ISSUE BRIEF

INSTITUTE OF STRATEGIC STUDIES ISLAMABAD
Web: www.issi.org.pk
Phone: +92-51-9204423, 24
Fax: +92-51-9204658

PRIVATIZATION OF STATE-OWNED ENTERPRISES (SOES) AND ITS IMPLICATIONS FOR PAKISTAN

By
Ahmad Naeem Salik
Research Fellow

Edited by
Najam Rafique

January 27, 2021

(Views expressed in the brief are those of the author, and do not represent those of ISSI)

State-owned enterprises (SOEs) caused a colossal loss of Rs. 692 billion since 2017 to the national exchequer due to lack of reforms in these enterprises along with mismanagement and bad governance. The Government of Pakistan has embarked on a fresh program of privatization of state-owned enterprises (SOEs) and properties for reducing public sector debts and fiscal deficits. It is expected that the privatization process will increase the efficiency of all economic sectors by invoking private sector's technical competence.

The government is working to complete the privatization of four to five public sector entities (PSEs) during current fiscal year 2021. There are 19 PSEs on the active list for privatization including Pakistan Steel Mills (PSM) and Pakistan International Airlines owned Roosevelt Hotel in New York.[1] The Finance Bill for the FY 2020-21 has incorporated Rs. 100 billion privatization proceeds as part of the 'Non-Tax Revenue Receipts' for the FY 2020-21.[2] Unsustainable budget deficits, high taxation, and burdensome funding are common factors precipitating the need to privatize. The justification for privatization therefore is driven by the need to improve efficiency.

In general, countries have privatized industries to achieve several objectives. These include:

1. Raising revenue for the government.

---

[1] https://nation.com.pk/16-Oct-2020/govt-working-to-complete-privatization-of-4-to-5-pses
[2] https://nation.com.pk/22-Jun-2020/privatization-process-contributes-rs100bn-for-fy-2020-21

2. Raising investment capital for the industry or company being privatized.
3. Reducing the government's role in the economy.
4. Promoting wider share ownership.
5. Increasing efficiency.
6. Introducing greater competition.
7. Exposing firms to market discipline.
8. Decreasing government subsidies.[3]

Previous governments in Pakistan had attempted to take care of these enterprises since the 1980s with some success in certain sectors and total failure in others. Most large banks, cement, fertiliser, telecom and other businesses were successfully deregulated and sold to the private sector as the initial emphasis of policymakers shifted from supporting public sector enterprises to their privatization in the 1990s and beyond. While the move proved successful in certain cases, the attempts to reform or sell power companies failed except in the case of the divestment of KESC. Likewise, repeated attempts to restructure and reform PIA, Pakistan Railways and PSM have also proved futile, in fact, affairs at these organizations have worsened.[4]

Industrialization is the key to the development of any economy and while small and medium enterprises play an important role in providing jobs, technological intensive heavy industries, such as shipping, auto manufacturing, electronics, and aviation, are essential for the industrial and economic progress of any country. Unfortunately, majority of Pakistan's SOEs are inefficient, non-competitive and are incurring losses to the tune of billions of rupees, and providing monetary support to these loss-making enterprises puts a huge strain on the government's finances.[5]

Since the fiscal deficit is a perennial problem for Pakistan's struggling economy, structural reforms warrant reduction of expenditures. With limited options, fiscal managers usually cut development spending. The privatization decisions that are currently seen taken in haste are to cajole IMF to revive the stalled $6 billion loan program for Pakistan. The government decided to privatize PSM at the earliest to ease pressure on fiscal account. Options are being weighed to rejuvenate the PSM under the public-private partnership mode in phases that was estimated to cost around $800

[3] https://www.adb.org/sites/default/files/evaluation-document/35461/files/ses-public-sector.pdf
[4] https://www.dawn.com/news/1591855
[5] https://nation.com.pk/16-Apr-2020/privatization-and-state-owned-enterprises

million. The PSM plant would be revived to achieve its built-in capacity in the first phase within one and a half-year, while the production capacity would be jacked up to three million tons in the second phase.[6]

In Pakistan, privatization of loss making SOEs has not been a top priority for successive governments, even though it has immense economic consequences. The current government policies of privatization are rooted in either the desire to use the proceeds of sales for financing the budget deficit, or simply to meet the deadline for publishing the Expression of Interest (EOI) imposed as a consequence of IMF or other lender conditions. Privatization will be effective and popular only if both public and private managers act in the public interest.[7]

There is a need for innovative solutions to attract private sector investment in SOEs operating in key sectors e.g., rail, aviation, energy, road and commodity sectors. Some of the ways in which this can be done would be to improve regulatory quality and contract enforcement in order to attract private sector investments in key sectors of economy and create conducive environment for moderating competing interests of all economic agents in those sectors. Privatization/disinvestment process initiated by the government needs to be pursued with full political zeal, professional capacity, transparent process and engagement of all stakeholders.[8]

According to the Organization for Economic Co-operation and Development (OECD), public-sector organizations have come to constitute more than a fifth of the world's largest enterprises.[9] In Pakistan, had they been managed properly, these entities could have been the primary vehicle of fast-paced performance as seen in other countries. Instead, the burden of inefficient SOEs on the economy has become too large for any government to handle, and allowing the damage to fester will only exacerbate the challenge. The government and private sector should try to make a difference between what constitutes private business and privatisation. Pakistan needs to facilitate private business which is required for economic growth, but it should not be mixed with privatisation.

6 https://www.thenews.com.pk/print/763919-ccop-approves-psm-privatization-structure
7 https://www.thenews.com.pk/print/333293-governance-and-privatization-of-state-owned-enterprises
8 https://www.researchgate.net/publication/283331051_State-owned_Enterprises_in_Pakistan_The_Need_for_Corporate_Governance_and_Private_Investment
9 http://webcache.googleusercontent.com/search?q=cache:rW0XTp9DXkgJ:www.oecd.org/daf/ca/Global-Knowledge-Sharing-Network-on-SOEs-Proceedings-June-2016.pdf+&cd=5&hl=en&ct=clnk&gl=pk