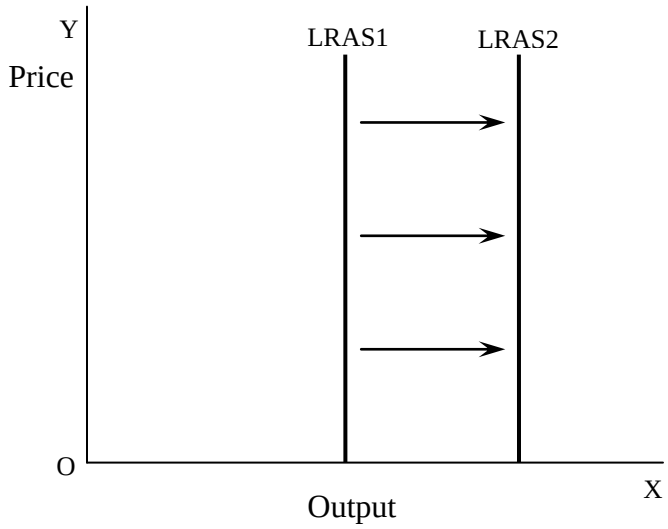
Privatisation and Deregulation

Privatisation is a supply side approach to bringing about increases in economic growth. Supply side economics is the application of microeconomic policies intended to increase the overall supply of goods and services. By increasing the efficiency of the factor inputs in the production process output should increase. This should have the effect of shifting aggregate supply to the right and increasing the potential level of output as shown in the diagram below.



<u>Arguments in favour of Privatisation:</u>

Economists offer several arguments in favour of transferring government run firms to the private sector:

- Opening up production and consumption to market forces ***increase competition, economic efficiency and consumer choice.***
- ***Breaking down monopolies*** into more competitive industries introduces competition into the goods markets.
- Enables the privatised firms to ***compete for finance*** on the private capital markets both home and abroad.
- Ensures that ***firms become accountable to their shareholders*** and their desire for profit.
- Ensures that businesses are ***run on commercial rather than political grounds***.
- ***Reduces the burden on the government's finances*** to support nationalised industries.

<u>Arguments against Privatisation:</u>

The process of privatisation and deregulation is intended to increase the level of competition. However, this may not happen for a number of reasons:

- Privatisation may simply ***create private sector monopolies*** with high barriers to new firms entering the industry. There are a number of reasons why these might exist:

    - The existing firm has significant economies of scale that new firms cannot compete as in the case of natural monopolies
    - The start up costs for new firms are prohibitive

- ***Privatised firms make decisions based on commercial profit*** maximising grounds. Nationalised firms make decisions in the public interest. If the government wants to focus on poverty reduction and development then production can be organised appropriately. Privatisation may enable increased capital investment and reduction in the firm's long run average costs. However, it is argued that such a goal of productive efficiency through expanding the use of capital is not appropriate for some LDCs. Some of the problems associated with this might be:

    - More sophisticated technology may need more maintenance
    - Imported capital may worsen the countries balance of trade
    - Lack of trained maintenance staff may prevent the capital being used effectively

- Privatising strategic industries such as the copper industry means that ***government revenue will diminish*** as profits from copper sales are directed to the shareholders, many of whom, in the case of multinationals live abroad. Lower government revenue may mean lower government spending on education and health.

Privatisation Process in Pakistan

History and evolution of privatisation in Pakistan:

The concept of privatisation is not new to the policy makers of this country. It may be traced as back as in 50s, when Pakistan Industrial Development Corporation (PIDC) was established in 1952 to boost up the industrial development in the country. This premier Corporation established over 50 industrial undertakings in the length and breadth of the country and after their successful operation and management, these units were transferred from the public to the private sector. The tide of nationalisation, which swept the whole economy in the first half of 70s, was reversed in 1977. The privatisation of State Owned Enterprises (SOE) became an important instrument of economic policy of the government in late 80s. However, it was in 1991 that privatisation process in Pakistan became effective.

In this topic, we will limit our discussion only to the privatisation process post-1991. In 1990-91, the new government declared privatisation as its primary economic policy objective. The agenda of privatisation announced by the Government covered a wide spectrum of fields like industries, banks, development finance institutions,

telecommunications and infrastructure facilities. The government announced the creation of a Privatisation Commission on 22nd January, 1991 to implement the disinvestment programme within the shortest possible time. The birth of Privatisation Commission institutionalised privatisation efforts in Pakistan.

While providing a legal cover to the privatisation process, the government at the same time also moved to protect the interests of the stakeholders, of which labour was given primary importance. A separate Inter-Ministerial Committee was constituted to deal with the labour employed in the SOEs and safeguard their rights. The Committee negotiated a package of incentives for labour employed in these enterprises with the representatives of workers. The agreement with labour was executed on October 15, 1991. The agreement has provided the basic parameters to safeguard the interests of labour and include minimum one year service guarantee after privatisation, reservation of 10% shares for the labour, opportunity to the employees to purchase the unit by putting competitive bid and several other concessions to the workers. It also provided a scheme of Golden Hand Shake (GHS) and Voluntary Separation Scheme (VSS) for the workers and officers of the public sector undertakings.

Overall results of the privatisation process in Pakistan are mixed. In certain sectors like power generation, financial institutions, cement and automobile the performance of the privatised units is satisfactory and the new management have succeeded in improving the quality of product and service as well as financial health of the units. The workers have also benefited in terms of higher salaries and better working conditions. In other sectors like edible oil and roti plants privatisation has not been very successful.

During January 1991 to June 2003 the Commission completed 132 transactions for Rs 101 billion. During the financial year 2003-2004, the Commission has successfully completed privatisation of 8 transactions including privatisation of Habib Bank Limited, AC Cement Rohri, Thatta Cement Limited, Kohinoor Oil Mills, and Capital Market Transactions (OGDCL, SSGC, POL, ARL, DG Khan Cement and NBP). The total sale proceeds realized during the year amounted to Rs.33.3 billion. Out of the sale proceeds received during the year, the Commission has remitted Rs.11.2 billion to the Government of Pakistan for debt retirement and poverty alleviation program. The Commission during period from July 2004 to April 25, 2005 has realized Rs. 33.8 billion from sale of GOP shares in PIA, PPL, KAPCO, Falleti's Hotel and 10% additional shares of Kohat Cement, Dandot Cement Ltd. By 25th April 2005, the Government of Pakistan had completed or approved 147 transactions at gross proceeds of Rs 168 billion. Some of the major transactions recently completed are:

- Sale of 51% of GOP stake in **Habib Bank Limited** for Rs. 22.4 billion
- 51% shares of **United Bank Limited** sold in October, 2002. Payment of Rs.1.85 billion received.
- 75% shares of **MCB Bank** ***(****formerly* ***Muslim Commercial Bank)*** were sold in April, 1991 for Rs.2.42 billion. Remaining shares were divested during the years 2001 and 2002 for proceeds of Rs.1.29 billion.

- Divestment of approx. 23% shares of **National Bank of Pakistan** through IPO/POs during the years 2001 to 2003.
- 70% shares of **Bank Al-Falah** ***(****formerly* ***Habib Credit & Exchange Bank)*** were sold in July, 1997 for Rs.1.63 billion. 2% shares were meant for the HCEBL employees 28% shares sold in block for Rs.1.2 billion.
- **Allied Bank Limited** was privatised in 1991 with 51% shares being sold to the ABL employees.
- **Banker's Equity Limited** was privatised in June, 1996 with 26% shares for proceeds of Rs.618.7 million.
- Sale of 5% ordinary shares of **Oil & Gas Development Company Limited (OGDCL)** through Capital Market for Rs. 6.8 billion.
- Sale of **Thatta Cement** for Rs. 794 million
- Sale of 10% shares of **Sui Southern Gas Limited (SSGCL)** for Rs. 1.7 billion through Capital Market
- Sale of shares of **Kohinoor Oil Mills Limited** for Rs. 81 million
- Sale of 6% shares of **Pakistan International Airlines (PIA)** for Rs. 1.3 billion through Capital Market
- Sale of 15% shares of **Pakistan Petroleum Limited (PPL)** through Capital Market for Rs. 5.7 billion
- Sale of 20% shares of **Kot Addu Power Company (KAPCO)** through Capital Market for Rs. 5.3 billion

Number of privatised transactions

(1991 – September, 2015)

Sector	No. of Transactions	Amount (Rs. In million)
Banking	7	41,023
Capital Market Transaction	27	303,493.9
Energy	15	54,255.2
Telecom	4	187,024
Automobile	7	1,102
Cement	17	16,177
Chemical	16	1,643
Engineering	7	183
Fertilizers	7	40,281

Ghee Mills	24	842
Mineral	1	6
Rice	8	236
Roti Plants	15	91
Textile	4	371
Newspapers	5	271
Tourism	4	1,805
Others	5	152
Total	173	648,954

Some Major Forthcoming Transactions:

Pakistan Internaltional Airlines Corporation (PIAC) is a Government owned airline company, the biggest airline company of Pakistan. Pakistan International Airlines can trace its origins to the days when Pakistan had not yet gained independence from the British Raj. In 1946, the country's founder Muhammed Ali Jinnah realized the need for a flag carrier for the prospective country and requested financial help from wealthy businessmen Mirza Ahmad Ispahani and Adamjee Haji Dawood for this purpose. Around that time, a new airline 'Orient Airways', was registered in Calcutta on 23 October 1946. In February 1947, the airline bought three DC-3 airplanes from a company in Texas and obtained a license to fly in May of the same year. The airline started its operations in June, offering services from Calcutta to Akyab (Burma) and Rangoon (Burma). On 14 August 1947, Pakistan gained independence and the Orient Airways started relief operations for the new country. It was the first and only Muslim owned airline in the British Raj and flew from 1947 to 1955. On 7 June 1954, Orient Airways started its operations by offering flight services between East and West Pakistan, with service from Karachi to Dhaka. On 11 March 1955, Orient Airways merged with the government's proposed airline, becoming Pakistan International Airlines Corporation. The newly formed airline also inaugurated its first international route, Karachi-London Heathrow Airport via Cairo and Rome,

Pakistan International Airlines Corporation (PIAC) is majority owned by the Government of Pakistan (87%) while the remainder (13%) by private shareholders. The airline is under the administration of Ministry of Defence.

In the late 1990s, the Government of Pakistan considered selling the airline to the private sector due to the persistent losses suffered by the airline. The government announced its privatization plans but they were never implemented. Several steps towards outsourcing of non-core business have been initiated. Catering units (starting with Karachi Flight Kitchen), ground handling (starting with ramp services) and engineering, are to be

gradually carved out of the airline and operated as independent companies. During 1997, Pakistan called in a team from International Finance (IFC), the consulting arm of the World Bank, to advise on restructuring and privatization of Pakistan International Airlines (PIA). However, no agreement was reached.[26] The government has had many plans for the privatization of the State owned airline. However, no reasonable agreement or solution has been found to this day. On 18 February 2009 the carrier was dropped from the privatization list, but still listed in the Upcoming Transactions of the Privatisation Commission's website.

Pakistan Steel Mills (PSM) is the biggest industrial mega corporation of Pakistan owned and controlled by the Government of Pakistan. Pakistan Steel Mills is listed in the few world's nation that capable of producing steel (10-50 million tonnes of steel) and iron foundries locally. This enormously huge corporation was built with the collaboration of Union of Soviet Socialist Republic (USSR) on 30th December, 1973. Its initial idea and studies were conceived by the Council of Scientific and Industrial Research (PCSIR) and put forward the concept to the Five-Year Plans of Pakistan (1955-1960). In 1958, Soviet premier Nikolai Bulganin offered technical and scientific assistance to Prime Minister Hussein Shaheed Suhrawardy regarding the steel mills and expressing interests in establishing the country's first steel mills. After 20 years of policy development and studies of PCSIR, President General Yahya Khan finally gave the approval of the foundation of the state-owned steel mill. Finally, an agreement was reached with the V/O Tyaz Promexport of the USSR in January 1969. In 1971, Pakistan and Soviet Union finally proceeded to enter in a government agreement, upon which, the Soviet Union agreed to provide techno-financial assistance for the construction of a coastal based integrated steel mill at Karachi.

Since its foundation, the steel mills has been under the management of government-ownership and strictly put under the close coordination of civil bureaucracy. In 2006, Prime Minister Shaukat Aziz decided to integrate the steel mills under the Privatization Programme. When the news reached to the country, amid demonstration and spontaneous political protests began to take place against the government of Pervez Musharraf and sparked lengthy debates in parliament, which members of the opposition walked out of in disgust.

In spite of all the political unrests on the issue of privatisation of PSM, a consortium was invited by the Government. The consortium involving Saudi Arabia-based Al Tuwairqi Group of Companies submitted a winning bid of $362 million for a 75% stake in Pakistan Steel Mills at an open auction held in Islamabad.

On 23rd June 2006, a nine-member bench of the Supreme Court annulled the sale of the country's largest industrial unit to a three-party consortium and had directed the government to refer the matter to the Council of Common Interests (CCI) within six weeks. It had declared the $362 million transaction with the Russian-Saudi-Pakistan investors as null and void.

In 2012, Ukraine announced to provide the technological development and help in restoration of raw materials supply chain after viewing the performance of steel mills. The Ukrainian Ambassador quoted, "for major operational units of Pakistan Steel Mills is remarkable". The Ambassador of Ukraine Volodymyr Lakomov said that Ukraine is keen to make business relationship with Pakistan and the steel mill PSM will be a "symbol of friendship" between the two countries.

Privatisation of Pakistan Steel Mill is still considered as an upcoming transaction in Privatisation Commission's website.

Expected Upcoming Transactions	
Name of SOEs / transactions	**Type of sale envisaged**
Oil and Gas:	
Oil and Gas Development Corporation Limited (OGDCL)	International / Domestic Capital Market Offering
Power:	
Heavy Electrical Complex (HEC)	Divestment with Management Control
Northern Power Generation Co. Ltd. (NPGCL-GENCO-III) - Thermal Power Station – (TPS) Muzaffargarh(1350 MW)	Divestment with Management Control
Lahore Electric Supply Company Limited (LESCO)	Divestment with Management Control
Faisalabad Electric Supply Co (FESCO)	56% shares alongwith management control
Islamabad Electric Supply Company Limited (IESCO)	Divestment with Management Control
Quetta Electric Supply Company Limited (QESCO)	Divestment with Management Control
Peshawar Electric Supply Company Limited (PESCO)	Divestment with Management Control
Multan Electric Power Company Limited (MEPCO)	Divestment with Management Control
Hyderabad Electric Supply Company Limited (HESCO)	Divestment with Management Control
Sukkur Electric Power Company (SEPCO)	Divestment with Management Control
Central Power Generation Company Ltd – CPGCL (GENCO – II)	Divestment with Management Control
Jamshoro Power Generation Company Ltd – JPCL (GENCO- I)	51% shares alongwith management control

Industry, Transport and Real Estate:	
Pakistan International Airlines Corporation (PIAC)	Restructuring followed by divestment of 26% Govt. equity stakes to strategic partner with Management control
Pakistan Steel Mills Corporation (PSM)	Not yet determined

Need for Privatisation in Pakistan:

Dr. Ishrat Husain, the Governor of State Bank of Pakistan, in his speech at the Overseas Universities Alumni Club and the 21st Century Business & Economics Club on August 12th 2005, gives the exact answer to the questions arising about the rationale for privatisation in Pakistan. According to him, two decades later, after the nationalization of 1970s, it turned out that nationalization was not only unrealistic and flawed but the consequences were exactly opposite to what the intentions were. The collapse of the Soviet Union and the bankruptcy of the socialist model eroded the ideological underpinning of this strategy and the actual results on the ground in Pakistan and almost all the developing countries shattered the ideal and utopian dreams of the proponents of this philosophy. Pakistan's public enterprises including banks became a drain on the country's finances through continuous haemorrhaging and leakages and a drag on the economic growth impulses. The poor instead of benefiting were actually worse off as almost Rs.100 billion a year were spent out of the budget annually on plugging the losses of these corporations, banks and other enterprises. These public enterprises became the conduit for employing thousands of supporters of political parties that assumed power in the country in rapid succession and a source of patronage, perks and privileges for the ministers and the favoured bureaucrats appointed to manage these enterprises. These employees and managers had neither the managerial expertise nor technical competence to carry out the job. Instead of providing goods & services to the common citizens at competitive prices efficiently, the public enterprises turned into avenues for loot and plunder, inefficient provision of services and production of shoddy goods.

In the past, private entrepreneurs in Pakistan did not make 'profits' in the real economic sense by earning a return on their investment in a competitive world. On the contrary, they earned 'rents' through the maze of permits, licences, preferred credit by the banks, subsidies, privileges, concessions and specific SROs granted to few favoured firms. Naturally when one sees people becoming rich not through the dint of their hard work and enterprise but by manipulation, or bypassing the established rules and laws, we should not be surprised to see the venom against the so called 'private profits'.

The policy reforms introduced in Pakistan in 1991 has three key essentials – (i) Liberalisation, (ii) Deregulation, and (iii) Privatisation. But unfortunately, Pakistan could not follow through these reforms in a continuous and consistent manner despite the fact that both Benazir and Nawaz Sharif governments were fully committed to these reforms. For example, 12% shares of PTCL were first sold to the general public in 1993-94 and it has been on the privatisation agenda of every successive government since then.

According to a popular view in Pakistan it is okay to sell the loss making enterprises but retain the profit making entities such as PTCL and PSO in the public sector. The main economic logic behind this divestiture is that it will promote efficient allocation of scarce resources, optimal utilization of resources, making sound, timely and market responsive investment choices, winning and retaining customer's loyalty through better service standards and lower product prices or user charges and contributing to the expansion of the economy through taxes, dividends etc. The basic reason for privatising these enterprises is that the government should not be in the business of running businesses but regulating businesses. The role of the government should be that of a neutral umpire, who lays down the ground rules for businesses to operate and compete, to monitor and enforce these rules, to penalize those found guilty of contraventions and to adjudicate disputes between the competing business firms. If the government owned firm itself, there is a strong conflict of interest and the other competitors lose confidence in the neutrality of the umpire. Under these circumstances, the market becomes chaotic, disorderly and unruly as there is no neutral 'person' to monitor and enforce the rules. The economy thus pays a heavy price for this loss of the market mechanism in the production, sale and distribution of goods and services. The present controversy between the PIA and private airlines is a manifestation of this tendency. The same argument can be applied in case of PTCL. If the Government had continued to own and manage PTCL, the private sector competing firms would have felt that they would always remain at a disadvantage in relation to the PTCL. The constant fear that the government's coercive powers and full force of policy making ability would always be used to safeguard and enhance the interests of PTCL. This would have kept the private firms away from investment in the fixed telephone or wireless loop segments.

The fears about employment losses in the industry as a result of privatisation are also, by and large, unfounded. The example of the *banking industry* privatisation controverts those who claim that privatisation means jobs are lost. In 1997 when the restructuring, down-sizing and privatisation of the nationalized commercial banks picked up speed there were 105,000 employees working in the financial sector. After privatisation was completed, the banking industry has expanded and the work force has expanded to 114,000. It is true that the pattern of employment has changed and more productive and skilled workers have been taken in at the expense of low skilled or unskilled.

Telecom sector has already generated, after deregulation, hundreds of thousands of new jobs through public call offices, calling cards and pre-paid card companies, Internet Service Providers, mobile phone companies, broad band services, and other value added services under the private sector. As the penetration ratios in Pakistan are still quite low, there is going to be a large expansion in the telecom sector. Industry estimates that 100,000 new jobs will be added during next 3 – 5 years.

Conclusion:

Privatisation contributes to economic growth through productivity gains, efficient utilization of resources, better governance and expansion in output and employment. Profit making enterprises under the public sector may be making profits due to the unique market structure such as monopoly or other privileges or concessions conferred upon

them by the government but it does so at the expense of the consumer who has to pay higher than market price for the product or the services. The ordinary consumer gets a benefit only through competition among private sector firms in form of lower prices and better services as has been demonstrated in the cases of banking, telecommunications and, more recently, air travel.

In a deregulated market environment, public ownership becomes a serious constraint as the rule – bound procedures and the rigidity in the structure do not allow public sector companies the flexibility to respond promptly to dynamic market conditions. Furthermore, the government's role as a regulator and neutral umpire becomes questionable once it is itself a participant in the game through its own company. This stifles competition and subverts expansion and growth by the private sector companies.