in Pakistan's future and its intellectual, professional, and financial resources should be harnessed towards that end. However, diaspora funding is a sub-optimal means to engage the expat community and faces significant challenges unless there is a fundamental restructuring of stated objectives and timelines. While the government continues to work on tweaking its national debt management strategy, the primary role of the diaspora should be reconsidered. The Government of Pakistan may be better served channelling the significant goodwill it has with this community into seeking tangible help to bring investments into the country (both capital and talent), spurring innovation and catalysing exports. Let expats be dynamic ambassadors, entrepreneurs, and connective tissues, rather than staid sources for placing poorly priced bonds. ◆

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