Privatisation kerfuffle

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Recent weeks have seen much debate on privatisation in Pakistan. When the old chestnut — 'it is not the business of government to be in business' — is trotted out, what is ignored is that the government is actually never 'out' of business. The entire national business environment is created by government, of which the condition of our public-sector enterprises (PSEs) is only a partial reflection.

In its role as legislator, regulator, debtor, price- and wage-setter, the issuer of SROs, infrastructure provider, etc, the government determines business conditions. Political considerations in the design of fiscal policy and the weight of special interests in the making of other policy distort the framework within which business is done. Without economy-wide structural reform, privatisations may simply see private oligopolies replace government monopolies — intensifying private wealth, rather than creating national growth.

Policy failure, over time, has deflated business confidence. Investment levels have fallen to 14pc of GDP, the lowest for decades. Investment by large-scale manufacturing has plummeted, from Rs352 billion in 2009, to Rs198bn in 2013, or by 40pc at current market prices (60pc at constant 2006 prices). Will LSM now make mega investments in privatisation?

The government is clearly committed to an entirely value-optimising privatisation process. But if undertaken in a hurry, there's a risk that deals may need to be 'sweetened' to expedite disposal — for example, by granting the buyer control with only a fraction of share ownership; and/or through an effective price discount, or, selectively, as with independent power producers, high, government-guaranteed dollar returns.

Additionally, privatisation must be designed to be value-additive for the broad economy. In context, it is worth reviewing what past privatisation in Pakistan may have achieved. Most corresponding investment, foreign and domestic, flowed into finance, power and telecom. These sectors have grown substantially, are now reliably efficient, greatly augment consumer convenience, and perform very profitably for their investors. However, identifying their contribution to national growth and development is elusive.

Pakistan has the lowest banking penetration of any country in South Asia, at about 12pc (India and Bangladesh 35pc). Lending to the private sector has fallen, from 67pc of the banks' investments and loans, to 48pc now. With the government the dominant borrower, 'crowding out' is more marked than when banks were government-owned. Capital markets for debt and capacity for project and infrastructure finance — essential aspects of a financial market — are virtually absent. A growth-fostering financial sector must have been envisaged when banks were privatised. It has not been achieved.

What cripples the power sector today is public-sector managed transmission and distribution. Huge losses and poor revenue collection perpetuate the circular debt. The whole case for privatisation emphasises the initiative and 'best practices' that private sector control brings. But successive governments have failed to use the private sector to rectify distribution — doable through good management, as KESC is beginning to show.

On the other hand, generation, the least complex part of the chain, is privatised (under expensive, dollar-based, 'take or pay' contracts). More generation is planned, which simply means more public debt. We need a complete overhaul in priorities here.

The telecom sector has created excellent connectivity, and may play a powerful development role once its mobile banking initiative proceeds beyond facilitating payments and begins to integrate the huge pool of the unbanked into our banking system. Thus far, though, privatisation's contribution to national growth remains muted. Looking ahead, the privatisation policy will pivot around two goals: the highest viable value for the government and economy-wide gains.

How can we identify ‘fair-value’ for respective PSEs? Some are financial disasters, others perform well below potential. Persistent subordination of commercial objectives to political ends is the cause, and is inevitable while PSEs function under ministerial control. Had regulation functioned independently, had PSEs enjoyed normal corporate governance and operational freedom, considerable enterprise value could have accrued. Value now can only become transparent when operational realities are stripped of the costs of political impositions, ie managerial weaknesses enhanced by (often) ‘crony’ CEOs and politically convenient rather than professional boards working with controlled prices, and massive overstaffing.

The selling price of a PSE will depend on its privatisation terms, such as the degree to which prior company restructuring absorbs accrued losses, and separates future liabilities and excess employees, as well as independence on pricing policies and credible regulation. In setting these terms, the government will have to evaluate between options. Also, in situations, choices will have to be made between further public listing, outright privatisation, public-private partnerships, or even retention.

Consistent principles would be fundamental for transparency and credibility. But the fact that PSE oversight is fragmented across ministries could lead to piecemeal and divisive approaches, and therefore inconsistency.

To avoid this, PSEs would need to be brought under unified supervision, independent of the ministries and be placed under an overarching holding company board, composed largely of private professionals, who would appoint CEOs and boards for each PSE. Managing the spectrum through an integrated entity provides the benefit of corporate governance focus, development of common evaluation yardsticks, and holistic strategies for optimal outcomes.

Wherever the PSE is to be sold, external privatisation advisers should be appointed after hard appraisal. The holding company should pass its final recommendations to the privatisation commission for implementation. The finance ministry will have final oversight in all matters. Though the divestiture process may then take some months longer, the exercise is necessary.

Cross-political party consensus and popular support should be forthcoming if transparency and professionalism are assured, and the benefit of lessons learnt from experience is incorporated.

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