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|  | |  | | --- | | http://jang.com.pk/thenews/weekly-images/busrev/mm_header.jpg |  |  | | --- | | **Monday, March 19, 2012, Rabi-Us-Sani 25, 1433 A.H** |  |  |  |  |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | |  | |  |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | --- | | |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | | |  |  | | --- | --- | |  |  | |  | |  |  | | --- | --- | |  |  |     Bottom of Form | | |  | | | |  |  | | |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | |  |  |  |  |  |  |  | | |  |  |  | | --- | --- | | |  | | --- | | THINK TANK  **Flawed privatisation approach** *By Dr Ishrat Husain*  There has been a hiatus in the privatisation of state-owned enterprises for the last five years. Recently, the Privatisation Commission has announced a capital market transaction roadmap. Under this programme, sales of public shares will take place through initial public offerings (IPOs), secondary public offerings (SPO), global depositary receipts (GDR) and follow on public offering (FoPo). The main objective is to raise funds for meeting fiscal deficit and mobilise foreign exchange to fill in the widening gap in the balance of payments. Will these transactions achieve the stated objective? The companies for which local markets will be accessed are PPL, HBL, NBP, PARCO, KAPCO, SLIC, NICL, IESCO and FESCO. All these companies have been performing well and can do even better if their boards and management are allowed to operate on purely commercial basis without government interference. These companies are all paying dividends and making a contribution to the non-revenue taxes. A comparison should be made whether the projected net present value (NPV) of the flows of these dividends exceeds or is equal to or is lower than the expected sale price of the shares being off loaded. If the NPV is positive then the disposal of the shares is simply a transfer of resources from the public sector to the private share holders. In that case, the fiscal deficit may temporarily see an immediate dip because of the stock of cash received from sale proceeds but in the long run the loss of dividend income flows to the government over time may widen the deficit. Under this scenario, the government may feel happy and take credit for reducing fiscal deficit by a few percentage points but the country will be worse off. This is a typical problem of stock-flow conversion that the politicians, judges and other decision makers do not fully take into account. Had this factor been considered and its consequences fully understood, the Supreme Court decision on the privatisation of Steel Mill would have been quite different. For an on-going concern the net asset value already includes land and fixtures for the specific use of that particular concern. Any land surplus to the current or future use can be stripped from the sale transaction. If the new owners make a written commitment to expand the production capacity to 3 million tons, the surplus land could be included in the sale on the explicit condition that it could not be diverted for any other alternative use. Since that fateful decision we have witnessed a substantial loss to the exchequer and a virtual shutdown of production. Steel being an essential input into the automobile and housing industry has knock-on effect on these downstream industries. The sufferers are the consumers who have to pay higher prices, the country's foreign exchange reserves that are depleted by importing steel products and the exchequer which has to finance the losses. Leaving aside what happened in the past, let us revert to the transactions on hand. If the hemorrhage to fiscal account is being caused by the losses of PIA, Railways, WAPDA, PEPCO, Pakistan Steel and more recently PNSC, shouldn’t these be the candidates for privatisation rather than those making positive contribution in form of taxes and dividends. A Cabinet Committee on Restructuring of eight state-owned companies was formed during the tenure of Shaukat Tarin. The Committee's mandate was to restructure these companies and make them profitable. For the last two years the Committee has met several times but no palpable progress has been made in reaching the end point. Had the restructuring been completed, the Privatisation Commission would have been asked to sell these companies to strategic investors. The government would still keep control by holding majority shares but transfer management to professional teams of the strategic investor. At the same time privatization has to be accompanied by (a) strengthening regulatory agencies such as NEPRA and OGRA (b) separating Civil Aviation Authority and PIA from the Ministry of Defence so that private airlines are provided a level playing field to compete (c) forming a Transportation Regulatory Agency for road and railways, and private commercial companies allowed to use public railway infrastructure; (d) encouraging private energy companies and independent power producers to set up new capacity and distribution units. Privatisation without strong and capable regulators and market competition is not in the national interest as it is not simply change in ownership but in outcome under which resources are more efficiently utilized and allocated. If this approach is adopted, the state-owned enterprises after privatisation would not only augment the government revenues through payment of dividends and corporate taxes and increased value of the residual shares but also bring about efficiency and lower prices of goods and services to the consumers. Infrastructure deficiencies would be removed while the cost to industry and exporters would decline. In the telecommunications, fertilisers, electronic media and the banking sectors, privatisation coupled with strong and capable regulators and market competition have brought net additional revenues to the government (Rs50 billion annually from banking sector alone), lower prices of telecom services to the consumers, a substantial increase in domestic production of fertilizers and a wide choice of viewer ship to the general public. Competition in the banking sector is still a long way to go (as spreads are still high) but we have at least 15 well capitalised and viable banks in the country and concentration ratios in the banking industry are declining. Sui Southern and Sui Northern gas companies performed well as long as there was no excess demand for the natural gas. But as soon as new domestic connections in hundreds of thousands were given on political considerations, supply diverted to CNG pumps at subsidized rates, domestic gas well head prices frozen at unrealistic prices, excess demand was created. It was rationed through non-price allocation resulting in huge unaccounted for gas losses, rent-seeking and corruption. If both these companies are privatized and other distribution companies allowed to compete, a more rational allocation of gas can be achieved. This clearly shows how profitable state-owned companies can turn into a liability because of political interference. Critics of privatisation point out at the KESC to substantiate their viewpoint. Despite all the various difficulties and problems confronted by the privatized KESC including interference by the politicians in hiring, retention of surplus labor and severance payments of substantial amounts, some visible changes are beginning to be seen. Investment and institutional reforms have cut line losses in the Defence–Clifton areas from 23 percent to 8 percent and recoveries have jumped substantially. In another year’s time, if the company is allowed to operate according to its plan and is supplied the required gas feed stock, Karachi would be rid of load shedding. Serious efforts should therefore be made to implement this package, i.e. privatize State owned companies, unleash competition and protect consumer interest.  The writer is the dean of the IBA and a former SBP governor | | |