PRIME POLICY REPORT

STATE OWNED ENTERPRISES IN PAKISTAN

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PPR

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NOTE FROM THE EDITOR

The news about five major regulatory bodies losing autonomy after being placed under various ministries has taken everyone by surprise. Although government functionaries opine that this will not affect their decision making process, it seems like a step backwards since regulators play a crucial role in facilitating the functioning of market economy by resisting government intervention on one hand, and by guarding the consumers against unfair business practices on the other hand. In the Business Climate Review, I bring to you my take on this issue and a few other happenings of last month.

The Market Analysis deliberates on the long standing issues pertaining to inefficiencies of the State Owned Enterprises. Here, we dig deeper into the causes of these inefficiencies and propose some reforms which may help ameliorate the situation.

The last section gives you the snapshot of the economy, which seems to be positive. While inflation is still under control, decline in the growth of large scale manufacturing industries and exports is posing serious challenges for the economy. We hope this year brings with it better economic reforms which can translate into economic development.

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Business Climate Review

by Ali Salman

Business Climate Review sums up important developments spanning entire federal government economic governance over last month. It discusses possible consequences of decisions, policies and regulations announced by the federal cabinet, regulators and Federal Board of Revenue for business climate of Pakistan. The analysis is based on this idea that economic freedom is good for business climate and any law that increases arbitrariness, red-tape and size of government is counterproductive. Also, we believe that government should not choose winners and losers by legalizing exemptions or favors.

Privatisation- on back burner and laid back

It can be inferred from various news items that the privatisation programme under the current PML-N administration has mostly been on back-burner. According to a news item (Express Tribune, 3rd December 2016), the Ministry of Industries has technically blocked the privatisation process of Heavy Electrical Complex (HEC), frustrating the government's fifth attempt to sell the enterprise. Apparently, representatives of the Ministry of Industries, State Engineering Corporation and HEC joined hands to technically knock out the two investment houses that had applied for becoming financial advisers for the company's privatisation. This points to only one thing: either the Prime Minister or the Finance Minister are not supportive of the much needed privatisation programme- perhaps both. It is otherwise inconceivable that line ministries instead of supporting privatisation would actually take steps to block it.

According to another news item (Express Tribune, 2nd December 2016), the government has directed Pakistan Steel Mills' (PSM) management to partly settle its domestic liabilities by selling the inventory while also seeking a government-owned bank's support to settle payments to foreign creditors. PSM's outstanding liabilities are over Rs150 billion. Of these, Rs51 billion comprises NBP loans, Rs10 billion worth of loans from other banks, over Rs40 billion in gratuity dues and SSGC's bill of Rs40 billion that led to the suspension of gas supplies in June 2015. Instead of considering an outright sale, the government is now considering a long-term lease. It may be recalled that in 2006, then Chief Justice of Supreme Court annulled the privatisation transaction of Pakistan Steel Mills- which was valued then at Rs. 22 billion. In the ten years elapsed, the PSM has accrued fresh liabilities of Rs. 100 billion. The current government has done nothing to reverse this trend and has only spent time in a ping pong with Sindh government. Once again, both Finance Minister (Minister in charge for privatisation) and the Prime Minister should be considered responsible for the delay caused in stopping hemorrhage of scarce tax revenues after the bad.

Exporters Package is a part of problem

In 2013, Pakistan had recorded an export of25,078 million dollars, which were 1.1% higher than 2012. In January 2017, the SBP reported the exports at $21,977 million dollars in 2015-16. This is a decline by 12.36% during the time period, when a 1% decline is observed in the global level of exports of goods and services. This decline is despite the acclaimed GSP Plus status that Pakistan had obtained in

December 2013, suggesting that PML-N has comparatively enjoyed an advantage over its predecessor government in terms of market access.

Finally, the government has come up with a solution. Spend fiscal resources to fix business problems. Essentially, the government spend 180 billion rupees from January 2017 to June 2018 by abolishing customs duty and sales tax on import of cotton, man-made fiber other than polyester and sales tax on import of textile machinery. In addition, changes have been made in duty draw back- duty draw back rates. Thus the government will provide significant fiscal incentives- largely by reducing its trade tax revenue- in order to register gain in the exports.

As a result of these measures, the government expects gain of $2 to $3 billion dollars in exports by June 2018.

In July 2016, the finance minister confidently announced that exports will receive a boost with zero-rated facility for five export sectors. The exports actually declined even in last six months, when compared on a month-to-month basis with 2015. The zero-rated facility proved ineffective in boosting exports.

From 2005 to 2008, government of Pakistan spent 50 billion rupees in R&D subsidies for the textile sector. Hardly any money was actually spent on R&D, and most of it ended up at a price transfer- the buyers benefited at the cost of tax payers.

The real issues underlying the decline of textiles and broadly export sector are: low productivity owing to poor quality of human resource at design and quality stages, uncertainty in energy supply, an inward looking protective tariff regime, artificial support from the government and a general lack of competitiveness in the business firms.

Independent regulators play critical role in market economy

The news about transfer of five key regulators from the cabinet division to line ministries has received wide attention (Express Tribune, 20th December 2016). However, practically, these regulators were not independent even earlier.

An independent regulator is a critical institution which facilitates the functioning of market economy by resisting government intervention on one hand and by guarding the consumers against unfair business practices on the other hand. This function can only be performed if a regulator is administratively and financially independent of the government. Thus all regulators should be protected by the constitution and their budgets should not flow from the finance ministry. Regulators should finance their activities from the fees they charge from businesses. However, what really happens that they deposit all revenue back to the finance ministry, which eventually "releases" the money back to them according to the budget.

Obviously, this is a flawed system. Therefore, just by placing the regulators from the cabinet division to line ministries, the independence (or dependence) of regulators would not vary significantly. Real independence is financial and our regulators are totally dependent upon the finance ministry to this extent.

The new tax on entertainment

According to a news item (Express Tribune, 30th December 2016), the Punjab government now claims 65 rupees on every 100 rupees that the cinema goers will spend on watching movies. There is a long history of how the government literally destroyed Pakistan's cinema in seventies and eighties. As masterfully captured in satire by Uxi Mufti in his book 'kaghaz ka ghora' (lit. paper horse), the federal government, in seventies, monopolized the import of film rolls used in production. It then established controls in other forms including contents and eventually established NAFDEC. This was complete nationalization of entertainment, which led to a long and deeply rooted decline of cinema in Pakistan. In last few years, this trend witnessed a reverse with good movies coming out from Pakistan, starting from Khuda ke liye. When a ban on showing of Indian movies was lifted- which was imposed in the wake of 1965 Indo-Pak war, this gave a great boost to cinema owners. Not only old cinema houses were restored but several new cinema complexes were built in large cities. However, this was the result of private sector efforts which received support due to removal of restrictions by the government. Therefore, a high rate of 65% excise duty on admission tickets is not only anti-business, it is anti-business also.

MARKET ANALYSIS

State Owned Enterprises in Pakistan

Introduction

Many of the State Owned Enterprises (SOEs) in Pakistan have lost their financial viability and their quality of service delivery has continuously been deteriorating. Instead of playing any productive role in the economic growth of the country, most of the SOEs in Pakistan are incurring huge losses and becoming a burden on the economy.

During past three years, losses incurred by the three major SOEs- Pakistan Steel Mills (PSM), Pakistan Railways (PR) and Pakistan International Airlines (PIA)- have increased to about Rs. 705 billion.

The establishment or existence of SOEs is generally justified on the argument that such organisations can help in the provision of certain goods at a lower price. Provision of goods at a cheaper price requires efficiency at every stage of the business process. However, many of the SOEs in Pakistan are so inefficient that they cannot even sustain without continuous support of the government.

This can be easily justified by analysing the current state of power sector SOEs which are suffering from severe transmission and dispatch losses. In June 2013, government has cleared the circular debt of Rs. 480 billion, accumulated by the power sector SOEs. However, due to inefficiencies prevailing in power sector SOEs the circular debt has again surged to around Rs. 660 billion, out of which Rs. 348 billion has been accumulated in last three years. Moreover, during the past three years electricity tariffs have been repeatedly increased even though the cost of producing electricity has been declined due to downfall in the global oil prices.

The total losses of PIA, PSM, PR and power sector SOEs have surged to Rs. 1.365 trillion which is around 9 percent higher than the current year annual development plan- amounted to Rs. 1.25 trillion.

Due to borrowing of SOEs form commercial resources the amount of funds available to the private sector is continuously declining. The outstanding debt acquired by the SOEs from commercial banks has reached to Rs. 829 billion by the end of December 2016, which is in fact 100 percent higher than the outstanding position of the debt acquired by SOEs by the end of May 2013. Whereas, the flow of credit towards the private sector has increased by just around 43 percent during the same period.

This analysis sheds light upon the state of the SOEs and discusses possible reforms which can improve the current situation. Section I of this study will highlight some of the major reasons behind poor performance of SOEs. Section II will present certain options which can be helpful in the revival of these organisations. Section III will shed some light on challenges in the implementation of proposed options.

Structure of the analysis

Section 1
Reasons behind the under performance of SOEs

Section 2
Proposals for the Revival of SOEs

Section 3
Challenges in the Implementation of Proposed Options

[1] "Losses of PIA, PSM, Railways surge to Rs705bn in 3 years" reported by Dawn News on October 17, 2016
[2] "State of Power Sector" reported by Business Recorder on December 19, 2016
[3] "Losses of PIA, PSM, Railways surge to Rs705bn in 3 years" reported by Dawn News on October 17, 2016
[4] State Bank of Pakistan
[5] "Plan to lease out Pakistan Steel Mills for 45 years" reported by DAWN on January 17, 2016
[6] Ibid
[7] Muhammad Naveed Iftikhar (2015), State Owned Enterprises in Pakistan: The Need for Corporate Governance and Private Investment" Published by PRIME Institute

1. Reasons Behind the Underperformance of SOEs

1.1 Ambiguous Role of SOEs

The existence of publically owned enterprises becomes unjustifiable and unviable in those sectors of the economy where the private sector is functioning efficiently. There are many sectors of Pakistan's economy in which inefficient and loss making SOEs still exist despite having active participation of the private sector. For instance, several private enterprises are involved in the production of steel which undermines the rationale behind the operations of Pakistan Steel Mills (PSM)- which is well known for its losses, inefficiencies and poor service delivery standards.

The accumulated losses and liabilities of PSM were Rs. 26 billion in 2008 which have now swelled to Rs. 415 billion- an increase of over 1000 percent in eight years. The government has also injected Rs. 85 billion in terms of bail out packages during the last eight years. All efforts to revive this loss incurring enterprise have repeatedly failed, yet the government has failed to come up with a solution. The much-touted privatization of the PSM and other entities, planned since 2013, has not materialized till now. There is little justification in the government running a steel mill when the private sector is there to fill the requirement, and do it without incurring any losses to the tax payers.

Even in those areas where SOEs can play their role effectively their performance is continuously deteriorating due to poor governance practices and flawed institutional design. For instance, government can play a significant role in railways but due to old fashioned organisational and governance structure the performance of Pakistan Railways- an attached department of Ministry of Railways- is not up to the mark. Pakistan Railways has suffered losses of around Rs. 26 billion during the fiscal year 2015-16. The quality of service delivery and the level of operations of PR also fallen substantially over the years.

Hence government should revive the institutional design and governance structure of loss making SOEs operating in those sectors in which they can play a productive role. However, in the areas where private sector is participating actively, privatisation of SOEs is the ultimate preferable solution.

1.2 Flawed Accountability Structure

Lack of accountability is generally considered as one of the major reasons behind the underperformance of SOEs. However, a deeper look into operational and organisational structure of SOEs reveals that it is not the lack of accountability but it is in fact multiplicity of accountability layers which is hindering their performance. The SOEs are answerable to multiple oversight organisations and there is a lack of clarity in the roles and jurisdictions of these organisations.

Furthermore, SOEs have to fulfil variety of operational directions provided by different oversight organisations. The operational directions provided by one such organisation usually contradict with the directions provided by the other, which further complicates the business strategy of these SOEs. The multiplicity of oversight organisations and accountability platforms is evident from the following diagram:

Figure 1: Multiple Platforms Oversighting SOEs

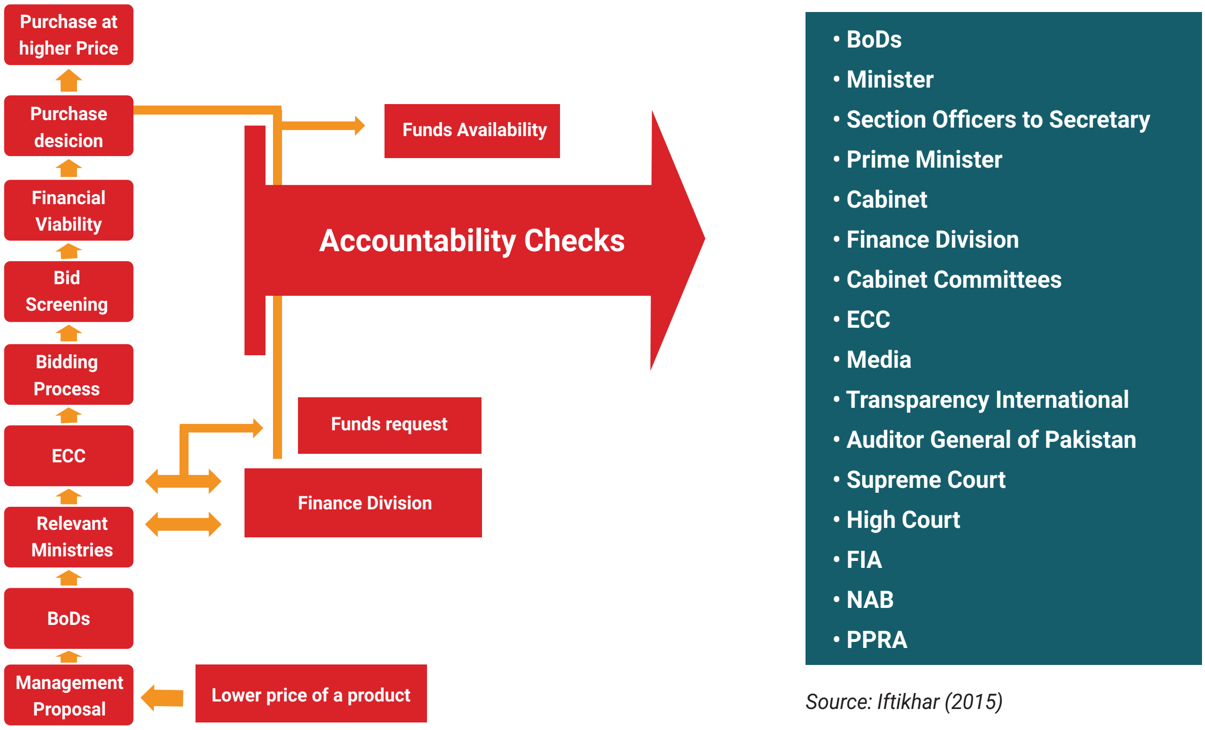
Source: Iftikhar (2015)

The above diagram reveals that multiple organisations have the oversight rights starting from board of directors to various parliamentary, judicial and regulatory bodies and offices.

The variety of accountability checks also creates inefficiencies in the procurement process of the SOEs. SOEs have to follow multiple guidelines, provided by multiple oversight organisations, for the procurement of a certain product. These guidelines often contradict with each other which not only makes the procurement process complex but it also consumes a lot of time. As a result, an SOE which decides to purchase a certain product at a lower prices ends up procuring at a higher cost- prices are driven by the market forces, they do not wait for accountability watchdogs.

The following diagram explains the complexity of public procurement process of an SOE.

Figure 2: Procurement Process



Source: Iftikhar (2015)

1.3 Lack of Accountability through Market Phenomenon

Markets- which are free from government intervention- are inherently a better accountability platform than the cumbersome bureaucratic oversight structures. Under a well-functioning market phenomenon, no firm can stay in the business while making huge losses.

However, SOEs in Pakistan operate under an inherently flawed bureaucratic accountability structure in which there is no incentive for them to operate efficiently. The reason behind this is that the loss making SOEs always turn towards their last resort (the government of Pakistan)- which provides guaranteed commercial loans and makes other types of fiscal allocations to bailout the losses. For instance, in case of PSM the government has provided more than 6 bailout packages. The outstanding guarantees provided by the government to SOEs reached to around Rs. 663 billion as of march 2016, yet these organisations are unable to improve their performance.

1.4 Lack of Capital Investment

SOEs lack resources and incentives not only to invest in the development of new assets but also to maintain the existing assets which are depreciating over time. Due to lack of capital expenditure in different SOEs the quality of service delivery is continuously deteriorating.

This can be observed in many of the SOEs operating in different sectors of the economy. For instance, there is a lack of capital expenditure in the upgradation of transmission and distribution of gas and electricity due to which the transmission network has been facing severe breakdowns for the past several years. Though government allocates certain amount in terms of capital expenditure for SOEs, this type of expenditure cannot be effective without addressing the inefficiencies in the governance of these organisations.

1.5 Inefficient Governance Framework

Corporate governance offers a framework that clearly identifies the roles and responsibilities of the stake holders responsible for governance and management of any organisation. SOEs in Pakistan are operating under different governance frameworks including Companies Ordinance 1984, corporations and in some cases as an attached department of a certain ministry (as in the case of PR).

Most of these legal and governance frameworks do not fulfil modern day requirements of the commercial world. As a result, the SOEs which are operating under such old fashioned governance frameworks cannot compete with their domestic and international counterparts.

Let's take the example of PIA, which is operating under Pakistan International Airlines Corporation Act, 1956. The enactment of 1956 requires that the chairman of the board of PIA should also be its Chief Executive Officer. Conflict of interest and abuse of position is inevitable in this case. It is quite possible that the Chairman Board of Directors (BoDs) might be influencing the voting process of BoDs for his or her own compensation without taking care of the mandate of the company and rights of the shareholders.

Though the government has issued Public Sector Companies (Corporate Governance) Rules 2013, there are still certain SOEs (such as PIA, National Highway Authority, WAPDA, Port Qasim Authority and Pakistan National Shipping Corporations) which are operating under special legal arrangements. This heterogeneity in the governance structure of SOEs is also creating unpredictability and inconsistency in the management of SOEs.

Iftikhar (2015) noted that, "The weak corporate governance will continue to pose challenges in terms of transparency, lack of clarity of roles, political interference and ineffective oversight by the BoDs that create difficulties for the SOEs to operate efficiently and vibrantly. "

1.6 Poor Regulatory Structure

The independence of regulatory bodies, which regulate the functions of SOEs, play a significant role in the efficient functioning of such enterprises. Instead of politicised policies, independent regulators design policies and regulations which are business friendly and are helpful in improving the performance of different organisations.

In Pakistan the independence of regulatory bodies is still in its infancy. The flawed institutional design does not allow any independence and autonomy to the regulators. Though some independent regulators were established in the 1990s and 2000s, successive governments however remained hesitant in providing complete autonomy and independence to these regulators which effects transparency and incentivise corruption in these organisations.

Surprisingly, on December 19, 2016 the government of Pakistan stripped off the autonomy of five regulatory bodies including: Pakistan Telecommunication Authority (PTA), Oil and Gas Regulatory Authority (OGRA), National Electric Power Regulatory Authority (NEPRA) and Public Procurement Regulatory Authority (PPRA). Previously, these regulatory bodies were under the administrative control of Prime Minister or the Cabinet Division but now the administrative control of these bodies has been transferred to the relevant ministries.

This move will likely to result in the concentration of power in the centre and will circumvent the rights promised to the provinces under 18th amendment. By amending the Rules of the Business the parent ministries will directly interfere in the internal affairs of the regulatory bodies which will affect the effectiveness of such platforms.

The very purpose behind the existence of these regulatory bodies is to provide a protection to the consumers and investors against the unfriendly government policies. However, this type of new arrangement will erode the confidence of investors and consumers. It should be realised that if the regulatory structure of the SOEs remains inefficient and centralised, the performance of SOEs will continue to deteriorate.

2. Proposals for the Revival of SOEs

2.2. Implementation of Corporate Governance Rules

The performance of SOEs cannot be improved under the current governance structure which solely relies on the public service department. There is a need to introduce modern practices of corporate governance in the SOEs. These practices are proved to be more effective in ensuring accountability, transparency and clarification of roles and responsibilities of key stakeholders of these SOEs.

There are generally four major objective of corporate governance:

i) Accountability - which requires proper mandate for the accountability of such organisations and clarity of ownership structure of the SOEs.

ii) Fairness - which requires that the operations and governance of such organisation should be based on sound principles rather than arbitrary practices.

iii) Transparency - which requires the transparency and availability of data and information related to SOEs.

iv) Independence - which requires the autonomy of stakeholders that are involved in the governance and management of SOEs

Many countries have implemented corporate governance rules in order to overcome the challenges faced by SOEs. Independent central boards have been established in different countries in the form of holding companies (Singapore's Tamasak Holding); central shareholding (Khazana Model of Malaysia); specific departments (Department of Public Enterprises, India) and central monitoring authorities such as New Zealand's Crown Monitoring Authority.

Many countries have enacted different laws in order to implement sound regulatory and governance framework in the SOEs. Examples include, Finland's Management of State Capital Act 2007 and Philippines's Government-owned and Controlled Corporation Act 2010.

Pakistan has also issued Corporate Governance Rules for SOEs in 2013- under the provision of Companies Ordinance 1984- became effective on August 08, 2013. Following box presents salient features of these rules.

Box 1: Salient Features of Public Sector Companies (Corporate Governance) Rules 2013

- These rules are applicable on all public sector companies- directly or indirectly owned by the government.
- 40 percent of the members of BoD shall be independent within two years of the notification of the rules.
- The Board shall recommend at least three individual to the government for appointment as CEO and shall appoint the chief executive after receiving approval of the government.
- The Board shall form different separate committees such a human resource committee, procurement committee etc.
- Chairman of BOD shall be separated from CEO
- Every public sector company shall appoint Chief Financial Officer, Company Secretary, and Chief Internal Auditor.
- Capacity building of the BoD members through an appropriate training program offered by any local or foreign institution.
- Annual accounts of the public sector companies shall be audited by an independent external auditor.

Though the establishment of Corporate Governance Rules has received a positive response from all segments of the economy but these rules will not serve the desired purpose if they are not implemented efficiently. Implementation of corporate governance requires the following actions:

- Capacity building of government officials, BoDs and other key stakeholders of the SOEs.
- Development and implementation of effective board nomination process

• Autonomy and independence of BoDs and empowering of the BoDs to appoint CEOs on merit
• Elimination of unnecessary multiple layers of accountability that creates complexities in the accountability process
• Strengthening the role of SECP to ensure compliance of these rules
• Development and implementation of a sound mechanism which tracks the progress made on the implementation of these rules

2.2. Private Capital Mobilisation

As stated earlier, SOEs are not getting the required funds in terms of capital expenditure due to lack of incentives framework and also due to week fiscal position of the government. As a result, SOEs are unable to develop new productive assets and the existing assets are continuously depleting.

Box 2: Mobilisation of Private Capital in Aviation Sector

Aviation sector of Pakistan has also been struggling due to lack of capital investment, poor infrastructure and also due to lack of effective regulatory framework. Private sector has a capacity to invest in this sector but prior to year 2015, the ownership, operations and regulation came under the head of Civil Aviation Authority (CAA). This type of arrangement has made it difficult for the private sector to engage in any form of public private partnership.
However, the Aviation Policy of Pakistan 2015 provides a business friendly framework which can be helpful in attracting private investment in the "facilitation of airports, maintenance units of aircrafts and ground handling services". Aviation policy of 2015 also contains provisions for the separation of regulatory and operational role of the CAA.

Box 3: Private Capital Mobilisation: A case of Pakistan Railways

The commuters and businessmen have long been suffering from the underperformance of Pakistan Railways. This public sector organisation has been underperforming due to lack of locomotives, poor quality of infrastructure, politicised hiring system resulting into excess of labour and expansion of debt stocks- alongside inefficient regulatory and accountability frameworks.
The earnings of Pakistan railway have shown some improvement in the last fiscal year due to some recent initiatives of the government i.e. the total earnings of Pakistan railway reached to Rs. 35.97 billion in 2015-16 as compared to Rs. 31.92 billion in 2014-15. However, at the same times its expenses also increased to Rs. 64.23 billion in FY16 as compared to Rs. 57 billion in FY15.
Along with the investment through PSDP, the government is spending around Rs. 35 billion on the salaries and pensions. However, due to weak fiscal position government cannot expand its support further.
This creates a need for the mobilisation of funds through the private sector. Private sector has a potential to sponsor much of the operations of Pakistan Railways and this can be achieved under different arrangements. For instance, government can take over maintenance of the railway tracks and private sector train operators can be allowed to use the tracks alongside public sector trains. Private sector funds can also be mobilised through utilisation of redundant real estate assets which came under the ownership of Pakistan Railways.
This type of arrangements will not only attract private investment in this public organisation but it will also benefit private sector through reduce cost of business by reducing the cost of transportation.

The problem of lack of capital investment can be solved through mobilisation of private capital. There is a need to attract private sector investment in the SOEs which can help in minimising the budget constraints faced by these organisations. In order to do this certain options can be utilised such as outsourcing, infrastructure usage and listing on the stock exchange. It should be realised that mobilisation of private capital is not the most feasible solution for all the SOEs. For those loss making

SOEs, which are operating in those areas in which private sector is actively participating, privatisation is the most feasible and effective solution. However, there are still certain segments of the economy in which government can engage private sector for the mobilisation of funds. Box 2 and 3 presents two of such cases in which private sector can play a significant role in the revival of SOEs. There is a need to introduce and implement such type of enabling frameworks on priority basis to attract more private sector investment in this sector. However, private capital cannot be mobilised without having a robust regulatory framework; efficient, cost effective and less time consuming contract enforcement mechanism; level playing field for the private sector; and secured property rights.

3. Challenges in the Implementation of Proposed Options

SOEs in Pakistan are operating under heterogeneous frameworks including Companies Ordinance 1984, corporations, attached departments of ministries etc. This heterogeneity is hindering the applicability of Corporate Governance Rules 2013 in many of the large SOEs. Corporate Governance Rules 2013 are applicable only on those companies which are registered under Companies Ordinance 1984 therefore, many SOEs such as PIA, PR, Pakistan Post, NHA etc. remain out of the preview of these rules.

A capable, efficient and autonomous BoDs can effectively implement corporate governance practices in any organisation. However, in Pakistan there is no formal framework for the nomination of BoD members and also there is no formal mechanism to evaluate their performance. The Companies Ordinance 1984 and Public Sector Companies (Corporate Governance) Rules 2013 contain provisions for ensuring autonomy of BoDs. However, different ministries circumvent the authority and autonomy of BoDs by giving direct instructions to the management of different SOEs. There is also a lack of qualified members on the BoDs of different SOEs.

There is also a lack of clear and effective regulatory framework which clarifies the ownership and regulatory rights of different SOEs. It is often observed that controlling ministries often overrides the decisions of BoDs.

Securities and Exchange Commission of Pakistan (SECP) is the apex regulator which is responsible for supervision and enforcement of CG Rules. However, SECP face serious challenges in terms of holding government for the implementation of CG Rules in different.

An efficient contract enforcement mechanism and proper protection of property rights are the two factors which can help in attracting private sector investment. Both of these important indicators are in a dismal condition in Pakistan. For instance, in the Doing Business Index of the World Bank, Pakistan is ranked 157 out of 190 economies in the area of Enforcing Contracts. Proper protection of property rights also helps in promoting research and innovation and hence promote investment in the economy.

Other challenges include political intervention for the implementation of politicised policies through SOEs and negative perceptions of the people regarding private ownership of different SOEs.

Conclusion

Most of the SOEs in Pakistan are incurring huge losses and are posing serious challenges for economic growth of the country. Government of Pakistan has to spend billions in terms of bailout packages for the survival of these organisations. This study presents certain fundamental issues behind the poor performance of SOEs in Pakistan and suggests possible reforms which can improve the situation.

The study highlights that many of the SOEs in Pakistan are underperforming due to unclear role of these organisations, multiplicity of accountability layers, lack of capital investment, flawed governance structure and also due to lack of accountability through market phenomenon.

The implementation of corporate governance rules and mobilisation of private capital can be helpful in improving the performance of these SOEs. However, the study recommends that those SOEs should be privatised which are operating in the areas where private sectors is actively playing its role.

The study also indicates that heterogeneity in the legal structure, inefficient BoDs, political interventions in governance of SOEs, poor regulatory structure, inefficient contract enforcement mechanism and weaknesses in the protection of property rights are some of the major challenges which are creating problems in the implementation of corporate governance and also in attracting private investment.

It should be realised that bailout packages and other types of fiscal allocations cannot help in the revival of SOEs in Pakistan without reforming the governance structure and mobilisation of private capital.

SNAPSHOT OF KEY ECONOMIC INDICATORS

Outlook of Pakistan's Economy (July-December FY17)

The first half of the current fiscal year has passed, resulting in a mixed bag of economic indicators for Pakistan. Though FDI has increased, we are also faced with a trade deficit and a lower growth rate for large scale manufacturing industries compared to the same period last year.

During the first half of the current fiscal year, foreign direct investment increased by around 10 percent as compared to the same period in the last fiscal year. However, this increase may be difficult to sustain, as investment from China, a major contributor to the FDI, has declined by 54%. Exports of goods have decreased by 2% over this period, compared to the previous fiscal year. This is mainly due to a decrease in major food and textile exports. For instance, Basmati rice exports have seen a decline of 26% while raw cotton exports have declined by 50%.

Imports, on the other hand, have increased by around 10% over the same period last year, particularly due to a spike in the import of machinery and heavy vehicles. This increase in imports and decrease in exports has resulted in a trade deficit of around $12 billion.

Continuous decline in the growth of Large Scale Manufacturing Industries (LSMI) is also threating economic growth of the county. LSMI were growing at a rate of around 6.9 percent during July to November FY14, it came down to 4.4 percent during the same period of last fiscal year and it further declined to 3.4% in this fiscal year.

If FDI continues to increase over the next half of FY17, and the trade deficit is decreased through greater exports, this may spell better times for Pakistan’s economy in the coming fiscal year.

Table 1: Economic Snapshot

Particular	Reporting Period	Value
T-Bill		**(%)**
03-M	Dec-16	5.9
06-M	Dec-16	5.9
12-M	Dec-16	5.9
PIB 10-years	Dec-16	8.4
6-M Kibor	Dec-16	6.1
Discount Rate	Dec-16	5.8
Inflation	**Dec-16**	**3.7**
External Indicatrors		**($ Bn)**
Export	Dec-16	2.3
Import	Dec-16	4.9
Trade Deficit	Dec-16	-2.6
Home Remittances	Dec-16	1.6
Current Account	Dec-16	-1.1
FDI ($ Mn)	Dec-16	595
Public Finance		**(Rs. Bn)**
Tax Collection	Sep-16	26
Direct Taxes	Sep-16	11
Indirect Taxes	Sep-16	15
Credit to Private Scetor (Rs. Bn)	As of Dec 16	4,411
LSM growth MoM (%)	Sep-16	4.8
FX Reserves ($ Bn)	13 Jan 17	23.2

Sources: SBP, Finance Ministry

Table 2: Key Targets and Projections

	Govt Target*	SBP Projection**	IMF Projection***	ADB Forecast****
		Percent		
Real GDP Growth	5.7	5.7	5	5.2
CPI- Full year average	6	4.5 - 5.5	5.2	4.5
		% change		
Export	n.a	n.a	4.1	n.a
Import	n.a	n.a	9.9	n.a
		% of GDP		
Current a/c Balance	n.a	n.a	-1.8	-1.2
Fiscal Balance	-3.8	n.a	-3.8	-5.3
Remittances ($ Bn)	n.a	n.a	20	n.a
Tax Revenue (Rs. Bn)	3,956	n.a	4,244	n.a

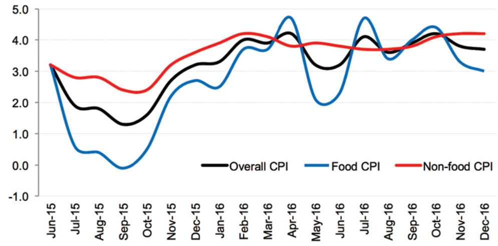
*Sources: *Budget in Brie 2016-17, **Monetary Policy Statement, ***IMF Country Report (June 2016), ****AsianDevelopment Outlook 2016*

Table 3: Balance of Payment Account - Key Items Only

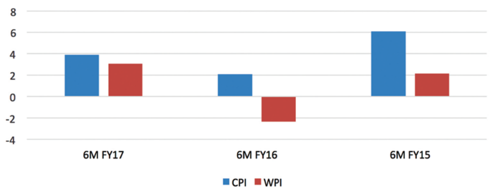
$ (Mn)	6M (FY17)	6M (FY16)	% change
Current Account Balance	**-3,585**	**-1,865**	**n.a**
Balance on Trade in Goods	**-10,819**	**-9,361**	
Exports of Goods FOB	10,527	10,776	-2%
Imports of Goods FOB	21,346	20,137	6%
Balance on Trade in Services	**-1,709**	**-1,275**	
Exports of services	2,535	2,895	-12%
CSF inflows	121	126	-4%
Imports of services	4,244	4,170	2%
	6M (FY17)	**6M (FY16)**	
Workers' Remittances	**9,459**	**9,688**	-2%
U.S.A	1164	1305	-11%
U.K	1094	1251	-13%
Saudi Arabia	2,735	2,896	-6%
UAE	2,118	2,173	-3%
	6M (FY17)	**6M (FY16)**	
Direct Investment in Pakistan	1081	979	10%
U.S.A	38	-44	n.a
U.K	45	84	-47%
Saudi Arabia	77	76	2%
China	204	444	-54%
Portfolio Investment in Pakistan	254.4	237	n.a
Equity	254.4	237	n.a
Debt	998	455	n.a

Figure 1: Trends in Inflation

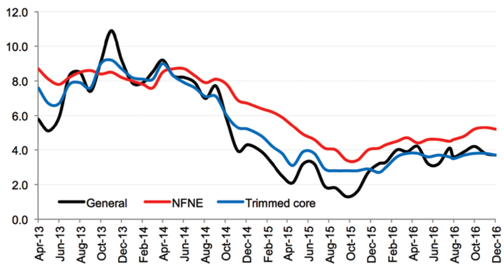
YoY Food versus Non-food Inflation (%)
Source: PBS



YoY Average CPI and WPI (% change of indices)
Source PBS



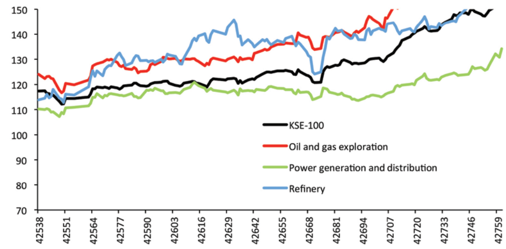
YoY Headline versus Core Inflation (%)
Source: PBS



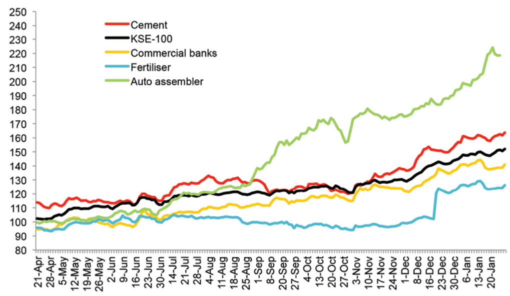
Source: PBS

Figure 2: Performance at Stock Market

Year to-date PSX's benchmark index versus sectoral performance (rebased to 100)
Source: www.khistocks.com



Year to-date performance at Pakistan Stock Exchange (indices rebased to 100) *Source: www.khistocks.com*
KSE-100 is benchmark PSX index; others are BR's sectoral indices



Source: www.khistocks.com
KSE-100 is benchmark, PSX index, others are sectoral indices

Table 4: Key Export Categories: Percentage Year on Year Change (FY16)

KEY EXPORT CATEGORIES - PERCENTAGE CHANGE 6M FY17 over 6M FY16					
Commodities (units)	**Quantity (total)**	**Price ($ Mn)**	**Price (% change)**	**Quantity (% change)**	**APR* (% change)**
Total	n.a	9,911	-4%	n.a	n.a
Food (M.T)	**n.a**	**1,659**	**-11%**	**n.a**	**n.a**
Rice	1,697,439	713	-18%	-13%	-5%
Basmati	192,354	170	-26%	-21%	-6%
Non-Basmati	1,505,085	543	-15%	-12%	-3%
Sugar	0	0	-100%	-100%	-100%
Textile	**n.a**	**6,156**	**-2%**	**n.a**	**n.a**
Raw cotton (M.T)	21,626	36	-50%	-53%	7%
Cotton yarn (M.T)	243,557	651	-7%	6%	-12%
Cotton cloth (TH.SQM)	930,271	1,048	-6%	-15%	12%
Knitwear (TH.DOZ)	62,926	1,193	0%	17%	-14%
Bedwear (M.T)	172,988	1,043	5%	9%	-4%
Towel (M.T)	84,196	373	-8%	-7%	-1%
Readymade garments (TH.DOZ)	15,615	1,101	6%	2%	4%
Art, silk & synthetic textile (TH.SQM)	53,941	102	-31%	-64%	94%
Petroleum products	**n.a**	**89**	**-93%**	**n.a**	**n.a**
Naphtha (M.T)	65,043	35	32%	52%	-13%
Other manufacturing goods	**n.a**	**1,511**	**-7%**	**n.a**	**n.a**
Sports good	n.a	145	-8%	n.a	n.a
Football (TH.DOZ)	1,528	71	-12%	-7%	-5%
Gloves (TH.DOZ)	1,129	51	3%	4%	-1%
Leather tanned (TH.SQM)	7,358	170	-8%	-16%	10%
Leather products	n.a	255	-6%	n.a	n.a
Leather garments (TH.DOZ)	426	159	-5%	-5%	0.05%
Leather gloves (TH.DOZ)	2,348	89	-8%	-6%	-2%
Footwear (TH.Paris)	4,641	46	-6.7%	-14%	8.0%
Surgical goods	n.a	164	-7%	n.a	n.a
Chemical & pharma products	n.a	394	-3%	n.a	n.a
Plastic material (M.T)	63,428	106	15%	-1%	16%
Engineering goods (TH.NOS)	n.a	84	-2%	n.a	n.a
Cement (M.T)	2,798,553	145	-15%	-10%	-5%
All other items	**n.a**	**495**	**7%**	**n.a**	**n.a**

***ARP= Average Realised Price**
Sources: PBS

Table 5: KEY IMPORT ITEMS - PERCENTAGE CHANGE 6M FY17 over 6M FY16

Key Import Items - Percentage YoY Change FY16					
Commodities (units)	**Quantity (total)**	**Price ($ Mn)**	**Price (% change)**	**Quantity (% change)**	**APR* (% change)**
Total		24,402	10%		
Food (M.T)	**n.a**	**2,864**	**9%**	**n.a**	**n.a**
Tea	107,406	257	-8%	18%	-22%
Palm Oil	1,214,248	844	2%	-9%	11.3%
Pulses	458,738	371	38%	4%	33.3%
All other food items	n.a	1,064	19%	n.a	n.a
Machinery group	**n.a**	**5,667**	**41%**	**n.a**	**n.a**
Power generation	n.a	1,652	109%	n.a	n.a
Textile group	n.a	259	11%	n.a	n.a
Electrical	n.a	962	8%	n.a	n.a
Telecom	n.a	660	-5%	n.a	n.a
Transport group	**n.a**	**1,407**	**6%**	**n.a**	**n.a**
Road motor	n.a	1,198	28%	n.a	n.a
CBU Heavy vehicles	n.a	337	41%	n.a	n.a
CBU Motor cars	n.a	163	10%	n.a	n.a
CKD Heavy vehicles	n.a	147	22%	n.a	n.a
CKD Motor cars	n.a	307	21%	n.a	n.a
Other transport	n.a	137	75%	n.a	n.a
Petroleum group (M.T)	**n.a**	**4,992**	**11%**	**n.a**	**n.a**
Petroleum products	7,738,132	3,206	19%	60%	-26%
Petroleum crude	4,021,888	1,155	-22%	35%	-42%
Textile group (M.T)	**n.a**	**1,364**	**-12%**	**n.a**	**n.a**
Agriculture group	**n.a**	3,595	-5%	**n.a**	**n.a**
Metal group	**n.a**	**1,959**	**3%**	**n.a**	**n.a**
Iron and Steel (M.T)	1,544,559	973	6.6%	17%	-9%
Miscelleanous group	**n.a**	**574**	**7%**	**n.a**	**n.a**
All other items	**n.a**	**1,979**	**3%**	**n.a**	**n.a**

n.a = not available; PBS does not release data *ARP= Average Realised Price

Sources: PBS

Figure 3: Trends in Exchange Rate

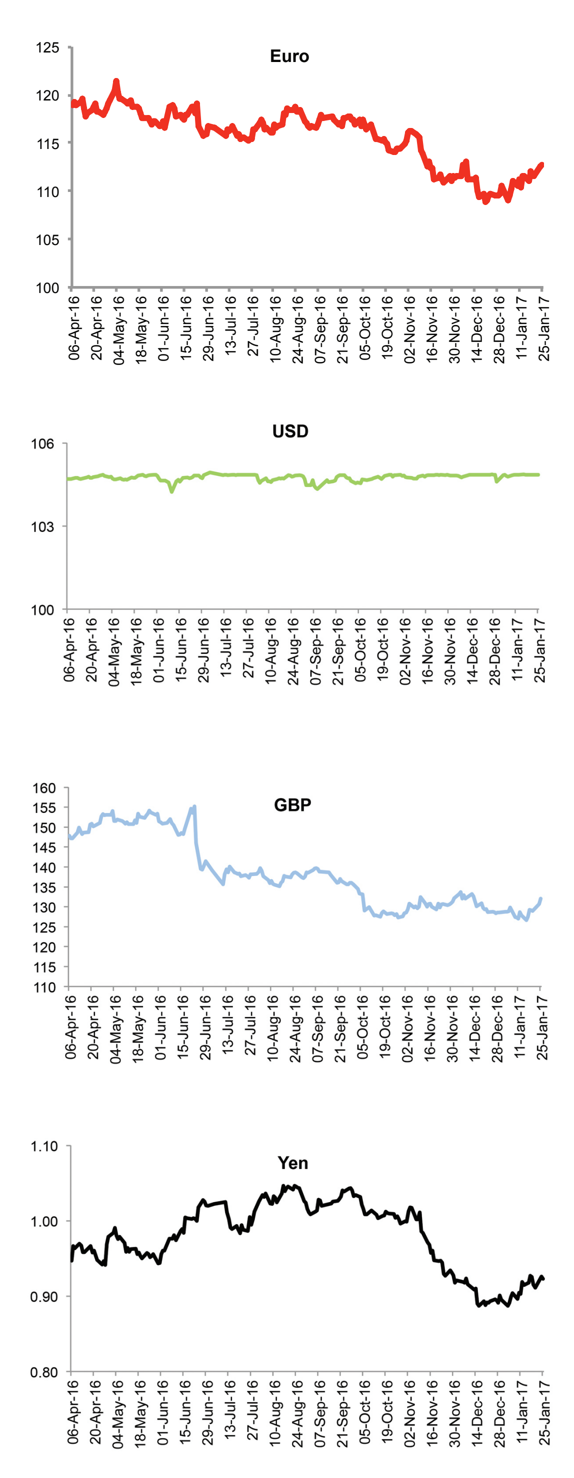


Figure 4: Key Commodities World Market

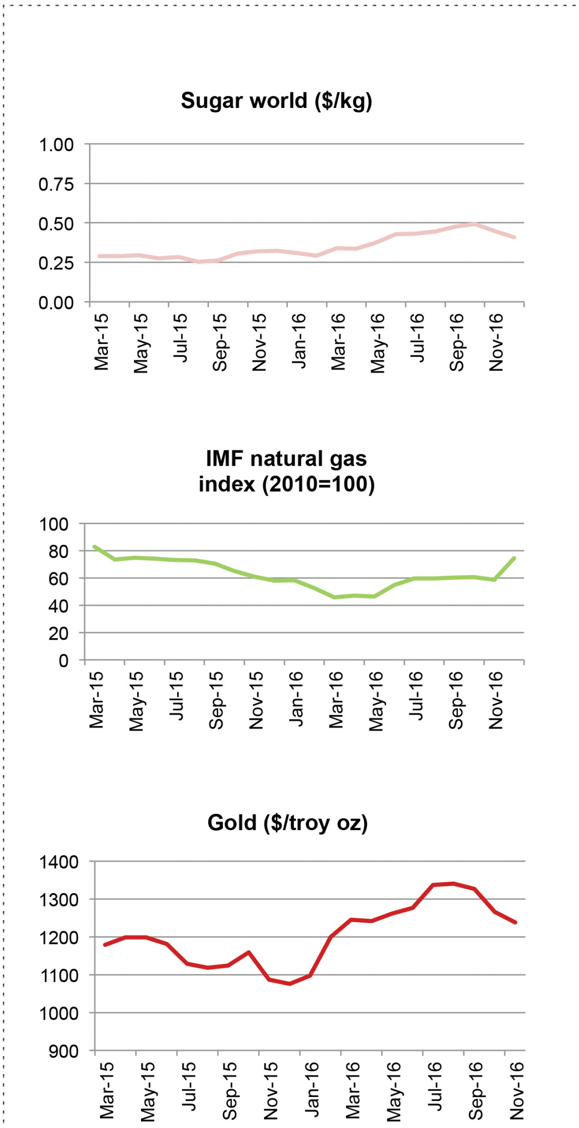


Figure 4: Key Commodities World Market

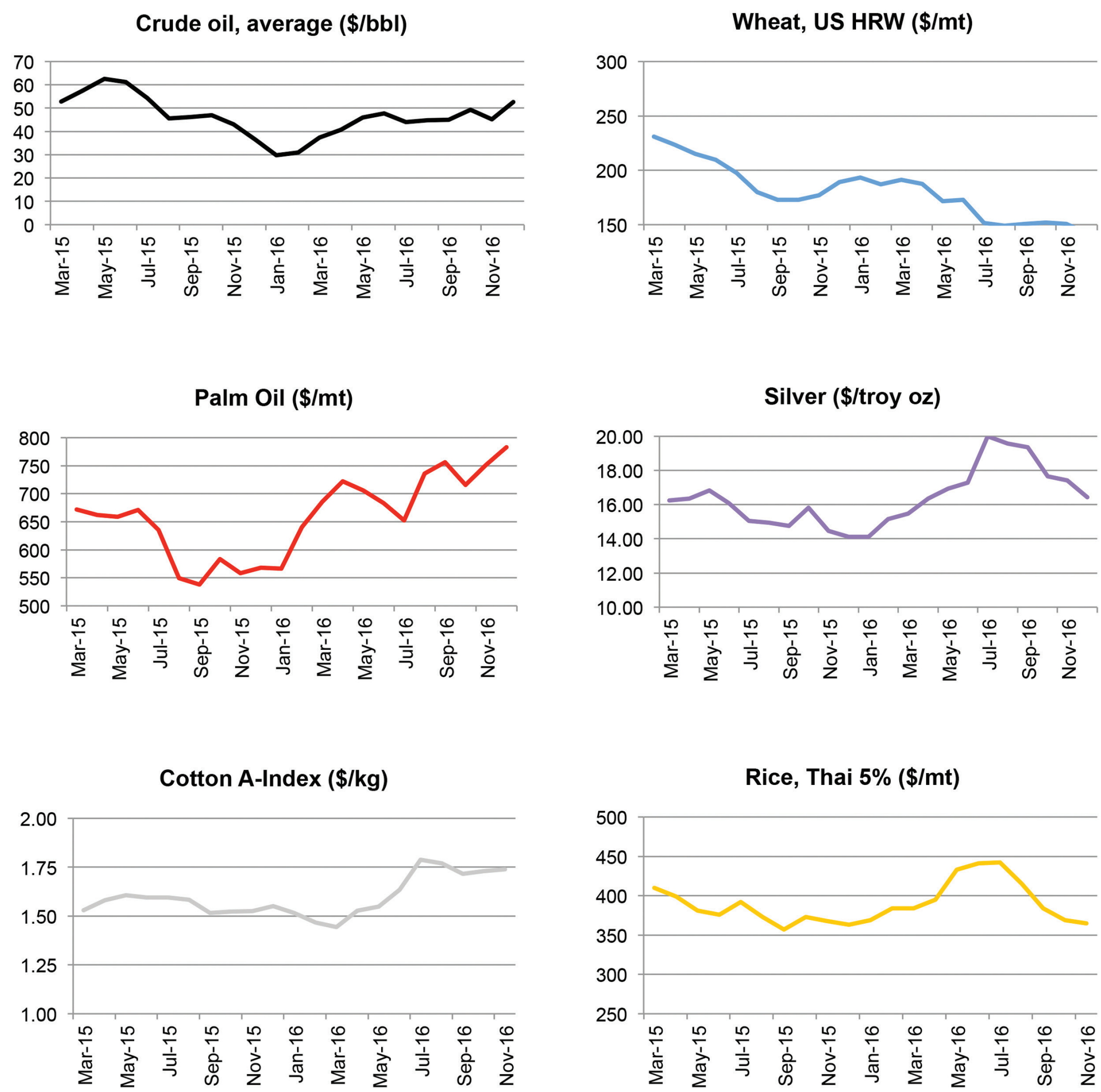


Table 6: Ease of Doing Business Index

Doing Business Rankings - Key Indices only								
	Starting a business	Dealing with construction permits	Getting electricity	Registering property	Getting credit	Trading across border	Paying taxes	Enforcing contracts
Pakistan	141	150	157	169	82	172	156	157
India	155	185	26	138	44	143	172	172
Bangladesh	122	138	187	185	157	173	151	189
Singapore	6	10	10	19	20	41	8	2
Vietnam	121	24	96	59	32	93	167	69
Turkey	79	102	58	54	82	70	128	33

Source: Doing Business

Performance of Large and Medium Scale Enterprises

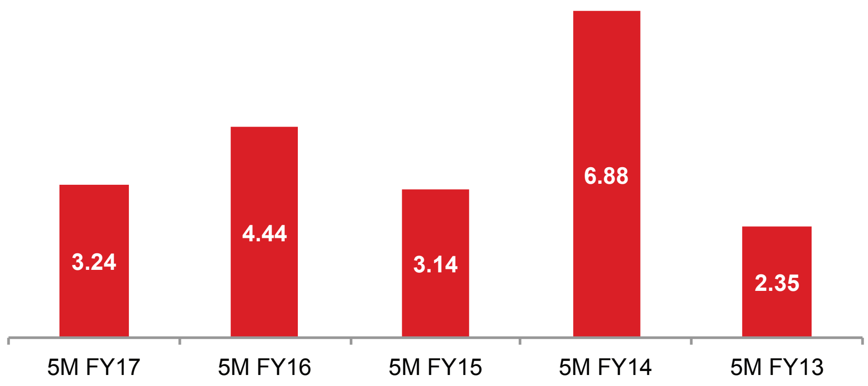
Major LSM Drivers

		Percentage change	
	Weight	5MFY17	5MFY16
Textile	20.92	0.02	1.03
Food, Beverages & Tobacco	12.37	3.78	4.89
Coke & Petroleum Products	5.51	-1.68	4.59
Pharmaceuticals	3.62	7.64	7.05
Chemicals	1.72	-3.60	11.67
Automobiles	4.61	5.57	32.26
Iron & Steel Products	5.39	14.53	-6.01
Electronics	1.96	14.52	-7.25
Leather Products	0.86	-17.85	1.12
Paper & Board	2.31	3.76	-18.17
Engineering Products	0.40	-5.86	-19.39
Rubber Products	0.26	0.47	10.04
Non-Metalic Mineral Products	5.36	10.48	5.95
Wood Products	0.59	-97.08	-23.48

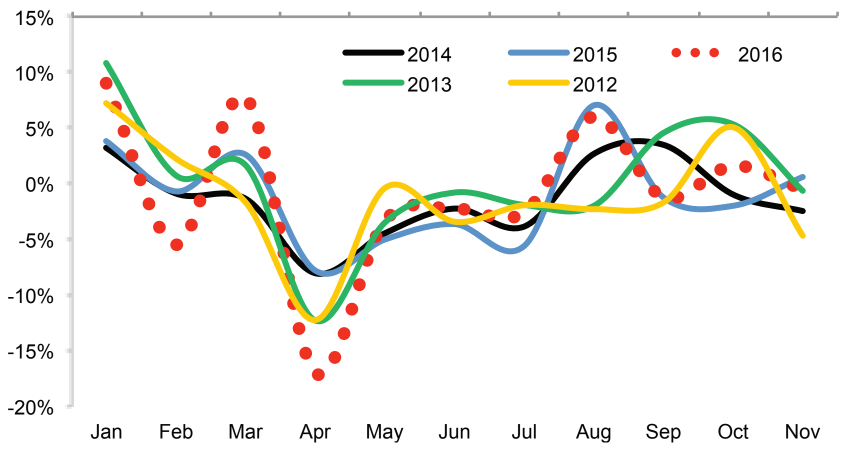
Source: PBS

Performance of Large and Medium Scale Enterprises

LSM growth (%)
Source: PBS



Year-wise LSM month-on-month growth (%)
Source: PBS



Source: PBS

INDICATIVE TOPICS FOR PPR

01. Taxes
02. Credit Market
03. Capital Market
04. Investment Policy
05. Business Regulations
06. Civil Service Reforms
07. Research and Innovation
08. Tariffs and Trade Barriers
09. Inflation and Sound Money
10. State Owned Enterprises
11. Legal System and Property Rights
12. Human Capital, Labour Market and Regulations

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