

## IS PRIVATIZATION IN PAKISTAN PURPOSEFUL?

Dr. Akhtar Hasan Khan

The philosophy of privatization stems from the role of state in economic life. The thinking of the international financial institutions and free market economists is that, as in USA, the state should confine itself to regulation only and the operation and ownership of industrial enterprises and utilities should be left to the private sector. However, there is an opposite view expressed by a distinguished economic historian, Gershenkron, in his seminal article “Economic Backwardness in Historical Perspective<sup>1</sup>”. Gershenkron’s argument is that in those states which start late in the race of development, the public sector has to play a vital role in accelerating the pace of economic growth. As is in developing countries, the private sector is shy, inexperienced and not equipped to embark on rapid industrialization. Pakistan alongwith other developing countries followed the activist role for the state in industrialization and the rate of industrial growth in Pakistan has been very high.

The second main thrust for privatization is the belief that private sector units are more efficient than public sector units. This is not true across the board. In a study<sup>2</sup> which made a comparison between public industrial enterprises and private firms producing similar goods, the conclusion was that changing the ownership of industry from public to private is neither a necessary nor a sufficient condition for more efficient operation of specific industrial enterprises. However,

<sup>1</sup> Gershenkron, Alexander, Economic Backwardness in Historical Perspective, Praeger, London, 1962

<sup>2</sup> S.N.H. Naqvi & A.R. Kemal, “The Privatization of the Public industrial Enterprises in Pakistan”, PDR Summer 1991.

on the other hand it is often correctly claimed that due to political interference and over-staffing, the efficiency of the public sector units is reduced.

The third argument for privatization is its fiscal impact. The favourable fiscal impact of privatization is expected from the sale proceeds being used to retire national debt, as well as elimination of losses of the public sector units as the losses were being financed from the budget. The opposite view is that the public enterprises after nationalization in 1973 doubled the payment of their taxes as compared to the pre-nationalization period. Moreover, if the public sector enterprises are making profit and giving the government return higher than the rate at which it is borrowing from the market, the privatization of profitable enterprises would have an adverse impact on the budget. Hence this argument does not hold for profitable public sector enterprises.

The fourth argument for privatization is to foster competition and to strengthen capital markets. If all the units in certain sectors like cement are owned by the state and these are sold to different parties, there would be healthy competition. However, if the market situation is such that there are public sector units as well as private sector units for the same commodity there will be no further fostering of competition by privatization. Capital market is strengthened, if the government share holdings are sold in the market as was done in case of PTCL and more recently in the case of Muslim Commercial Bank and Al-Falah Bank. Capital market is not strengthened at all, if one public sector unit is handed over to the private party without some of its shares being offered to the public. Hence it is necessary for strengthening and deepening of capital market that some percentage of the shares of public enterprises is sold to the public through stock exchange.

Another objective of privatization is to encourage direct foreign investment. The direct foreign investment in profitable public units is not likely to be beneficial for the economy, as against the benefit of an initial purchase price, one has to calculate the recurring remittance of profit in foreign exchange for years and decades to come. Direct foreign investment therefore should be attracted by policy and design into new and risky ventures rather than through the purchase of profitable enterprises. In fact purchase of existing operational units by foreign buyers is not an addition to the capital stock of the country.

## I

Privatization is a complex exercise with multifaceted implications and has to be conducted with a number of caveats. The first is that it should be absolutely transparent process with full legal safeguards and watertight procedures, otherwise the valuable public assets may be sold at throw away prices and causing a huge loss to the national assets. It has also been observed that privatization should avoid crony capitalism as in Chile and Argentina, it has been associated with giving away expensive public assets at cheap rates to political cronies. Privatization gives tremendous patronage to the government in power which may be exercised to favour vested political interests rather than to serve long run national objective, negating the basic objective of improving efficiency in the economy.

The second imperative of privatization is sequencing and timing. It is essential that all the assets should not be sold in a short period, because in the short period the buying power of private sector may not be adequate to offer the correct prices for all the privatized assets. It may crowd out fresh foreign investment and lead to reduction in the rate of investment in the economy.

The third essential condition for the success of privatization is that the economy should be deregulated and unnecessary restrictions and procedures for industrial enterprises should be done away with. Privatization should therefore be part of a process to strengthen private sector by giving it assets as well as improving regulatory framework for their operation. To give units to the private sector but to keep it throttled by massive regulations would not improve the operational efficiency. Hence the sale of privatized units should be staggered over time.

Fourthly there should be a preference to privatize first the loss making assets, then the less profitable and finally the more profitable. In case the loss making units could not be sold independently these could be bunched with a profitable public enterprise.

Fifthly the investment climate must also be kept into view. Privatization after 11<sup>th</sup> September, 2001 was not an opportune time because the international stock markets slumped and the investor's confidence slided sharply after that eventful episode. As a result of terrorist activities in Pakistan and given the fact that Pakistan having a long border with the Afghanistan, the investment climate in Pakistan deteriorated more sharply than in other countries.

Finally it must be ensured that the party which is buying the industrial units does not use it for stripping the assets and selling the real state because if the party does this, there will be a serious loss of out put, employment and taxes to the national economy.

### III

There have been two tides of privatization in Pakistan. The first tide is from 1992 to 1994 and the second tide from July 2001 to October 15, 2002. In the first period assets worth Rs.120 billion were divested and in the second period assets worth Rs.65 billion were divested. The consultants engaged by Asian Development Bank have conducted a thorough study of the first period. It is a detailed report but the following table sums up their findings with respect to the overall assessment of the privatization process.

**Table:**

	<b>Better</b>	<b>Same</b>	<b>Worse</b>	<b>Total</b>
PMEs *	9	13	16	38
Misc.	3	10	1	14
Ghee Mills	2	12	5	19
Rice Mills	2	-	6	8
Banks	2	2	-	4
Total	18	37	28	83
Percentage	22	44	34	100%

Source: Impact and Analysis of Privatization in Pakistan: ADB Report October 1998.

\* Public Manufacturing Enterprises.

The above table clearly indicates that only 22% of the privatized units were performing better than in the pre-privatization period, 44% approximately the same and about the third i.e 34% worse than before. It is quite clear that the compelling reason for privatization that of improving the efficiency of the units, was only attained by about 1/5 of the units, whereas the rest were working with the same efficiency or worse than before. No wonder in the article\* quoted above the authors had reached the conclusion that, "in Pakistan there is nothing hardly

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\* Ibid Page 1.

good or bad about public sector or even the private sector for that matter”. On the whole, operational efficiency deteriorated after privatization.

Moreover, the most tragic consequence of privatization was the closure of many units which are listed below; -

- 1) Naya Daur Motors
- 2) Dandot Cement
- 3) Zeal Pak Cement
- 4) National Cement
- 5) General Refractories
- 6) Pak PVC
- 7) Swat Elutriation
- 8) Nowshera PVC
- 9) Nowshera Chemicals
- 10) Pak China Fertilizer
- 11) Karachi Pipe Mills
- 12) Metropolitan Steel
- 13) Pak Switchgear
- 14) Quality Steel
- 15) Indus Steel Pipe
- 16) Fazal Veg. Ghee
- 17) Haripur Veg. Oil
- 18) Khyber Veg.
- 19) Suraj Ghee Indus.
- 20) Hydari Veg. Ghee

The closure of these units has played havoc to the national economy and the first phase of privatization has contributed to the lower rate of industrial and economic growth. The GDP growth which was above 6% in the 1980s declined to around 4% in the post privatization period.

The reasons for closure are many. First the units were sold out without checking the creditworthiness of the party. Schon Group whose horrible reputation is household knowledge in Pakistan was given three units, National

Fibre, Pak China and Quaidabad Woolen Mills. All these were closed after privatization. The ADB consultants have opined: “It has been suggested by some that these were not privatized transparently and Schon Group were able to access other offers before submitting their bids”. Moreover, they did not pay the first installment and the Privatization Commission did not take a strong line to forfeit the bogus investors. The Consultants were shocked to observe: “Both companies are being bailed out without underlying ownership problem being resolved”. Messrs. Saeed Qadir and Sartaz Aziz owe an explanation to the nation for the unwarranted favour shown to Schon Group and also to Tawakkil Group, if we do not doubt their integrity, to say the least.

Among the other major units which closed after privatization was Zeal Pak Cement. The buyer was not interested in running the factory but in stripping the assets. This is a frequent bane of privatization. Assets strippers buy, pay one installment, remove the machinery, sell the real state and then walk away. Obviously, this is not effective privatization.

All the engineering units except Millat and Al-Ghazi Tractors (both are running well) were closed after privatization, as their buyers had no intention of running them. Operating engineering units is not like running the rice mills and in fact the buyers lacked management and technical expertise to run engineering units. Hence privatization was a big blow to the engineering sector in Pakistan, which was already very weak and had a small base.

The Privatized units also formed cartels to exploit the consumers. A cartel was formed between D.G. Khan Cement and Maple Leaf Cement to exploit the consumers in that region.

Of the three privatized banks MCB is reported to be running better. Same is the case of ABL. Nevertheless the latest figures from January 2002 to June 2002 reveal that both these privatized banks have declared much less profit compared to Habib Bank Limited. The third privatized financial unit Bankers Equity Limited (BEL) has been closed after privatization as billions of depositors money was swindled by the party to whom it was privatized. The credentials of the party were not investigated and it was obvious that the purchase money was paid from the deposits of BEL. The chairman of the Board of Directors of BEL before privatization was the Governor of the State Bank of Pakistan and after privatization a well-known thug. A leading financial institution was closed as a result of privatization and it had the strong negative impact on financial markets.

Another rule for effective privatization, which was not observed in this period, is not to give more than one unit to a party. Considering the slogan of 22 families and the cry against concentration of industrial wealth in the 1960s, the Government should have learnt from the history and evolved a prudent policy – one unit for one party. However, two big units i.e. MCB and DG Khan Cement were given to Mian Mansha and three units to the scandalous Schon Group.

Analysis of the first tide of privatization has shown that it has not been able to achieve the intended goals of privatization. The procedure according to ADB Consultants was not transparent but smacked of cronyism and corruption. The credentials of the parties were not properly investigated. Even the anticipated fiscal impact was not realized because the proceeds of privatization were not

credited to a separate Debt Retirement Fund but were put into Federal Consolidated Fund from where these were utilized for current expenditure.

## VI

Kot Adu was major privatization during Benazir's second term as Prime Minister. Kot Adu is WAPDA's biggest generating unit with the following capacity :-

<b>KAPCO</b>	<b>MW</b>
Combined Cycle 1-4, 9&10	624
Gas Turbines 5-8	40C
CC Unit 11 & 12	20C
Gas Turbine 13 & 14	264
	1,488
Combined cycle 15 – June 1997	1,621

There was no need to privatize an already existing big power unit which was running efficiently. Its units were either gas turbine or combined cycles which can use either oil or gas. Gas is far cheaper than oil for generating electricity and Kot Adu was mostly running on gas. However, the government decided to sell 26% stake in it at a price of US\$215 million. Subsequently 10% shares were to sold for US\$76 million and the government realized only US\$291 million from the sale of 36% share.

The most interesting feature this privatization was that the government handed over the management of the unit to minority shareholders, which perhaps has never been done in the corporate history of the world. It was provided in the sale agreement that there would be nine directors, four independents, four nominees of the purchasers and one of WAPDA. As a result of court's

intervention it was decided that there would be seven directors, four nominees of WAPDA, two nominees of the purchasers and one CEO appointed jointly by WAPDA and purchasers. However, it meant that although the government is the largest shareholder yet it will have no representation on the board as the foreigner purchasers did not want government interference.

Initially it was decided that after privatization KAPCO will sell electricity to WAPDA at a tariff of 5.6 US cent per KWH. Subsequently this tariff was reduced to 4.9 US cent per KWH. WAPDA's cost of generation at Kot Adu with gas feed stock was not more than 2.5 US cent per KWH. Hence, the government received US\$291 million but WAPDA became a bankrupt organization after the sale of KAPCO and setting up of other independent power plants like HUBCO. The foreign party has been able to repatriate the total amount of US\$291 million during the last six years and WAPDA is being forced to pay twice the cost at which it was generating electricity at KAPCO before privatization. This is the most senseless privatization in Pakistan. In fact the whole policy of IPPs has terribly ruined WAPDA and its consumers all over the country are suffering because WAPDA has to pay such high rates to the IPPs including KAPCO and HUBCO. The electricity tariff in Pakistan which is deemed to be the highest in Asia has also made the industry uncompetitive in world market.

## V

The second tide of privatization was from July 2001 to October 15, 2002. The major privatization which took place during this period included; (1) sale of GOP "Working Interest" in six oil concessions, (2) sale of 51% GOP stake in

UBL, (3) sale of Pak Saudi Fertilizer Ltd., and (4) two capital market transactions amounting to Rs13.6 billion.

It is interesting that whereas in the entire financial year 2001-2002, the total value of privatized transactions was Rs19.6 billion, alone in the last three and half months before handing over power to the elected representatives, the privatized transactions amounted to Rs15 billion. The privatization of this period is too recent to be analyzed fully in its operation and impact. One thing is clear that it was pushed by IMF as the privatization of all programmed public assets was part of the undertaking given to the Fund for its latest financing facility under the name of Poverty Reduction and Growth Facility (PRGF).

However, long-term national economic interest and strategic consideration were not kept in view while drawing up the list for privatization. The time honoured and prudent government policy dictated by national interest for all concessions was that to have “Working Interest” in the oil companies formed after oil discovery in order to ensure that oil is drilled both according to the national as well as private interest of the company. As a result of this “Working Interest” arrangement, GOP had a seat on the Board of Directors. Oil and gas companies therefore could not hide anything from the GOP regarding their output, royalty etc. Now GOP has sold its “Working Interest” leaving the field open to the oil and gas companies to play the game of multinationals. The sale of “Working Interest” was therefore not in national interest.

Pak Saudi Fertilizers was a very profitable public sector unit producing Urea. It has been sold to a group led by Fauji Foundation. The sale of unit from Public Sector Corporation to Fauji Foundation is not privatization, to say the

least. It was a very profitable unit yielding handsome profit to GOP and now the profit would go to the Fauji Foundation.

The sale of shares of MCB & NBP and other capital market transactions were the correct decision as the privatization through gradual sale of shares to the public is the most preferred form of privatization.

The sale of UBL to Abu Dhabi and Best Way Group is altogether inexplicable. First GOP poured Rs30 billion into UBL to cover its non-performance loans and make it privatizable. This was not done in the case of earlier sale of MCB and ABL. After pouring such a huge amount of Pakistani tax payers money it has been sold to foreigners for Rs12.35 billion. In the first bidding Mian Mansha was shown to be the highest bidder but bidding was held again and Abu Dhabi and Best Way Group were on the top in the second round. GOP lost Rs17.65 billion in its privatization exercise. GOP has not explained as to why Rs30 billion of tax payers money was poured in UBL for privatization and what was the hurry in handing over this unit a week before the national elections.

Therefore, whereas the gross proceeds from privatization during the second period amounted to Rs34.7 billion but if we deduct Rs30 billion poured in UBL then the net receipts are only Rs4.7 billion. In the second phase the government has sold public assets which were highly profitable for a trivial net amount of Rs4.7 billion.

Policy makers have a great advantage in a modern age of internet as with a click of the mouse they can learn from the experience of other countries in the field of privatization. International experience of privatization has been varied. Chile is a successful case of privatization but Yotopoulos<sup>3</sup> has pointed out there was serious charges of sales to the cronies in Chile. There were similar charges of crony capitalism in Argentina where privatization proved a failed exercise. In India privatization has proceeded at a slow pace and is stalled at present due to protest from the unions of public enterprises, which were to be privatized. Stiglitz<sup>4</sup>, an American Nobel Laureate in his recent book on Globalization has pointed out that rapid pace of privatization in the USSR at the behest of IMF has led to sharp economic decline.

China's economic achievement is unique in human history. A nation of more than one billion people has been able to quadruple its per capita income in less than two decades. The Washington Consensus and international financial institutions have been putting pressure on China to privatize its public enterprises, some of which are running at a loss. However, China did not pay any heed to the foreign advice but what it did was to stop fresh investment in public enterprises. Thirty years ago public enterprises accounted for about 90% of the national industrial output. At present they account for only 30%. As the fast expanding new investment especially by multinationals have over taken the public enterprises. In the process many loss making enterprises which could not modernize themselves have closed or automatically phased out.

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<sup>3</sup> Yotopoulos Pan (1989) Tide of Privatization Lessons from Chile World Development (1989)

<sup>4</sup> George Stiglitz Globalization 2002 Harper and Row

Pakistan should have followed China's example and instead of undertaking sweeping tides of privatization conducted in a non-transparent manner, detrimental to national interest, we should have rather lured private investors alongwith foreign investors to set up new industry which would have gradually reduced the size of public sector enterprises.

It seems we have not learnt a lesson from our previous privatization and now the government intends to privatize major assets like PSO, OGDC, PTCL and HBL, and NBP. PSO, PTCL and OGDC are highly profitable organizations and their profits for last two years are as follows ;-

(Rs billion)

<b>Organization</b>	<b>2000-01</b>	<b>2001-02</b>
PSO	2.25	3.19
OGDC	16.49	16.37
PTCL	18.19	19.81

Source: Ministry of Finance.

PSO is Pakistan's largest corporate unit and the only corporate unit included in Asia's 500 leading enterprises. The other two oil distributors are foreign companies Shell and Caltex. If we sell PSO, foreign companies can throttle oil supply to different points in time of emergency. Hence both economic and strategic consideration demand that PSO should not be privatized.

OGDC produces 36% of domestic crude oil and 29% of natural gas in the country while the remaining production of oil and gas is by foreign companies. OGDC operations are spread all over the country and privatization of all these public enterprises producing oil and gas would again be a strategic blunder. Moreover, it is a revenue spinner and giving handsome profit to the government.

Secondly, if OGDC is privatized, a number of new drillings will be entirely in the hands of foreign companies whose decisions may not be in Pakistan's interest.

It is an ideal competitive situation in which public sector PSO and OGDC are competing with foreign multinationals and both of them should be encouraged to drill more. Moreover, no developing country has handed over its entire oil and gas sector to foreign countries. In most developing countries the oil and gas sector is a public enterprise as the scale of operation is so large and the profit so huge, that none except Pakistan has found it in their national interest to privatize the entire oil and gas sector.

PTCL is again a revenue spinner and the only company with ground lines in each nook and corner of the country. Handing over this profitable strategic asset to a foreign company will be devastating for Pakistan's economy and security.

HBL and NBP should not also be privatized. This would incapacitate monetary and credit policy of the government to realize national socio-economic goals particularly in the context of advancing credit to small borrowers to correct imbalances created by advances to large parties only by the private banks.

Privatization in Pakistan has not met its objectives, for the reasons noted above. At present it is in national interest to remove PSO, OGDC, PTCL, HBL and NBP from the list of privatization, as their privatization would be strategically dangerous and economically unjustifiable. If we go along with the announced pace of privatization our economy, which already in recession will suffer and we will lose our economic sovereignty. Moreover, IMF's next demand will be to privatize Mangla and Tarbela dams, which would bring an utter ruin to the economy.

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