Federal Privatisation Policy for Commercial State-Owned Enterprises

A Policy Proposal by

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Preface

Privatisation process needs to be guided by clear policy guidelines and rationales and should be communicated openly. The Privatisation Policy of 1994 is the only available privatisation policy currently instituted to guide the privatisation of State-Owned Enterprises under the Privatisation Commission. The policy predates the Privatisation Commission Ordinance 2000, and it is no longer sufficient to complete the policy framework required to shift non-essential public assets and responsibilities to the private sector.

This became more obvious after the introduction of a comprehensive SOE Ownership and Management Policy. The difference that has emerged in these policies is compromising the Privatisation Commission's mandate and ability of implementation of the Federal government's Privatisation Programme.

While there may be confusion regarding the privatisation of all SOEs, there is clarity that the government's interest in for-profit business and commercial activity must be withdrawn.

A Federal Privatisation Policy is proposed which can help to progressively reduce the size of government, and transition into a more efficient model of governance where opportunities and needs may exist.

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1 Introduction

1.1 Background

State-Owned Enterprises (SOEs) have been a burden on the Pakistani taxpayer. Commercial SOEs tend to distort markets and commercial sectors. Privatisation is the stated policy of the government in reference to commercial SOEs. The history of privatisation in Pakistan is marked by cycles of state intervention for political considerations, and divestment in state-owned enterprises (SOEs) due to fiscal burden and economic sustainability.

Privatisation in Pakistan has historically aimed to enhance allocative efficiency, foster competition, and promote broader ownership of equity capital. However, the process is fraught with challenges, including valuing assets accurately, ensuring transparency in transactions, and maintaining the viability of privatized enterprises.

Early privatisation attempts date back to the 1980s; however, the first proper wave of privatisation occurred between 1991- 1999, started under a PML-N government and continued in the PPP tenure. Subsequently, in the alternating PML-N and PPP governments in the 1990s, privatisation enjoyed bipartisan support. The privatisation drive continued for 15 years including an increased spurt of privatisation activity witnessed in President Musharaff's government in the early 2000s. It came to halt after the judicial activism in 2006, where privatisation transaction of Pakistan Steel Mills was reversed by the Supreme Court of Pakistan.

Box 1: Global Experience
According to evidence gathered on privatisation outcomes from 1989 to 2003 in both developed and developing economies, privatisation has had a generally positive overall impact in terms of increasing competition, efficiency and consumer outcomes. However, the lessons learnt from these accumulated experiences, including both successes and failures, demonstrate that economic institutions matter. This means strong rule-of-law, robust competition and enforcement, hard budget constraints, and sound governance and regulation (Guriev and Megginson, 2005) in *A Policy Maker's Guide on Privatisation (OECD, 2019)*.

Subsequently, the driving forces that had sustained privatisation as a bipartisan policy weakened, and the privatisation programme became dormant. Now, considering the government's commitment to the IMF to reduce the SOE funding burden, there is a possibility that privatisation may pick up pace once again. To contextualize, guide and structure present-day privatisation, it is important to delve into the imperatives that motivate present-day privatisation and propose an appropriate policy to guide it.

1.2 Rationale and Overview

The Federal Policy for the Privatisation of Commercial State-Owned Enterprises (CSOEs) is an attempt to streamline government responsibilities through the elimination of the state's role in commercial activities in the for-profit sectors.

Following the Ministry of Finance Triage Report (2021), this exercise is focused only on the commercial SOEs owned and controlled by the Federal Government. The key factors for limiting the exercise to the commercial SOEs, as defined in the Triage Report, are as follows:

• More than 98% of the government's assets and almost 100% of the losses in the SOEs portfolio are related to commercial SOEs.

• The operational performance of commercial SOEs has a direct bearing on fiscal risks and fiscal deficit of the federal government.

• The non-commercial SOEs are largely self-sustaining entities or are established to achieve a social objective which falls within the social policy objectives of the government which otherwise private sector is unable to perform.

The 85 commercial SOEs mainly operate in seven sectors: Power (20), Oil and Gas (8), Infrastructure Transport and Communication (12); Manufacturing, Mining and Engineering (14); Finance (18); Industrial Estate Development and Management (4); and Wholesale, Retail and Marketing (4) and miscellaneous (5). While the Ministry of Finance acknowledges 85 commercial entities under state ownership, it excludes 45 entities from the privatisation process on various grounds thus further reducing the list to 44 entities only.

SOEs impose a considerable fiscal burden on the economy, primarily due to recurring operational inefficiencies and constant reliance on government support. These enterprises often fail to generate sufficient returns, necessitating substantial fiscal interventions. It is evident from the fact that SOEs in Pakistan has accumulated Rs.5.9 trillion losses since 2014 (Finance Division 2024). In addition to managing the financial losses of SOEs, the government provides substantial support through subsidies and grants, as highlighted by the Finance Division (2024), the government allocated Rs. 436 billion in subsidies and grants to sustain SOEs during the first six months of FY24 diverting critical public resources. This ongoing support not only depletes fiscal resources but also exacerbates the country's debt challenges, as the government is compelled to finance these fiscal pressures through increased borrowing.

The cumulative losses of SOEs were estimated at Rs. 405.86 billion between July and December 2023, with the sector-wise distribution of these losses summarized in the table below.

Sr. No	**Sector**	**Losses (In PKR Million)**
1	Power Sector	144,656
2	Transport	226,703
3	Pakistan Steel Mills Corporation (Private) Limited	14,411
4	Communication	1330
5	Sui Southern Gas Company Limited	4,669
6	Utility Stores Corporation (Private) Limited	2,121
7	Misc.	2,812
8	Total	**408,672**

Source: Central Monitoring Unit, Finance Division, 2024

The privatisation of SOEs offers a viable solution to address these challenges. By introducing private sector dynamism, privatization fosters competition, improves operational efficiency, and enhances governance structures. Privatization also eliminates the need for recurring bailouts, reducing the strain on public finances and promoting sustainable economic growth. This approach reflects a strategic shift towards a more market-driven economy, ensuring the optimal utilization of resources for long-term national development. Literature also underscores the benefit of privatization, where privatization positively impacts fiscal stability by reducing public enterprise deficits, lowering government transfers and enhancing revenue from privatized firms. While short term labor market adjustments may occur, the unemployment in long run tend to decline (Davis, et al. 2000). Similarly, studies also highlight that privatised enterprises often outperform their state-owned counterparts due to reduced political interference and stronger market discipline (Bertay, et al. 2020).

Acknowledging the above stated challenges and opportunities, this policy seeks to provide a clear and aggressive prescription to divest the government from commercial and for-profit activities. It lists visible and hidden obstacles to privatisation and mitigation strategies. It identifies and analyses the present drivers of privatisation policy. It defines a vision for the privatisation policy, choosing to describe the situation the policy endeavors to create in 3 years, to enable the policy to be short and medium-term focused. It defines policy objectives. It lists the policy actions needed to launch the privatisation program. It touches on pre-privatisation restructuring and privatisation tools that may be used. It suggests possible approaches to address various issues.

1.3 Obstacles to Privatisation

Privatisation is hindered by recurrent issues, and these include:

a. Political resistance from labour unions on the termination of jobs
b. Conflicting positions by the provincial governments on land assets
c. Poor corporate governance in CSOEs discourage investors from participating in privatisation
d. Conflicting interests of CSOE Management on how to privatise or restructure delay the process
e. Legislative uncertainties increase the risk of privatisation failure
f. Bureaucratic interests in the parent ministries and their board appointments create delay the privatisation process
g. Lack of trust about the privatisation process in the public eye
h. Lack of confidence in Pakistan judicial system by investors
i. Weak regulatory oversight bodies which may not safeguard the interests of citizens and consumers after privatisation
j. Privatisation plans of the incumbent government are targeted by the opposition to build anti-government sentiment

No.	Obstacles to Privatisation	Mitigation Strategy
1	Labour Unions	Ensure appropriate compensation/ re-training for retrenched employees
2	Resistance from provincial governments on land ownership and utilization	Incentivize provincial governments to allow them to acquire land of CSOEs
3	Poor corporate governance in CSOEs	Improve corporate governance through independent boards
4	Conflicting interests from CSOE Management	Proactively engage with “troublemakers”
5	Legislative uncertainties	Proposed amendments in the Ordinance and introduce comprehensive legislation
6	Opportunities of board appointments	Withdraw the discretion of secretaries and government officials in the SOEs board appointments
7	Lack of public trust in the process of privatisation	Educating the public through videos and other means
8	Lack of confidence in the judicial process	Proactively engage judiciary

9	Weak regulatory institutions	Improve the capacity of regulatory institutions
10	Opposition from political parties	Secure political consensus through an All-Parties Conference

1.4 Drivers of Privatisation

At the present moment, there are certain imperatives that are driving the need for privatisation, laying the context that indicates what is the kind of policy that is needed to drive this program. Awareness of these drivers will ensure that a clear, deliberate and appropriate privatisation policy is developed. Here is a list of the key drivers of the privatisation policy, in decreasing order of importance:

i. A rapid shrinkage of fiscal space that does not give Pakistan the luxury of funding and managing CSOEs. While the government may feel very strongly about not being in the business of doing business, the reality is that the strongest driver of a privatisation policy is that the Pakistan government simply cannot afford running companies.
ii. Commitments to the IMF to pursue an aggressive privatisation program.
iii. Ensuring that private sector engines get to work to build key sectors of the economy such as electricity, petroleum, finance and manufacturing. These sectors cannot become strong propellants to lift the Pakistan economy without being buoyed by private sector capital, structure and initiative.
iv. Clearing away CSOEs from the government's table so that it can focus on other key sectors, such as the social sector. The government simply does not have the bandwidth to do it all.

What *not* to privatize?

The Triage Report determined the following criteria for the government to remain involved in business by defining them as "Core Functions":

i. Ensuring national food security
ii. Developing and managing large scale infrastructure requiring substantial investments
iii. National defense and security related entities
iv. Entities established through G2G or inter-governmental arrangements
v. Entities supplying goods and services of national economic interest

It is our view that these criteria need to be re-examined and redefined. For example, in the name of "food security", we have piled up significant commodity debt in the provincial governments. Similarly, the large-scale infrastructure requirements should be carefully reviewed in terms of economic and social returns. The "national economic interest" is vaguely defined and creates room for the government to increase its footprint. Probably the only exception is national defense and security related entities and to some extent, G2G entities.

Triage Report on Privatisation

The Triage Report did not offer any detailed framework or policy guidance on the matter of privatisation itself. The following passages specifically addressed privatisation, and they are reproduced verbatim in the Box 2. It shows that the Triage Report itself caused a significant delay by entrusting the parent ministries with the privatisation process. It establishes the need of a prescriptive policy guideline for privatisation process.

Box 2: Privatisation perspective in Triage Report

37. The decision of inclusion or exclusion of any property, rights, concession etc. in the privatization list is taken by the Cabinet Committee on Privatization on the proposals of the concerned ministries/divisions. While the proposed entity remains within the administrative control of the relevant ministry, the privatization process is managed by the Privatization Commission as per the prescribed procedure. The restructuring of any entity, which is under privatization, is undertaken by line ministries in consultation with the Privatization Commission.

38. The entities identified for privatization in Category (2b) and (2c) shall be processed by the line ministries/divisions for consideration of the Cabinet Committee on Privatization as per indicative timelines in the Action Matrix and Timeline for Implementation of SOE Triage Outcome. The privatization shall be undertaken in phases, taking into consideration the readiness of the entity for privatization as well as the market appetite. Prioritization of entities on the privatization list shall be decided by the Cabinet Committee on Privatization, as per its mandate, by taking into account inter-alia, the financial and operational performance of the entity concerned, the associated fiscal risk as well as the market conditions. (Government of Pakistan, Triage Report, P-13)

2 Privatisation Policy

A legislative framework is critical to overcoming the obstacles to privatisation, providing legal security, defining competencies, and offering a platform for stakeholder engagement for fast-track privatisation.

2.1 Policy Vision

To oversee the privatisation of commercial state-owned enterprises thereby enabling the government:

i. To transfer the effective control and ownership of CSOEs to the private sector
ii. To reduce government expenditures and leakages on non-essential functions

iii. To minimize public sector involvement and investment in the for-profit sectors

Privatisation policy will allow the public sector to overcome fiscal obligations sustainably, streamline organizational functions, and unlock un/under-utilized resources for maximizing benefit to the entire country.

Here are the characteristics of the vision of how the government may desire to see SOE management three years from now:

i. A vibrant corporate landscape in Pakistan where the ownership of all commercial SOEs has been transferred to the private sector, and their management is being undertaken by the private sector, with the exception of specified social sector or strategic SOEs (the criteria based on which an SOE may be classified as strategic need to be redefined) so the casual labelling of SOEs as strategic is not used as a tactic to stall privatisation.)
ii. This commercial landscape would sit upon the foundations of a strengthened regulatory framework, where all existing regulators that oversee the operation of the SOEs in their respective sectors are strengthened, their goals and objectives updated, and their capacities enhanced to enable them to achieve these goals and objectives.
iii. All legal restructuring, corporatization and streamlining of the functioning of the CSOEs (considering previous experiences) would have been undertaken.
iv. A clear, time-bound roadmap would be finalized and operationalized for any SOEs that still remain to be privatised after 3 years.

2.2 Policy Objectives

The Federal Privatisation Policy has the following set of objectives:

i. To provide procedural clarity to the Privatisation Commission
ii. To simplify and fast track the privatisation process
iii. To minimize and space out conflict during and after privatisation
iv. To transfer the effective control and ownership of CSOEs to the private sector
v. To reduce government expenditures and leakages on non-essential functions
vi. To minimize public sector involvement and investment in for-profit sectors
vii. To free up resources and allow greater public investment in social sectors

The government should provide an annual estimate and collection target of privatisation proceeds which should be separately published as a document as an addendum to the annual budget.

2.3 Principles of Policy

The Privatisation Programme and transactions will follow these principles:

a. The divestment will improve the efficiency and profitability of the operations of the enterprises being sold.
b. The transaction should be conducted in an open and transparent manner with adequate preparation and time so as to get the best price for a public asset-i.e., adequate price discovery efforts are made.
c. The transaction should improve market competitiveness in general and in the sector in particular.
d. The receipts from privatisation should not be used to fund current fiscal needs, since that is likely to slow down much needed fiscal reforms.
e. The receipts from privatisation should be parked in a special fund earmarked for capital injection in strategic SOEs, restructuring of CSOEs, compensation for retrenched employees, and for their skills development and capacity building.

2.4 Policy Guidelines

According to Privatisation Commission Ordinance 2000, "the Commission shall carry out privatisation, in accordance with the prescribed procedure, through any of the following modes- (a) sale of assets and business; (b) sale of shares through public auction or tender; (c) public offering of shares through a stock exchange; (d) management or employee buyouts by management or employees of a state owned enterprise; (e) lease, management or concession contracts; or (f) any other method as may be prescribed."

Following policy guidelines are proposed to help the Privatisation Commission achieve its mission efficiently and effectively.

1. As each entity to be privatised has unique dynamics, the Privatisation Commission shall deliberate and determine a scale of minimum and maximum financial gain through the transaction, which may lie somewhere on this scale.

2. The method of privatisation will be determined according to the unique dynamics of each CSOE i.e. the nature of the relevant market, business growth potential, implications for competition, financial health of the SOE, and overall business environment.

3. The Privatisation Commission shall classify the CSOEs already approved for privatisation in four categories.

a. **Fast-track Privatisation:** The commercial SOEs earning profit for the government must be put on the top of the list of SOEs to be privatized instead of keeping them as profit earners. They, like a magnet, will attract prospective buyers, and that not only will set the pace of privatisation of the SOEs but restore the trust in the domestic and foreign investors that the government is not interested in doing business and that it wants to see the private sector thrive and flourish.
b. **Strategic Divestment:** There are enterprises which are performing relatively well with mixed financial performance yet with strong business prospects. The government should follow strategic divestment by offering shares to qualified private sector players with the goal of bringing in productivity gain, professional management and improvement in profitability. Strategic divestment should be coupled with management control by the private investors.
c. **Asset Stripping:** There are enterprises which have outlived their utility in terms of core business objective but have valuable assets including land on their balance sheet. Asset stripping should be allowed to realize their commercial value and proceeds should be used to settle liabilities. The land can be re-notified and can be disposed of either by sale through auction or can be leased in case a viable business plan is proposed by the private sector. The land can also be allotted to the provincial government.

d. **Direct Sale/Auction:** There are enterprises in mature industries but reporting consistent financial losses which should be fully privatised either through an open auction or a negotiated sale with qualified buyers in the same sector.

4. The Privatisation Commission, where advisable, should take qualified buyers into confidence and should share relevant sensitive corporate information prior to asking them to submit binding offers. Appropriate non-disclosure agreements should be signed with potential bidders before sharing sensitive corporate data. This will help in building confidence among potential investors and will increase the chances of successful transactions.

5. In the case of privatisation of a CSOE where it is a monopoly, the privatisation must not result in a change of hands only from the public to private sector (like the example of K-Electric). The government must ensure that the sector is already deregulated and liberalized on a priority basis.

6. Job loss is a significant concern during and after privatisation, necessitating comprehensive strategies to support affected employees. Various policy options for retrenched employees are as follows, which can be adopted on a case-to-case basis.
   - Offer equity at a price determined by the Privatisation Commission
   - Voluntary redundance package like golden handshake scheme
   - Where necessary, the services of deserving employees may be placed under the federal government till their retirement.

   Past experiences, such as the agreements reached with the All-Pakistan State Employees Workers' Action Committee during the 1990s, underscore the importance of negotiation and well-defined agreements to address political resistance and social concerns.

3 Implementation

3.1 Implementation Mechanism

i) The Commission will create a **Privatisation Fund Management Committee** to manage spending from the Privatisation Fund as established under Section 16 of the Privatisation Ordinance 2000. As a matter of policy, all proceeds will go towards funding the retirement of liabilities of CSOEs, and to the Privatisation Commission's operations involved in the execution of this policy only.

ii) A **Liability Retirement Cell** within the Privatisation Commission will be created to takeover liability record of CSOEs and advise debt retirement. The Privatisation Commission will retire CSOE liabilities using the monies from the Privatisation Fund.
   a. The principle for retirement will be to pay off the smallest claims first.
   b. The mechanism for payments will be from the Privatisation Fund directly to creditors.
   c. Claims initiated after the approval of this policy will not be paid via the Privatisation Fund.

iii) **Property Registration System.** The success of privatization heavily depends on a fully functional and transparent property registration system. Such a system ensures clear ownership records, accurate valuation, and unambiguous transfer of rights, all of which are fundamental to fostering investor confidence. The Privatisation Commission shall establish this system on a priority basis.

iv) All legal disputes arising as a course of the above will be resolved only in the **Privatisation Appellate Tribunal** as laid down in Section 28 of the Privatisation Commission Ordinance 2000.

3.2 Action Plan

It is envisaged that the following actions are needed to secure trust and ensure transparency for smooth implementation of the policy:

i. An agreement and understanding are needed amongst all privatisation stakeholders to define and then carry out a process to develop and finalize an official privatisation policy.
ii. Once this agreement is finalized, it needs to be announced and implemented.
iii. Appropriate steps may be taken to raise awareness amongst citizens about the importance and need for privatisation in Pakistan, through campaigns using social and mainstream media.
iv. A detailed time-bound privatisation plan needs to be developed by the Privatisation Commission for 2025-27.
v. The capacity of the Privatisation Commission and its secretariat needs to be strengthened accordingly, to implement the privatisation policy and privatisation plan.
vi. An exercise needs to be conducted to determine which SOEs can be candidates for privatisation, which should also include enterprises associated with the armed forces owned businesses.

3.3 Contingency Plan & Safeguards

Contingency plans for failed privatisation attempts, along with regulatory measures to protect consumer interests and prevent monopolistic practices, will strengthen the process of privatisation. The Financial Advisor hired for the said transaction will also prepare a contingency plan.

3.4 Enhancing Transparency

The Privatisation Commission shall ensure transparency in all proceedings and transactions of privatisation. Mechanisms to ensure transparency include but are not limited to independent audits, citizen oversight committees and regular public reporting. These measures would build and ensure accountability throughout the privatisation process.

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