

The Privatization Program



September, 2014

Policy Paper No.24

THE PRIVATIZATION PROGRAM

by

Dr. Hafiz. A. Pasha

September, 2014

Social Policy and Development Centre - Karachi

ACRONYMS

ABL	Allied Bank Limited
ADB	Asian Development Bank
ARL	Attock Refinery Limited
CCI	Council of Common Interests
CCOP	Cabinet Committee on Privatization
CEOs	Chief Executive Officers
EFF	Extended Fund Facility (EFF)
FDI	Foreign Direct Investment
FESCO	Faisalabad Electric Supply Company
FPI	Foreign Portfolio Investment
GDP	Growth Domestic Product
GDR	Global Depositary Receipt
GHPL	Government Holdings (Private) Limited
HBL	Habib Bank Limited
HEC	Higher Education Commission
HESCO	Hyderabad Electric Supply Company
IESCO	Islamabad Electric Supply Company
IMF	International Monetary Fund
JPCL	Jamshoro Power Company Limited
KAPCO	Kot Addu Power Company Limited
KESC	Karachi Electric Supply Company
KSE	Karachi Stock Exchange
MCB	Muslim Commercial Bank
NBP	National Bank of Pakistan
NICL	National Insurance Company Limited
NIT	National Investment Trust
NPCC	National Power Construction Corporation
NPGCL	Northern Power Generation Company Limited
NRL	National Refinery Limited
NSC	National Safety Council
OGDCL	Oil and Gas Development Company Limited

PASMIC	Pakistan Steel Mill
PECO	Pakistan Electric Company
PEPCO	Pakistan Electric Power Company
PIA	Pakistan International Airline
PIBs	Pakistan Investment Bonds
PML(N)	Pakistan Muslim League (Nawaz)
PNSC	Pakistan National Shipping Corporation
POL	Pakistan Oilfields Limited
PPL	Pakistan Petroleum Limited
PPP	Pakistan People's Party
PRCL	Pakistan Reinsurance Company Limited
PSEs	Public State Enterprises
PSO	Pakistan State Oil
SBP	State Bank of Pakistan
SLIC	State Life Insurance Corporation
SME	Small and Medium Enterprises
SNGPL	Sui Northern Gas Pipelines Limited
SSGC	Sui Southern Gas Company
SSGCL	Sui Southern Gas Company Limited
UBL	United Bank Limited
WAPDA	Water and Power Development Authority

TABLE OF CONTENTS

	Page #s
1. THE FRAMEWORK	2
1.1. The Law	2
1.2. The PML (N) Manifesto.....	2
2. POST- PRIVATIZATION	4
2.1. Level of Composition	4
2.2. Post-Privatization Experience	5
2.3 Lessons Learned	6
3. THE PRIVATIZATION PORTFOLIO	7
3.1. Size, Modalities and Composition	7
3.2. Progress	10
4. CRITERIA FOR PRIVATIZATION	11
4.1. Market Sale of Shares	11
4.2. Privatization to Strategic Investor	12
5. IMPACT OF PRIVATIZATION	14
5.1. Market Sale of Shares	14
5.2. Privatization to Strategic Investor	14
6. CONCLUSIONS AND RECOMMENDATIONS.....	15

List of Charts and Tables:

Chart 1: Structural Benchmarks in IMF Program.....	10
Chart 2: Case for Privatization.....	13
Chart 3: Impact of Different Forms of Privatization.....	14
Table 1: Privatization Proceeds – 1991-2011	4
Table 2: Units up for Privatization in Agreement with IMF	7
Table 3: Key Financial Statistics of Major PSEs	8
Table 4: Market Capitalization of Shares by Sector.....	9
Table 5: Gains / Loss from Sale of Shares	12
Table S-1: Application of Criteria for Evaluation of Case for Privatization.....	17
Table S-2: Application of Criteria for Evaluation of Case for Privatization.....	17

THE PRIVATIZATION PROGRAM

Privatization of state assets provokes strong emotions. The proponents see this as a way of reducing the burden on the exchequer by transfer of loss-making public state enterprises (PSEs) and achieving efficiency gains through a private sector management less vulnerable to graft and corruption. Opponents argue that privatization could lead to the creation of private monopolies, with adverse implications on employment and consumer welfare. The consequence would be a further concentration of wealth and a return to the days of large 'robber barons'. The view that is recommended by the pragmatists on this issue is that privatization should be promoted only of state companies operating in a competitive environment in industry, finance and trade, but that this process should be strictly avoided in the case of natural monopolies and of strategic assets like natural resources.

Pakistan is about to embark once again on a major round of privatization of a wide range of state assets after a gap of six years. This paper analyses the major issues in the context of the proposed privatization program.

Section 1 of the paper describes the framework for privatization that currently exists in Pakistan. It also highlights the policy on privatization enunciated in the manifesto of the ruling party, PML (N). Section 2 reviews the history of privatization in the country and identifies the post-privatization performance in key sectors. This section also highlights the major lessons learnt.

Section 3 describes alternative models of privatization and the size and composition of the proposed Privatization Program, as agreed with the IMF in the Extended Funded Facility (EFF). Section 4 sets up the criteria for selection of units and modalities for privatization. These criteria are then applied to the units included in the Program. The projected impacts of the proposed privatization process on key variables like production, employment, public finances, balance of payments, inflation, etc., are identified in Section 5. Finally, the key conclusions and recommendations are presented in Section 6.

1. THE FRAMEWORK

1.1. The Law

Pakistan does not have a comprehensive Privatization Law like Turkey, Philippines, Algeria, Morocco, Tunisia, Jordan, Bulgaria and others. Instead, privatization is undertaken under the *Privatization Commission Ordinance of 2000*. It describes the structure and functions of the Privatization Commission, the financial provisions, the process of privatization, jurisdiction of the Courts, regulatory and other provisions.

The Ordinance has a key provision regarding the utilization of privatization proceeds distributed to the federal government. According to Section 16(2), ten percent shall be used for the poverty alleviation programme and ninety percent for retirement of federal government debt.

Also, Section 5 states that the Privatization Commission must “advise the federal government that monopolies are not created in the process of privatization”. Policy decisions are taken by the Cabinet Committee on Privatization (CCOP).

The *Constitution of Pakistan* contains an important provision which has important implications on the process of privatization. Article 173(2) states the following:

‘Subject to the existing commitments and obligations, mineral oil and natural gas within a Province ... shall vest jointly and equally in that Province and the Federal Government’.

This may be taken as implying that any state companies in oil and gas exploration, extraction and distribution should be privatized only after formal approval in the Council of Common Interests (CCI). Further, the proceeds should be shared on a 50:50 basis between the federal government and provincial governments (where the natural resources are located).

1.2. The PML (N) Manifesto

The policy on privatization of the party is given in the section of the manifesto on ‘State Owned Enterprises’, which is part of the first chapter on ‘Economic Revival’. The focus is on state-owned institutions like PIA, Railway, Pakistan Steel Mills,

WAPDA and other institutions who are a major drag on Pakistan's economy, with losses of Rs 400 billion per annum. It is proposed to reform these institutions through a combination of privatization and restructuring.

As such, after induction into power, PML (N) proposed to initiate the following actions to turn around the loss-making PSEs:

- Appoint independent and professional boards who in turn will appoint competent CEOs of state enterprises. Professional competence and merit will be the only criteria for appointment of boards and CEOs.
- The immediate task of the boards and CEOs will be to manage these corporations effectively and to plug the losses.
- Assign quantifiable targets and monitor on a regular basis. Performance evaluation will also be carried out to ensure accountability.
- Stop every kind of political interference in the affairs of these enterprises.
- Undertake deep-seated and urgent reforms in the relevant sub-sectors.
- Identify enterprises which need to be privatized and assign targets to the Privatization Commission to ensure completion of the privatization process within the assigned time frame.
- Operational standards will be prescribed and complete autonomy will be given to achieve them.
- PIA shall be transformed into a profitable and reputed airline of the Region.
- There will be a special focus on Pakistan Railways to improve its operations. It has strategic importance and is the favored mode of transportation for the common man and cargo carriages. A fully autonomous board will be set up to oversee the working of Railways.

The initial implementation of the above reforms has been weak.

2. PAST PRIVATIZATION

2.1. Level and Composition

The major process of privatization started in 1991 during the tenure of the first Nawaz Sharif government. The peak was attained in the Musharraf period, 1999 to 2008.

Altogether, 169 units have been involved in this process. The largest privatization proceeds have been from the sale of telecommunications companies, especially PTCL, with a share of 39 percent in total proceeds (see Table 1). Next in size is the banking and finance sector, with privatization and market sale of shares worth Rs 174 billion, representing a share of 37 percent. Major banks transferred to private owners include ABL, MCB, UBL and Habib Bank.

Sectors	Number of Units	1991-1999	1999-2008	1991-2008	%
Banking and Finance*	31	5.6	168.5	174.1	36.6
Energy Sector	14	10.3	41.5	51.8	10.9
Telecom Sector	4	30.5	156.8	187.3	39.3
Industry	105	11.9	49.0	60.9	12.8
Others	15	0.5	1.7	2.2	0.5
TOTAL	169	58.8	417.5	476.3	100.0

*including capital market transactions of Rs 133.1 billion
Source: Privatization Commission

Fourteen units in the energy sector have also been privatized, yielding Rs 52 billion (share of 11 percent) including KESC, NRL and KAPCO. 105 industrial units were privatized from various sectors including automobiles, cement, chemicals, engineering, fertilizer, ghee, rice and rot plants and textiles. Some of the major industrial units privatized include DG Khan cement, Wah Cement, Mustekham Cement, Javedan Cement, Pak-Saudi Fertilizers, Pak-Arab Fertilizers and Pak American Fertilizers. Rs 61 billion have been generated from the sale of industrial units, with a share of 13 percent.

24 capital market transactions have been undertaken. This includes POL (24 million shares), OGDCL (15 percent of shares)¹ PPL (15 percent of shares), UBL (19.6

¹ Including a GDR of 9.5 percent of shares.

percent of shares) and HBL (7.5 percent of shares). The total yield from these sales is Rs 133 billion, about 28 percent of the total proceeds.

Large revenues of Rs 418 billion were generated from privatization during the Musharraf period, equivalent to 88 percent of the cumulative proceeds since 1991, including almost \$ 6 billion of foreign exchange receipts. This represents a share of 30 percent of the total FDI and FPI combined during this period and 70 percent of the foreign exchange reserves at the time of transition in 2008 to the PPP government. Clearly, the Musharraf government used privatization as a way of promoting FDI and building up foreign exchange reserves. As we shall show later, a similar policy is now being followed by the PML (N) government.

2.2. Post-Privatization Experience

Asian Development Bank has assessed the performance of 100 units after privatization in Pakistan. Only 20 units appear to be performing better than before. In the case of manufacturing, 16 out of the 38 privatized units were performing worse than in the pre-privatization period. Transparency has been weak and regulatory mechanisms ineffective and extremely politicized².

A comparison of nationalized banks in the late 1970s with privatized banks in recent years yields interesting conclusions. First, the latter are more risk-averse. Only 31 percent of the assets are in the form of credit and as much as 50 percent in government securities. As opposed to this, nationalized banks devoted 55 percent of their assets to credit and only 27 percent to investment in risk-free government treasury bills and bonds.

Second, the share of nationalized bank credit to agriculture was over 13 percent as compared to 5 percent only by the private banks currently. A credit plan at that time ensured that enough credit was allocated to priority sectors like agriculture, SMEs and exports. Third, the margin between the return on advances and on deposits was lower at about 5 percent in the late 70s as compared to over 7 percent currently. This highlights the likelihood of cartelization behavior by private banks.

² Tahir, Pervez (2014), "Privatisation and business-politics nexus", *Daily Express Tribune*, September 5, 2014.

KESC is the only power distribution company that has been privatized. There are ten other distribution companies under PEPCO. KESC's performance compares unfavorably with PEPCO. Transmission and distribution losses are as high as 31 percent as compared to 21 percent in the latter. Billing losses are 15 percent, almost 5 percent higher than in PEPCO.

2.3. Lessons Learned

The above findings clearly indicate that privatization is no guarantee for improved efficiency. This depends not only on the management skills and experience of the new private strategic investor but also on the market environment and presence of effective regulatory mechanisms.

Khan (2012)³, who served as Secretary of the Privatization Commission, has undertaken a comprehensive study of the Impact of privatization in Pakistan. He has emphasized on the need for full transparency of transactions and cast some doubts on the process followed for privatization of MCB and HBL.

There is also a need for proper valuation and coverage of assets of the unit to be privatized. The Supreme Court stopped the privatization of PASMIC because of this problem. In some cases, like KESC, despite a commitment, enough investment has not been made in the renovation and upgradation of assets.

One of the biggest lessons is that gains from privatization hinge crucially on the presence of autonomous, effective and alert regulatory agencies, free from any political influence and with quasi-judicial powers. This will prevent monopolistic behavior or emergence of cartels and protect consumer interests.

There is a view that post-privatization banks have effectively formed a cartel and raised their margins between the rate of return on advances and deposits. Apparently, the State Bank of Pakistan (SBP) has not done enough to get this margin reduced. The same suspicion about price-setting behavior applies to private cement companies.

³ Khan, A.H, 2012, "The Impact of Privatization in Pakistan", Ferozsons, Lahore.

3. THE PRIVATIZATION PORTFOLIO

3.1. Size, Modalities and Composition

The modalities that are proposed to be adopted in the privatization program are as follows:

- (i) market sale of shares
- (ii) privatization in 'as-is' condition
- (iii) restructuring then privatization

The list of units in each category is given in Table 2 by sector.

Sectors	Market Sale of Shares	Privatization	Restructuring then Privatization	
Energy	<ul style="list-style-type: none"> • OGDC • PPL • MPL • GHPL • Pak-Arab Refinery • KAPCO 	<ul style="list-style-type: none"> • IESCO • FESCO • HESCO • NPCC • JPCL • NPGCL 	<ul style="list-style-type: none"> • PSO • SSGC • SNGPL 	
Banking	<ul style="list-style-type: none"> • HBL • UBL • ABL • NBP 	<ul style="list-style-type: none"> • SME Bank 		
Finance and Insurance	<ul style="list-style-type: none"> • SLIC 	<ul style="list-style-type: none"> • NICL • NIT • PRCL 		
Industry		<ul style="list-style-type: none"> • HEC • PECO • PASMIC 		
Transport and Communications		<ul style="list-style-type: none"> • PIA • PIA Hotels • PNSC 		
Others		<ul style="list-style-type: none"> • Convention Centre, Islamabad 		
TOTAL	11	17	3	31
Source: Privatization Commission				

Market sales are proposed in the case of 11 entities. These are mostly blue chip companies like OGDC, PPL, HBL, UBL, NBP, etc. Seventeen units are targeted for privatization and three for restructuring followed by privatization.

The sectoral distribution is dominated by the energy sector, with 15 units in the privatization portfolio. The next sector in importance is banking and insurance with 9

units. Three industrial units, viz, HEC, PECO and PASMIC are targeted for privatization. Three units, namely, PIA (plus hotels) and NSC are from the transport and communications center.

The large size of the Privatization Program is indicated by the value of assets of the units in the portfolio. According to Table 3, the value aggregates to almost Rs 7 trillion (\$69 billion). This is why it is sometimes referred to as the potential 'sale of the century'. Of course, not all assets will be sold in one go.

PSE	Year	Total Assets	Net Profit (after Tax)	Return on Assets (%)
Energy Sector				
OGDC	2013	414,011	90,777	21.9
PPL	2013	347,578	42,155	12.1
Mari Gas	2013	34,192	2,421	7.1
KAPCO	2012	99,345	6,071	6.1
Banking Sector				
HBL	2013	1715,271	23,027	1.3
UBL	2013	1009,739	19,738	2.0
ABL	2013	734,196	14,643	2.0
NBP	2013	1371,718	5,306	0.4
Financial Sector				
SLIC	2011	293,707	520	0.2
NICL	2009	27,273	2,525	9.3
NIT	2013	51,127	1,365	2.7
Transport				
PIA	2012	192,355	-32,368	-16.8
PNSC	2013	33042	660	2.0
Distribution				
PSO	2013	281,308	12,557	4.5
SSGCL	2012	173,285	2,447	1.4
SNGPL	2012	173,325	3,044	1.8
*Data not available on PASMIC and PECO Source: Annual Accounts / Reports				

During the year, 2014-15, the targeted proceeds are Rs 198 billion (\$2 billion). This is likely to accrue mostly from market sales of shares, like a large GDR of OGDC in the international capital market. The market value of shares in the key sectors

mentioned above is given in Table 4. It appears that in order to achieve the target 10 percent to 15 percent of the shares will have to be sold.

Sectors	June 2012	Share (%)	June 2013	Share (%)	June 2014	Share (%)
TOTAL	3518	100.0	5155 (46.5)*	100.0	7023	100.0
Oil and Gas	1158	32.9	1639 (41.5)	31.8	1965 (19.9)	28.0
Electricity	119	3.4	186 (56.3)	3.6	19.6 (5.4)	2.8
Banks	753	21.4	952 (26.4)	18.5	1509 (58.5)	21.5
Insurance	62	1.8	86 (38.7)	1.7	144 (67.4)	2.1
Financial Services	41	1.2	57 (29.0)	1.1	68 (19.3)	1.0
TOTAL OF ABOVE SECTORS	2133	60.6	2920 (36.9)	56.6	3882 (32.9)	55.3**
*Figures in brackets are growth rates **The Government owns about 50 percent of the shares. Source: SBP						

The nature of the privatization portfolio clearly indicates that the government has moved away from restructuring and then privatization of loss-making PSEs. Only few of the 31 enterprises, namely, PIA, PASMIC and some of the units in the energy sector are loss-making. Others include some highly profitable entities like OGDC, PPL, Mari Gas, KAPCO, NICL, etc.

Clearly, under the pressure of the IMF, the emphasis is on quick generation of foreign exchange by market sales of profitable entities. As in the case of the policy adopted by the Musharraf government the objective is to build up foreign exchange reserves quickly and promote FPI into Pakistan. In some ways, the approach is one of 'selling family silver to repay debts'.

The structural benchmarks in the program with IMF with regard to privatization are given in Chart 1. The biggest action relates to the sale of 26 percent of PIA shares by end-December 2014.

Chart 1 Structural Benchmarks in IMF Program			
<ul style="list-style-type: none"> • Hire three Financial Advisors for three PSEs in the capital market transactions list and three PSEs in the strategic privatisation list 	Date: <i>end March 2014</i>	Status	<i>Partially Met</i>
<ul style="list-style-type: none"> • Privatize 26 percent of PIA's shares to strategic investor 	Date: <i>end December 2014</i>		
<ul style="list-style-type: none"> • Offer the minority shares of UBL and PPL to domestic and foreign investors 	Date: <i>end June 2014</i>	Status	<i>Met</i>

3.2. Progress

Two market sales of shares, of UBL and PPL respectively, have been completed last quarter. The key facts on these sales are given below, as provided by the Privatization Commission.

UBL

- Raised over Rs 38 billion against sale of 242 million shares at price of Rs 158 per share
- Generated foreign exchange of over \$310 million
- Oversubscribed by 63 percent
- Sale of almost 20 percent of the total shares
- Currently being traded at Rs 179.13 per share (even after the recent fall in KSE). Loss of 12 percent. Rise in value of 53 percent per annum (since 2012)
- Share of domestic investors is less than 20 percent

PPL

- Raised Rs 15.3 billion or US\$155 million
- Deal price higher than floor price by 7 percent at Rs 219 per share
- Oversubscribed by 104 percent
- Sale of 4.25 percent of shares
- Currently being traded at Rs 224.99 per share (even after the recent fall in KSE). Loss of 3 percent.
- No significant share of domestic investors

It may be noted that the investors in UBL and PPL shares have already seen appreciation in value of 12 percent and 3 percent respectively. Clearly, the proceeds to the government would have been greater if the sale had been deferred somewhat.

4. CRITERIA FOR PRIVATIZATION

4.1. Market Sale of Shares

The basic decision is if a share should be sold by the government from its holding of equity in a company. The decision depends upon the factors described below.

We designate the following:

g_c = projected annual capital gain/loss in the market value of a share

d = rate of annual dividend on a share

τ = projected mark-up annually on long term PIBs

Then, market sale of shares owned by the government in a company is justified if;

$$g_c + d < \tau \quad \dots \quad \dots (!)$$

This test can be applied retrospectively, as done in Table 5. In a rapidly rising stock market, (1) is unlikely to be case because g_c is higher. Also, p-e- ratios are still relatively low in Pakistan and scope for future capital gains is high. Further, if the government is successful in achieving economic revival and raising the GDP growth to almost 6 percent in the next three years, then the stock market is bound to respond very positively.

Table 5 applies the above test to some major market sales by the Musharraf government from 2001 to 2007. Out of 14 transactions, nine show a loss according to the above criterion. The dynamism of the market after 2002 is the explanation for this result.

Therefore, the decision as to whether to go in for more market sales hinges crucially on expectations of the future growth of share prices at three levels – market, sector, individual scrip. In particular, shares in the oil and gas sector like OGDC, PPL and MPL are likely to continue appreciating and, as such, sales of shares of these companies ought to be avoided.

Further, in the case of shares of companies with ownership of natural resources, oil and gas, the Article 172(3), referred to earlier, becomes applicable. Therefore, the provincial governments will need to be involved in the decision to sell. In the event a sale takes place, then 50 percent of the proceeds will have to be reverted to them.

Sale No.	Company	No. of Shares (million)	Sale Date Month/Year	Sale Price (Rs)	Current Price (Rs) (5/9/14)	Annual Rate of Capital Gains (%) [g.]	Comment (Gain / Loss)
1	NBP	37.3	2/02	10.00	57.90	15.0	Loss
2	MCB	24.0	10/02	27.67	282.82	21.4	Loss
3	POL	28.5	10/02	180.28	588.81	10.4	Loss
4	ARL	10.2	1/03	101.80	188.05	5.4	Gain
5	NBP	37.3	11/02	20.96	57.90	8.8	Loss*
6	DGK Cement	3.6	12/02	17.50	78.93	13.7	Loss
7	NBP	13.1	11/03	46.11	57.90	2.1	Gain
8	OGDC	215.0	11/03	31.86	269.81	21.4	Loss
9	PPL	102.9	7/04	54.74	223.86	15.1	Loss
10	KAPCO	160.8	4/05	29.94	64.00	7.7	Gain
11	UBL	21.9	8/05	49.64	178.06	15.2	Loss
12	OGDC	408.6	12/06	114.93	269.81	11.1	Loss*
13	UBL	202.3	7/07	195.00	178.06	-1.3	Gain
14	HBL	51.7	10/07	235.00	186.77	-3.2	Gain

Source: Privatization Commission | KSE

4.2. Privatization to Strategic Investor

Based on past experience and the need to avoid the creation of monopolies, the following criteria have been identified to determine if a unit should be privatized and handed over for management to a strategic investor:

		Score
1.	Profit-Making	
	If losses	1
	If small profits	½
	If large profits	0
2.	Monopoly	
	If a competitive market	1
	If a monopoly	0
3.	Regulatory Authority	
	If presence of:	
	Strong Regulatory Authority	1
	Weak Regulatory Authority	0
4.	Valuation of assets	
	If proper and full valuation of assets	1
	If not	0

Criteria for Evaluating Case for Privatization		Score
5.	Outstanding Liabilities	
	If no or small liabilities	1
	If large liabilities	0
6.	Performance of Social Functions	
	If Social functions not performed	1
	If performed	0
7.	Over employment	
	If large over employment	1
	If no or small over employment	0
8.	If Political Opposition / Resistance from Trade Unions / Transparency Issues	
	If no	1
	If yes	0

According to the above criteria, the case for privatization of a unit is strong / weak if it is making losses/high profits; if it will be in a competitive market / become a monopoly; if the relevant regulatory authority is effective / ineffective; if it is possible / not possible to fully evaluate the assets; if there are small / large outstanding liabilities; if the unit is not performing / performing basic social functions; if there is over employment / proper level of employment; and if there no political opposition or resistance from trade unions.

The combined (un-weighted) score is as follows:

Maximum Score 8

Minimum Score 0

A unit has to have a score of at least 5.5 (just over 2/3rds of the maximum score) to be considered for privatization.

These criteria are applied to the 20 units earmarked for privatization in the Statistical Appendix. The results are summarized in Chart 2.

Therefore, according to the above criteria, there is a case for privatization of ten out of the twenty units in the proposed privatization portfolio.

Chart 2 Case for Privatization	
Yes	No
PASMIC	PIA
NSC	PIA Hotels*
NIT	PSO*
SME Bank	SSGC
HEC	SNGPL
Convention Centre	IESCO
NPCC	FESCO
JPCL	HESCO
PRCL	NICL
NPGL	PRCL
10	10
*Marginal case	

5. IMPACT OF PRIVATIZATION

The direction of impact of different forms of privatization is given in Chart 3. It is clear that the impact varies with the modality of privatization.

5.1. Market Sale of Shares

This does not lead to any change in management. As such, there

	Market Sale of Minority Shares	Restructuring + Privatization or Privatization
Production	0	+
Employment	0	-
Fiscal	+ / -*	- / +**
Balance of Payments	+ / -	+ / -
Consumer Welfare	0	?
*Better now; worse later		**Worse now; better later
? Not Clear		

is no impact on production or employment. The major short-run impact of a favorable nature is on the balance of payments and public finances. If sales lead to larger FPI, then there is some improvement in the reserve position, as has happened recently with the sale of UBL and PPL shares. Similarly, the proceeds from sale of shares help in the retirement of federal debt and reduce the cost of debt servicing.

However, the subsequent effects are negative. The repatriation of dividends or encashment of shares affects the balance of payments position. Also, by sale of shares the government foregoes the future stream of dividend income. This is especially the case with sale of shares of profitable companies like OGDC and PPL. Currently, these two companies account for almost 56 percent of the total flow of dividends to the government from PSEs.

5.2. Privatization to a Strategic Investor

In this case if the new private management is more efficient then there could be gains in production. Also, the surplus employment could be retrenched. There could be some net losses initially if the outstanding liabilities have to be retired. For example, the loans of and guarantees issued to PIA aggregate to over Rs 100 billion and that of PASMIC to Rs 42 billion. The price that these units fetch may be lower than the outstanding liabilities. However, following the privatization the government will save the annual cost of subsidies.

The balance of payments impact depends on whether the strategic investor is a foreign entity. If this is the case, then there is more FDI. The impact thereafter is negative due to repatriation of profits.

Consumer welfare gains are ambiguous. If higher efficiency translates into lower prices consumers may benefit. As opposed to this, there is the danger of exercise of monopoly power of formation of a cartel. The cement units privatization in the last decade may have led to cartelization, which the CCP has not been able to break. Similarly, the SBP has been unable to prevent the increase in the margin between the returns on advances and no deposits, following the large-scale privatization of the banking sector.

Under pressure of the IMF, the government has opted for market sale of shares of profitable companies primarily to build foreign exchange reserves, of up to \$2 billion in 2014-15. Restructuring of loss-making PSEs has taken the back seat. Only some initial steps have been taken to improve the workings of PIA and the Railway.

6. CONCLUSIONS AND RECOMMENDATIONS

On the basis of application of rational criteria, the paper recommends a truncated process of privatization. Market sales of shares of profitable companies with valuable assets like OGDC, PPL, MPL, etc., must be avoided. The shares of such companies are likely to continue appreciating in future and yield large capital gains.

Privatization to a strategic investor may be resorted to in ten out the twenty units included in the list agreed with the IMF. As per the manifesto of the PML-N, the focus should instead be more on restructuring of loss-making PSEs.

In particular, bulk over 80 percent, the losses are in the power sector. The government has done little to improve efficiency in the sector by replacement and modernization of old plants and the transmission system, cutting down of billing losses, build up of arrears, etc. Given the state of the power sector, especially of low liquidity due to accumulation of circular debt, it is unlikely that any private investor would like to rapidly take over a GENCO or a DISCO.

It is extremely important that interests of employees are protected. A proper severance package must be offered. In addition, a portion of the shares being sold must be allocated to employees, either individually or collectively, subject, of course, to payment of the reservation price.

There will be need to strengthen regulatory agencies like CCP, SECP and others to ensure that no monopoly or cartel emerges post-privatization. Also, to the extent that units to be privatized are performing social functions, then these should continue after privatization, possibly with a subsidy from the government.

The posture of the government, which is seen as business-friendly, requires that transparency of transactions be fully preserved. The development of a business–political nexus must be avoided. Members of the Privatization Commission have to be careful about any conflict of interest.

The Privatization Program must be handled carefully and with concern for different stakeholders. It should not degenerate into a desperate rush for selling ‘family silver’ to acquire foreign exchange, as happened in the earlier years of the Musharraf era. Instead, if proper restructuring of major national enterprises takes place, as is beginning to happen in the Railway and PIA, then the benefits to the economy and to the people in general will be substantially larger.

Criteria	PIA	PIA Hotel	PASMIC	NSC	PSO	SSGC/SNGPL	NIT
Profit Making	1	0	1	½	0	½	½
Monopoly	1	1	1	1	1	0	1
Regulatory Authority	½	1	1	1	0	0	1
Valuation of Assets	0	0	0	1	1	1	1
Liabilities	0	1	0	1	1	1	1
Social Functions	0	1	1	1	0	0	1
Over employment	1	1	1	1	1	1	1
Political Opposition/ Resistance by Unions/ Transparency Issues	0	0	½	1	1	1	1
TOTAL	3½	5	5½	7½	5	4½	7½
%	44	63	69	94	63	56	94
<i>Privatization (Yes/No)</i>	<i>No</i>	<i>No / Yes*</i>	<i>Yes</i>	<i>Yes</i>	<i>No / Yes*</i>	<i>No</i>	<i>Yes</i>
*marginal cases							

Criteria	IESCO/ FESCO	HESCO	NPGL	NPCC	JPCL	PRCL	SME Bank	NICL	HEC	PECO	Convention Centre
Profit Making	1	1	1	1	1	0	1	0	1	½	1
Monopoly	0	0	1	1	1	0	1	0	1	1	1
Regulatory Authority	1	1	½	0	½	0	1	0	1	1	0
Valuation of Assets	0	0	1	1	1	1	1	½	1	1	1
Liabilities	0	0	0	0	0	1	0	1	0	0	0
Social Functions	0	0	1	1	1	½	0	1	1	1	1
Over employment	1	1	1	1	1	1	1	1	0	0	1
Political Opposition/ Resistance by Unions/ Transparency Issues	0	1	1	1	1	1	1	1	1	1	1
TOTAL	3	4	6.5	6.0	6.5	4.5	6	4.5	6	5.5	6
%	38	50	81	75	81	56	75	56	75	69	75
<i>Privatization (Yes/No)</i>	<i>No</i>	<i>No</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>No</i>	<i>Yes</i>	<i>No</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>

The Social Policy and Development Centre (SPDC)

Established in 1995, the Social Policy and Development Centre (SPDC), a non-profit research think tank, has made a significant intellectual contribution in placing issues of pro-poor growth and social development on Pakistan's policy-making agenda. With a focus on development, poverty, inequality, governance, social sector policies, climate, gender issues and pro-poor macro-economic policy, it contributes to the national goal of social development through research, policy advice, and advocacy. The Centre also collaborates and cooperates with organizations working on issues relevant to its mandate both at home and abroad and is a partner with several national and international networks on social and economic issues. Determining its own agenda, SPDC has successfully maintained a balance between responsive and proactive social sector research.



Social Policy and Development Centre
15-Maqbool Co-operative Housing Society
Block 7 & 8, Karachi 75350, Pakistan
Tel: (92-21) 111-113-113
Fax: (92-21) 3453-4285
E-mail: spdc@spdc.org.pk

Find us on



www.spdc.org.pk