PRIVATIZATION

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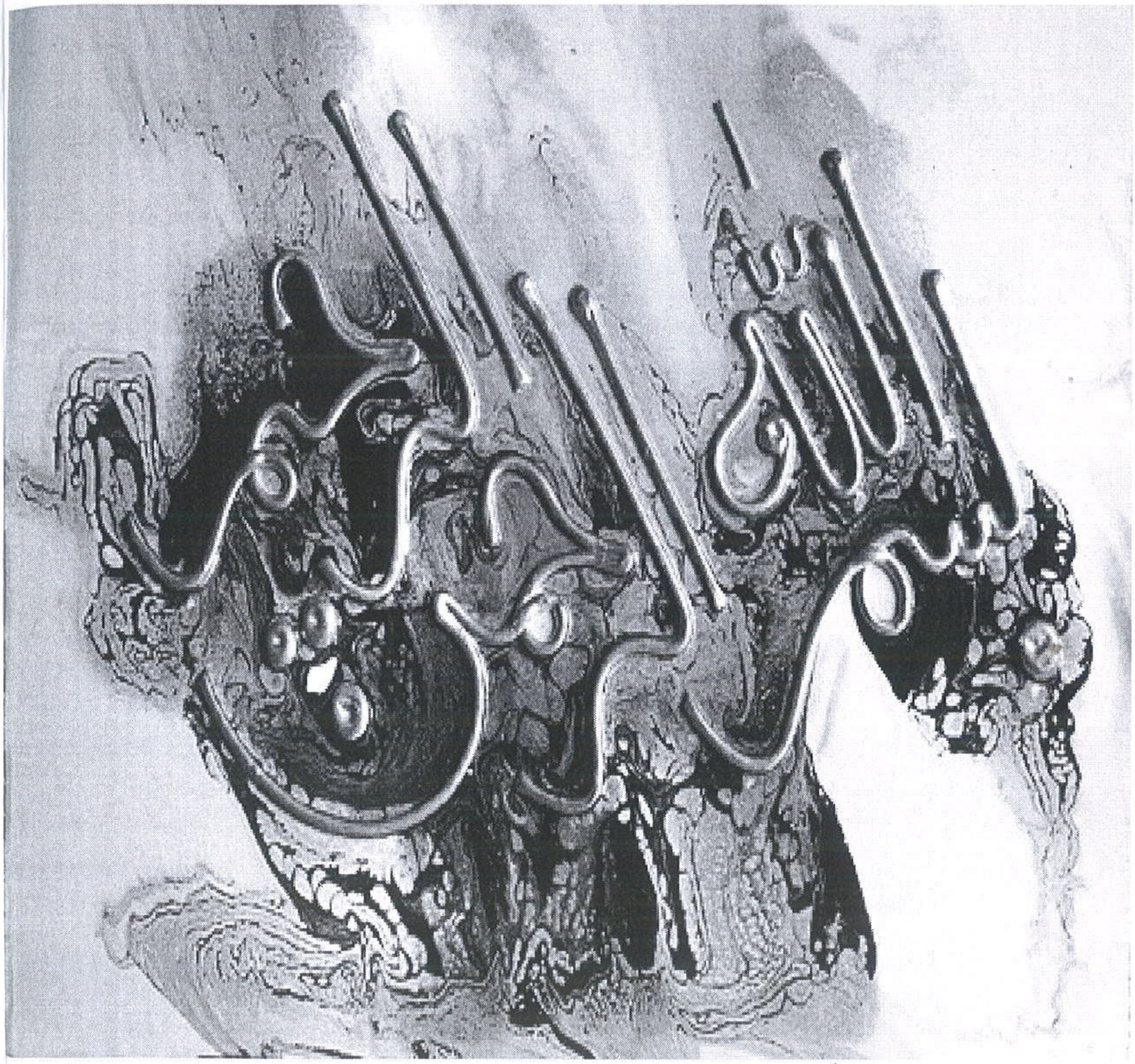

بسم الله الرحمن الرحيم

And remember the name of your LORD & devote yourself to Him with a complete Devotion (73:8)

NUST
School of Electrical Engineering & Computer Science (SEECS)

PRIVATIZATION

End semester project

By

MUHAMMAD UMAIR 2008-NUST-BICSE-218

SHOAIB RAFIQUE 2008-NUST-BICSE-231

ENGINEERING ECONOMICS

DEDICATION

This project is dedicated to

THE CREATOR OF HEAVENS AND EARTH, THE ONLY ONE **ALLAH. WHO CREATED** THE ENTIRE UNIVERSE AND MANY OTHERS.

And to our PROPHET MUHAMMAD (PEACE BE UPON HIM)

At last we will dedicate this project to our beloved teacher for his guidance, Motivation and encouragement, which enabled us, complete this project successfully.

MR. MUHAMMAD YOUSAF

APPROVAL

This project is approved by

MR. MUHAMMAD YOUSAF

Director Humanities

AIR COMMODORE (RETD) MUHAMMAD ASLAM

03 July 2009

Director Basic Sciences

03 July 09

WING COMMANDER (RETD) MAQSUD UL HASSAN KHAN

DECLARATION

We the group members declare that we have all understood what this project is about and all the given information in this project is correct and accessed through lawful means.

2008-NUST-BICSE-218 **MUHAMMAD UMAIR**

SIGNATURES

2008-NUST-BICSE-231 **SHOAIB RAFIQUE**

SIGNATURES

ACKNOWLEDGEMENT

All praise due to Allah. First and foremost we thank ALLAH, the generous, for having finally made this humble effort a reality and giving us will power, courage and sprit to complete this project.

We are also thankful to our colleagues who supported us in providing the innovative ideas and energies that we required for completion of this project.

We are thankful to our parents who supported us in every type of difficulties which we faced during making of this project.

Last but not the least we group members are thankful to each other for co-ordination and working in friendly environment with dedication.

May ALLAH , the most high bless all of us, and may HE caused the efforts of all involved to be purely for him and may HE store its awards for us with himself

AMEEN

Contents

Definition

Privatization is the incidence or process of transferring ownership of a business, enterprise, agency or public service from the public sector (government) to the private sector (business). In a broader sense, privatization refers to transfer of any government function to the private sector including governmental functions like revenue collection and law enforcement.[1]

In short we can say that the process of moving from a government-controlled system to a privately run, for-profit system.

Introduction

The decision to privatize comes from a policy determination that the Government no longer needs particular assets or no longer needs to be in control of all the means by which products or services are obtained or delivered. Most broadly defined, privatization substitutes, in whole or in part, private market mechanisms for the traditional Government role as employer, financier, owner, operator, and/or regulator of a product or service .This definition admits a wide variety of actions, from innovative contractual arrangements to outright divestiture of activities or assets. But all of these actions share common objectives: *To remove the agency from those activities that are not inherently governmental functions or core business lines; to improve the management of remaining activities; to reduce the costs of doing business; and to shift greater performance and financial risk to the private sector.*

One of the main arguments for the privatization of publicly owned operations is the estimated increases in efficiency that can result from private ownership. The increased efficiency is thought to come from the greater importance private owners tend to place on profit maximization as compared to government, which tends to be less concerned about profits.

Types of privatization

There are three main methods of privatization:

- **Share issue privatization** (SIP) - selling shares on the stock market
- **Asset sale privatization** - selling the entire firms or part of it to a strategic investor.
- **Voucher privatization** - shares of ownership are distributed to all citizens, usually for free or at a very low price.

Share issue privatization is the most common type of privatization.

Share issue can broaden and deepen domestic capital markets, boosting liquidity and potentially economic growth, but if the capital markets are insufficiently developed it may be difficult to find enough buyers, and transaction costs (e.g. under pricing required) may be higher. For this reason, many governments elect for listings in the more developed and liquid markets. Euro next, and the London, New York and Hong Kong Stock Exchanges are popular because they are highly developed and sophisticated.

As a result of higher political and currency risk deterring foreign investors, asset sales are more common in developing countries.

Voucher privatization has mainly been used in the transition economies of Central and Eastern Europe, such as Russia, Poland, the Czech Republic, and Slovakia.

A very substantial benefit to share or asset sale privatizations is that bidders compete to offer the state the highest price, creating revenues for the state to redistribute in addition to new tax revenue. Voucher privatizations, on the other hand, would be a genuine return of the assets into the hands of the general population, and create a real sense of participation and inclusion. Vouchers, like all other private property, could then be sold on if preferred by what companies are offering.

History of Privatization in Pakistan

The demand for denationalization gained currency towards the end of Z A Bhutto era when nationalization of nearly 3,000 rice-husking, cotton-ginning and vegetable ghee (cooking oil) manufacturing units created widespread resentment among the middle level businessmen and industrialists.

Mian Masud, a former president of Rawalpindi Chamber of Commerce and Industry (RCCI) is still mourned by his family members as a victim of Bhutto's nationalization since he died of shock when his family lost Fazal Vegetable Factory in Islamabad and another in Multan. Youngest of seven brothers, Mian Masud had taken upon himself to compaign for the denationalization of the vegetable ghee units and his family and friends attribute his death to his tireless but apparently futile campaign. His children and brothers have risen again in Multan-based Fazal (Fatima) group to join the rank of 44 industrial families in Pakistan in 1997. (See Rise of Chaniotis)

The white paper on " Economy under Bhutto" released by General Zia un 1979 charged that " *in the name of social-justice, ill-conceived, ill-prepared and inadequately analysed changes were introduced in a hurry, with only short-term policy objectives in view, with the result that instead of achieving social goals of better social justice these only succeeded in stifling growth*". It argued that " nationalization intended to break the economic potential of any possible political opposition and at the same time it placed with the govt. tremendous economic power of patronage, resources and employment opportunities which could be used for the support of the party". It charged that nationalization was discriminatory and particularly mentioned the case of Ittefaq Foundary, as an exemple of victimization since "some small units belonging to political opponents were taken over while much larger units were not touched........The nationalization of Ittefaq Foundary which was only one of the large number of several units was an obvious exemple of selection of units on political criterion".

Zia set up a Commission headed by PICIC Chairman N M Uqaili to look into the state of the State enterprises which recommended that govt. should denationalize sick units. Three units namely Ittefaq Foundary, Nowshera Engineering and Hilal Vegetables were returned to the previous owners while cement and fertilizers which were the monopoly of the govt. were opened to the private sector. Vegetable Ghee Denationalization Order was promulgated to denationalize cooking oil factories but the move was opposed tooth and nail by the bureaucracy which was heading the nationalized units.

- **Nawaz Sharif's privatization.**

As Chief Minister Punjab, Nawaz Sharif presided over the liquidation/ privatization of several units of Punjab Industrial and Development Board (PIDC) like Pasrur Sugar Mills, Samundri Sugar, Rahwali Sugar, Paras Textile, Harapa Textile and Ghazi Textile. How and on what prices these units were sold is still a secret but according to Company Review in the daily DAWN in May 1991, Pasrur Sugar Mills was sold to United Sugar Mills of United group for a ***" token price of Rs one only".***

Samundri Sugar Mills was sold to Monoos and Rahwali Sugar to a Muslim League politician Sheikh Mansoor, following single line advertisement in newspapers under the caption, " Bids invited for Rahwali Sugar Mills". The recklessness and favoritism shown in privatization of the PIDB units by Chief Minister Nawaz Sharif was to become the hallmark of his privatization as Prime Minister.

British Prime Minister from 1979-90 Margaret Thatcher carried out one of the most successful privatization programme under which nearly four dozen govt. entities including British Steel, British Airways, the telephone system, water, electric and gas companies, the coal mines and the railroads were sold for nearly 100 billion dollars. Her promise to " roll back the frontier of the State" got the fancy of many world leaders. Both Benazir who ruled Islamabad as prime minister in 1988 and Nawaz Sharif who was the uncrowned King of Punjab during Bhutto's rule started peddling privatization as the linchpin of their economic agenda.

In April 1989, within four months of coming into power, Benazir govt. employed N.M.Rothschild & Sons to undertake study of privatization strategy and selection of projects suitable for privatization. The consultants who submitted report on 22nd May, 1989 suggested a strategy of widespread ownership and identified 14 units for privatization in two phases. These units were

Muslim Commercial Bank, Habib Bank, PIA, PSO, Sui Northern Gas Pipeline, Sui Southern, Pakistan National Shipping, Pak-Saudi Fertilizer, National Refinery, Pak-Suzuki Motors, Gharibwal Cement, Al-Ghazi Tractors, Millat Tractors adn Mustehkam Cement.

In its first term, Benazir govt. tried to privatize Sui Southern Gas Company and engaged a British Consultant Morgan Grenfell who were paid US $ 39,431 and a Pakistani Consultant Sidat Hyder Aslam was paid Rs 4,20,000. However after considerable spade work, proposal to privatize Sui Southern was dropped and it was decided that 10% shares of PIA, 30-40% shares of Pak-Saudi Fertilizer and 60% shares of MCB will be privatized. The govt. however could not carry out the proposed plan and only 10% shares of PIA were divested before Benazir was dismissed on August 5,1990 giving way to the first Nawaz Sharif government.

Nawaz Sharif was a reaction to Zulfikar Ali Bhutto and like Bhutto's nationalization his privatization was swift. ***He lacked Bhutto's chrisma but he countered Bhutto's idealogy, by imitating him. In many ways he imitated Bhutto better than Bhutto's own daughter Benazir.***

Within Six weeks of coming into power he privatized Muslim Commercial Bank (MCB) to a national group of 12 leading industrialists led by Mian Mansha of Nishat . A Privatization Commission was set up under the chairmanship of General Saeed Qadir who sold off the State enterprises as hearily as he had poured billions of tax payer's money into building them as Minister for Production under Zia ul Haq.

The Commission invited bids for 25 units between March and July 1991 but the results were not encouraging since no bid was received for nine units and the response for the remaining units was also poor. In August 1991 the Commission invited bids for 100 units and the national newspapers described it as the world's single biggest lot offered for privatization. A total of 235 bids for 81 units were received for which 26 bids were accepted by the govt.

In addition to Privatization Commission of Saeed Qadir, govt. set up a Commission for Privatization of WAPDA headed by former Secretary Abdul Rahim Mahsud, a committee for privatization of Pakistan Telecommunication under Deputy Chairman Planning Commission A G N Kazi and another for privatization of banks headed by Governor State Bank. Completely diverse and independant procedures were worked out for privatization of units of these four entities.

Nawaz Sharif had earmarked 115 units for privatization and when his government was dismissed on April 18,1993, he had privatized two banks, 68 industrial units and 10% Shares of Sui Northern Gas Pipeline for a consideration of Rs 12,018 million. As opposition leader, Benazir hounded his privatization with charges of corruption and leading to concentration of wealth in few hands. So widespread were the charges of concentration of wealth that his government was forced to set up a committee headed by former Finance Secretary H U Beg to investigate into it. *The report of the committee never saw the light of the day.*

A committee was also set up in the Monoply Control Authority to look into the allegations that cement prices have escalated in the market because of the monoply created by the privatization of five cement factories to Mian Mansha and his associates. Out of 88 industrial units privatized to date, 19 were vegetable ghee units and 16 roti plants and rice-husking units while 20 bigger units accounted for more than half of the privatized assets and it were these units which were privatized to the big business.

Mansha and his associates walked away with MCB and five cement plants, Schon group got Pak-China Fertilizer and National Fibre, Takakkal got Baluchistan Wheels adn Naya Daur Motors while Bibojee group of Habib Ullah Khattak got back the National Motors (Originally Gandhara Motors). An unknown person Sikandar Jatoi was successful in bidding for Metropolitan Steel, Zeal Pak Cement and Shikarpur Rice.

When Nawaz was dismissed on April 18,1993, the Dissolution Order listed " the lack of transparency in the process of privatization and in the disposal of public/ govt. properties" as one of the grounds for dismissal. The Attorny General in his written reply and arguments before the Supreme Court charged that the process of privatization lacked transparency, the reference prices were changed, methodology for fixing the reference prices was not made within the stipulated time and the mode of transfer of management enabled the new owners to pay the balance from windfall profits.

Although Nawaz government was restored by Supreme Court, three judges found its privatization to be faulty and in conflict with the provisions of the constitution. The dissenting Justice Sajjad Ali Shah found corruption in privatization as a valid ground for dismissal of the government.

- **Benazir Bhutto's privatization (1993-96)**

Benazir Bhutto summed up the corruption in Nawaz Sharif's privatization when she told the workers of Larkana Sugar Mills in August 1996 that " *Ab karkhana sahi keemat per bikey ga aur sahi aadmi ko meelay ga, (Now the factories will be sold to right people, at right price)"*. Her choice of words conveyed that she was fully aware that under Nawaz Sharif, units had been privatized to front men at throwaway prices. But instead of plugging the loopholes in the privatization procedures used by her predecessor she capitalized on them. Though, being an amateur in corporate matters, and because of poor craftiness of Naveed Qamar as compared to his predecessor, her bids to privatize United Bank (UBL), Pak-Saudi Fertilizer, Oil and Gas Development Corporation (OGDC) and sale of Pakistan Petroleum Limited (PPL) to front men and favorites were aborted by the hue and cry raised by the opposition, labour unions, press and presidential intervention.

One of her first move, on coming to power, for the second term was to reconstitute Privatization Commission, merging into it the other three committees dealing with privatization of WAPDA, Pakistant Telecommunication and banks, appointing Naveed Qamar, a close friend of her husband Asif Ali Zardari, as its chairman.

Privatization in Pakistan, policy and programme published in January 1994 said that the new government has carried out a review of the privatization work of Nawaz Sharif and was preparing to implement its own new mandate.

About Nawaz Sharif's privatization it simply said that " the policy pursued in recent past, both in its concept and implementation specifically suffered from poor and hasty planning and a naive assumption taht a complex procedure could be reduced to the level of ordinary auction. The failure was compounded by weak legal arrangements adn inconclusive labour issues.

"All this deprived the nation of the fruits of privatization, which were well within reach" it lamented and went on to identify what PPP government felt was a meaningful privatization and what ought to be its objectives.

" In many countries, benefits of privatization have trickled down to the consumers, workers, investors as well as government. Large investments were made by new owners, subsequent to privatization to expand and diversify production. As a result domestic welfare improved. This we intend to replicate in Pakistan. The privatization policy envisages the creation of a mechanism for the reduction of debts so that our children inherit an industrialized, not a bankrupt nation", the document declared.

" The govt. believes that one of the principal benefits to the nation from privatization of its public assets is by way of reduction of our public sector debt burden. The burden of domestic and international debt can be reduced from the sale of those very assets for which the debt was partially created", it said.

In her second term, Benazir privatized 20 industrial units, one financial institution, Kot Addu Power Plant and 12% shares of Pakistan Telecommunications Ltd.

Arguments for and against privatization

- ### Pro-privatization

Proponents of privatization believe that private market factors can more efficiently deliver many goods or service than government due to free market competition. In general, it is argued that over time this will lead to lower prices, improved quality, more choices, less corruption, less red tape, and quicker delivery. Many proponents do not argue that everything should be privatized. According to them, market failures and natural monopolies could be problematic. However, some Austrian school economists and anarcho-capitalists would prefer that everything be privatized, including the state itself.

The basic economic argument given for privatization is that governments have few incentives to ensure that the enterprises they own are well run. One problem is the lack of comparison in state monopolies. It is difficult to know if an enterprise is efficient or not without competitors to compare against. Another is that the central government administration, and the voters who elect them, have difficulty evaluating the efficiency of numerous and very different enterprises. A private owner, often specializing and gaining great knowledge about a certain industrial sector, can evaluate and then reward or punish the management in much fewer enterprises much more efficiently. Also, governments can raise money by taxation or simply printing money should revenues be insufficient, unlike a private owner.

If there are both private and state owned enterprises competing against each other, then the state owned may borrow money more cheaply from the debt markets than private enterprises, since the state owned enterprises are ultimately backed by the taxation and printing press power of the state, gaining an unfair advantage.

Privatizing a non-profitable company which was state-owned may force the company to raise prices in order to become profitable. However, this would remove the need for the state to provide tax money in order to cover the losses.

ADVANTAGES OF PRIVITIZATION

- **Performance.** State-run industries tend to be bureaucratic. A political government may only be motivated to improve a function when its poor performance becomes politically sensitive, and such an improvement can be reversed easily by another regime.
- **Increased efficiency**. Private companies and firms have a greater incentive to produce more goods and services for the sake of reaching a customer base and hence increasing profits. A state-owned firm would not be as productive due to the lack of financing allocated by the entire government's budget that must consider other area's of the economy.
- **Specialization** A private business has the ability to focus all relevant human and financial resources onto specific functions. A state-owned firm does not have the necessary resources to specialize its goods and services as a result of the general products provided to the greatest number of people in the population.
- **Improvements.** Conversely, the government may put off improvements due to political sensitivity and special interests — even in cases of companies that are run well and better serve their customers' needs.
- **Corruption.** A monopolized function is prone to corruption; decisions are made primarily for political reasons, personal gain of the decision-maker (i.e. "graft"), rather than economic ones. Corruption (or principal-agent issues) during the privatization process - however - can result in significant under pricing of the asset. This allows for more immediate and efficient corrupt transfer of value - not just from ongoing cash flow, but from the entire lifetime of the asset stream. Often such transfers are difficult to reverse.

- **Accountability**. Managers of privately owned companies are accountable to their owners/shareholders and to the consumer, and can only exist and thrive where needs are met. Managers of publicly owned companies are required to be more accountable to the broader community and to political "stakeholders". This can reduce their ability to directly and specifically serve the needs of their customers, and can bias investment decisions away from otherwise profitable areas.
- **Civil-liberty concerns**. A company controlled by the state may have access to information or assets which may be used against dissidents or any individuals who disagree with their policies.
- **Goals**. A political government tends to run an industry or company for political goals rather than economic ones.
- **Capital**. Privately held companies can sometimes more easily raise investment capital in the financial markets when such local markets exist and are suitably liquid. While interest rates for private companies are often higher than for government debt, this can serve as a useful constraint to promote efficient investments by private companies, instead of cross-subsidizing them with the overall credit-risk of the country. Investment decisions are then governed by market interest rates. State-owned industries have to compete with demands from other government departments and special interests. In either case, for smaller markets, political risk may add substantially to the cost of capital.

- **Security**. Governments have had the tendency to "bail out" poorly run businesses, often due to the sensitivity of job losses, when economically, it may be better to let the business fold.
- **Lack of market discipline**. Poorly managed state companies are insulated from the same discipline as private companies, which could go bankrupt, have their management removed, or be taken over by competitors. Private companies are also able to take greater risks and then seek bankruptcy protection against creditors if those risks turn sour.
- **Natural monopolies**. The existence of natural monopolies does not mean that these sectors must be state owned. Governments can enact or are armed with anti-trust legislation and bodies to deal with anti-competitive behavior of all companies public or private.
- **Concentration of wealth**. Ownership of and profits from successful enterprises tend to be dispersed and diversified -particularly in voucher privatization. The availability of more investment vehicles stimulates capital markets and promotes liquidity and job creation.
- **Political influence**. Nationalized industries are prone to interference from politicians for political or populist reasons. Examples include making an industry buy supplies from local producers (when that may be more expensive than buying from abroad), forcing an industry to freeze its prices/fares to satisfy the electorate or control inflation, increasing its staffing to reduce unemployment, or moving its operations to marginal constituencies.

- **Profits**. Corporations exist to generate profits for their shareholders. Private companies make a profit by enticing consumers to buy their products in preference to their competitors' (or by increasing primary demand for their products, or by reducing costs). Private corporations typically profit more if they serve the needs of their clients well. Corporations of different sizes may target different market niches in order to focus on marginal groups and satisfy their demand. A company with good corporate governance will therefore be incentivized to meet the needs of its customers efficiently.
- **Promote competition:** Due to lack of competition, the banks were not attending to the services they provide to depositors. The purpose of privatization of banks is to promote competition.

- **Reduce burden of government:** The most important factor of privatization is that these banks had been an extra burden on government. The privatization of banks reduces the burden of the government. It is in the interest of the country to sell banking business to private persons.
- **Increase the process of industrialization:** The sale of banking business to private owners is helpful in increasing the process of industrialization because the banks extend credit for setting up industrial unit in different parts of the country.
- **Service motives:** Due to the nationalization, the service motive was decreased instead of increasing. Workers do not care for any depositor. The purpose of privatization was to increase the service motive.
- **Economic growth:** Privatization will promote credit creation which will be helpful in rapid economic growth of Pakistan.

Anti-privatization

Opponents of privatization dispute the claims concerning the alleged lack of incentive for governments to ensure that the enterprises they own are well run, on the basis of the idea that governments are proxy owners answerable to the people. It is argued that a government which runs nationalized enterprises poorly will lose public support and votes, while a government which runs those enterprises well will gain public support and votes. Thus, democratic governments do have an incentive to maximize efficiency in nationalized companies, due to the pressure of future elections.

Opponents of certain privatizations believe certain parts of the social terrain should remain closed to market forces in order to protect them from the unpredictability and ruthlessness of the market (such as private prisons, basic health care, and basic education). Another view is that some of the utilities which government provides benefit society at large and are indirect and difficult to measure or unable to produce a profit, such as defense. Still another is that natural monopolies are by definition not subject to competition and better administrated by the state.

The controlling ethical issue in the anti-privatization perspective is the need for responsible stewardship of social support missions. Market interactions are all guided by self-interest, and successful actors in a healthy market must be committed to charging the maximum price that the market will bear. Privatization opponents believe that this model is not compatible with government missions for social support, whose primary aim is delivering affordability and quality of service to society.

Many privatization opponents also warn against the practice's inherent tendency toward corruption. As many areas which the government could provide are essentially profitless, the only way private companies could, to any degree, operate them would be through contracts or block payments. In these cases, the private firm's performance in a particular project would be removed from their performance, and embezzlement and dangerous cost cutting measures might be taken to maximize profits.

Furthermore, large corporations can pay public relations professionals to convince decision-makers that privatization is a sensible idea, whether or not this is actually the case. Corporations typically have far more resources for expert testimony, advertisements, conferences and other propaganda efforts than anti-privatization advocates. Of course, this fact has no bearing on the merits of privatization itself.

Some would also point out that privatizing certain functions of government might hamper coordination, and charge firms with specialized and limited capabilities to perform functions which they are not suited for. In rebuilding a war torn nation's infrastructure, for example, a private firm would, in order to provide security, either have to hire security, which would be both necessarily limited and complicate their functions, or coordinate with government, which, due to a lack of command structure shared between firm and government, might be difficult. A government agency, on the other hand, would have the entire military of a nation to draw upon for security, whose chain of command is clearly defined. Opponents would say that this is a false assertion: numerous books refer to poor organization between government departments (for example the Hurricane Katrina incident).

Furthermore, opponents of privatization argue that it is undesirable to transfer state-owned assets into private hands.

They talk about disadvantages of privatization

DISADVANTAGES OF PRIVITIZATION

- **Performance**. A democratically elected government is accountable to the people through a legislature, Congress or Parliament, and is motivated to safeguarding the assets of the nation. The profit motive may be subordinated to social objectives.
- **Improvements**. the government is motivated to performance improvements as well run businesses contribute to the State's revenues.
- **Corruption**. Government ministers and civil servants are bound to uphold the highest ethical standards, and standards of probity are guaranteed through codes of conduct

and declarations of interest. However, the selling process could lack transparency, allowing the purchaser and civil servants controlling the sale to gain personally.

- **Accountability**. The public does not have any control or oversight of private companies.
- **Civil-liberty concerns**. A democratically elected government is accountable to the people through a parliament, and can intervene when civil liberties are threatened.
- **Goals**. The government may seek to use state companies as instruments to further social goals for the benefit of the nation as a whole.
- **Capital**. Governments can raise money in the financial markets most cheaply to re-lend to state-owned enterprises.
- **Lack of market discipline**. Governments have chosen to keep certain companies/industries under public ownership because of their strategic importance or sensitive nature.
- **Cuts in essential services**. If a government-owned company providing an essential service (such as the water supply) to all citizens is privatised, its new owner(s) could lead to the abandoning of the social obligation to those who are less able to pay, or to regions where this service is unprofitable.
- **Natural monopolies**. Privatisation will not result in true competition if a natural monopoly exists.
- **Concentration of wealth**. Profits from successful enterprises end up in private, often foreign, hands instead of being available for the common good.
- **Political influence**. Governments may more easily exert pressure on state-owned firms to help implementing government policy.
- **Downsizing**. Private companies often face a conflict between profitability and service levels, and could over-react to short-term events. A state-owned company might have a longer-term view, and thus be less likely to cut back on maintenance or staff costs, training etc, to stem short term losses. Many private companies have downsized while making record profits.
- **Profit**. Private companies do not have any goal other than to maximize profits. A private company will serve the needs of those who are most willing (and able) to pay, as opposed to the needs of the majority, and are thus anti-democratic. The more necessary a good is, the lower the price elasticity of demand, as people will attempt to buy it no matter the price. In the case of price elasticity of demand is zero (perfectly inelastic good), demand part of supply and demand theories does not work.
- **Privatization and Poverty**. It is acknowledged by many studies that there are winners and losers with privatization. The number of losers —which may add up to the size and severity of poverty—can be unexpectedly large if the method and process of privatization and how it is implemented are seriously flawed (e.g. lack of transparency leading to state-owned assets being appropriated at minuscule amounts by those with political connections, absence of regulatory institutions leading to transfer of monopoly rents from public to private sector, improper design and inadequate control of the privatization process leading to asset stripping.[6]

Objectives of privatization

The objectives of privatization described by government of Pakistan are as follows

1. Creation of liberal economic environment.
2. Removal of trade and tariff barriers.
3. Improvement in national productivity.
4. Achieving rapid industrialization
5. To facilitate access of private sector to financial resources.
6. To improve efficiency and profitability of the enterprises.
7. To insulate economy from political interference.
8. To develop a viable capital market.
9. To release resources for social and physical infrastructure.

Reasons for privatization

Countries privatize because ownership is significant determinant of enterprise performance. In both developed and developing countries, good SOE performance has been very difficult to bring about and even harder to sustain. Governments facing financial crisis often try to improve performance by bringing in new and dynamic mangers, and paying them incentive salaries. and they grant managers autonomy to set prices and hire and fire, and agree to overdue tariff increases and payment of past due bills. These measures often have a positive effect, but as the crisis dissipates, so does political resolve.

The other reason for privatization is the performance of public sector enterprises. As we know a large scale nationalization of private sector banks and insurance company took place in early 1970's. Since then, the performance of these public sector enterprises has been poor. Majority of them were at loss. 91 out of 115 public sectors industrial enterprises were having heavy losses. At 15% annual rate of return, as assumed by ministry of finance the accumulated profits of public sector enterprises under the control of ministry of production were estimated to be Rs. 14.3 billion as compared to only Rs. 0.34 billion, shown in the balance sheet in June 1990.

Another problem with these enterprises was their bureaucratic control and we all know that bureaucrats are neither competent nor qualified enough to run the state enterprises. They, therefore, submitted themselves to political compulsions and provided jobs to those who were recommended by politicians and/or to their own kins. Modernization of machinery was also subjected to political ends. With these problems in view, partial privatization i.e. selling a portion of shares without transferring management, would not have done the needful. Hence, the policy of complete privatization of public sector enterprises was decided.

IS PRIVATIZATION IN PAKISTAN PURPOSEFUL?

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.

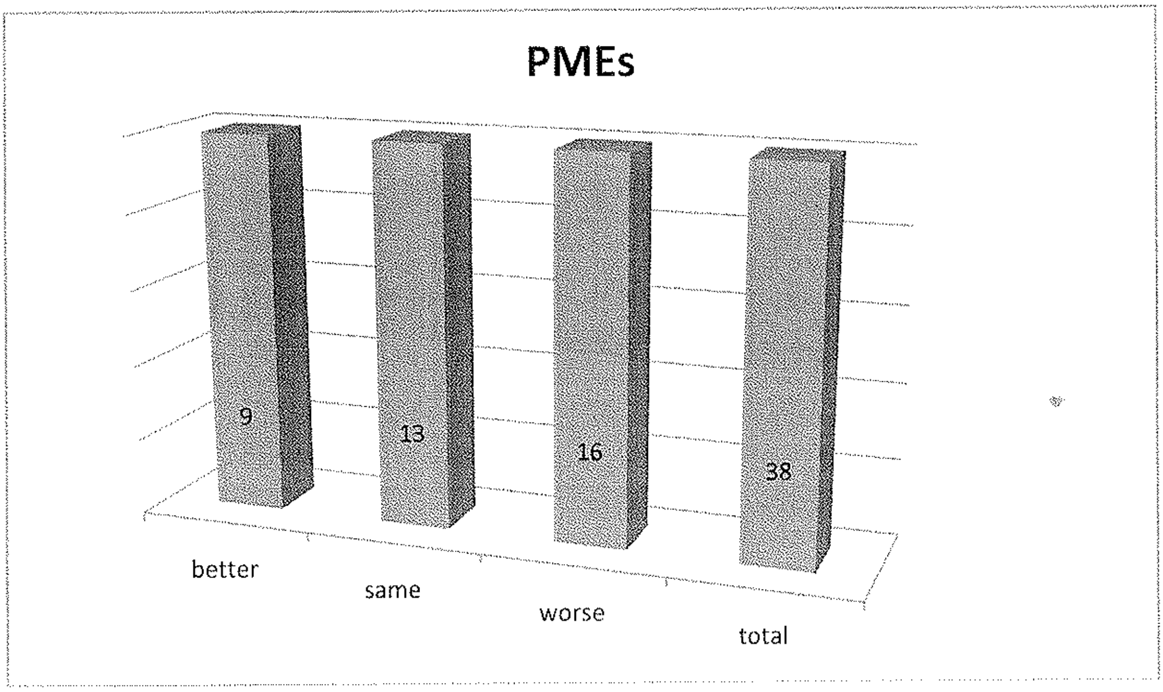


Figure 1

Misc.

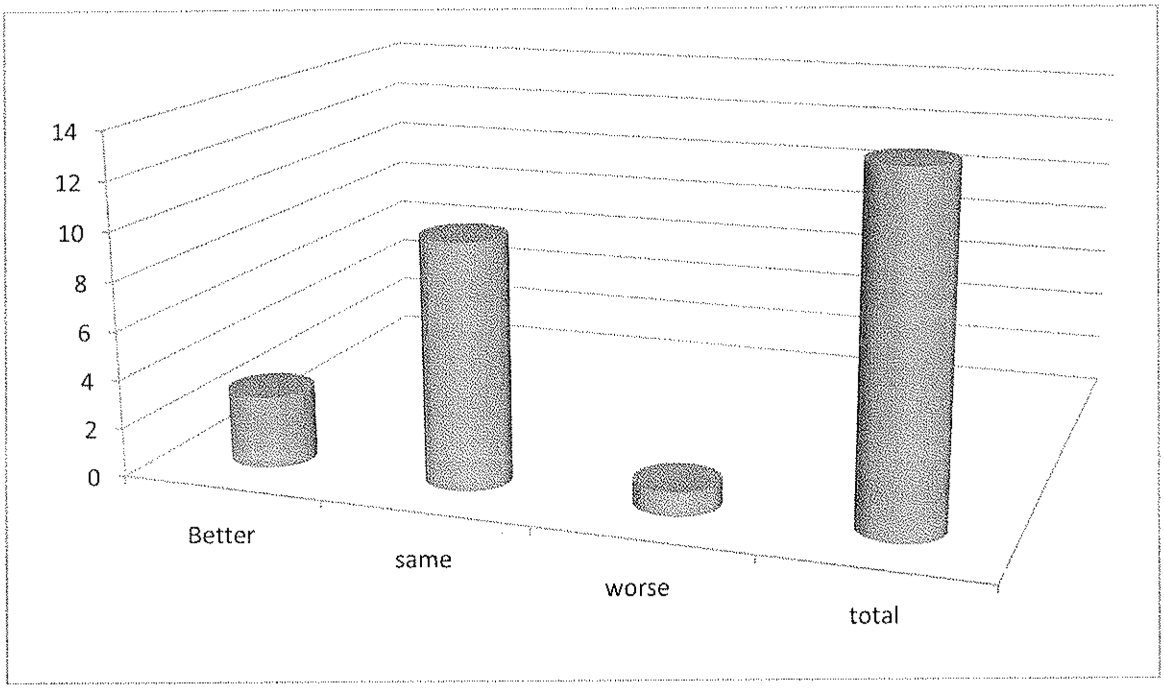


Figure 2

GHEE MILLS

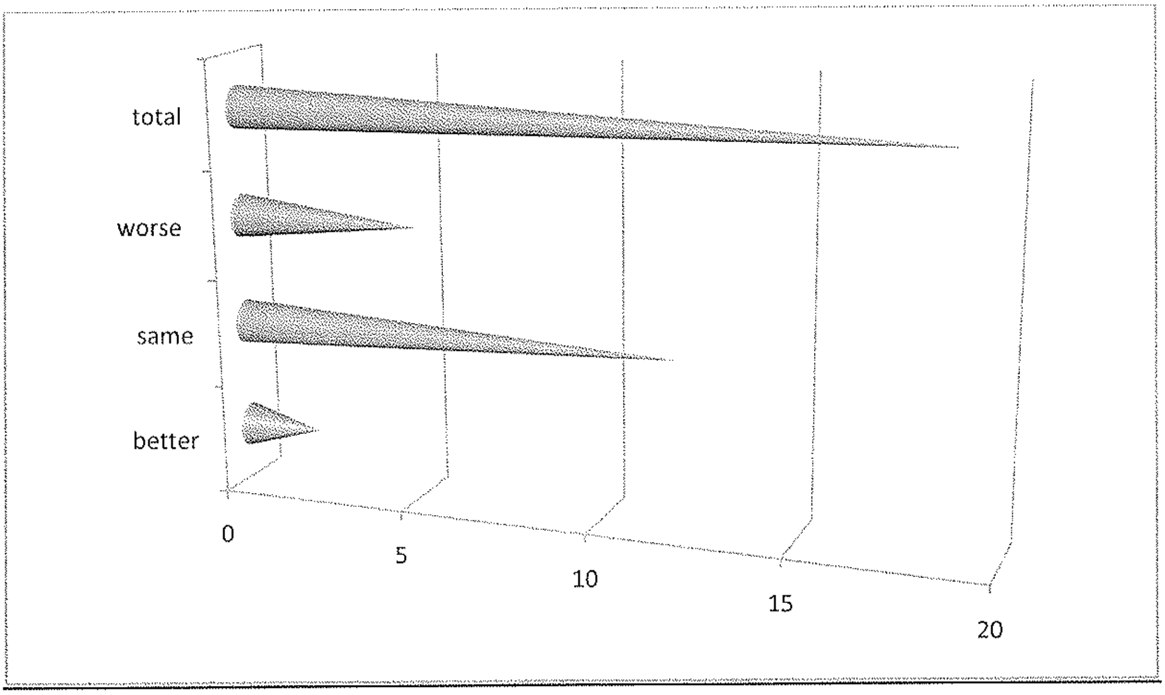
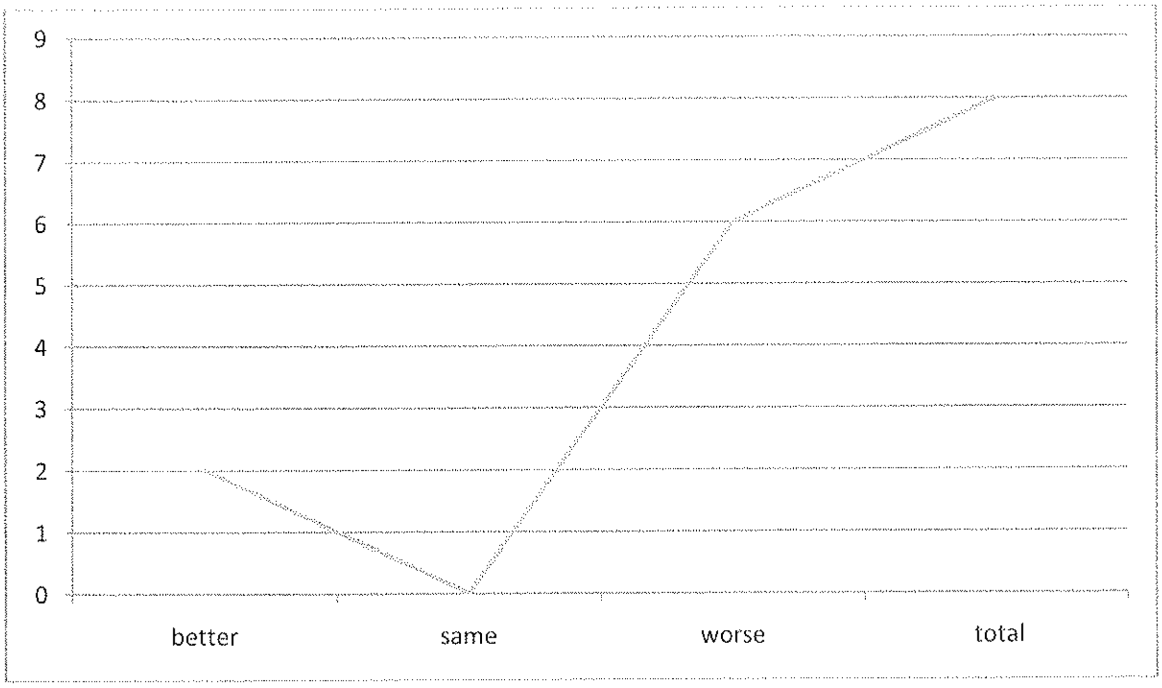


Figure 3

RICEMILLS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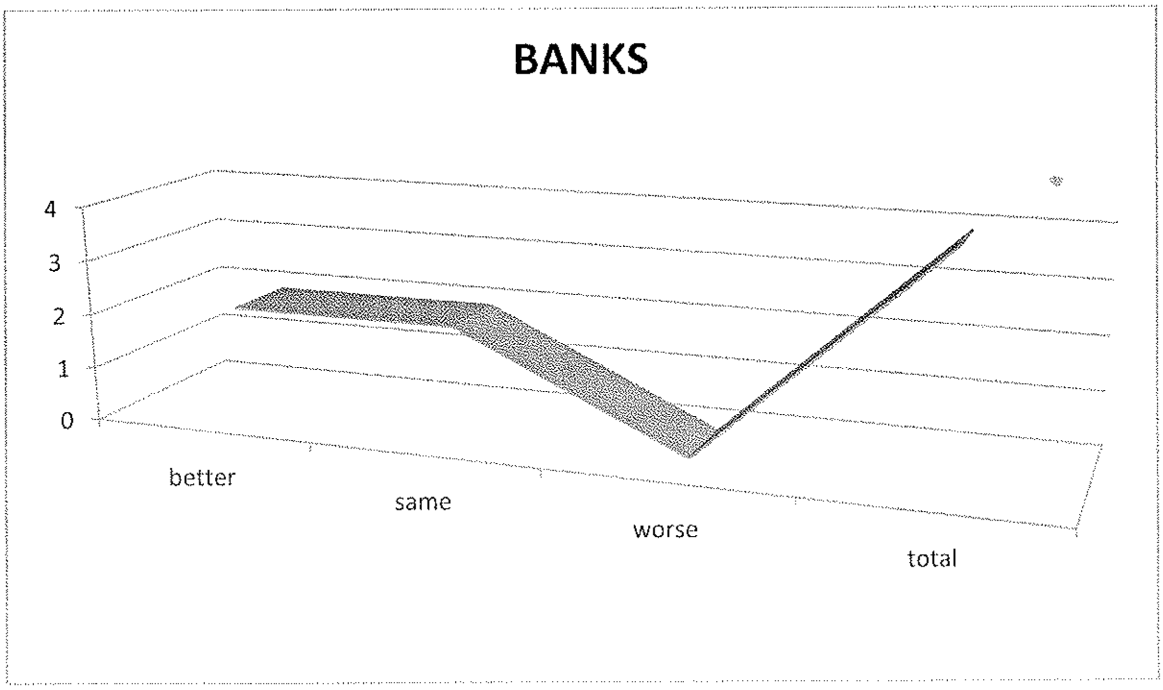
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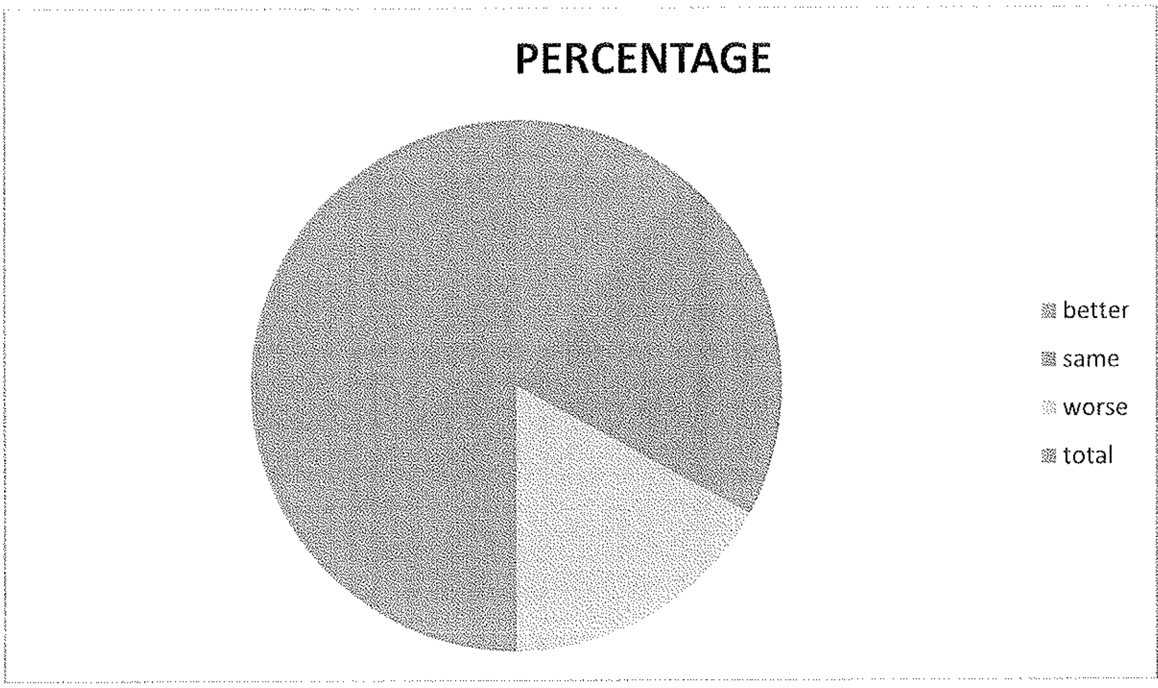


Table:

	Better	Same	Worse	Total
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%

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 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 7 Fibre, Pak China and Quaidabad Woolen Mills. All these were closed after privatization. The ADB consultants have opinioned: "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 9 credited to a separate Debt Retirement Fund but were put into Federal Consolidated Fund from where these were utilized for current expenditure.

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 ;-

KAPCO	MW
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 10 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.

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 [11] 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 [3] 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 [4], 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.

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)

Organization	2000-01	2001-02
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.

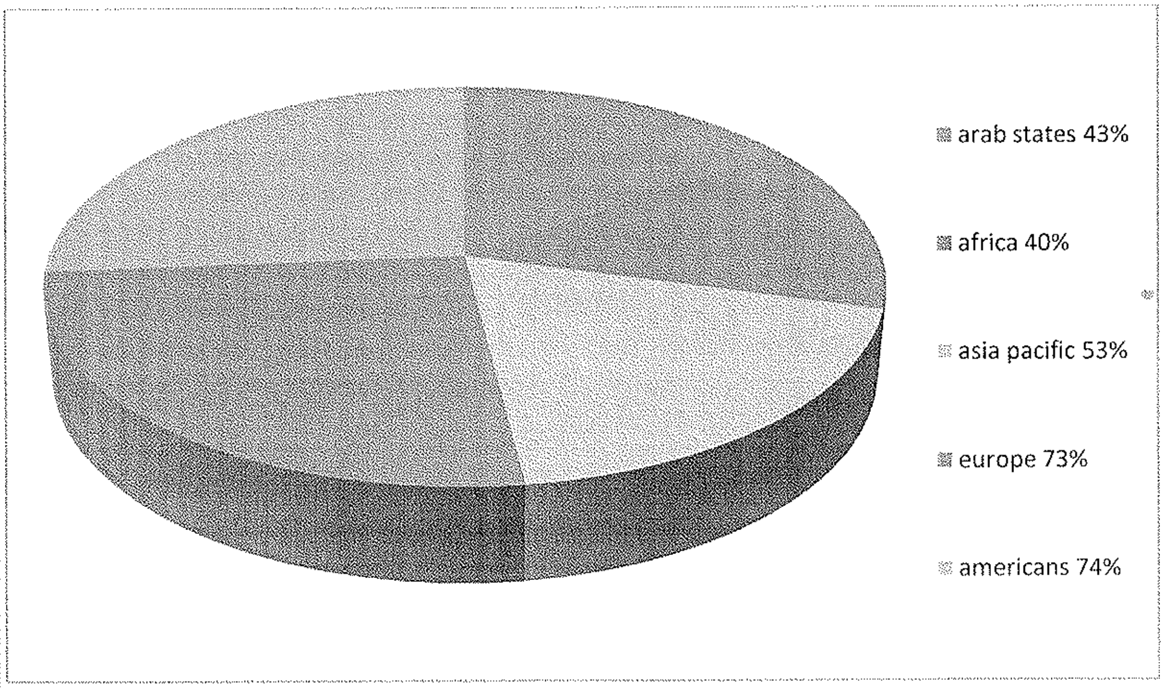
It is an ideal competitive situation in which public sector PSO and OGDC are competing with foreign multinationals and both of them should be encouraged to drill more. Moreover, no developing country has handed over its entire oil and gas sector to foreign countries. In most developing countries the 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.

Global landscape of Privatization



Conclusion

At last I will say that privatizing sometimes can be very useful and some times can be effect economy badly, as in case of Pakistan the electricity crisis arouses due to privatization of electricity generating companies. As in some cases privatizing the huge profit gaining firms cause harm to economy. So, government should privatize the institutions according to devised plan thinking carefully so that it should not affect economy. Government should take necessary steps to improve performance and to end the political influence in the public sector economy. Doing this will help us solving the issues like unfair jobs given eligible persons, corruption and will result in up growth of economy. Which is badly needed in a country like Pakistan.

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