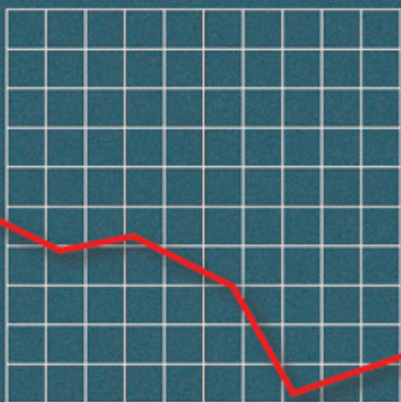
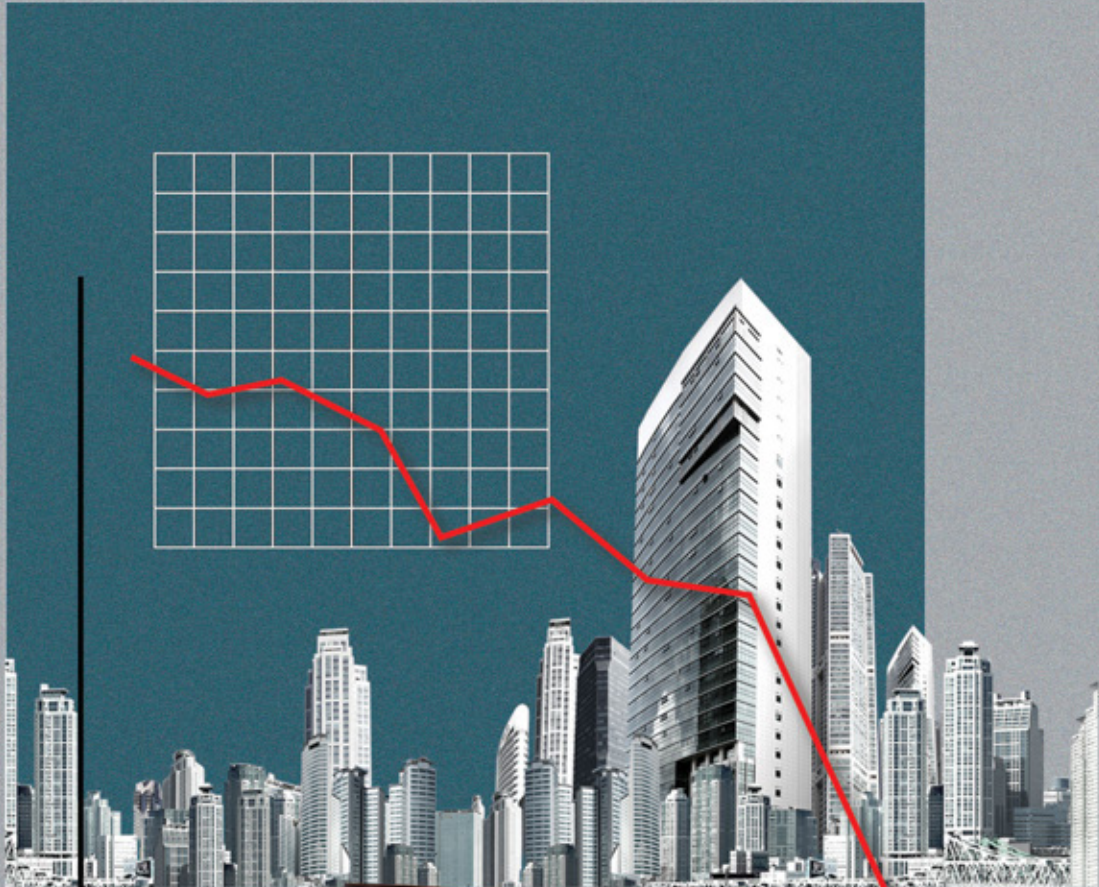


THE CASE FOR PRIVATIZATION OF PAKISTAN'S STATE-OWNED ENTERPRISES



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Most State-Owned Enterprises (SOEs) in Pakistan are not performing well due to numerous reasons. The discussion on SOEs' current and future performance is divided like any other economic and social policy debate. Some want to privatize every SOE. Others do not want to divest shareholdings of the government from any SOE. Most of the time the discussion revolves around ideological orientation. Currently, Pakistan is going through a severe financial crisis. Therefore, it is imperative that we develop some rationale for owning or privatizing SOEs.

Technology, globalization, and management models have advanced significantly in the last couple of decades. Consequently, it is not appropriate to continue with the same models of governance and management of SOEs as had been followed since their establishment some time ago.

According to various government reports, there are around 200 SOEs associated with the federal government. However, this number is misleading. There are only around 50 SOEs of substance which have a significant share of public sector SOEs' holding. Almost all of these SOEs operate in the Energy, Communication and Manufacturing sectors. On the other hand, most SOEs are only not for profit companies created as project companies or project management unit types of entities. Many of them should be closed, disbanded, or liquidated. As a result, it can be stated that substantive work is needed on around 50 SOEs in the sectors mentioned above. Another important aspect of privatization or reform of SOEs is that there cannot be a one-size-fits-all approach. Each SOE and sector operates under unique local and global circumstances. Hence specialized/precision treatment will be needed for each SOE instead of generalized/antibiotic treatment of all ailing SOEs.

There are some SOEs which do not have any economic or social rationale to be operating under the public sector. For example, Pakistan International Airlines & Pakistan Steel Mills have been incurring huge losses without delivering quality services and products. We have local and

international private players operating in these sectors which are more efficient than our SOEs. It is simply not possible to operate these SOEs optimally in such competitive sectors. Hence an earliest divestment or privatization of such entities needs to be pursued.

Pakistan Railways is a major SOE. The case of Pakistan Railways is unique in many ways. For a country like Pakistan with a vast geography Pakistan Railways is vital for passenger traffic and freight services. However, the balance of public investment has significantly tilted towards highways and motorways. This lack of investment has severely impacted the modernization efforts of Pakistan Railways.

There is a need to implement aviation sector model in the Railways sector. Non-moving infrastructure can be owned and operated by the government, who may engage private sector in this infrastructure upgradation and operations. However, the moving infrastructure needs to be opened up for the private sector. The current governance model of Railways sector may not allow private sector participation as many such experiments and pilot projects failed recently. Some private sector trains have also been doing well. However, as a direction, Pakistan Railways needs both public investment and private sector investment.

As another case study, petroleum and power companies are operating as monopolies. Many petroleum companies are generating profit but there has rarely been any kind of benchmarking of such companies. The efficiency gains also need to be assessed considering their monopoly powers in this sector are guaranteed by the state. Power sector distribution companies need immediate attention. However, there is a need to consider that these companies should not be turned into private monopolies. Sector reforms are needed in the power sector before inviting private sector in the distribution business. Competitive market in the power sector is still elusive. The journey towards a competitive market started in 1990s but it was never implemented in letter and spirit. Cost plus tariff structures and inefficient

governance of power companies has added over Rs 3 trillion circular debt in the last decade. The introduction of upfront tariffs and competitive bidding started very late in this process. This delay has severely impacted the governance and financial health of the Power sector.

Moving forward, the geographic coverage and multiple business of distribution companies needs to be split to create a more manageable size of operations for the private sector. Karachi Electric experience has informed us that privatization alone cannot solve all problems. There has to be appropriate sectoral and market reforms for the efficiency gains of the private sector.

There is a need, therefore, to encourage the listing of SOEs on the stock exchange. It will improve governance and transparency which will be helpful in preparing these SOEs for privatization process.

The federal government has also enacted P3A act that governs public private partnership projects.

Some of the SOEs should also be engaged for inviting private sector investment under this new law.

Lastly, the legal structure of privatization commission and process was crafted in 1990s. Only a few changes have been made since the beginning of privatization process. This institutional structure cannot handle privatization at this time. There is a need to consider various innovative and recent options for divestment instead of typical asset sale.

Hence the debate on privatization should go beyond whether to privatize or not to privatize. It should include questions like what is to be privatized and what is not to be privatized right now; how to privatize an SOE; how to govern SOEs efficiently and transparently; and how to engage private sector investment and management in improving the state of affairs in some of the SOEs. Each SOE in Pakistan is operating under unique local and global circumstances and needs specialized treatment after close analysis, instead of a generic treatment for all.

