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THE PRIVATIZATION POLICIES IN PAKISTAN

Current Situation and Future Challenges

October 1997

Research Institute of Development Assistance(RIDA)
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Research Institute of Development Assistance (RIDA),
The Overseas Economic Cooperation Fund, Japan (OECF)
Takebashi Godo Building, 4-1, Ohtemachi 1-chome, Chiyoda-ku, Tokyo 100, Japan
TEL : 03 (3215) 1895 (Macro-Economic Studies Group)

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[1] The Research Institute of Development Assistance (RIDA) was established in 1993 by OECF in order to ensure the effective implementation of development assistance and to enhance its quality by strengthening research activities in economic and social development and in development assistance. The Overseas Economic Cooperation Fund, Japan (OECF) was established in 1961, as a development financial institution of the Japanese Government with the purpose of promoting Japan's overseas economic cooperation by providing funds for the industrial development and economic stability of developing countries.

FOREWORD

The national flag of Pakistan is composed of a white new moon and a star on a ground of dark green and white on the pole side. The green symbolizes "peace and prosperity," the new moon "growth," and the star "light and knowledge."

Since partition and independence, together with India, from British rule in 1947, Pakistan has overcome political, economic and military difficulties. And in this year of 1997, in order to attain economic "growth" to bring "peace and prosperity" by using experiences to this day as "light and knowledge," Prime Minister Nawaz Sharif published a "Prime Minister's Economic Revival Programme." Pakistan is going to step forward from the ground up in this 50th anniversary year of independence.

This report has been compiled by the Research Institute of Development Assistance of the OECF, based on a field survey in April 1997, immediately after establishment of the Sharif administration. We hope this report will contribute to all who wish to study further the economic development of Pakistan and effective methods of assistance to this country. Meanwhile, please note that the opinion expressed in the report is the view of the authors who carried out the study, and does not represent the formal opinion of the Overseas Economic Cooperation Fund.

Finally, we wish to express our gratitude to the Pakistan government and related organizations, and the many others who extended such tremendous support and assistance in our implementation of this study.

October 1997
Shunro Kageyama
Vice President, Chief Economist
Research Institute of Development Assistance
The Overseas Economic Cooperation Fund

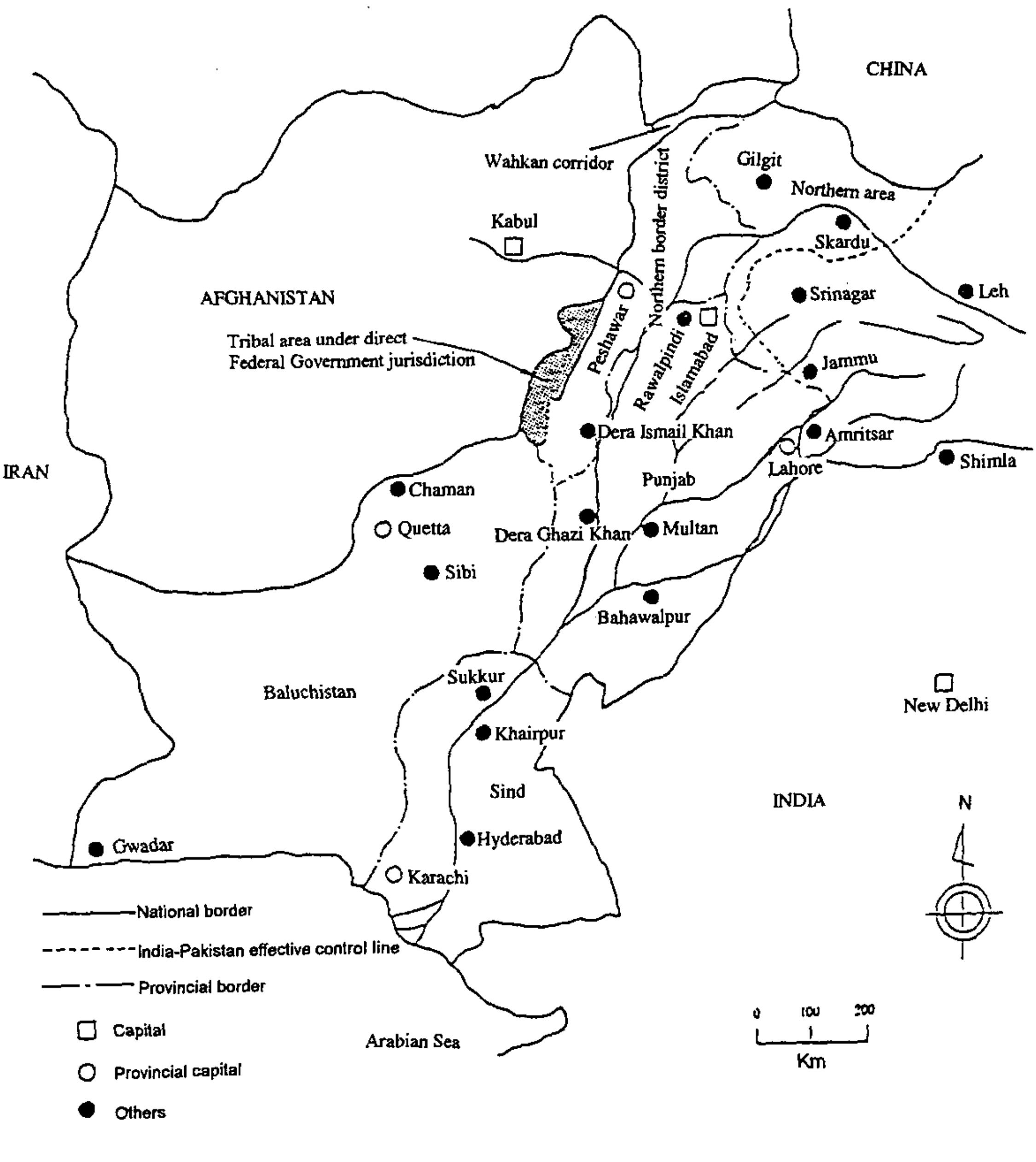
Authors and members of the survey and report

Mikio Murasaki	International Project Department, Sumitomo Metal Industries, Ltd. former Economic Advisor, Macro-Economic Studies Group, Research Institute of Development Assistance
Kazumi Asako	Professor, Economic Institute, Hitotsubashi University, visiting researcher of the Research Institute of Development Assistance
Naoya Tamada	Financial Advisor, 4th Division, Operations Department II
Chie Matsushita	Economist, Macro-Economic Studies Group, Research Institute of Development Assistance

<Outline of Pakistan>

1. Official name: Islamic Republic of Pakistan
2. Capital city: Islamabad
3. Land area: 796 thousand km^2 (about 2.1 times the area of Japan)
4. Population: 128.01 million (estimated at the end of 1994)
5. Main ethnic groups: Punjab, Sind, Patan and Baluchi
6. Religion: Islamic: 97%, Hindu: 1.5%, Christian: 1.3%
7. Form of state: Federated parliamentary system
8. Currency: Pakistan rupee (1 US dollar = about 37 rupee, June 1997)
9. GDP per capita: $404 US (1994)

Map of Pakistan



<Chronological Table of Pakistan History>

Year		Event	Government
1947	August	Partition and independence with India from British rule. Capital: Karachi (First Governor-general: Muhammad Ali Jinnah)	
1948	May	First India-Pakistan War	
	September	Death of Jinnah	
1949	July	India-Pakistan Cease-fire Line marked out.	
1951	October	Assassination of Prime Minister Liaquat.	
1955	May	Border conflict with Afghanistan	
1956	February	Adoption of New Constitution by the Constitutional Congress.	
	May	Publication of the First Five-Year Plan.	
	October	National Border with Iran marked out.	
1958	October	Commander in chief of the army, Ayub Khan assumed presidency after Military coup d'etat.	Ayub Khan
1959	October	Introduction of Basic democratic system, political parties' activities banned.	
1962	March	Promulgation of the New Constitution.	
1963	March	Signing of China-Pakistan Border Treaty.	
1965	September	Second India-Pakistan War	
1966	November	Removal of Government office buildings to Islamabad, the new capital city of the country.	
1967	November	Formation of "Pakistan People's Party (PPP)" by Bhutto, Former Minister of Foreign Affairs.	
1968	October	Intensification of Students' anti-government uprising in East Pakistan. Spread to West Pakistan.	
1969	March	Declaration of Martial law throughout the country. President Ayub transferred full powers to Yahya Khan.	Yahya Khan
1971	April	Independence of East Pakistan as "Democratic Republic of Bangladesh."	
	December	Third India-Pakistan War. Unconditional surrender of Pakistan. President Yahya Khan resigned and Zulfikar A. Bhutto was inaugurated as president.	Zulfikar Bhutto
1972	January	Beginning of Nationalization policy for major industries. Withdrawal from the British Commonwealth.	
1973	April	Promulgation of the New Constitution.	
1974	January	Beginning of Bank nationalization policy.	
	February	Recognition of Bangladesh.	
	December	Resumption of India-Pakistan trade.	

1977	March	PPP won an overwhelming victory in the general election for the National Assembly. General strike throughout the country, responding to the opposition party alliance's ("Pakistan National Alliance (PNA)") appeal. Accusation of PPP for wrongdoing at election brought on intensive uprising.	
	July	Coup d'etat by the Army Chief of Staff, Zia Ul-Haq. Detention of Prime Minister Bhutto.	
1978	September	Chief martial-law administrator, Zia Ul-Haq assumed presidency.	Zia Ul-Haq
1979	December	Invasion by Soviet Union into Afghanistan.	
1981	September	The Military and Economic Comprehensive Assistance Treaty lasting for five years was concluded with the United States.	
1988	May	Death of President Zia Ul-Haq caused by an airplane crash.	
	December	PPP won the National Assembly election. Benazir Bhutto took office of prime minister.	Benazir Bhutto
1990	August	President Ishaq Khan put Emergency Power in action. Dismissal of Prime Minister Bhutto. Dissolution of Lower House.	
	October	"Islamic Democratic Alliance (IJI)" won the general election. Inauguration of Nawaz Sharif as Prime Minister.	Nawaz Sharif
1993	April	Dismissal of Prime Minister Sharif and dissolution of the Lower House.	
	July	Qureshi was appointed interim Prime Minister.	Qureshi (interim)
	October	PPP won the general election. Prime Minister Bhutto reappointed.	Benazir Bhutto
1996	December	Dismissal of Prime Minister Bhutto and dissolution of the Lower House.	Malik Miraji Khalid (interim)
1997	February	The Pakistan Muslim League (PML) won an overwhelming victory in the general election. Nawaz Sharif was reappointed as Prime Minister.	Nawaz Sharif

(Source) "Pakistan-Country Study for Japan's Official Development Assistance," Japan International Cooperation Agency, 1996

"Journal of Research Institute for International Investment and Development," Export-Import Bank of Japan, 1994

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SUMMARY

Pakistan has promoted economic structural adjustment since it received a structural adjustment loan from the IMF in 1980. However, as can be seen from the economic growth rate and fiscal deficit, Pakistan has not achieved structural reform in its economy. This survey was made focusing on privatization of state-owned enterprises (SOEs), a measure for improvement in economic efficiency and fiscal reforms, to examine problems inhibiting effective privatization.

Chapter I: Trends of the Pakistan economy and state-owned enterprises

State-owned enterprises in Pakistan hold a significant position in economic activity with 12% of GDP. No attempt at SOE reform was made through the 1980's, and the budget deficit in Pakistan has not been improved very much since the 1970's. Privatization of state-owned enterprises is one of the most important factors in improving economic efficiency and reducing fiscal deficit.

The role and position of state-owned companies in the Pakistan economy can categorized chronologically as follows:

1.1 Nationalization policy (1972 to 1977)

Key industries including banks were nationalized in 1972 by the Economic Reform Order issued as a part of socialization policy, and state-owned enterprises rapidly increased in number. However, in addition to their lack of economic efficiency, the oil crises of the 1970's slowed economic growth (annual GDP growth rates were 3.3% in 1975, 2.8% in 1976) and worsened fiscal and international balances of payment.

Table 1: Macro indexes of Pakistan (1970 - 1977)

	1970	71	72	73	74	75	76	77
Real GDP growth rate	1.2%	6.8%	6.8%	7.5%	3.9%	3.3%	2.8%	7.7%
Fiscal balance (in relation to GDP)	-8.3%	-4.8%	-4.8%	-6.8%	-5.9%	-10.3%	-9.4%	-8.4%
Revenue	17.2%	15.2%	13.5%	13.1%	14.2%	13.2%	14.4%	14.4%
Expenditure	25.5%	21.3%	18.3%	19.9%	20.2%	23.5%	23.8%	22.8%
Current balance (in relation to GDP)	-6.7%	-3.9%	-3.9%	-1.0%	-10.5%	-9.3%	-5.9%	-4.9%

(source) Government of Pakistan, Finance Division "Economic Survey 1995-1996," IMF "International Financial Statistics 1996"

1.2 Move to private sector-oriented economy (1978 to 1989)

Pakistan reviewed its nationalization policy and launched promotion of the private sector in 1978. Also, the World Bank and IMF introduced a structural adjustment policy in 1980, and measures were taken to stimulate private investment through deregulation. At this point, the economic growth rate recovered (7.3% in 1979), and the international balance of payments improved after 1985. However, reforms of existing state-owned enterprises were left untouched, and political demand for employment led to expand production of the state-owned companies (their production to GDP, 8.0% in 1978, rose to 11.6% in 1988). As a result, the fiscal deficit has not improved in general aside from the period from 1980 to 1982.

Table 2: Macro indexes of Pakistan (1978 - 1989)

	1978	79	80	81	82	83	84	85	86	87	88	89
Real GDP growth rate	5.5%	7.3%	6.4%	7.6%	6.8%	4.0%	8.7%	6.4%	8.8%	6.4%	4.8%	4.6%
Fiscal balance (in relation to GDP)	-7.5%	-9.2%	-5.7%	-5.8%	-4.7%	-6.8%	-6.2%	-7.2%	-9.1%	-8.5%	-6.3%	-7.4%
Revenue	14.9%	15.6%	17.1%	17.2%	16.3%	16.4%	17.4%	16.7%	18.3%	17.9%	18.5%	19.6%
Expenditure	22.4%	24.8%	22.7%	23.0%	21.1%	23.3%	23.6%	23.9%	27.4%	26.4%	24.8%	27.0%
Current balance (in relation to GDP)	-4.0%	-5.7%	-3.9%	-3.3%	-2.9%	0.1%	-4.0%	-3.6%	-2.1%	-1.7%	-3.8%	-3.6%

(source) Government of Pakistan, Finance Division "Economic Survey 1995-1996," IMF "International Financial Statistics 1996"

1.3 Privatization of state-owned companies (1990 to 1997)

Privatization of state-owned companies started in 1990. However, the progress of privatization has been slow so far, and the fiscal deficit has not been very much improved. Growth rate of large-sized manufacturing industries, including state-owned companies, has been sluggish at 2.6%, and this has prevented growth of the entire economy. On the other hand, international deficit has been improved due to export preference policy and worker's remittance.

Table 3: Macro indexes of Pakistan (1978 - 1989)

	1990	91	92	93	94	95 (1)	96 (2)
Real GDP growth rate	5.6%	7.7%	2.3%	4.5%	4.4%	4.6%	3.1%
Fiscal balance (in relation to GDP)	-5.4%	-7.6%	-7.9%	-8.9%	-6.9%	-6.3%	-
Revenue	20.0%	17.8%	18.5%	18.1%	19.1%	-	-
Expenditure	25.4%	25.3%	26.4%	27.0%	26.0%	-	-
Current balance (in relation to GDP)	-4.2%	-3.3%	-3.9%	-6.0%	-3.5%	-	-

(source) Government of Pakistan, Finance Division "Economic Survey 1995-1996," IMF "International Financial Statistics 1996" where: (1) Tentative, (2) Estimated

1.4 Economic policy program of the incumbent administration (1997 to present)

Despite full-scale introduction of structural adjustment policy under the assistance of the IMF, conditionality was hard to achieve, and the Pakistan government announced that it would give up the Stand-by Arrangement in March 1997. However, the government revealed its "Prime Minister's Economic Revival Programme" instead, with the two major goals of tax reform for fiscal balance improvement and export promotion to increase foreign currency earnings. Further, promotion of privatization of SOEs was strongly supported in the Programme.

Chapter II: Current situation of privatization policy

The Pakistan government has actively promoted privatization since 1990. Yet most of the privatized companies are in the manufacturing industry, and privatization of banks, power plants, and transportation has been delayed. The causes are;

i) distrust by investors of unclear procedures for privatization; and

ii) increase in labor cost due to inability to dismiss surplus workers.

Privatization of state-owned companies can be described in brief as follows:

2.1 Outline of privatization in Pakistan

The Privatization Commission was established by the first Sharif administration in January 1991, and the Commission is in charge of selection of companies to be privatized, evaluation of assets, and reception of bids at sales of the companies.

2.2 Characteristics of privatization policy, and the role of the government

The "Privatization in Pakistan," published by the second Benazir Bhutto administration in October 1996, describes basic policies and characteristics of privatization and roles of the government. It has been taken over by the current Sharif administration. The basic policies are:

i) Privatization should lead to improved efficiency and competitiveness in manufacturing and service industries;

ii) Privatization measures should be taken to reduce fiscal burdens such as subsidies to state-owned companies;

iii) Privatization should be utilized as a means to obtain foreign currency for improvement of international balance of payments, foreign exchange reserves and foreign debts.

Also, roles of the government are described as follows:

i) privatization of public utilities in areas of communication, electricity, gas, etc. should be restricted to a certain degree to protect consumers; and

ii) agreements with workers should be concluded to prevent unfair dismissal in the course of privatization.

2.3 Privatization method in Pakistan

Privatization in Pakistan is accomplished in the following forms;

i) Sale of state-owned companies to the private sector through bidding;

ii) Sale of stocks of state-owned companies at appraised value on the stock exchange market;

iii) Sale to employees' unions;

iv) Sale to private investors based on management right transfer contracts with "modaraba" companies (companies of the Islamic commercial form);

v) Conclusion of lease for a certain period or transfer contract of management rights to private investors; or

vi) Lease of management rights for a certain period to employees' union.

On the other hand, sale is made as:

i) Sale of all stock of state-owned companies through bidding;

ii) Partial sale of stock including transfer of management rights; or

iii) Partial sale of stock without transfer of management rights.

In privatization, preferred right of purchase was given to former owners in the 1970's. However, in the 1990's the Privatization Commission formed the order of preference for purchases at 1. Employees' union; 2. Former owners; and 3. Other investors.

2.4 Present situation of privatization

At the end of October 1996, 150 state-owned companies invited bids for privatization. Among them, 89 companies (59% of the total in number) have been sold to the private sector, or transfer of management rights has been completed. Of the privatized companies, 80 companies are from the manufacturing industry. Privatization of the automobile sector has proceeded with 7 of 11 state-owned companies, the cement sector with 11 of 15 companies and the edible oil sector with 11 of 26 companies respectively. Privatization in the manufacturing industries seems to be making satisfactory progress.

On the other hand, privatization of large-scale state-owned companies was slow in the finance sector with only 3 of 20 banks privatized and in the electricity sector with only 1 of 11 power plants. In the transportation sector, announcement of bidding is only scheduled for 4 of 11 companies.

Table 4: Classification of state-owned companies by category (as of end October 1996) (unit: bidding price shown in million of rupee)

	Already privatized		To be privatized	Bids not announced yet	Total
	Number of companies	Bidding price	Number of companies	Number of companies	Number of companies
Manufacturing industries	80	11,990.9	26	23	129
Automobile	7	1,111.9	2	2	11
Cement	11	7,550.8	3	1	15
Rice polishing	8	237.4	0	0	8
Engineering	7	148.6	3	3	13
Edible oil (ghee)	16	589.0	6	4	26
Roti	12	78.3	1	0	13
Chemical fertilizer	1	435.0	3	3	7
Chemical	12	1,610.6	1	0	13
Others	6	229.4	7	10	23
Finance	3	3,707.0	6	11	20
Insurance	0	0.0	0	3	3
Petroleum and gas	0	0.0	2	12	14
Mining	0	0.0	0	3	3
Electricity (thermal power plant)	1	7,546.5	10	0	11
Communication	0	0.0	1	0	1
Transportation and airline	0	0.0	4	7	11
Publishing, printing and media	5	272.1	0	7	12
Others	0	0.0	12	16	28
Total	89	23,516.5	61	81	232

(source) Privatization Commission, Government of Pakistan

2.5 Causes for delay in progress of privatization

Privatization has progressed, especially in the manufacturing industries, while large-sized state-owned companies such as power plants have not been privatized in full. The causes of delay may be:

-Distrust of investors since information on procedures and progress is not well disclosed,

-Lack of incentive for investors to bid since laws prevents reduction of surplus staff. (Dismissal is not allowed for twelve months even after privatization.)

Chapter III: Business results after privatization

Business achievements of former state-owned companies after privatization in cement and automobiles have achieved results: on the other hand, other sectors such as edible oil, bread, etc. have not been successful. The causes are:

i) Sale to companies lacking management abilities due to insufficient examination of purchasers in the bidding process, and,
ii) No system to monitor business results after privatization is established.

3.1 Automobile sector

Business situations of the seven privatized companies are generally satisfactory and they have succeeded in improving product quality and financial state. Some companies are negotiating for mergers with foreign businesses.

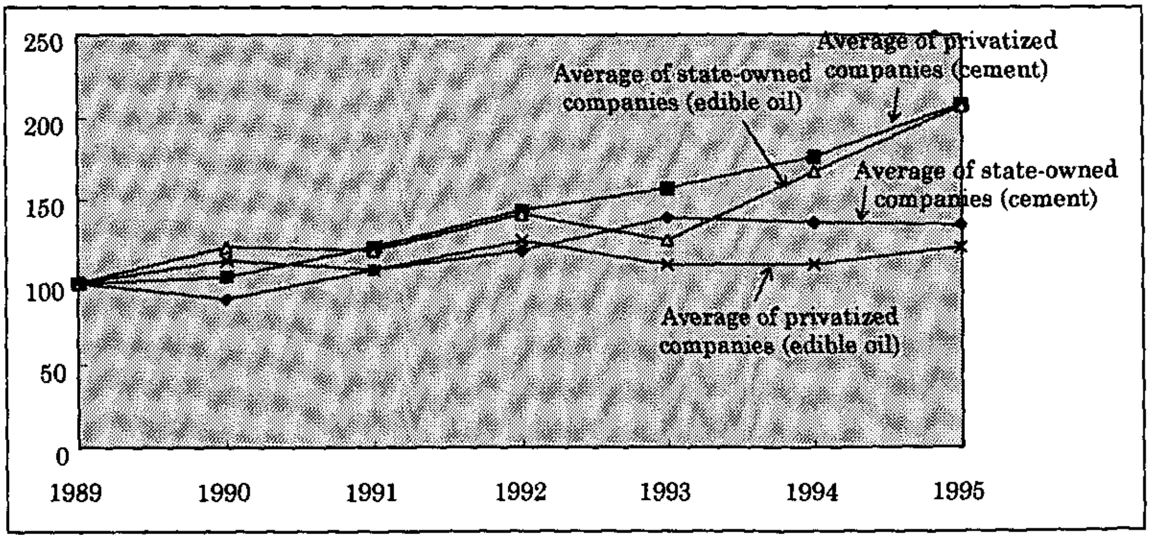
3.2 Cement sector

The three privatized companies experienced increases in production and profits after privatization with active investment in equipment.

3.3 Edible oil sector

Production and profits of the two privatized companies are low, and business results have not improved.

Fig. 1: Production indexes (1989=100)



3.4 Other manufacturing industries

As 3 of the 46 privatized companies were sold to investors without sufficient financial resources or to employees not possessing management abilities, the companies were forced to discontinue operation due to bad debts or failures in management. The remaining companies are also unprofitable.

3.5 Problems with business results after privatization

Most of the privatized companies in the manufacturing industries are small, and not a few of them were forced to discontinue operation after privatization. Even in the automobile, cement and edible oil sectors with larger companies, their business results vary according to situation.

Reasons for the poor results are:

i) Financial status and management abilities of the purchasers are insufficient;
ii) There is no financial institute to support management after sale; and
iii) There is no consultation service to give advice on management after privatization.

Chapter IV: Future challenges for the privatization policy

Privatization procedures should be carried out in a fair manner. Also, purchasers should undergo strict examination in the bidding process. For economic efficiency after privatization, systems for the monitoring of business conditions after privatization should be established and the companies should be guided and supported via the financial sector when problems arise. In addition, reduction of surplus labor force should be facilitated by vocational training and creation of new employment.

Problems and suggestions for future OECF operations are described in the following.

4.1 Problems with regard to privatization procedures

1. Transparency of procedures: Provision of legal system and information disclosure of bidding procedures
2. Examination system of purchasers for state-owned companies: Establishment of a system to examine in advance financial status and management background of the purchasers, and business and operational plans after

privatization.

4.2 Problems of support system after privatization

1. System to monitor privatized businesses: A monitoring section should be established in the Privatization Commission to give necessary advice for proper operation of privatized companies so that privatization may lead to efficient productivity.
2. Reinforcement of financial sector: Guidance and support by the financial sector are required for business management after privatization. Accumulation of operational know-how and development of human resource should be further promoted for this sector.
3. Vocational training and reduction of surplus workers: Vocational training system should be improved so that surplus workers can easily change jobs. Also, new employment should be created to take in unemployed persons and facilitate staff cuts.

4.3 Prospects for OECF operations

1. Indirect support for privatization: Economic infrastructure is needed to increase productivity of privatized companies, and the OECF should give assistance to Pakistan, taking into account the importance of infrastructure.
2. Support through the financial sector: As state-owned banks still have an important role in the financial market, support in the form of two-step loans through state-owned banks would be effective. It is also necessary to improve bank appraisal systems and to reinforce consultation services for management assistance systems for end users .
3. Support for human resource development and job creation: Human resource development and job creation should be encouraged through industrial promotion assisted by the OECF.

PREFACE

1. Background

With a deterioration of the balance of payments in the second half of the 1970's, Pakistan received the first structural adjustment facility by the International Monetary Fund (IMF) in 1980. Since then, successive leaders of Pakistan have promoted structural adjustment policy with the assistance of the World Bank and IMF. However, the basic economic situation consisting of factors such as fiscal and international balances of payment has not fully reflected the structural adjustment effort carried our over the years.

Why did structural adjustment policy fail in Pakistan? To answer this question, OECF compiled the "Country Sector Survey on Pakistan" in 1992. This report made analysis on Pakistan's trade deficit, the main origin of the increase of foreign debt and budget deficits, and the cause of inflation, focusing on the recovery of a stabilized macro economy, which is one of the objectives of the structural adjustment policy. These issues still remain unchanged. Since entering 1990's, Pakistan has started privatization of state-owned companies and vitalization of the private sector through deregulation, in order to achieve the other objective of the adjustment policy which is economic efficiency. In response to this trend, the OECF organized the Pakistan Research Society in 1995 to study privatization and vitalization of the public sector.

This report examines further issues regarding effective privatization policy, focusing on privatization of state-owned enterprises, which is one of main policies for improvement of economic efficiency and fiscal recovery. A survey was made by sending questionnaires to state-owned companies as well as privatized former state-owned enterprise, with the purpose of making a comparison within business categories. Response to the questionnaire was not so satisfactory, however, the answers are valuable as reference data compiled by an independent organization from a neutral viewpoint.

The structural adjustment policy led by the World Bank and IMF has already been discussed by Ishikawa (1994)[1] and Japan Research Institute (1995),[2] which made critical analysis of structural adjustment policy in eastern Asian countries. However, the policy in Pakistan has only been discussed in the reports by the World Bank and IMF or in those by the Pakistan government, in other words, by supplier

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1 Shigeru Isikawa, 1994. "Government and Market in Development - World Bank's Structural Adjustment Policy and "Eastern Asia," "Journal of International Politics and Economy" No. 31, pp7-39

2 Japan Research Institute, 1995. "Report on Comparative Analysis of Structural Adjustment Policy"

side and recipient side of the facility, and little examination has been made from a neutral point of view.

2. Method of research

Research was begun in 1996. First of all, examination of data and documents available in Japan was conducted. The "Country Sector Survey on Pakistan" by the OECF (1992) and achievements by the Pakistan Research Society[3] in 1995 as well as succeeding documents were the main subjects of this examination.

Secondarily, field surveys were conducted in December 1996 and April 1997 to obtain detailed information on the Pakistan economy, with input from many organizations including governmental agencies.

Moreover, as mentioned above, a questionnaire for research via interview was entrusted to BMA Capital Management, a consultant company in Karachi, to analyze the actual state of privatization in the manufacturing industry. The data obtained from this research is analyzed in Chapter III.

3. Structure of the Report

This report consists of the following four chapters:
Chapter I analyzes the background of Pakistan's adoption of structural adjustment policy referring to macro economic performance. Then, consideration is made on the structural adjustment policy from the 1980's and economic programs announced by the second Sharif administration. Through the process, clarification is made on the fact that leaving state-owned enterprises with 11% of GDP untouched was the main reason for difficulty in eliminating fiscal deficit.

In Chapter II, present status and progress of the privatization policy promoted since 1991 will be discussed.

Based on this discussion, Chapter III examines business performance of enterprises since privatization. In this Chapter, comparison by business category is made through the results of the interview according to the questionnaire, among manufacturing companies (state-owned and privatized companies) in Pakistan.

And in Chapter IV, description of proposed OECF loans in Pakistan together with problems preventing successful privatization is given.

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[3] On the theme of social development, and vitalization and privatization policy of the private sector in Pakistan, four specialists made lectures in the period from November 1995 to March 1996. These lecturers are Professor Shigemochi Hirashima at Meiji Gakuin University, Professor Toshio Toyota at Tokyo International University, Mr. Takashi Kurosaki at the Institute of Developing Economies and Mr. Sadazo Akizuki at Mitsui & Co., Ltd. (Organizations and titles at the time of lectures).

CHAPTER I

TRENDS OF THE PAKISTAN ECONOMY AND STATE-OWNED COMPANIES

The global economic environment changed from the middle of the 1970's through the beginning of the 1980's, when the price of oil, a main import for many developing countries, rose, while the price of exports, primarily industrial products including agricultural, fell. This worsened the international balance of payments in many developing countries. Also, domestic factors such as inefficient resource allocation due to inadequate macro economic policy, worsened fiscal deficit and inflation. Pakistan, relying on imported oil, was directly affected by the oil crisis, as were other developing nations, and macro economic performance was severely weakened after the middle of the 1970's.

In this chapter, the background of Pakistan's adoption of structural adjustment policy will be described in chronological order from initial adjustment begun in 1980, to full-scale adjustment in 1988 and the economic reform program by the government launched in 1997. Following this, the way in which privatization policy improved economic efficiency and contributed to fiscal improvement will be verified.

1.1 Nationalization policy (1972 to 1977)

1.1.1 Political and economic situation in the nationalization period (Zulfikar A. Bhutto Civilian Administration: December 1971 to July 1977)

The Zulfikar A. Bhutto Administration, established in December 1971, advocated socialist policies, citing that private-oriented policy by previous administrations gave rise to excessive economic concentration in a limited number of private financial cliques and expanded the gap between rich and poor. The administration promulgated the "Economic Reform Order" in 1972 to nationalize key industries including banks and attempted to improve labor conditions for industrial workers in urban areas by "New Labor Policies."

However, the nationalization policy was not consistent. The cotton spinning industry, the most important industry and the base for the financial cliques, was not nationalized, and some industries were returned to the private sector as a compromise due to intense protests by industrial capitalists. Thus, the nationalization policy of the Bhutto administration could not correct economic gaps, but rather discouraged thought toward private investment and made long-term investment difficult. Also, improvement of working conditions through the "New Labor Policies" resulted in wage raises without increases in productivity and worsened business results of state-owned companies.

The socialist policy under the Z. A. Bhutto administration did not achieve tangible results but rather led to sluggish production, and the first oil crisis further worsened the situation. This administration's policy can be characterized, from the historical point of view, as temporary government intervention in rushed accumulation of private capital, which ended in a negative effect on the medium to long-term economy.

1.1.2 Macro economic performance in the nationalization period

Table I-1 shows economic growth, fiscal balance and international balance in the 1970's. These macro economic indexes indicate the following trends:

(1) Economic growth

As the Z. A. Bhutto Administration's failure in nationalization slowed the Pakistan economy, which was further hit by the first oil crisis, the real GDP growth rate in Pakistan having been around 7% dropped to an average of 3.3% from fiscal 1974[1] to 1976. However, as mentioned above, the deregulation policy of the Haq administration improved the growth rate to an average of 6.8% in fiscal 1977 through 1979 and successfully overcame stagnation from the macro economic point of view.

(2) Fiscal balance

Prices rapidly rose from fiscal 1973 to 1975, affected by the first oil crisis, and the inflation rate of the consumer price index reached as high as an average of 23.36% in these years. Fiscal expenditures swelled under these circumstances, and the proportion of budget deficit to GDP quickly increased to 10.3% in fiscal 1975 from 5.9% the previous year. Despite vitalization of the economy by the Haq administration in fiscal 1977 and thereafter, the budget deficit was little improved, and its proportion to GDP rose to 9.2% again in fiscal 1979. This large deficit was caused by delays in the establishment of a tax collection system on the revenue side, which was unable to improve revenue structure relying on an indirect tax, and failure to suppress defense costs exceeding 30% of total expenditures.

(3) International balance of payments

Trade balance rapidly worsened in response to soaring oil prices during the

[1] The fiscal year in Pakistan begins in July and ends in June the next year. Therefore, fiscal year 1974 means July 1974 to June 1975.

first oil crisis, and the proportion of trade deficit to GDP suddenly grew to 10.1% in fiscal 1974 from 1.5% the previous year. Imports did not fall after that, and the import amount in fiscal 1974 was 21.7% of GDP and 19.7% in fiscal 1975. Exports did not grow from the middle of the 1970's, affected by the drop in international prices for primary products, and the trade deficit rose to even more than 10% of GDP in the middle of the 80's. In the meantime, the current balance deficit remained high at 5.7% of GDP in fiscal 1979, though it was somewhat reduced after the 1976 fiscal year with increase of remittances from workers working in the Middle East.

(4) Finance

Growth of money supply (M2) once marked -3.2% in fiscal 1974 but it grew and has remained steady at around 20% since then.

The proportion of investment to GDP has been relatively steady at 15%. That of saving to GDP, however, shrunk after fiscal 1974 from 12 to 13% in the beginning of the 70's and remained at 7.1% in fiscal 1979. This low savings ratio has been of concern, and appropriate measures to fill the gap between investment and savings are being awaited.

Table I-1: Macro economic indexes in Pakistan in the 1970's

	1970	71	72	73	74	75	76	77	78	79
Real GDP growth rate	1.2%	6.8%	6.8%	7.5%	3.9%	3.3%	2.8%	7.7%	5.5%	7.3%
Fiscal balance (rate to GDP)	-8.3%	-4.8%	-4.8%	-6.8%	-5.9%	-10.3%	-9.4%	-8.4%	-7.5%	-9.2%
Revenue	17.2%	15.2%	13.5%	13.1%	14.2%	13.2%	14.4%	14.4%	14.9%	15.6%
Expenditure	25.5%	21.3%	18.3%	19.9%	20.2%	23.5%	23.8%	22.8%	22.4%	24.8%
International balance of payments (rate to GDP)										
Trade balance	-5.4%	-3.7%	-3.7%	-1.5%	-10.1%	-10.3%	-7.8%	-9.0%	-10.2%	-11.9%
Current balance	-6.7%	-3.9%	-3.9%	-1.0%	-10.5%	-9.3%	-5.9%	-4.9%	-4.0%	-5.7%
Consumer price increase rate	5.2%	4.7%	4.7%	23.6%	26.4%	20.9%	7.1%	10.3%	6.0%	8.3%
M2 increase rate	11.0%	11.9%	21.8%	14.1%	-3.2%	20.0%	26.5%	21.1%	24.4%	23.4%
Domestic saving / GDP	13.0%	12.9%	12.7%	13.5%	9.6%	7.4%	10.8%	10.8%	8.8%	7.1%
Total investment / GDP	14.3%	14.0%	12.6%	11.4%	12.2%	14.6%	18.5%	18.6%	17.3%	17.0%

(source) Government of Pakistan, finance Division "Economic Survey 1995 - 1996," IMF "International Financial Statistics 1996"

1.2 Move to private sector-oriented economy (1978 to 1989)

1.2.1 Political and economic situation in the private sector-oriented economy period (First half of the Haq military regime: July 1977 to the first half of the 1980's)

The Zia UL-Haq regime adopted the private sector-oriented economy as an antithesis of the socialist policy by the previous administration and lifted the nationalization policy at the beginning of establishment. Under the fifth five-year plan (1978 to 1983 fiscal years), the "State-Owned Company Management Transfer Order" was promulgated in 1978 which stipulated methods for sale of state-owned companies to former owners, and the "Protection of Rights in Industrial Property Order" was proclaimed in 1979 to invalidate the "Economic Reform Order" which formed the foundation of nationalization policy of the previous administration.

Despite such policies, the Haq administration did not actually privatize existing state-owned enterprises but tried to activate the private sector while respecting the role of the public sector through, for example, drastic deregulation. The deregulation was effective in restoring private sector vitality which had been suppressed by the previous Bhutto administration, and the economy took an upturn in 1977 and thereafter.

However, this recovery was achieved not by structural reform but by growth of the cotton spinning industry supported by preferential measures by the government. Thus, trade structure was still constituted of import of primary products and agricultural processed goods and export of capital and intermediate goods, and as imports outgrew exports with revitalization of the economy, the trade deficit widened again. The fiscal balance did not improve either, and the proportion to GDP was 8.4% in fiscal 1977, 7.5% in 1978 and 9.2% in 1979, as expenditures including public investment increased without expansion of revenues. In conclusion, the Haq military regime in the early years was successful in overcoming a sense of impasse brought about by socialist policies of the former Bhutto administration, but it did not make any reforms in international or fiscal balance.

1.2.2 Structural adjustment policy

As described in the previous section, the macro economic performance in Pakistan in the latter half of the 1970's showed a temporary recovery in GDP growth rate, but as it was not realized by structural reform, it did not improve fiscal or international balance of payments in a distinctive manner.

Under these circumstances, the World Bank and IMF decided to extend structural adjustment loan, started at the end of the 1970's, also for Pakistan.

Pakistan received the first loan in December 1980 and more loans after that. Structural reform in Pakistan was begun under the Haq administration as a structural adjustment policy package agreed to by the World Bank and IMF.

The Haq administration employed policies to stimulate private investment through deregulation under the fifth five-year plan (1978 to 1982 fiscal years), as mentioned above and succeeded in revitalization of economic activities. IMF and the Pakistan government concluded a Three-year Extended Fund Facility (EFF) in December 1980, under which several structural reforms were carried out, such as devaluation of the rupee, liberalization of overseas trade, review of public investment, price liberalization, and revitalization of the private sector.

For the sixth five-year plan (1983 to 1987 fiscal years), a former Director-General of the Policy Reform Bureau of the World Bank took the office of Deputy Chairman of the planning committee and participated in formulation of the plan with a link to EEF. This plan put an emphasis on agricultural, energy and industrial sectors, and price liberalization was carried out in these sectors. In the agricultural sector, collection of irrigation facility fees, strict examination of projects and diversification of agricultural products were encouraged. Balance between the public sector and the private sector was to be corrected in the energy sector, and promotion of the private sector was the focus in the industrial sector.

1.2.3 Macro economic performance in the private-oriented period

How did the Pakistan economy perform in response to the structural adjustment policy? The macro economic indexes in the 1980's are (**Table I-2**) almost the same as those of the second half of the 70's. In other words, economic growth was relatively high, but the twin deficits were not remarkably reduced. That is, the Haq administration started structural reforms in the 1980's but could not completely solve the basic problems within the Pakistan economy.

(1) Economic growth

Average annual economic growth up to the fiscal year of 1987, when the Haq administration came to an end, was considerably high at 6.9%. This outstanding growth was realized partially by the structural adjustment policy. However, in addition to domestic factors, two other external factors contributed to this achievement.

The first factor was rapid increase in remittances from overseas with growth in the number of workers working in the Middle East after the first oil crisis. The amount of remittances reached as high as the level of exports in the middle of the 1980's. The remittances themselves are not included in GDP, but they contributed to ultimate economic growth through increase in total demand such as domestic consumption. The second factor was a large inflow of aid funds. The importance of Pakistan's security was highlighted by western countries in the 1980's after the Soviet invasion of Afghanistan.

These two external factors caused the Pakistan economy to grow in the 80's, yet they were temporary and unique by nature and did not result in a lasting growth.

(2) Finance, price, investment and saving

The bank sector in Pakistan consists of commercial banks, foreign banks, specialized banks and development financing banks under the central bank (State Bank of Pakistan; SBP). They were all state-owned banks, excluding the foreign banks, but some of them were privatized in the 1990's. Stock exchanges in Karachi and Lahore have proved productive, and insurance companies and leasing houses are also playing an important role in the financial sector.

Money supply (M1, M2 and M3[2]) grew at a rate of two digits through the 80's, and the balance at the end of the 1989 fiscal year expanded by 3.22 times for M1, 3.02 times for M2 and 4.10 times for M3 from that of the 1980 fiscal year. M1 and M2 increased almost at the same rate, while the growth of M3 was much greater. The change in money supply share in the financial sector was caused by increases in easy lending, and it led to bad debts for many financial institutions in the 1990's.

The SBP is responsible for macro economic policy but they are not fully independent of the government. As a result, they were affected by monetization of fiscal deficit through increase in government borrowing, and consumer price rose at an average of 7.3% in the 1980's as shown in **Table I-2**. The inflation rate however remained at one digit for ten years, and this can be seen positively when compared with many other developing countries. However, the pressure of monetization intensified at the beginning of the 1990's, and the annual inflation rate rose to two digits and remained at that level.

The percentage of investment to GDP was around 15% in the 70's but it rose slightly to about 17% in the 80's. Saving, on the other hand, had been at the one-digit mark till the second half of the 80's and finally returned to the level of the first half of the 70's in 1986 and thereafter. Yet the level is still low, and the gap between investment and saving has further widened.

[2] In Pakistan, M1 = currency + Demand Deposits + Other Deposits with SBP, M2 = M1 + Time Deposits, M3 = M2 + NDFC Borrower Certificate + Deposits in NSS s + Deposits of Cooperative Banks. NDFC = National Development Finance Corporation, and NSSs = National Saving Schemes.

(3) Fiscal balance

Fiscal balance in the 80's will be examined from the point of revenues and expenditures. The proportion of revenues to GDP at 13-15% in the 70's increased to 16-20% in the 80's. That of expenditures to GDP also rose from 18-23% in the 70's to 21-27% in the 80's. Thus, the fiscal balance has remained in the red at 6-9% and has not improved since the 70's (See **Table I-2**).

Table I-2: Macro economic indexes in Pakistan in the 1980's

	1980	81	82	83	84	85	86	87	88	89
Real GDP growth rate	6.4%	7.6%	6.8%	4.0%	8.7%	6.4%	8.8%	6.4%	4.8%	4.6%
Fiscal balance (rate to GDP)	-5.7%	-5.8%	-4.7%	-6.8%	-6.2%	-7.2%	-9.1%	-8.5%	-6.3%	-7.4%
Revenue	17.1%	17.2%	16.3%	16.4%	17.4%	16.7%	18.3%	17.9%	18.5%	19.6%
Expenditure	22.7%	23.0%	21.1%	23.3%	23.6%	23.9%	27.4%	26.4%	24.8%	27.0%
International balance of payments (rate to GDP)										
Trade balance	-12.2%	-10.4%	-12.4%	-9.8%	-12.6%	-10.9%	-9.0%	-7.0%	-7.2%	-6.9%
Current balance	-3.9%	-3.3%	-2.9%	0.1%	-4.0%	-3.6%	-2.1%	-1.7%	-3.8%	-3.6%
Consumer price increase rate	12.1%	11.7%	6.0%	2.5%	10.2%	5.6%	3.5%	4.7%	8.8%	7.9%
M2 increase rate	19.4%	7.7%	20.5%	23.1%	5.4%	14.2%	17.0%	18.1%	9.0%	6.3%
Domestic saving /GDP	7.8%	9.3%	8.3%	8.5%	7.7%	6.3%	10.9%	13.9%	12.2%	12.6%
Total investment /GDP	17.7%	17.1%	16.8%	16.9%	16.5%	16.5%	17.0%	17.5%	16.5%	17.3%

(source) Government of Pakistan, Finance Division "Economic Survey 1995 - 1996," IMF "International Financial Statistics 1996"

Secondly, among revenues, the proportion of direct tax including income tax continued to fall through the 80's to as low as 9.9% of the total revenues in fiscal 1989. The taxation system, largely relying on indirect tax revenues has not been corrected at all, and an increase in the rate of collection of direct tax, one of the biggest goals in the structural adjustment policy, was not achieved but rather the situation worsened (See **Table I-3**).

Table I-3: Trends of government revenue in the 1980's

	1981	1982	1983	1984	1985	1986	1987	1988	1989
Tax revenue	82.8%	82.8%	74.2%	72.3%	70.2%	79.8%	79.9%	79.3%	75.2%
Direct tax	**17.1%**	**15.6%**	**12.7%**	**12.6%**	**11.4%**	**10.7%**	**10.6%**	**10.5%**	**9.9%**
Income tax	16.0%	14.8%	11.9%	11.7%	10.7%	10.0%	9.9%	9.6%	9.0%
Fixed asset tax	1.1%	0.8%	0.8%	0.9%	0.8%	0.7%	0.8%	0.8%	0.9%
Indirect tax	**65.7%**	**67.2%**	**61.5%**	**59.7%**	**58.8%**	**69.1%**	**69.2%**	**68.8%**	**65.3%**
Consumption tax	26.2%	26.4%	21.8%	19.9%	17.4%	14.9%	15.0%	14.5%	14.7%
Sales tax	6.3%	5.9%	6.4%	6.0%	5.5%	6.2%	7.5%	10.6%	9.8%
Tariffs	29.0%	31.3%	29.8%	30.2%	32.6%	32.1%	32.5%	30.5%	31.9%
Levies (gas, petroleum)	0.0%	0.0%	0.0%	0.0%	0.0%	12.8%	11.1%	10.4%	6.1%
Others	4.2%	3.7%	3.5%	3.6%	3.3%	3.2%	3.2%	2.8%	2.8%
Nontax revenue	17.2%	17.2%	25.8%	27.7%	29.8%	20.2%	20.1%	20.7%	24.8%

(source) Government of Pakistan "Economic Survey 1995-1996"

Thirdly, expenditures have increased since the 1970's despite the long-held assertion that expenditures should be restrained. Referring to **Table I-4**, interest payment costs doubled from 11% of total expenditures in fiscal 1981 to 21% in fiscal 1989 with the increase in internal/external debts in the 80's. National defense spending was responsible for 26% of the total expenditures in the latter half of the 80's. Costs for defense and interest payments amounted to about 50% of total expenditures, and this expanded the scale of expenditures and heavily suppressed development spending. That is, Pakistan's expenditures are likely to be a problem in the future since priority for development spending required for sustainable growth has continued to fall.

Table I-4: Trends of government expenditures in the 1980's

	1981	1982	1983	1984	1985	1986	1987	1988	1989
Current expenditures	62.7%	66.3%	71.9%	71.7%	70.4%	76.3%	74.1%	76.1%	74.7%
National defense	**26.2%**	**26.7%**	**26.8%**	**27.3%**	**26.5%**	**27.1%**	**26.1%**	**25.4%**	**26.5%**
Administration	4.8%	4.8%	6.0%	5.6%	5.5%	6.8%	4.7%	5.1%	5.4%
Social services	7.5%	8.5%	9.8%	9.0%	9.2%	10.1%	9.6%	9.6%	9.1%
Subsidies	**3.5%**	**3.2%**	**4.7%**	**4.6%**	**4.2%**	**3.8%**	**4.4%**	**6.6%**	**4.1%**
Interest payments	**10.8%**	**12.8%**	**14.1%**	**14.1%**	**14.7%**	**15.7%**	**18.4%**	**19.0%**	**21.1%**
Others	9.8%	10.4%	10.6%	11.1%	10.3%	12.7%	10.9%	10.5%	8.6%
Development expenditures	37.3%	33.7%	28.1%	28.3%	29.6%	23.7%	25.9%	23.9%	25.3%

(source) Government of Pakistan "Economic Survey 1995-1996"

Subsidies to state-owned companies were more than 10% of total expenditures in the middle of the 1970's, but they were reduced in the course of private sector revitalization by the Haq administration to 3.2% in fiscal 1982. Nevertheless the subsidies began to rise again and were 6.6% in fiscal 1988. This was because political demand for expansion of employment was accommodated by a simple increase in the number of employees in state-owned companies through the 80's.

The share of state-owned companies in GDP grew from 8.0% in fiscal 1978 to 11.6% in 1988 fiscal as shown in **Table I-5**, relatively higher than the average for developing countries. As a result, the fiscal deficit was not been reduced except for the period from 1980 to 1982.

Table I-5: Share of state-owned companies in GDP

	1978	1985	1988
Pakistan	8.0%	11.5%	11.6%
Average for developing countries	9.1%	11.7%	11.0%

(source) World Bank Policy Research Paper, "Bureaucrats in Business" 1995

(4) International balance of payments

With the above-mentioned expansion of remittance from overseas, deficit in the current balance has remained between 1.7 and 4% of GDP, but trade deficit has remained large at more than 7% of GDP. Moreover, trade in Pakistan is characterized by delays in the changing of major exports, and promising export items have not yet been found.

Pakistan's main exports are goods with low added values such as agricultural products including rice, cotton yarn, cotton cloth, etc. Export of light industrial products such as ready-made clothes, underwear, etc., not to mention heavy industrial products, has not shown remarkable progress. Therefore, it is unlikely that Pakistan's international balance will improve in the short run. In addition, remittances from overseas workers, a main source of foreign currency, have begun to slow down and this poses cause for worry.

1.3 Privatization of state-owned companies (1990 to 1997)

1.3.1 Outline of structural adjustment policy after 1988

Pakistan was able to alleviate its sluggish economy, which lasted from 1977 through the structural adjustment policy started in 1980. However, the success was realized mainly by stimulation of private sector vitality which had been suppressed for a long time, and the fiscal and international deficits remained unchanged or even worsened through the 1980's. To cope with these circumstances, the Pakistan government formulated a medium-term plan in July of 1988 for structural adjustment with full-scale reforms to aid the twin deficits and to achieve sustainable development.

The basic principle of the structural adjustment was introduction and propagation of market principles, and economic deregulation was promoted as a means to reach the goal. Reform programs were carried out in the fiscal, external (trade), financial and price areas. Goals and problems related to the 1988 medium-term plan will be described according to area.

(1) Fiscal balance

First, the rate of fiscal deficit to GDP should be reduced (Target in 1991: 4.8%). The revenue structure, largely dependent on import tariffs and nontax revenues (fees), should be corrected, and a wider base for revenue should be exploited. In concrete terms, adoption of a general sales tax and taxation on agricultural income should be examined. At the same time, expenditures should be restrained by reinforcing budget control, and for that purpose, subsidies for wheat production and fertilizers should be cut.

(2) Trade

Import liberalization and tariff-system improvement should be promoted by lifting embargos and import restrictions. Exchange rate should be set more flexibly to accelerate reduction of trade deficit. Short-term borrowing of external funds should also be limited.

(3) Finance

Borrowing (net) from domestic banks to compensate for fiscal deficits should be reduced in terms of rate to GDP (0.6% in fiscal 1989 to 0.2% in fiscal 1990), and an auction system should be established for treasury bills. From the macro economic point of view, growth of liquidity should be suppressed (Target in fiscal 1990: 10.4%) to keep inflation under control.

(4) Price

Public utility charges and the prices of essential items such as electricity, petroleum, natural gas, fertilizer, and foods should be reviewed and adjusted when necessary, and subsidies should be cut. Prices were actually raised in April of 1991 for railway passenger fares (15%), freight fares (12%), electricity charges (12%), natural gas price for household use (17.7%) and that for industry (15%). Public utility charges have been raised several times since then.

1.3.2 Macro economic performance in the privatization period

How has the macro economy been changed by this full-scale structural adjustment since 1990 Economic performance in this period will be examined using macro economic indexes in the 1990's referring to **Table I-6**.

(1) Economic growth

The average growth rate of real GDP up to fiscal year 1994 was 4.9%, with some fluctuation in the 1991 (7.7%) and 1992 (2.3%) fiscal years. This is rather stagnant when compared to the average in the 1980's (6.9%). Fine weather in 1994 increased cotton production, and the cotton processing and the textile sectors showed improvement, but real GDP growth rate remained at 4.6%. Slow economic growth is expected to continue, and the growth rate in fiscal 1996 is estimated at 3.1%, the second lowest growth next to 2.3% in 1992, when a devastating flood slashed agricultural production. Growth in the large-sized manufacturing sector is also slow at 2.6% and caused the entire economy to be sluggish.

The inflation rate represented by the consumer price index was 10.6% on an average till 1994, compared to 7.3% in the 1980's. The inflation rate in fiscal 1995 is said to be about 11%, and attention should be paid to the future course as well as to execution of economic measures by the Sharif administration.

(2) Fiscal balance

The proportion of revenues to GDP has risen to 18-20% in the 1990's from 16-20% in the 1980's. However, as the rate of expenditures to GDP also increased to 25-27% from 21-27% in the 80's, fiscal balance has remained in the red at 5-9% and has not improved since the 70's and the 80's. The target for deficit reduction (rate to GDP in fiscal 1991: 4.8%) was not achieved with the actual figure being 7.6% in fiscal 1991.

But the fiscal deficit began to fall after that, and it has dropped to 6.3% in fiscal 1995. The Sharif administration is trying to reduce the deficit by cutting defense spending, debt payment and public investment. But the fiscal state is worsing due to tax cuts as a preparatory step for expansion of the tax base, a drop in tax revenues caused by the inactive economy, and interest payments on rapidly increasing short-term borrowing, etc.

(3) International balance of payments

International balance of payments improved slightly at the beginning of the 90's. Imports including cotton, cotton products, leather, and ready-made clothes have been boosted by preference measures for exporters, and exports were also controlled successfully. With the rapid increase in remittances from overseas workers, the current deficit dropped to 3.5% from 6% in fiscal 1993.

Some improvements have been made with the international balance of payments through the structural adjustment policy, but the basic structure of a deficit-producing economy in which the trade deficit is made up for by remittances has remained unchanged much through the 70's and 80's.

The latest import and export trends show remarkable increases in the export of clothing, textiles, and leather processed goods in place of raw cotton and raw leather products, drop in import of edible oil, pulses and nuts, and chemical products, and growth in imports of sugar, petroleum and petrochemical products. The resultant trade deficit in fiscal 1995 was 3.7 billion dollars. The deficit amount in fiscal 1996 is expected to be about 3.6 billion dollars.

(4) Finance, investment, saving and foreign currency reserve

Money-supply increase rate (M2) has remained at 10-20%, with the exception of a high mark of 25.9% in fiscal 1992.

The proportion of investment to GDP was about 17% in the 1980's and it rose slightly to about 18% in the 90's. Saving reached the 17% mark in the fiscal years of 1991 and 1992, contributed to by increase in private saving through expansion of foreign currency deposits after financial reforms in 1992 and increases in government saving. The gap between investment and saving was temporarily narrowed to 1% in the 1990's, but the devastating flood in late 1992 raised consumption and public investment for reconstruction in 1993 and after. Thus, the improvement lasted only for a short while, and the investment/saving ratio has remained low, at the level of the 80's, and constitutes a weak point of the Pakistan economy.

Foreign currency reserves began to deteriorate in the second half of the 1990's and repeated a cycle of rapid decrease followed by slight increase from 1996 to 1997. The amount was 847 million dollars as of May 1997 and it does not even amount to one months imports for the country.

Table I-6: Macro economic indexes in Pakistan in the 1990's

	1990	91	92	93	94	95(1)	96(2)
Real GDP growth rate	5.6%	7.7%	2.3%	4.5%	4.4%	4.6%	3.1%
Fiscal balance (rate to GDP)	-5.4%	-7.6%	-7.9%	-8.9%	-6.9%	-6.3%	-
Revenue	20.0%	17.8%	18.5%	18.1%	19.1%	-	-
Expenditure	25.4%	25.3%	26.4%	27.0%	26.0%	-	-
International balance of payments (rate to GDP)							
Trade balance	-6.9%	-5.3%	-5.8%	-5.4%	-4.4%	-	-
Current balance	-4.2%	-3.3%	-3.9%	-6.0%	-3.5%	-	-
Consumer price increase rate	9.1%	11.8%	9.5%	10.0%	12.4%	-	-
M2 increase rate	10.6%	16.3%	25.9%	17.5%	19.0%	-	-
Domestic saving / GDP	13.5%	17.4%	17.0%	14.8%	15.6%	10.9%	11.0%
Total investment / GDP	17.3%	17.4%	18.6%	19.1%	18.4%	-	18.2%

(source) Government of Pakistan, finance Division "Economic Survey 1995-1996," IMF "International Financial Statistics 1996"
However, (1) tentative, and (2) estimated.

1.3.3 Role and evaluation of the World Bank and IMF in the structural adjustment policy

(1) Role of the World Bank and IMF

The World Bank and IMF play an extremely important role in formulation and implementation of the structural adjustment policy in Pakistan.

Many developing countries have proceeded with structural adjustment since the 80's, and they usually receive Structural Adjustment Loans (SAL) to reduce serious international deficits and are encouraged by the Bank to enforce structural adjustment policy as conditionality. The two major goals of the Bank's structural adjustment are 1. To restore and maintain a stable macro economy; and 2. To improve economic efficiency. These are considered to form a base for sustainable economic growth and are positioned as political targets in the medium term from three to ten years. Actual measures to be taken are determined at deliberations among the borrower country, the financing country and the World Bank as a package of political and institutional reforms related to 1. and 2. mentioned above. The two major goals are desirable targets in the medium to long-term, but what is more important is the contents of the political and institutional reform package as a means to achieve the targets. There is no universal prescription efficacious for countries, each with their own respective histories, cultures, social systems and degrees of economic development. As the structural adjustment policy is not always successful, especially in countries being unaware of the actual state of their own markets, the structural adjustment policy by the World Bank and IMF have been under pressure, receiving criticism in recent days.

Pakistan received the first adjustment facility of 50 million dollars from the IMF in December of 1980 for the fertilizer sector. Subsequently, Pakistan received seven loans totaling 1.038 billion dollars in the 80's for its energy, export development, agriculture and finance sectors. Reforms have been supported during this period by formulation of a medium-term plan for structural reform in July of 1988.

The World Bank and IMF continued extending structural adjustment loans in the 90's, and possibility of continuation and new loans has been discussed based on macro economic performance and progress of the structural adjustment policy. Pakistan administrations endeavored to achieve structural adjustment through privatization of state-owned companies and deregulation in the 90's. The care taker administration, formed in November 1996 after dismissal of Benazir Bhutto by President Leghari, appointed Sharid Burki from the World Bank as Economic Advisor (Minister of Finance, actually) to show their positive attitude toward the policy. The second Sharif administration, which won an overwhelming victory in the general election in February the next year also followed the basic policy of the previous administration. The "Prime Minister's Economic Revival Programme" was published in March 1997, and taxes were reduced for tariffs, sales, incomes, corporations, etc. and the introduction of an agricultural income tax was enforced throughout the country. Other measures for improvement of economic efficiency included reduction in scale of state-owned companies, staff cuts, administrative reforms, and promotion of exports.

(2) Progress of structural adjustment

<u>Recovery and maintaining of stable macro economy</u>

The structural adjustment policy by the World Bank and IMF was reinforced in the 1990's, but neither stability of Pakistan's macro economy nor micro efficiency has been recovered as hoped for by the Bank and IMF. At continuation or renewal of IMF's Stand-by Arrangement or the World Bank's SAL, or granting of a new loan, the state of structural reform has been repeatedly evaluated. When new political targets should be set or existing goals should be revised, compromise has been sought around an achievable limit. During this period, Pakistan's twin deficits have not been reduced much, and numerical targets have been gradually modified downward.

For the Stand-by Arrangement by IMF initiated upon the foreign currency crisis in 1995, for example, performance evaluation standards were set at a fiscal deficit to GDP within 5% (or 4.6% when including revenue from privatization of state-owned companies), increase rate of domestic liquidity such as money supply at 14.1% or less, exchange devaluation by 7%, introduction of import tariff of 5% at the minimum with as few exceptions as possible, adoption of 10% temporary import tax, petroleum price raise by 7%, etc. However, major economic indexes indicating macro economic performance did not meet the standards. Only controllable measures like import tariffs, temporary import taxs and oil price increases were enforced, and fiscal deficit to GDP reached 6.3%. Domestic liquidity increased to 18.5% due to monetization of the budget deficit.

Based on such poor performance, a new structural adjustment policy was agreed to between IMF and the Pakistan government in October 1996, and it initially said exchange rate should be devaluated by 8.5%, and the fiscal deficit in 1996 should be kept within 4% of GDP and the domestic liquidity increase rate within 13.1%. The target level was raised, however, despite the macro economic performance being lowered in the previous year because both IMF and the Pakistan government seemed to prefer optimistic prospects. These increased rates are compatible with the macro economic environment with real GDP growth rate of 5.0 to 5.5%, inflation rate of 10 to 11%, and 1% point improvement to 5.9% of current balance deficit rate to GDP.

Improvement of economic efficiency

Micro economic efficiency is to be improved as part of the structural adjustment policy through efforts such as taxation on agricultural income, effective use of sales revenue from privatization, and sound management of the bank sector. The second Sharif administration, reinstalled in February 1997, presented the "Prime Minister's Economic Revival Programme" with detailed examination of opportunities for recovery, which will be discussed in the following chapters with consideration to privatization of state-owned companies.

1.4 Economic policy program of the incumbent administration (March 1997 to present)

The second Sharif administration had a conference with the IMF mission at Islamabad on March 21, 1997 and announced they would give up the 831 million-dollar Stand-by Arrangement. The amount was not so large in relation to Pakistan's total need for external aid, but the decision aroused anxiety concerning influence on other supporting countries, since IMF's Stand-by Arrangement implies approval of Pakistan's economic policy.

To clear doubts that the administration is not earnest about achieving the targets, they unveiled the "Prime Minister's Economic Revival Programme," a series of economic reform packages. On March 28, Finance Minister Sartaj Aziz declared a 20% import duty cut and reduction of the maximum tariff to 45%. He also mentioned an income tax cut. It was also decided that corporate tax for state-owned companies would be reduced from 33% to 30% and for private enterprises from 43% to 35%. Financial institutes would have a tax cut from 58% to 55%. The objective of these reforms is improvement of the tax collection rate in Pakistan. The country's current tax revenue is about 3% of GDP, much lower than the average of about 7% for other developing countries at the same level. Finance Minister Aziz disclosed a plan for sales tax rate reduction from 18% to 12.5%, and 3% taxation at the retail level in urban areas from around July 1997 after enforcement of the sales tax cut. These measures are expected to reduce the fiscal deficit to 4% of GDP in 1997 from the estimated figure of 6% in 1996.

In a press release on March 29, the IMF made clear its support for the economic reform packages by the Sharif administration. On condition that the economic reform packages be implemented and macro economic performance be improved, IMF would review the Enhanced Structural Adjustment Facility (ESAF) and Extended Fund Facility (EFF). As to the IMF's major concerns whether the Sharif government could achieve the goal of fiscal deficit reduction, Finance Minister Aziz provided the prospect that ESAF would be resumed by October 1997.

The Programme encompasses a variety of packages including fiscal reconstruction, export promotion, industrial advancement, reform of state-owned companies and agricultural programs. Those relating to tax reform and export promotion were released on March 28, and others followed one after another. Details of the Programme are shown in **Table I-7**, and the outline and related problems are discussed in the following.

1.4.1 Outline of the new economic program

(1) Basic policy

The incumbent administration attributes the major problems of the current Pakistan economy to slow economic growth, chronic deficits in international balance of payments and budget. As a basic policy to revive the economy, they placed an emphasis on supply realized by enhanced productivity of domestic industries.

The government's development strategy in the Programme is: 1. A wide range reduction in import tariffs and sales taxes shall be enforced to stimulate domestic industries, and to revitalize the economy and increase production, cost cutting and increased motivation shall be promoted; 2. Sales increases shall be linked with growth in tax revenues; 3. Fiscal balance shall be improved by the increase in tax revenues; 4. Prices shall be kept stable by suppressing money supply with regard to fiscal compensation; 5. Sustainable economic growth shall be realized. Export industries will be given first priority, and international balance of payments shall be improved by increased exports.

(2) Tax reform

Measures for tax reforms in **Table I-7** indicate across-the-board cuts ranging from sales to wealth tax. The basic principle for tax reforms is as follows:

1) The entire tax rate system including tariffs, sales taxes, income taxes, corporate taxes and wealth taxes shall be simplified, and strict collection of agricultural income taxes shall be enforced.
2) Decrease in tax revenues due to tax cuts shall be made up for by revenue increases through expansion of tax base and vitalization of the economy.
3) The ratio of direct and indirect taxes, now heavily biased toward the indirect, shall be corrected. A modern and fair tax collection system shall be constructed to enable the proper and efficient collection of income tax.

(3) Export promotion

The government is actively promoting exports as a means to improve the chronic international deficit. Measures shall be taken in such fields as simplification of customs clearance, tax incentive for export industry, and improvement in financial support. For the target to double exports in three years, the government is determined to foster domestic industries through augmentation of export industries.

1.4.2 Problems with the Programme

The government plans to achieve economic growth by means of:

(i) Stimulation of industries by tax cuts - Promotion and reinforcement of industries - Revitalization of the economy - Tax revenue increases - Fiscal balance improvements - Stable prices; and

(ii) Tax cuts for import duties on capital and intermediate goods for the export industry, reinforcement of the export industry - Export increases - International balance of payments improvements.

To realize such development, the following problems should be solved:

(1) Problems with tax reform

A precondition for the (i) scheme is the establishment of a tax collection system which enables fair tax collection and expansion of tax base. That is, a tax collection system which links economic revitalization to tax revenue increase is essential. However, the current incomplete and corrupt system prevents fiscal balance improvement. It is, therefore, essential to eliminate corrupt practices such as tax evasion and unfair application of tax exemptions before implementing tax cuts.

In this respect, the government concludes in the Programme that the import duty "system was complicated by various tax exemptions, and it brought about corruption and rent-seeking activities." Also, the Programme points out that "many tax payers escape from tax payment using unjust application of tax exemptions." And the system in general "has been complicated, and combined with heavy taxation, it led to dissatisfaction by tax payers and caused bribery at tax offices." To solve these problems, it is necessary "to change the tax payment procedures to an objective system based on application documents so that tax payers make a correct declaration, and unfair connections with tax offices should be kept to the minimum," and "all the organizations involved with tax collection from central to local governmental offices should be simplified and streamlined, and tax collection should be taken care of by a single organization."

This Programme, however, does not present specific measures or plans for organizational reform. If tax cuts are enforced without changing the current system, it is highly likely that tax-base expansion would fail, tax revenue would be drastically reduced and fiscal deficit would be further deteriorated. In conclusion, without concrete measures and steady enforcement, tax reform in this Programme would not be realized, but would rather bring Pakistan's fiscal state into further difficulty.

(2) Problems with export promotion

With respect to the (ii) scheme, import-tariff cuts are cited as a means to stimulate industries. The precondition of this scheme is import-tariff reduction for machinery and parts for the export industry which should help to reduce their production costs and enhance international competitiveness. However, mere reduction of import tariffs will hardly boost competitiveness or increase exports.

The government should formulate measures for industrial promotion on a long-term basis to guide the export industry and place the Pakistan economy on the course of development. In the Programme, the government says that it "shall form the Federal Export Development Board with the Prime Minister as chairman to monitor exports," but concrete measures should be prepared at the same time. Without formulation and implementation of such measures, import-tariff cuts would lead to excessive rises in imports and worsen the international balance of payments.

(3) Political background

The "Prime Minister's Economic Revival Programme" published by the new government could achieve remarkable results, but this depends upon its implementation. The point is whether the incumbent government can enforce the policies without compromising on opposition by those with vested interests. In this regard, political leadership holds the key to success.

Table I-7: Outline of the "Prime Minister's Economic Revival Programme"

I. Problems with the current Pakistan economy

(1) High-cost structure for investment and production in industries due to heavy taxation and expensive public utility charges;

(2) Increase in bad debts and indirect costs in the banking sector and high market interest-rates caused by rise in government borrowing;

(3) Weakened international competitiveness of export industry resulting from the above (1) and (2), and slow economic growth due to drop in domestic production;

(4) Increase in overseas debts and tight foreign currency reserves due to rise in trade deficit and overseas borrowing;

(5) Rapidly growing inflation rate caused by chronic fiscal deficits and easy money-supply to make up for it.

II. Basic policy of this Programme

(1) The most important target should be price stabilization. It should be achieved by reduction in production costs, stable goods supply through expanded production, and improvement of fiscal management.

(2) Supply-side economic policy should be promoted. Domestic manufacturing industries, especially export industries, should be reconstructed and promoted.

(3) Tax reform including reorganization of collection system and expansion of tax base should be employed to form a system in which economic revival leads to tax revenue increases.

III. Individual measures

1. Tax reform

(1) Customs duties

- (a) Current import adjustment tax shall be abolished.
- (b) The maximum tariff shall be lowered from 65% to 45% (excluding automobiles and some other items).
- (c) Tax rates shall be simplified and the 13 brackets shall be reduced to 5 brackets of 10, 15, 25, 35 and 45% respectively.
- (d) Import duties for machinery and equipment shall be uniformly reduced to 10% to promote investment. It is, however, set to 35% for those competing with domestic products.
- (e) Import duties for raw materials, secondary materials and intermediate goods shall be lowered to the range of 10-45%.
- (f) Tax rates for easily smuggled items shall be reduced to the range of 10-25% to prevent bootlegging.

(g) Laws and ordinances on reference tariffs shall be abolished on July 1, 1997 in principle.

(h) Tax revenue drops due to tax cuts shall be compensated for by extensive and efficient application of 10% tariff and expansion of tax base. However, wheat, chemical fertilizer and pharmaceutical products shall remain exempt from taxation.

(2) Sales tax

(a) As the current high sales-tax rate at 15-23% hinders smooth economic activities, standard tariffs shall be lowered to 12.5% to vitalize the economy.

(b) The 10% sales tax rate for some items shall be maintained, and a two-bracket tariff shall be set at 10% and 12.5%.

(c) Taxation at the retail level shall be introduced as a means to expand tax base. First, a 3% tax shall be imposed on sales and then, it shall be gradually adjusted to the ordinary tax rate according to progress of a voucher system.

(d) Food and pharmaceutical products shall be exempt from sales tax.

(e) Machinery and equipment shall be exempt from sales tax, whether they are of foreign or domestic origin, as an incentive to promote investment.

(3) Income tax

(a) A fair tax-collection system is not complete, especially in the case of income tax, due to tax evasion, unfair tax exemptions, corrupt collection system, and the number of income tax payers being only 800 thousand with a total population of 130 million. To abate this situation, income tax reform shall be promoted both through tax cuts and expansion of tax base.

(b) To encourage voluntary tax payment and tax declaration especially by those other than employment income earners, the individual income tax shall be reformed as follows:

1. Income tax rate

Taxable item (annual income)	Current tax rate	New tax rate
0 to 100 thousand rupees	10%	5%
100 to 200 thousand rupees	20%	10%
200 to 300 thousand rupees	30%	15%
300 thousand rupees or more	35%	20%

2. Basic deduction (monthly amount)

	Current	Reformed
Employment income earner	5,000 rupees	2,500 rupees
Female worker	5,500 rupees	3,000 rupees
Those other than employment income earner	4,000 rupees	2,000 rupees

3. A special preferred taxation system applicable to bonuses shall be reformed as follows. However, bonuses shall be taxed for those with total annual income of 300 thousand rupees or more.

Bonus amount	Rate
0 to 100 thousand rupees	3%
100 to 200 thousand rupees	5%
200 to 300 thousand rupees	10%
300 thousand rupees or more	15%

(c) As part of expansion of tax base, those falling under the list below shall be required to submit income tax declaration:

1. Owners of automobiles
2. Owners of real estate of 250 square yards or more
3. Overseas travelers
4. Those installing a telephone line

(4) Corporate tax

(a) Corporate tax shall be reformed as follows:

	Up to July 1997	From July 1997
State-owned company	3%	30%
Private company	43%	35%
Finance industry	58%	55%

(b) Businesses which spend 2% of after-tax profits for education, welfare, pension, etc. for employees shall be granted a tax reduction.

(5) Wealth tax

(a) Owners of a residential plot of 1,000 square yards or more, an apartment lot of 2,500 square yards or more, or an automobile of 1,600 cc or more shall be required to submit a wealth tax declaration.

(6) Others

(a) Income tax on agriculture shall be introduced. Provincial governments which have not legislated for an agricultural income tax shall be required to do so as early as possible. As an incentive for introduction of agricultural income tax, fiscal aid shall be given to provincial governments in an amount equal to tax revenue increase through expansion of agricultural income tax base.

(b) As bribery practices in the area of tax collection are a serious problem, the entire tax system from the central to local governments shall be simplified and streamlined. Also, unification of tax collection authority shall be examined.

(c) To reduce size of governmental ministries and agencies as well as state-owned companies, a governmental commission was established. Individual investigative commissions shall be formed for WAPDA, KESC, and state-owned petrochemical companies to make a proposal on down sizing, staff cuts, and more efficient management.

2. Export promotion

(1) Exports shall be promoted as the most important goal in the economic recovery policy.

(2) To achieve the target of doubling the export amount in three years, the following measures shall be taken:

(a) Import duties for machinery shall be cut to 10% for the export industry, and raw materials shall be exempted from import taxes.

(b) Restrictions on equipment installation period for the spinning industry shall be shortened to five years, and export ceilings in the machine and leather-shoe manufacturing industries shall be lowered to 20%.

(c) The tariff refund system shall be improved, and period to refund shall be reduced to fourteen days.

(d) To facilitate access to export financing and to re-promote export credit guarantee plans, exporters' difficulties in borrowing shall be examined and solved.

(e) To vitalize potential exports of non-traditional products such as software, fruits and vegetables, fertilizer, leather shoes, and snacks foods, exports shall be promoted by preferential treatment of transportation cost, simplified tariffs, introduction of import-tax refunds, diversification of planting, and improvement of packaging. The current import structure, heavily relying on textiles, shall be changed for diversification.

(f) Procedures for port use, customs clearance, etc. shall be simplified to reduce transportation and infrastructure costs in exporting. Private investment shall be encouraged in port facilities, road networks, and expansion of airport and railway networks. Privatization of trade-related infrastructure shall be given first priority by the Privatization Commission.

(g) Concerned ministries shall cooperate with each other to realize sustainable export growth and to reinforce international competitiveness through improved productivity.

(h) Investment in education and training for the labor force leading to improved productivity shall be given first priority in export promotion.

(i) The export promotion package will result in increases in export only if exporters succeed in adapting themselves to a new multinational trade system. Enterprises not meeting ISO 9000[3] standards will face difficulties in accessing the international market. Unfortunately, only a few companies have obtained ISO 9000 certificates in Pakistan, and this situation should be improved.

(j) The Prime Minister himself shall monitor export trends to achieve this most important target of export promotion and make every effort to solve related problems. For that purpose, FEDB[4] with the Premier as chairman shall conduct regular meetings.

[3] International standards for quality control and assurance established by the International Organization for Standardization (ISO) in 1987. ISO 9000 provides guidelines for operation.

[4] Abbreviation for Federal Export Development Board

CHAPTER II

CURRENT SITUATION OF PRIVATIZATION POLICY

Two major targets of structural adjustment policy promoted by the World Bank are: (i) Restoration and maintenance of macro economic stability; and (ii) Improvement of economic efficiency. The fist target has already been discussed in the "Country Sector Survey on Pakistan" compiled by the Overseas Economic Cooperation Fund (1992). The main points discussed in this report, such as increase in overseas borrowing due to trade deficit, rise in money supply caused by fiscal deficit, and growing inflation rate, remain unchanged.

This report is focused on the second target of the above mentioned policy and analyzes the present state of privatization of state-owned companies actively promoted through the 1990's as a means to improve economic efficiency. The result of this privatization and related problems will also be examined.

2.1 Outline of privatization in Pakistan

The first Sharif administration sold 10% of its stock in the Pakistan International Airline in 1990 through the stock exchange. This marked the beginning of a series of privatization programs in Pakistan. The administration implemented aggressive privatization and called for bids for as many as 115 companies in 1991. The results were privatization of medium to small-sized enterprises in the manufacturing industry on the lower end and that of the Muslim Commercial Bank and Allied Bank on the higher end.

The second Benazir Bhutto administration formed in 1993 took over the privatization policy of the previous administration, but their policy was different from their predecessor's in that they privatized large-sized public utilities such as electric companies. The second Benazir Bhutto Administration's achievements with regard to privatization policy were privatization of the Kot Addu Power Company, a thermal power plant owned by the Water and Power Development Authority (WAPDA) and the privatization of Bankers Equity Ltd.

The second Sharif administration also made clear that it would continue and take over such privatization policy.

2.2 Characteristics of privatization policy, and the role of the government

The "Privatization Commission" established in January 1991 under the first Sharif administration is in charge of privatization in Pakistan. This Commission chooses companies to be privatized, evaluates assets, and acts as a window for calling for bids by the private sector. The Commission is organized as in **Fig. II-1**, with sections for respective sectors under a board consisting of 8 members including a chairman. Each section is responsible for formulation and implementation of privatization strategies.

"Privatization in Pakistan," published in October 1996 by the second Benazir Bhutto administration, describes basic policy and characteristics of privatization together with the role of the government as follows:

(1) Basic policy of privatization

1) Privatization shall be enforced for the benefit of all the people.
2) Privatization should lead to improved efficiency and competitiveness of industries including service industries.
3) Privatization should be implemented through fair procedures.

(2) Characteristics of privatization in Pakistan

1) Privatization shall be enforced as part of deregulation and liberalization of the entire economy.
2) Privatization shall be enforced to reduce fiscal burden and financial aid to state-owned companies.
3) International balance of payments, foreign currency reserves and overseas debts shall be improved using privatization as a source for foreign currency.
4) Privatization shall be enforced so that business efficiency is improved and better service is provided at a lower price.

(3) Role of the government in relation to privatization

1) To protect consumers' benefits by imposing certain restrictions on privatization of public utilities such as communications, electricity and gas.
2) Compensation for employees who become surplus laborers as a result of privatization. In this respect, the following agreement was concluded between the government and the All Pakistan State Enterprises Workers Action Committee (APSEWAC), a representative organization of workers:
   i) Employees of a privatized company shall not be laid off for one year after privatization.
   ii) Workers who prefer voluntary retirement shall receive a retirement allowance in the amount calculated by multiplying four months of basic pay at retirement by the number of years worked, plus remuneration in the amount calculated by multiplying one month basic pay at retirement by the

number of years worked[1].

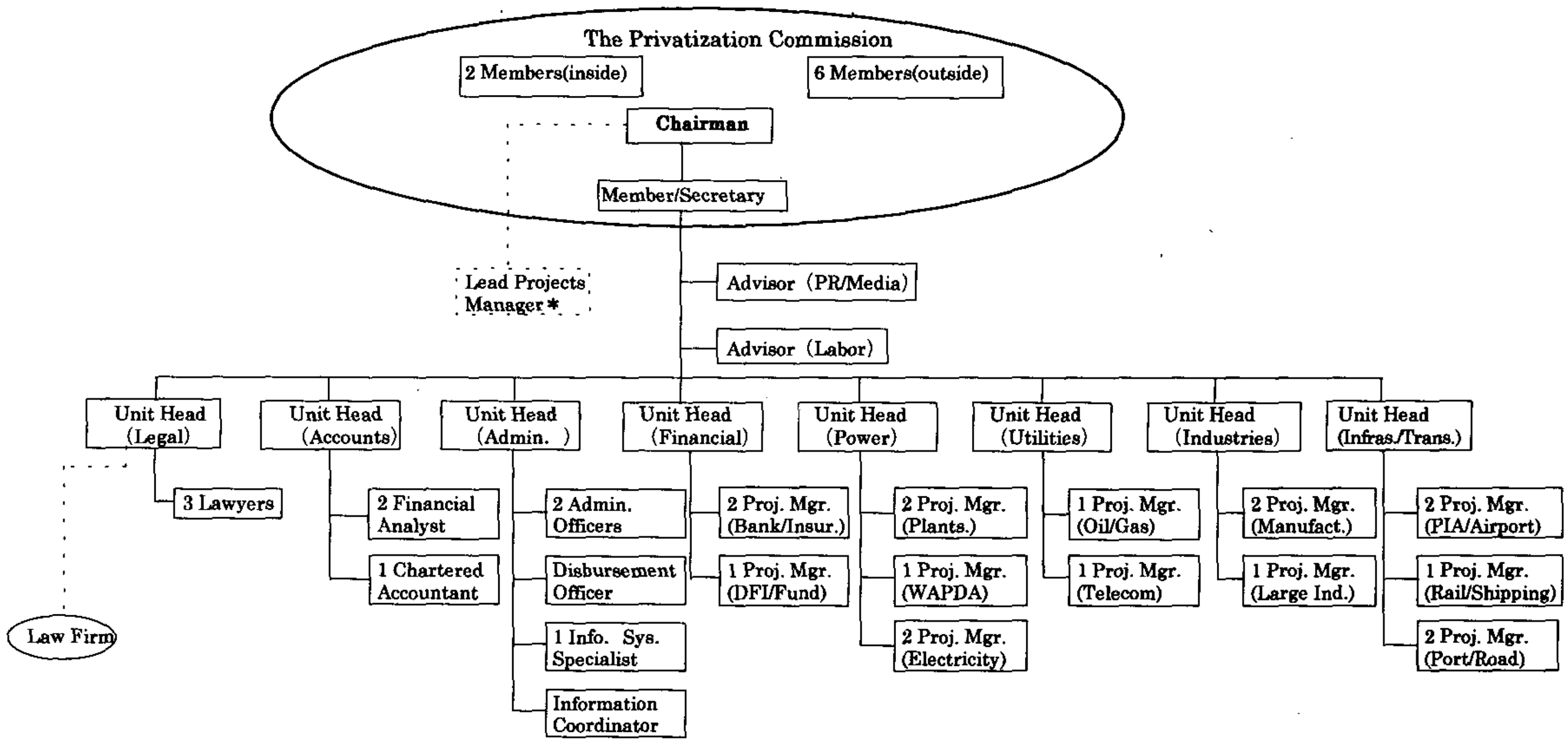
iii) Reemployment programs shall be reinforced such as recommendation for overseas work and vocational training.

iv) 10% of the stock of the privatized company shall be allocated to employees of the company concerned.

v) Employees shall be given preference in bidding for purchase of state-owned companies.

[1] Burden for payment shall be shared by the government and the company concerned. The company shall pay the remuneration, while the government and company shall each pay half of the retirement allowance. The total amount of government expenditures for this purpose was 1.84 billion rupees as of April 1997.

Fig. II-1: Organizational Chart of the Privatization Commission



* to be selected from among the Project Managers

(source) Privatization Commission, Government of Pakistan.

2.3 Privatization method in Pakistan

(1) Privatization method

Privatization is enforced according to one of the following forms:

1) Sale of a state-owned company to the private sector by bidding
2) Sale of stock of a state-owned company at an appraised value through the stock exchange
3) Sale to the Employment Management Group of the target state-owned company based on the market price negotiated with the Group considering assets, liabilities, and appraised net price of the company.
4) Conclusion of management right transfer contracts with "modaraba"[2] companies established by investors interested in the targeted company, for fund raising
5) Conclusion of a lease contract for a certain period or a transfer contract of management rights to private investors
6) Lease of management rights for a certain period to employees' union with the prospect of future purchase

Sales are made either through 1. Sale of stocks or assets by bidding, or 2. Sale of stocks through the stock exchange, and one of the following three methods is chosen:

i) Sale of all the stock of a state-owned company by bidding: Most medium to small state-owned companies are privatized in this manner at the moment. A successful bidder shall make payment to the Privatization Commission with 40% of the bid price and the remaining 60% in three yearly installments at the annual rate of 14% or in six yearly installments at 16%. The bidder should obtain guarantee at the time of making bid.
ii) Partial sale of stock including transfer of management rights: Large-sized state-owned companies such as banks, and electric utilities are privatized in this form of partial sale of stocks (at least 26%) including transfer of management rights. The remaining stock will be sold later. Kot Addu Power Company and Bankers Equity Ltd. were privatized in this manner.
iii) Partial sale of stock without transfer of management rights: For large-sized entities providing public services, partial sale is made without transfer of management rights through an international or domestic stock exchange. Pakistan Telecommunications Corporation was privatized in this manner.

[2] Commercial form based on Islamic profit and loss accounting.

(2) Purchasers of state-owned companies

State-owned companies are purchased mainly by foreign or domestic private individual investors or employees' unions of the company concerned. At bidding for the companies nationalized by the Zulfikar A. Bhutto administration in the 1970's, former owners were given preferential purchase rights. Thus, purchasers in Pakistan are divided into the three categories of former owners, foreign or domestic investors and employees' unions of the company concerned. According to the Privatization Commission, the order of preference is: 1. Employees' unions, 2. Former owners, and 3. Other investors.

2.4 Present situation of privatization

The Privatization Commission has called for public bids several times since the first announcement for tender for 115 state-owned companies in 1991. At the end of October 1996, tender was announced for 150 companies, 89 for which sale or transfer of management rights to the private sector has been completed,[3] with the remaining 61 companies being under negotiations or left without a prospective purchaser. There are 82 state-owned companies which have no plans for privatization (**Table II-1**). Among the 89 privatized companies, 12 of them were sold to the employees' union of the company concerned, while most of the remaining were sold to business groups with only 2 companies being sold to former owners. Despite the above-mentioned preferential purchase rights for former owners, very few companies were purchased by their former owners because most of them seemed to have a new business launched successfully and were not willing to buy back their old companies. There is also criticism of unfair privatization procedures not necessarily guaranteeing the preferences.

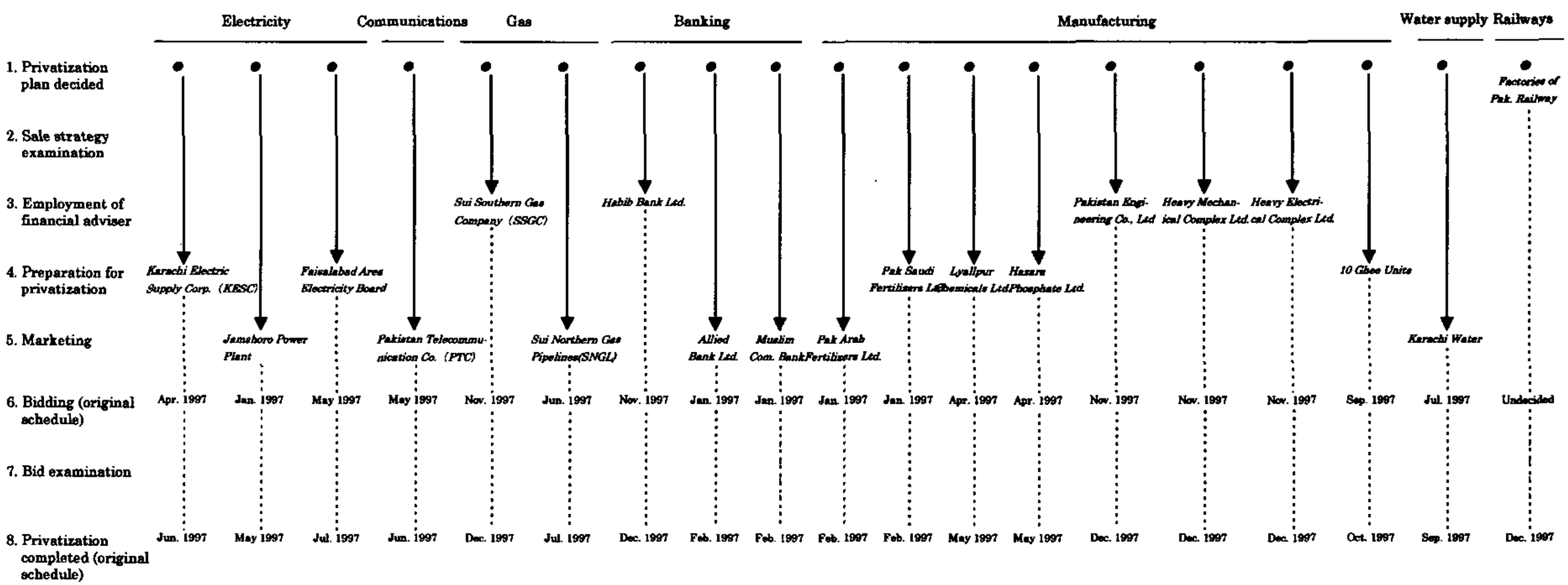
Looking at the classification of privatized companies by sector, it is possible to point out that a large portion is made up of manufacturing companies followed by five cases of publishing and printing (newspaper company). The companies for which tender is or will be announced are finance, electric power, transportation and airlines, aside from manufacturing. On the other hand, privatization has not progressed much in the areas of development finance, insurance, petroleum and gas, and mining. The total amount of bids came to about 2.35 billion rupees (See **Table II-1**).

Among 61 companies "to be privatized" in **Table II-1**, 13 of them are scheduled to be privatized by December 1997. What should be noted on this Table is that the privatization of 3 thermal power plants is proposed here. In the electricity

[3] Management rights have not been transferred for two of them (Indus Steel Pipes and Harnai Woollen Mills).

sector, only 1 of 11 thermal power plants has been privatized, but the Privatization Commission is determined to privatize another 3 companies by July 1997 (See **Fig. II-2**). Privatization is also being examined for a part of the railway sector.

Fig. II-2: Progress in privatization



(source) Privatization Commission, Government of Pakistan
The latest trends were reflected for banking and railway sectors

Table II-1: Classification of state-owned companies by category (as of end October 1996)

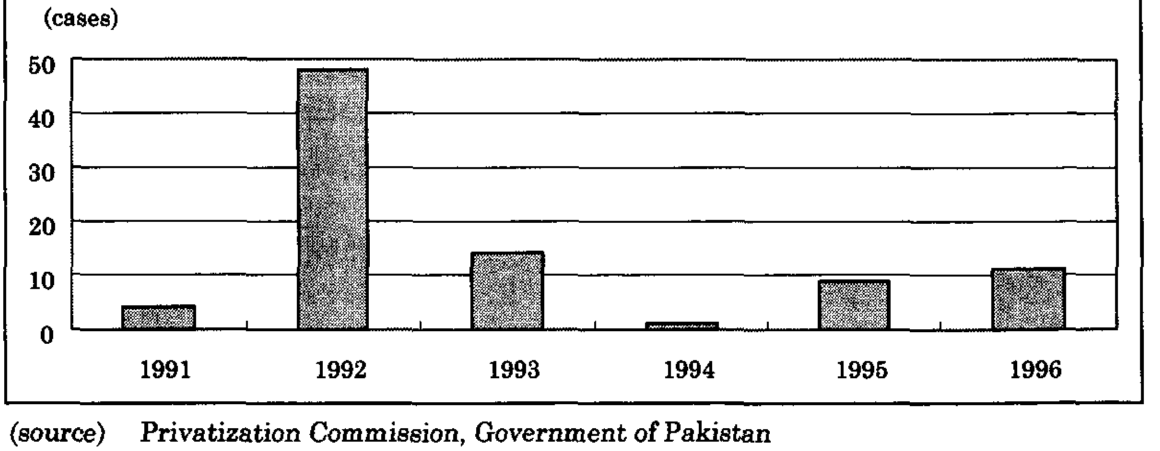
(unit: bidding price shown in millions of rupees)

	Already privatized		To be privatized	Bids not announced yet	Total
	Number of companies	Bidding price	Bidding price	Bidding price	Bidding price
Manufacturing industries	80	11990.9	26	23	129
Finance					
Commercial bank	2	3391.6	2	1	5
Specialized bank	0	0.0	1	2	3
Development Financial Institution	1	315.4	3	8	12
Insurance	0	0.0	0	3	3
Petroleum and gas	0	0.0	2	12	14
Mining	0	0.0	0	3	3
Electricity (thermal power plant)	1	7546.5	10	0	11
Communications	0	0.0	1	0	1
Transportation and airline	0	0.0	4	7	11
Publishing, printing and media	5	272.1	0	7	12
Others	0	0.0	12	16	28
Total	**89**	**23,516.5**	**61**	**82**	**232**

(source) Privatization Commission, Government of Pakistan

Referring to **Fig. II-3** for the transition of the number of privatized companies by year, despite a single case in 1994, the trend has been constant at around 10 cases in 1995 and 1996, after the peak of 48 cases in 1992.

Fig. II-3: Transition of the privatized company



(source) *Privatization Commission, Government of Pakistan*

2.4.1 Privatization in the manufacturing sector

(1) Management and operation system of state-owned companies in the manufacturing sector

Management rights for 32 companies in 10 industries[4] were confiscated under the "Economic Reform Order" promulgated in January 1972 by the Zulfikar Bhutto administration, and these companies were put under single control of the Board of Industrial Management (BIM). For more efficient operation of the state-owned companies, 10 corporations[5] were classified by sector under the BIM in January 1974. Further more, concerning industries other than the 10 manufacturing industries under the BIM, the edible oil industry was nationalized in 1973 and 24 related companies were placed under the control of the Pakistan Ghee Corporation from 1976.

Then, with the deregulation policy of the Haq administration, this state-owned company management system came to be reformed. The BIM was abolished in 1978 and the Ministry of Industries & Production became the controlling office for the manufacturing corporations. At that time, Federal Light Engineering Corporation (FLEC) and State Heavy Engineering & Machine Tool Corporation (SHE&MTC) were absorbed by State Engineering Corporation Ltd. (SEC). As of the end of fiscal year 1994, state-owned companies in the manufacturing industry consisted of 13 corporations, including 8 corporations controlled by the Ministry of Industries & Production, Pakistan Ghee Corporation, Carrier Telephone Industries Ltd., established before 1972, Karachi Shipyard and Engineering Works Ltd., Roti Corporation of Pakistan Ltd., and Telephone Industries of Pakistan Ltd. Value-added production of the 8 corporations under the Ministry of Industries & Production reached 4.54 billion rupees, equivalent to approximately 2% of GDP (See **Table II-2**).

[4] These 10 industries are 1. iron and steel, 2. basic metals, 3. heavy mechanical, 4. heavy electrical machinery, 5. automobiles, 6. tractors, 7. heavy and basic chemical, 8. petrochemical, 9. cement, and 10. public utilities (electricity, gas, oil refinery).

[5] These 10 corporations are 1. Federal Chemical & Ceramics Corporation Ltd. (FCCCL), 2. National Fertilizer Corporation of Pakistan Ltd. (NFC), 3. Pakistan Automobile Corporation Ltd. (PACO), 4. Pakistan Industrial Development Corporation Ltd. (PIDC), 5. State Cement Corporation of Pakistan Ltd. (SCCP), 6. Federal Light Engineering Corporation (FLEC), 7. State Heavy Engineering & Machine Tool Corporation (SHE&MTC), 8. State Engineering Corporation Ltd.(SEC), 9. State Petroleum Refining & Petrochemical Corporation Ltd. (PERAC), and 10. Pakistan Steel Mills Corporation Ltd. (PASMIC).

Table II-2: Government-Sponsored Corporations under the Ministry of Industries & Production (as of 1994)

Name of corporation (GOSs)	Number of affiliated companies (plants)	Value-added production (million rupees)
1. Federal Chemical & Ceramics Corporation Ltd.(FCCCL)	1	1,265
2. National Fertilizer Corporation of Pakistan Ltd.(NFC)	6	5,882
3. Pakistan Automobile Corporation Ltd.(PACO)	4	388
4. Pakistan Industrial Development Corporation Ltd.(PIDC)	4	509
5. State Cement Corporation of Pakistan Ltd.(SCCP)	4	3,024
6. State Engineering Corporation Ltd.(SEC)	6	3,159
7. State Petroleum Refining & Petrochemical Corporation Ltd.(PERAC)	2	16,462
8. Pakistan Steel Mills Corporation Ltd.	1	14,677
Total	**28**	**45,366**

(source) Government of Pakistan, Finance Division, Economic Advisor's Wing, "Government Sponsored Corporations"

(2) Progress of privatization in the manufacturing industry

The Pakistan government has promoted the sales of state-owned companies to the private sector through public tender since establishment of the Privatization Commission in 1991. Since then, privatization has been enforced mainly in the manufacturing industry (See **Table II-1**). According to **Table II-3** showing current situation of privatization in the manufacturing industry by sector, progress has been made in all sectors, especially in the rice polishing sector where all companies and plants have completed privatization and also in the chemical and Roti (bread) sectors where 12 among 13 companies and plants have been privatized. However, looking in terms of the bidding price, rice-polishing and Roti (bread) companies and plants are small in size, while the total of bids in the cement sector reached about 7.6 billion rupees and amount to a little more than 60% of the total bidding price in the manufacturing industry.

In the chemical fertilizer sector in which all companies and plants were in the black on their balance sheet as of the end of 1994, only 1 company (plant) of 7 was privatized. The Privatization Commission is now proceeding with privatization in this sector, especially for Pak Arab Fertilizers Ltd. and Pak Saudi Fertilizers Ltd., two companies which show favorable business performance (See the above **Fig. II-2**).

Table II-3: Progress of privatization in the manufacturing industry by sector

Sector	Number of privatized companies (plants)	Bidding price (million rupees)	Number of state-owned companies (plants)
Automobile	7	1,111.9	4
Cement	11	7,550.8	4
Rice polishing	8	237.4	0
Engineering	7	148.6	6
Ghee (edible oil)	16	589.0	10
Roti (bread)	12	78.3	1
Chemical fertilizer	1	435.0	6
Chemical	12	1,610.6	1
Others	6	229.4	17
Total	80	11,990.9	49

(source) Privatization Commission, Government of Pakistan

Table II-4 *shown in the following three pages,* classifies state-owned companies in the manufacturing industry into three categories: scheduled for privatization, having been privatized, and others.[6] As shown in the Table, as of the end of October 1996 among 42 remaining state-owned companies, 26 of them are scheduled to be privatized and 16 of them are not supposed to be privatized for the time being.

The companies "scheduled for privatization" in the Table mean those for which tender was announced for sale to the private sector, and they are further classified into 1. Those with bidders from private groups, with procedures for privatization under way; 2. Those without bidders despite announcement, with no prospect for privatization. The companies *in* Gothic *in* **Table II-4** *correspond to the* former category, and they are comprised of 4 companies in the National Fertilizer Corporation of Pakistan Ltd., 3 companies in the State Engineering Corporation Ltd. and 10 companies in the Ghee (edible oil) Corporation of Pakistan Ltd., totaling 17 companies. These companies are varied in progress of privatization, but they are scheduled to complete their privatization process within the year 1997.

[6] State-owned companies without plans for privatization

Table II-4 (1): Progress in privatization of manufacturing companies as of the end of October 1996

Government-Sponsored Corporations (GOSs)	State-owned companies: Companies scheduled to be privatized (tender announced)	State-owned companies: Companies without announcement of tender	Companies privatized after 1991
Federal Chemical Ceramics Corporation, Ltd. (FCCCL)	1. Ravi Rayon Ltd.		1. Antibiotic Ltd. 2. Ittehad Chemicals Ltd. 3. Kurram Chemicals Company, Ltd. 4. Nowshera PVC Ltd. 5. National Fibres Ltd. 6. Pakistan PVC Company, Ltd. 7. Sind Alkalis Ltd. 8. Pak Dyes & Chemicals 9. Swat Ceramics Ltd. 10. Swat Elutriation Plant 11. Ravi Engineering Ltd. 12. Nowshera Chemicals
National Fertilizer Corporation of Pakistan, Ltd. (NFC)	**2. Pak Saudi Fertilizers Ltd.** **3. Pak Arab Fertilizers Ltd.** **4. Lyallpur Chemicals Ltd.** **5. Hazara Phosphate Ltd.** **6. National Fertilizers Marketing Ltd.**	1. Pak American Fertilizers Ltd.	13. Pak China Fertilizers Ltd.
Pakistan Automobile Corporation, Ltd. (PACO)	7. Republic Motors Ltd. 8. Sind Engineering Ltd.	2. Pakistan Motor Car Co., Ltd. 3. TDC Vehicle Engineering Ltd.	14. Al-Ghazi Tractors Ltd. 15. Baluchistan Wheels Ltd. 16. Bolan Castings Ltd. 17. Millat Tractors Ltd. 18. Nayadaur Motors Ltd. 19. National Motors Ltd. 20. Pak Suzuki Motor Company
Pakistan Industrial Development Corporation, Ltd. (PIDC)		4. Bela Engineers Ltd. 5. Dir Forest Industries Ltd. 6. Larkana Sugar Mills Ltd. 7. Shahdadkot Textile Mills Ltd.	21. Cotton Ginning Factory 22. Quaidabad Woolen Mills 23. Harnai Woolen Mills 24. Indus Steel Pipes Ltd.

Table II-4 (2): Progress in privatization of manufacturing companies as of the end of October 1996

Government-Sponsored Corporations (GOSs)	State-owned companies		Companies privatized after 1991
	Companies scheduled to be privatized (tender announced)	Companies without announcement of tender	
State Cement Corporation of Pakistan, Ltd. (SCCP)	9. Javedan Cement Ltd. 10. Mustehkam Cement Ltd. 11. Thatta Cement Co. Ltd.	8. Associated Cement, Rohri Ltd.	25. Dandot Cement Company, Ltd. 26. D.G.Khan Cement Company, Ltd. 27. Gharibwal Cement Ltd. 28. Kohat Cement Ltd. 29. National Cement (Dandot) Ltd. 30. Maple Leaf Cement Factory Ltd. 31. Pak Cement Company, Ltd. 32. White Cement Industries Ltd. 33. Zeal Pak Cement Ltd. 34. Wah Cement Co., Ltd. 35. General Refactories Ltd.
State Engineering Corporation, Ltd. (SEC)	**12. Pakistan Engineering Co. Ltd.** **13. Heavy Mechanical Complex Ltd.** **14. Heavy Electrical Complex Ltd.** 15. Spinning Machinery Company of Pakistan Ltd.	9. Pakistan Machine Tool Factory Ltd. 10. State Engineering Project Company, Ltd.	36. Karachi Pipe Mills Ltd. 37. Metropolitan Steel Corporation, Ltd. 38. Pakistan Switshgear Ltd. 39. Pioneer Steel Mills Ltd. 40. Quality Steel Works Ltd. 41. Textile Machinery Co., Ltd.
State Petroleum Refining & Petrochemical Corporation, Ltd. (PERAC)	16. ENAR Petrotech Services Ltd.	11. National Refinery Ltd.	42. Pak Hy-Oils Co., Ltd. 43. National Petrocarbon Ltd.
Pakistan Steel Mills Corporation, Ltd.		12. Pakistan Steel Mills Corporation, Ltd.	

Table II-4 (3): Progress in privatization of manufacturing companies as of the end of October 1996

Government-Sponsored Corporations (GOSs)	State-owned companies		Companies privatized after 1991
	Companies scheduled to be privatized (tender announced)	Companies without announcement of tender	
Ghee Corporation of Pakistan, Ltd. (GCP)	**17. Morafco Industries Ltd.** **18. Kohinoor Oil Mills Ltd.** **19. Universal Oil & Vegetable Ghee Mills Ltd.** **20. Burma Oil Mills Ltd.** **21. Maqbool Company Ltd.** **22. A & B Industrial Gases Ltd.** **23. E.M.Oil Mills & Industries Ltd.** **24. The Punjab Veg.Ghee & General Mills Ltd.** **25. Dargai Vegetables Oil Processing Industries** **26. The Sargroh Vegetable Ghee and General Mills**		44. Fazal Vegetable Ghee Mills Ltd. 45. Suraj Ghee Industries Ltd. 46. United Industries Ltd. 47. Kakakhel Industries Ltd. 48. Crescent Factories 49. Sh.Fazal Rehman & Sons Ltd. 50. Wazir Ali Industries Ltd. 51. Hydari Industries Ltd. 52. Asaf Industries Ltd. 53. Bengal Vegetables Industries Ltd. 54. A & B Oil Industries Ltd. 55. Associated Industries Ltd. 56. Bara Vegetables Ghee Mills 57. Haripur Vegetables Oil Processing Industries 58. Chiltan Ghee Mills 59. Khyber Vegetables Ghee Mills Ltd.
Carrier Telephone Industries Ltd. (CTI)		13. Carrier Telephone Industries Ltd.	
Karachi Shipyard and Engineering Works Ltd. (KSEW)		14. Karachi Shipyard and Engineering Works	
Roti Corporation of Pakistan Ltd. (RCP)		15. Roti Corporation of Pakistan Ltd.	
Telephone Industries of Pakistan Ltd. (TIP)		16. Telephone Industries of Pakistan Ltd.	

(source) "Public Sector Industries Annual Report 1994 - 1995," Ministry of Industries & Production, Privatization Commission, Government of Pakistan.

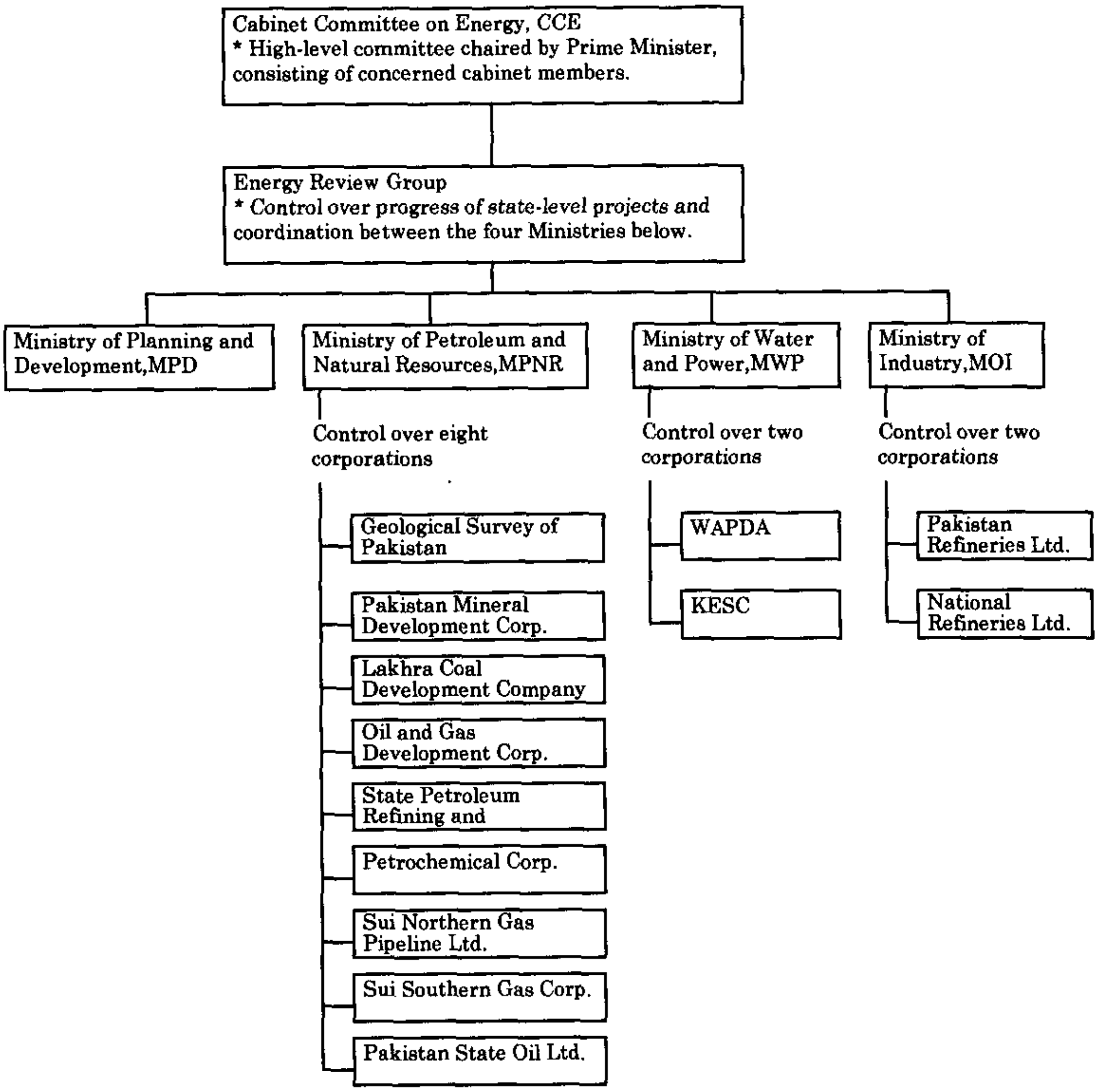
2.4.2 Privatization in the electricity sector

(1) Supervision and operation system in the electricity sector

The electricity sector in Pakistan, placed under the control of the Ministry of Planning and Development (MPD) and the Ministry of Water and Power (MWP) is operated by the Water and Power Development Authority (WAPDA) and the Karachi Electric Supply Corporation (KESC), from power generation to distribution. The supervision and implementation system is as shown in **Fig. II-4.**

Regarding the main operations of MPD, MWP, WAPDA and KESC, the MPD is responsible for formulating electricity demand forecasts and development plans, registrating large scale projects into five-year plan, and also for basic research operation concerning the whole energy sector. Under coordination with MPD, MWP is in charge of development projects of water resources and electricity, supervising WAPDA and KESC. More concretely, MWP checks applications requested from WAPDA and KESC concerning electric installation program, local electrification, and planning for approval by MPD. MWP is also responsible for establishing electricity utility rates. WAPDA is characterized as state-owned juridical person licensed under the 1910 Electricity Law. It's main operation is to supply electricity all over the country excluding KESC's service area. KESC was established in 1913 as a British private company but was reformed into a state-owned enterprise in 1952 after independence, and the government holds about 90% of the stocks now. Its service area is limited to Karachi district and its suburbs.

Fig. II-4: Administrational organization of the energy sector



(2) Electricity demand in Pakistan

The Pakistan government made a forecast in its eighth five-year plan (fiscal 1993 to 1997) that electricity demand would grow at an annual rate of 5.35%, and that peak demand would reach 11,173 MW in fiscal 1997, increasing from 8,611 MW in fiscal 1992. They thus formulated a plan to raise electric plant capacity from 10,027 MW in fiscal 1992 to 16,422 MW in fiscal 1997, taking into account the demand increase during that time and thereafter. As to increase in plant capacity, the plan allocates 3,572 MW to WAPDA, 63 MW to KESC, totaling 3,695 MW (including 1,450 MW for Ghazi Barotha Hydro), and 2,700 MW to the private sector.

The plant capacity increase is expected to be 3,476 MW for WAPDA and KESC and 4,583 MW for the private sector during the eighth five-year plan period, and it results in a total capacity of 18,086 MW at the end of the fiscal 1997, which greatly exceeds the planned level (See **Table II-5**). In this remarkable increase, the drastic growth in the private sector should be noted. As many as nineteen private power plants, including a large thermal plant of the Hub River Project, are being constructed (See **Table II-6**).

The present situation as of March 1997 with power plants as related to WAPDA, KESC and the private sector is shown in **Table II-7**.

Table II-5: Electric plant capacity during and after the seventh and the eighth five-year plans

	Plant capacity as of June 1986	seventh five-year plan (1988 to 1992)	At completion of the seventh five-year plan (June 1992)	eighth five-year plan (1993 to 1997)	At completion of the eighth five-year plan (estimate)
Total for public sector	6,657	11,753	9,890	13,585	13,366
WAPDA	5,549	9,985	8,152		*1 11,565
KESC	1,108	1,768	1,738		1,801
Private sector	0	1,330	0	2,700	4,583
PAEC *2	137	137	137	137	137
Total	**6,794**	**13,220**	**10,027**	**16,422**	**18,086**
(c.f.) Peak demand			8,611	11,173	

*1 Including KUPCO (Kot Addu 1 - 15) 1,620 MW after privatization.

*2 PAEC: Pakistan Atomic Energy Commission

(source) Government of Pakistan, KESC

Table II-6: Electric generating equipment in Pakistan (as of March 1997)

Power plant	Power generating capacity	Capacity of the plant in operation during the eighth five-year plan
I. WAPDA		
1. Hydro power plant		
i. Tarbela	3,478	Unit 13,14 (864 MW)
ii. Mangla	1,000	Unit 9,10 (200 MW)
iii. Warsak	240	
iv. Small Hydels	107	
Hydro power generation: Total	**4,825**	
2. Thermal power plant		
i. Multan Steam	260	
ii. Faisalabad Steam	132	
Faisalabad Gas Turbines	100	44 MW
Faisalabad Combined Cycle	144	
iii. Shahdara Gas Turbines	85	
iv. Guddu Steam Units 1-4	640	
Guddu Combined Cycle Units 5-13	1,015	Unit 9 (145 MW)
v. Sukkur Steam	50	
vi. Kotri Gas Turbines	30	
Kotri Gas Combined Cycle	144	44 MW
vii. Jamshoro Oil Fired Units 1-4	880	
viii. Muzaffargarh Units 1-6	1,370	Unit 1-6 (1,370 MW)
ix. Fluidized Bed at Lakhara 1-3	150	Unit 1-3 (150 MW)
x. Quetta Steam Gas Turbines	83	
xi. Pasni (Diesel Generators)	17	
xii. MESCO Steam	20	
xiii. KAPCO Units 1-15	1,620	Unit 11-15 (596 MW)
Thermal power generation: Total	**6,740**	
WAPDA: Total	**11,565**	Total of increased capacity: 3,413 MW
II. KESC		
1. Thermal power plant		
i. West Wharf&Duel Fuel	0	1. West Wharf & Duel Fuel, Construction stopped (81 MW)
ii. Korangi Steam Units 1,3,4	316	2. Unit 2 (66 MW) Operation stopped
Korangi Town Gas Turbines	100	
iii. SITE Gas Turbines	125	
iv. Bin Qasim Steam Units 1-5	1,050	
KESC: Total	**1,591**	No increased capacity
III. PAEC		
1. Nuclear power plant		
i. KANUPP	137	
IV. Private sector		
1. Thermal power plant		
i. HUBCO Units 1-3	969	Unit 1-3 (969 MW) *
Total	**14,262**	**Total of increase: 4,382 MW**

* Unit 4 is scheduled to start operation in April 1997.

Table II-7: Power plant on-going projects (MW)

Power plant	Plant capacity	Generated Power	PPAs signing date	Scheduled operation date	Remarks
Public sector					
i. KESC Bin Qasim Unit6	210	200	-	1997.07	*☆
ii. WAPDA Chashma Low Head	184	184	-	1998.12	
iii. WAPOA Ghazi Barotha	325	300	-	1999.10	☆
iv. PAEC Chashma Nuclear	1450	1450	-	2000.01	
Public sector: Total	**2169**	**2134**	-		
Private sector					
i. Hub Power Project Unit4	323	300	1994.11.24	1997.04	*☆
ii. AES Lalpir Ltd.	362	337	1994.11.03	1997.11	*
iii. AES Pak Gen (Pvt) Ltd.	365	337	1995.09.05	1997.12	*
iv. Kohinoor Energy Power Co. Ltd.	131	120	1994.11.08	1997.04	*
v. Southern Electric Power Co. Ltd.	117	112	1994.11.17	1997.09	*
vi. Japan Power Generation Ltd.	120	107	1995.03.21	1997.10	*
vii. Davis Energen (Pvt) Ltd.	10	10	1995.01.18	1997.07	*
viii. Power Generation Systems Ltd.	116	110	1995.09.25	1997.07	*
ix. Habibullah Coastal Energy Ltd.	140	136	1996.03.25	1997.12	*
x. Saba Power Company Ltd.	114	104	1994.12.26	1998.02	*
xi. Rousch (Pakistan) Power Ltd.	412	358	1995.02.25	1998.03	*
xii. Uch Power Project Ltd.	586	525	1995.11.23	1997.11	*
xiii. Fauji Kabirwala Power Co. Ltd.	157	144	1996.03.21	1998.11	
xiv. Altern Energy Ltd.	14	13	1995.09.18	1997.07	*
xv. Liberty Power Project	235	212	1995.11.26	1997.08	*
xvi. Eeshatech Ltd.	20	18	1996.03.19	1998.04	*
xvii. Northern Electric Company	6	6	1995.01.17	1998.11	
xviii. Consolidated Electric Power Asia Ltd.(CEPA)	1426	1320	1995.10.27	1999.09	
xix. KESC Gul Ahhmed Energy Ltd.	136	125		1997.04	*
Sabah Shipyard Pakistan Ltd.	288	274		1997.10	*
Tapal Energy Ltd.	126	120		1997.11	*
Private sector: Total	**5204**	**4788**			
Total	**7373**	**6922**			☆800 MW in total, about 12%

(note) * indicates plants scheduled to start operation by the end of the eighth five-year plan (June 1998).

☆ indicates plants funded by OECF loan.

(3) Basic privatization policy in the electricity sector

(a) System establishment to promote privatization

Electric power development is imminent in Pakistan to deal with rapidly growing electric demand. Mobilization of private resources and privatization of the power sector is being vigorously discussed in order to solve problems related to insufficient fiscal funds and inefficient management and operation of the WAPDA. For this reason, invitations for new private power plants and privatization of existing thermal power generation or distribution plants are being promoted.

The Pakistan government published the "Policy Framework and Package of Incentive for Private Sector Power Generation Projects in Pakistan" in March 1994: The hydro power version was also published in May as a means to advance privatization in the power sector. Through these policies, employment of private funds is encouraged to reinforce power generating facilities. Measures taken in the field of power generation is to introduce Independent Power Producer (IPP) system to invite private investment so that private entities can construct and operate power plants, and then sell produced electricity to state-owned power companies. Several preferential investment measures were adopted to facilitate the implementation of this system.[7] A Private Power and Infrastructure Board (PPIB) was established in September 1994 to act as a unitary window of government in case of bid announcements for private power and infrastructure projects, give support for bid examination, and contract consultation between private sector and governmental organizations.

(b) Privatization policy

The privatization of WAPDA and KESC has already been indicated, however hydro power plants and transmission sector are not expected to be privatized for the time being. Based on this policy, WAPDA shall follow the plan where hydro plants and transmission sector (national grid) remain state-owned, while thermal plants and end distribution sector are divided into about eight districts and privatized. That is, private funded power generation plants and distribution stations shall be operated by the state as the electricity pool sector, linking the power generation

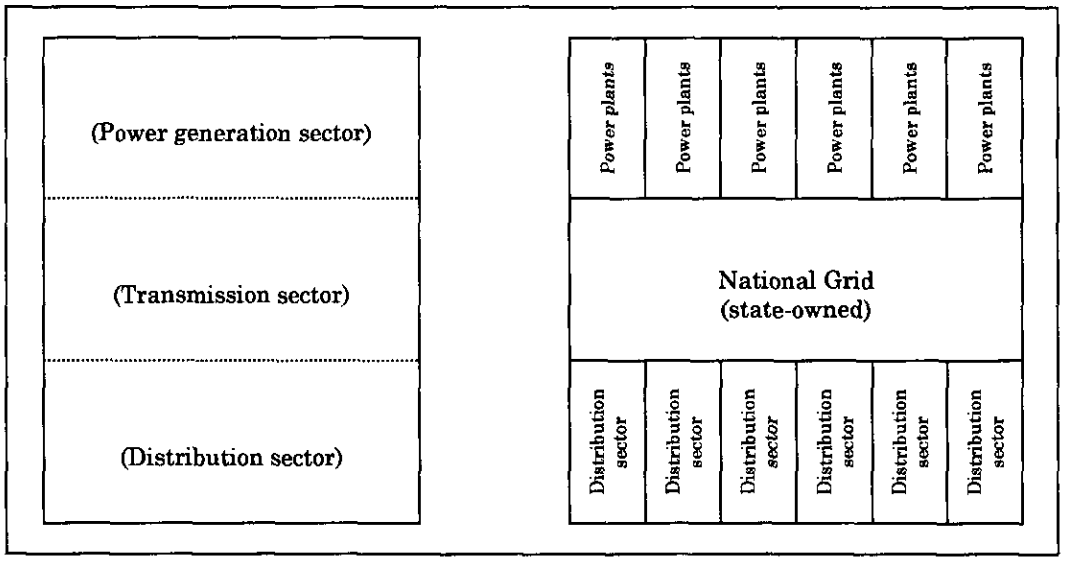
[7] Main preferential investment measures are as follows: (i) decision on construction sites, technology to be applied, and kind of fuel to be used at the power plant are at the private sector's discretion. (ii) Governmental guarantee for selling price control and for electric sale contracts between private power plants and WAPDA or KESC; (iii) Governmental guarantee for fuel procurement from state-owned enterprises, for foreign exchange risk, and for overseas remittance risks; (iv) Fund raising from the Private Sector Energy Development Fund (PSEDF) established mainly by the World Bank. Conditions of loans are set up within 40% of the project fund with 14% interest rate. The repayment period is 23 years including average grace period of 8 years.; (v) Reduction and exemption of corporate tax and indirect tax on machinery and equipment; (vi) Simplification of investment procedures.

sector and distribution sector divided into eight districts (See **Fig. II-5**).

KESC shall be privatized by selling part of its stock (26% of the total) owned by the state-owned financial institution. During the process of privatization, KESC shall not be divided like WAPDA for the time being, however, the transmission sector of KESC shall be connected to the national grid of WAPDA and finally, separate it into power generation sector and distribution sector.

The Pakistan government has promoted private investment in the electricity sector since fiscal 1994 and has adopted preferential investment measures. Many private power plants' construction programs have been scheduled since then. As shown in **Table II-4**, 19 private plants are under construction and 16 of them are expected to start their operation in fiscal 1997. These new power plants will make a great contribution to reinforce power generation capacity in Pakistan. In addition, the first to fourth units of the Hub River Thermal Plant, first example of private sector financed infrastructure project in Pakistan will have started operation in 1997 (The fourth is expected to start in April 1997).

Fig. II-5: Proposed privatization image of WAPDA and KESC



(4) Future projections on privatization

(a) Improvement of organization system for further promotion of privatization

Privatization program for WAPDA was already indicated as mentioned before, that is to say, power generation, transmission and distribution sectors will be divided and reorganized with private power plants. A National Electric Power Regulatory Authority (NEPRA) is expected to be established in order to coordinate the entire electricity sector including private thermal power plants and distribution stations, in addition to the reorganized WAPDA. The NEPRA is supposed to coordinate power supply and demand, establishment of electricity utility rates and planning of investment program in the electricity sector. As a result, the remaining operation of WAPDA will be the management of hydro power generation development and rural electrification.

However, it is worth paying attention to WAPDA's balance sheet. WAPDA is managed based on fixed buying prices through purchase contracts with the Hub Power Company Limited (HUBCO). However, the Sharif administration announced that the government wouldn't make any revision of public utility-rates just after its inauguration. For this reason, WAPDA can not obtain adequate sales revenue in accordance with the total purchase price. In addition, the rates collection system is partially inoperative, and uncollected income is actually a big burden on WAPDA's management.

On the other hand, the Private Power and Infrastructure Board (PPIB) was established in September 1994 as a governmental window to deal with privatization procedures.

(b) Future projections

Based on the above proposed system, the Pakistan government made public the following policy as an overall view of the future electricity sector:

i) Along with the policy to construct new thermal power stations with private funds, a power generation sector will be formed based on free competition between private independent companies;

ii) WAPDA shall engage in operation and management of multi-purpose large-sized hydro power plants;

iii) Build up a system where privatization of power generation and distribution sector is promoted, and dealing of electric power is controlled by the national grid;

iv) Establishment of private distribution system to supply electricity to end users.

(5) Evaluation of the privatization policy

The Pakistan government announced promotion of public investment in the electricity sector since fiscal 1994 and has introduced preferential investment measures. In response to this policy, many private power plants construction programs have been made since then. 19 private plants are now under construction, 16 of which will start operation in fiscal 1997. These facilities are expected to contribute to reinforcement of power generation in Pakistan. In addition, power generation and distribution sectors are also scheduled to be privatized, according to eight local district units (Faisalabad, Lahore, Gujaranwala, Islamabad, Quetta, Multan, Peshawar and Hyderabad). Power distribution sector is not on the privatization schedule for the moment, however the Faisalabad district, with a low distribution loss rate, is preparing for privatization and tenders will be invited in the middle of fiscal 1997.

Privatization in power generation sector has been achieved only with Kot Addu thermal Power Plant, through sale of stock to the private sector. 26% of total stock was sold to the private sector along with the management rights by bidding at the end of May 1996. Another 10% was sold after that, and the remaining 64% is scheduled to be sold gradually. The management rights from power generation planning to price setting were completely transferred to the private company. Regarding employment side, it is based on the employment agreement between APSEWAC and the government.

In this way, privatization of the electricity sector in this country is now being conducted and is expected to be enforced according to the plan.

2.5 Causes for delay in progress of privatization

Privatization policy has been promoted since 1991 and was achieved mainly in the manufacturing sector, while at the same time delays in privatization schedule of large-sized state-owned companies including power plants became evident. Causes for the delays could be summarized as 1. distrust of investors of unfair privatization procedures, and 2. increase in labor cost due to difficulty in firing surplus staff.

(1) Underhand privatization procedures

At the time of the privatization of the Muslim Commercial Bank, held in January 1991, the successful bidder was an industrial investor who was reported by some press to be very closely related to the Prime Minister instead of the former owner. This event gave rise to public distrust in the privatization policy as an example of the connection between the financial world and the government, as well as distrust of underhand privatization procedures. Future privatization, of large state-owned companies in particular, can be implemented more smoothly by securing transparency in procedures through information disclosure.

(2) Problem of surplus staff

Since expansion of employment in public enterprises has been promoted by political demand, large-sized state-owned companies are now facing the problem of surplus staff. On the other hand, an agreement concluded between APSEWAC and the government to protect employees against easy dismissal prevents efficient management through staff reduction. Negotiations between the management and the labor unions concerning managerial improvement after privatization are frequently met with difficulty, that is why, investors seem to loose their incentive to participate in new bidding sessions. In the case of Kot Addu Thermal Power Plant, negotiations with the WAPDA labor union were tough, and privatization was delayed for six months from the original plan. In the process, the government (Privatization Commission) come to an agreement with the union on conditions much more compromised than that of the APSEWAC. In the Zeal Pak Cement case, shutdown lasted for more than six months because of an employees' strike.

The problem of surplus staff may be resolved by fostering industries and creating employment to take in those dismissed. The most important thing is to promote smoothly the process of privatization by preventing opposition of public enterprise employees who were given vested interests.

CHAPTER III

BUSINESS RESULTS AFTER PRIVATIZATION

The present situation of privatization policy in Pakistan has been outlined, special attention was paid to manufacturing and electricity sectors to see the progress. In this chapter, the automobile, cement, and edible oil (ghee) sectors of the manufacturing industry, showing relatively successful progress in privatization, will be picked up and evaluated in comparison with other sectors, to see whether there is any problem to be solved in order to achieve the main objectives.

3.1 Automobile sector

Privatized companies in the automobile sector and their sale prices are shown in **Table III-1.**

Table III-1: Privatization in the automobile sector

Name of company	Bidding price (million rupees)	Privatized in
1. Al Ghazi Tractors	104	1991
2. Millat Tractors	306	1992
3. Pak Suzuki Motors	172	1992
4. National Motors	139	1992
5. Baluchistan Wheels	281	1992
6. Nayadaur Motors	41	1993
7. Bolan Castings	69	1993
Total	1,112	

(source) BMA Capital Management.

In the first half of the 1980's, the automobile sector was completely under the control of the government, and all policies relating to import, assembly of parts, sale and price setting were determined by the government. In the latter half of the decade however, entry of private companies was allowed, and state-owned enterprises were privatized in the 1990's. Most of the privatized companies succeeded in bettering of management, product quality, and fiscal conditions were improved. Some companies sought joint ventures with foreign enterprises as was the case with national Motors and Isuzu of Japan.

3.2 Cement sector

3.2.1 Achievements of privatization in the cement sector

Privatized companies in the cement sector and their sale price are as shown in **Table III-2**. In this sector, eleven companies have been privatized since the initial privatization of Dandot Cement in 1992, and four enterprises still remain state-owned.

Table III-2: Privatization in the cement sector

Name of company	Bidding price (million rupee)	Privatized in
1. Dandot Cement	637	1992
2. D.G.Khan Cement	1,800	1992
3. Gharibwal Cement	836	1992
4. Kohat Cement	528	1992
5. Maple Leaf Cement	291	1992
6. Pak Cement	189	1992
7. White Cement	137	1992
8. Zeal Pak Cement	240	1992
9. National Cement	110	1995
10. General Refactories	31	1996
11. Wah Cement	2,752	1996
Total	**7,551**	

(source) BMA Capital Management.

3.2.2 Business results for privatized companies in the cement sector

Figs. III-1 to **III-4** show recent business results for three state-owned companies and three privatized companies in the cement sector.[1] The three privatized companies were all privatized in 1992.

First of all, recent trends in production and sales index for each company will be compared with fiscal 1989 as a reference of 100. Both production and sales index are on the rise in general. When the state-owned enterprises are compared with the privatized, the latter have a stronger tendency of increase, especially in sales index. One of the reasons is that privatized companies succeeded to correct production price, which had been controlled at a low level, to meet manufacturing costs.

[1] These six cement companies are those who replied to a questionnaire for research through interview entrusted to BMA Capital Management, a consulting company in Karachi.

Fig. III-1: Cement sector companies, production index

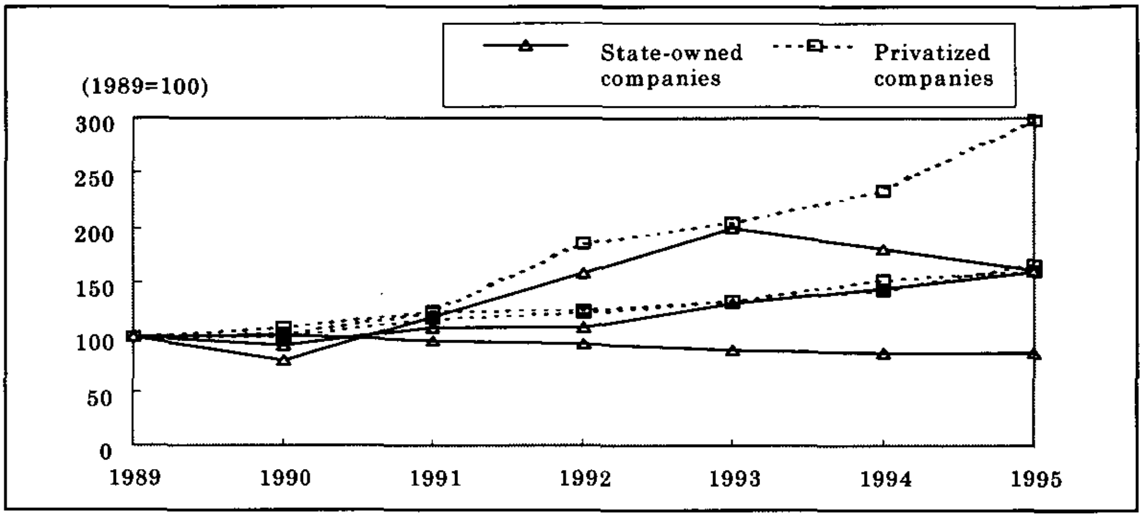
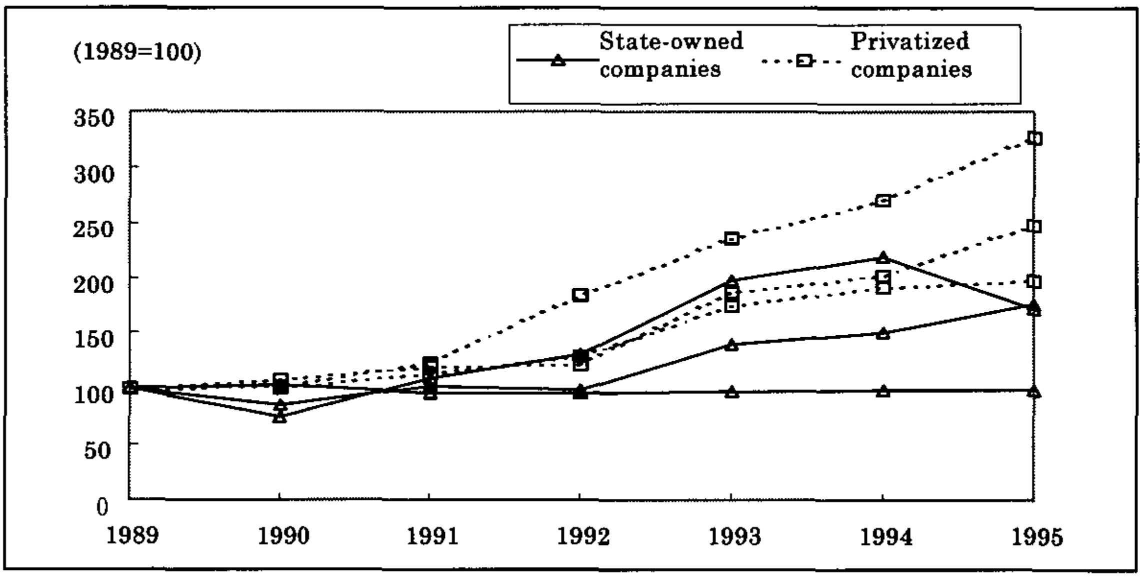


Fig. III-2: Cement sector companies, sales index



Referring to **Fig. III-3** showing profits and loss index, they all have an increasing tendency as can also be seen here. Especially, increased profits in the privatization year of 1992 and thereafter are remarkable for privatized companies, and the two state-owned companies also came into the black in fiscal 1993 with the remaining one company expanding profits. Therefore, it can be concluded that privatization policy had a favorable influence both on the state-owned and the privatized companies.[2] **Figure III-4** shows active investment in equipment, and it

[2] The Pakistan economy was in a depression in fiscal 1992 and recovered in fiscal 1993 and thereafter. However, the increasing tendency of index shown here considerably exceeds contribution by such macro economic factors. Lifting of price controls over cement leads to sales hikes naturally, but it should be noted that five out of six companies had increased production from fiscal 1989.

shows the positive management attitude of the privatized companies.

Fig. III-3: Cement sector companies, transition of profits and losses

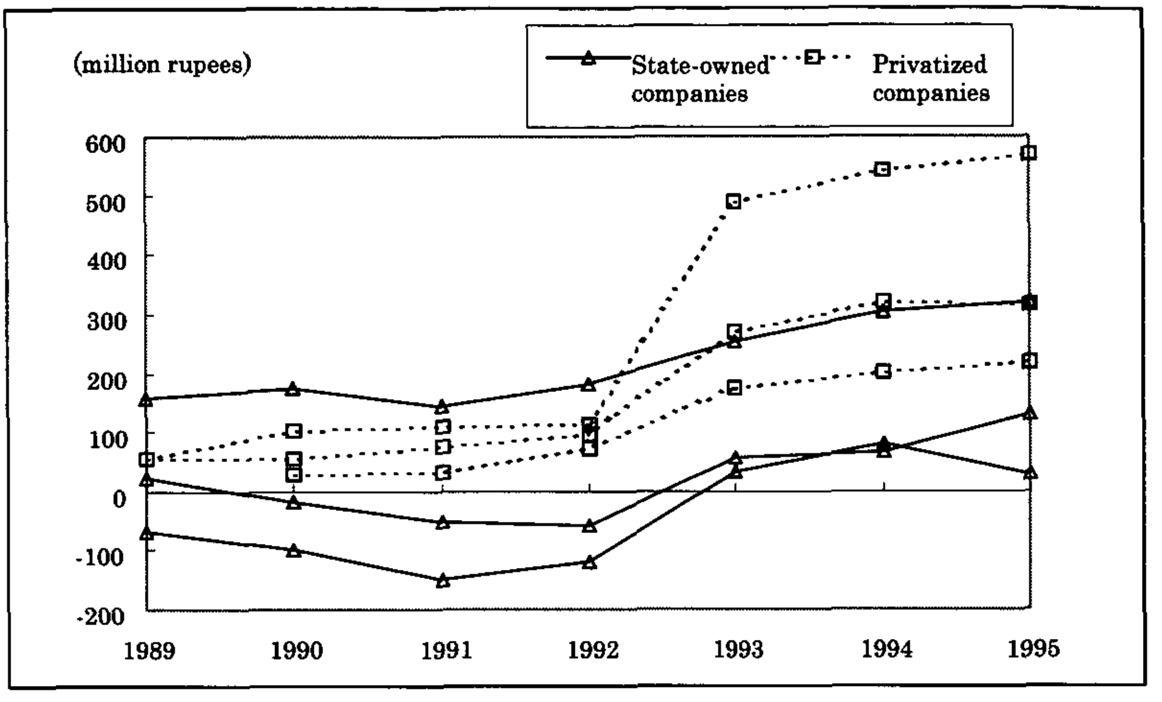


Fig. III-4: Cement sector companies, investment in equipment index

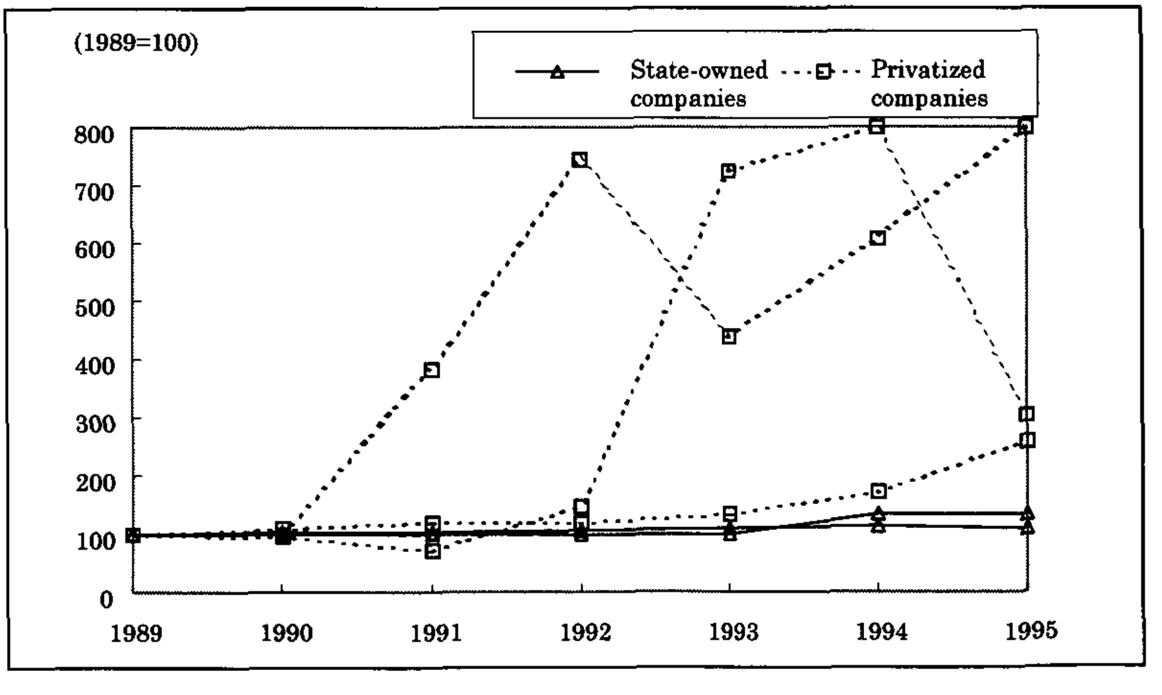
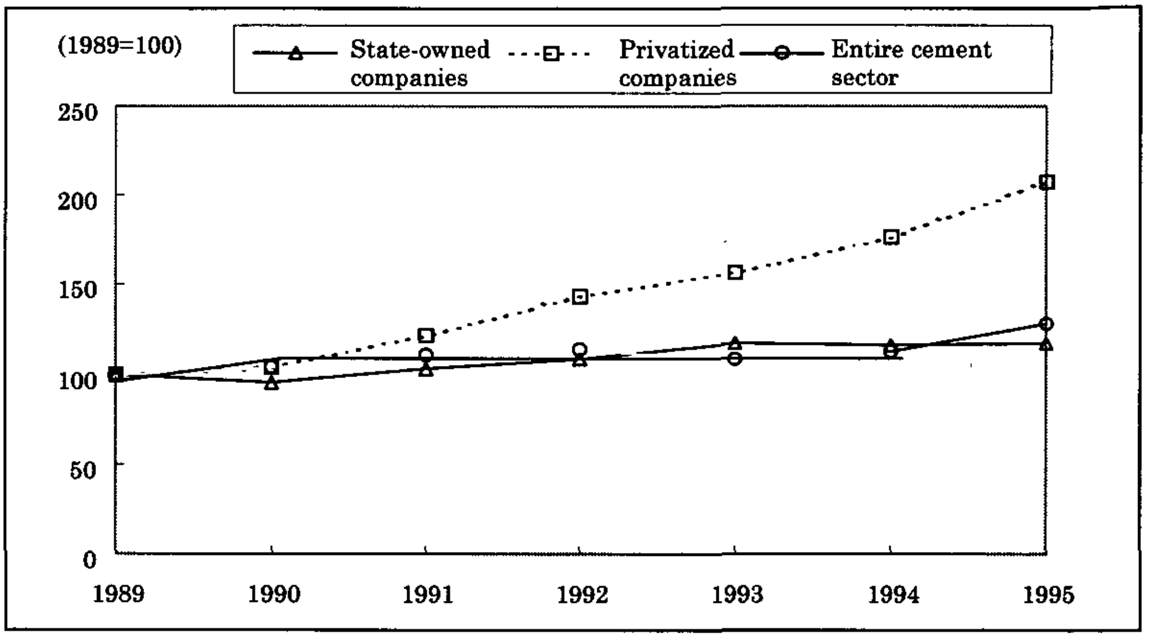


Fig. III-5 shows totals of the production index for the three state-owned companies and the three privatized companies respectively, and the degree of increase/decrease in production of the entire cement sector with fiscal 1989 as a reference of 100. According to this Fig., state-owned companies show almost the same level of production growth as the cement sector on a whole, although the privatized ones have grown more rapidly.

Fig. III-5: Production index in the cement sector



3.2.3 Results of privatization policy in the cement sector

There were 22 cement companies in Pakistan at the beginning of 1992 before privatization, and 16 of them were state-owned, affiliated with SCCP.[3] These state-owned companies held 70% of the total production capacity with the controlled price determined by SCCP and private companies had to follow this price.

The government has promoted privatization in the cement sector since 1992 and enforced deregulation of price controls, that resulted in rapid introduction of market principles based on free pricing. This accelerated introduction of competition between companies including privatized companies which went through mergers. In the case of Zeal Pak Cement, large-scale dismissal was attempted after privatization, but a strike broke out and operations were suspended for a long period of time. In this way, the cement industry has experienced several changes brought on by increasing privatization, and as the trends of achievements show, the sector is steadily advancing toward improved production based on market principles.

[3] State Cement Corporation of Pakistan Ltd. (SCCP)

3.3 Edible oil sector

3.3.1 Achievements of privatization in the edible oil sector

Privatized companies in the edible oil sector and their sale price are as shown in **Table III-3**. In this sector, 16 out of 26 companies were affiliated with Ghee (edible oil) Corporation (GCP) and privatization began from 1991. Now, the government is planning to privatize the remaining 10 companies.

Table III-3: Privatization in the edible oil sector

Name of company	Bidding price (million rupees)	Privatized in
1. Fazal Vegetable Ghee Mills Ltd.	21	1991
2. Sh.Fazal Rehman&Sons Ltd.	64	1992
3. United Industries Ltd.	16	1992
4. Kakakhel Industries Ltd.	55	1992
5. Associated Industries Ltd.	152	1992
6. Bara Vegetables Ghee Mills	31	1992
7. Wazir Ali Industries Ltd.	32	1992
8. Hydari Industries Ltd.	7	1992
9. Haripur Vegetables Oil Processing Industries	30	1992
10. Chiltan Ghee Mills	50	1992
11. A&B Oil Industries Ltd.	36	1993
12. Asaf Industries Ltd.	13	1993
13. Bengal Vegetables Industries Ltd.	19	1993
14. Khyber Vegetables Ghee Mills Ltd.	8	1993
15. Suraj Ghee Industries Ltd.	12	1993
16. Crescent Factories	44	1993

(source) Privatization Commission, Government of Pakistan

3.3.2 Business results for privatized companies in the edible oil sector

Most of the companies in the edible oil sector are small as can be seen by the level of bidding price. As for the cement sector, business results are shown in **Figs. III-6** to **III-9**, for two relatively large state-owned companies and three privatized enterprises[4].

Referring to production and sales index in **Figs. III-6** and **III-7**, three companies show a growing trend and two are unchanged. With comparison between the state-owned and the privatized companies, production and sales index remain unchanged for the privatized, while the two state-owned companies show increased production.

[4] As in the cement sector, these companies are those who replied to the questionnaire on privatization.

Fig. III-6: Edible oil sector, production index

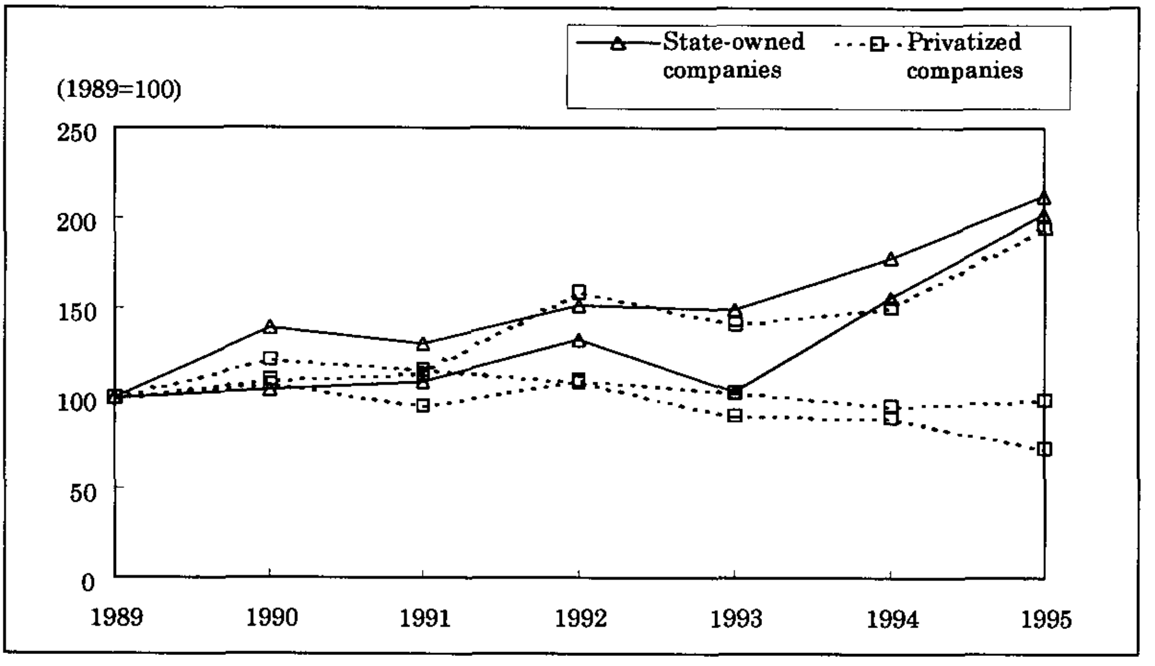
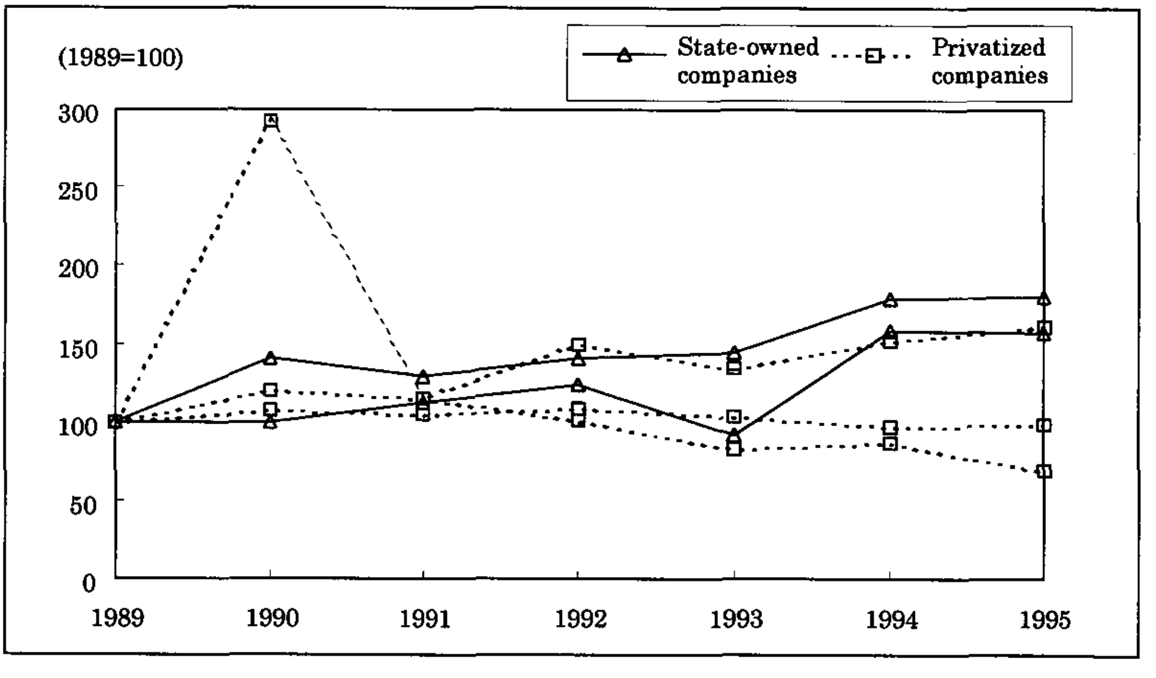


Fig. III-7: Edible oil sector, sales index



Profit and loss indexes shown in **Fig. III-8** have rather worsened since fiscal 1991, and four out of five companies were in the red in fiscal 1995. Investment in equipment index shown in **Fig. III-9** is low with the exception of one privatized company.

The reasons for these stagnant results by the privatized companies are as follows:

i) As edible oil is a material directly linked with national life, the price of edible oil produced by the state-owned companies is controlled and kept low by the government. Thus, the privatized companies have to sell edible oil at the same price as that of the state-owned, resulting in deficits every year. Under these circumstances, they are not in the business position to make new investments in plant and machinery to increase production. (The government controls price but does not grant subsidies to the state-owned companies. The state-owned companies make up for the deficits and increase production levels by borrowing from the state-owned banks.)

ii) One of the privatized companies was sold to the employees' union, and staff have not been reduced since privatization. This has caused accumulation of losses and prevents increases in production.

Fig. III-8: Edible oil sector, transition of profits and losses

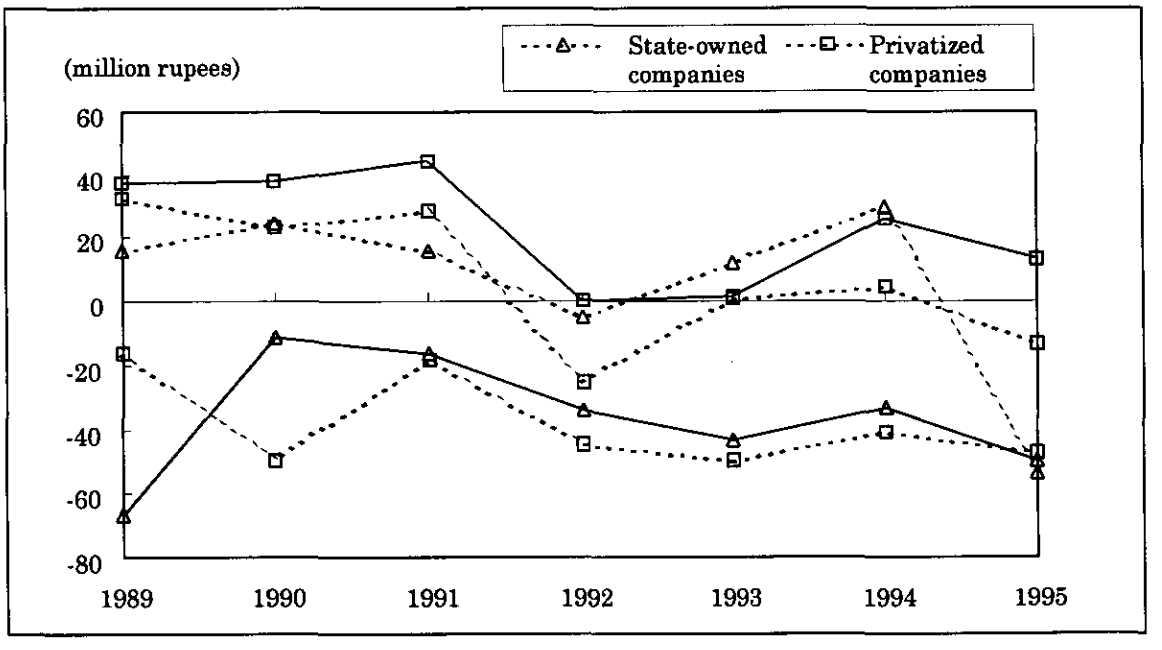
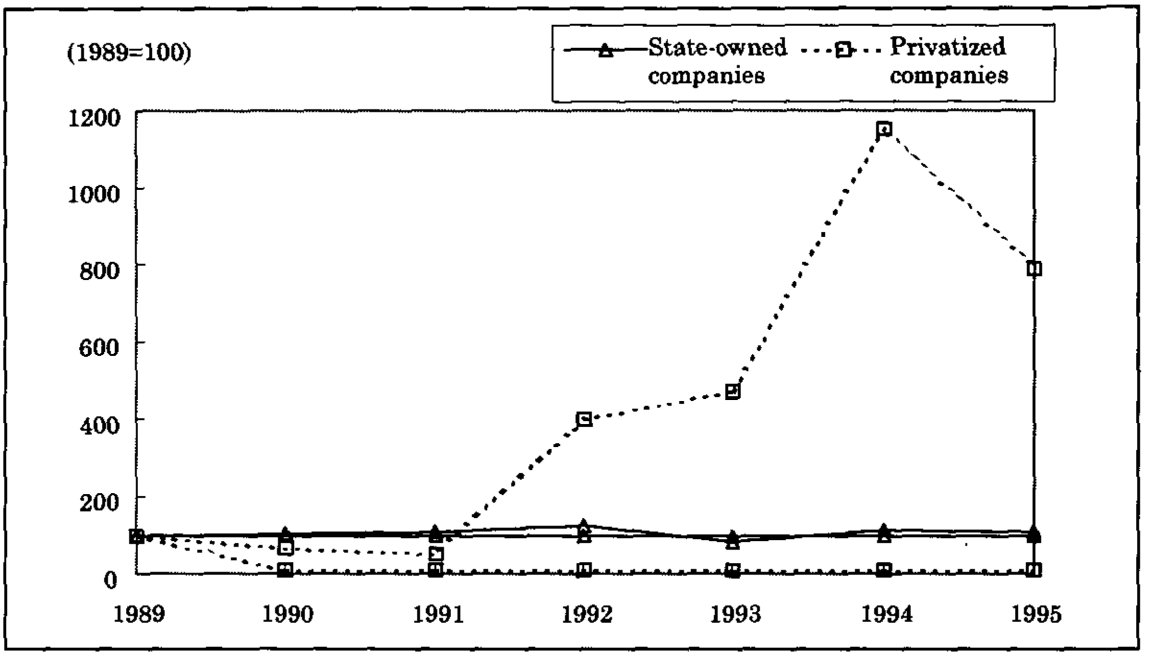


Fig. III-9: Edible oil sector, investment in equipment index



3.3.3 Results of privatization policy in the edible oil sector

It is clear that business results in the edible oil sector are much different from those of the cement sector. The cement sector has grown since privatization, and the privatized companies are doing remarkably well, while the edible oil sector is expecting losses despite some increase in production realized by the privatization policy. Privatization in the edible oil sector does not necessarily lead to improvements in management or business results. In addition, imports of edible oil are expected to increase from now on.

3.4 Other manufacturing industries (those other than automobile, cement and edible oil)

As shown in **Table II-3**, manufacturing industries include state-owned companies in engineering, Roti (bread), chemical fertilizer and chemical sectors aside from those in automobile, cement and edible oil, and privatization in these sectors is characterized as follows:

In these sectors, 46 companies have been privatized so far, with 31 remaining as state-owned. There are only two large-sized privatized companies, these being National Fibres in the chemical sector and Pak China Fertilizers in the chemical fertilizer sector. Moreover, the Privatization Commission is faced with the problem of default on the part of these companies. The other companies are all small in size and most of them were privatized from 1992 to 1993. As the system for examination of private investors was incomplete at the time of privatization, the companies were sold to organizations or employees' union having no experience in management, and the management, therefore, has not shown improvement. Sh. Fazal Rehman & Sons Ltd. in the edible oil sector, purchased by the Labor Management Group, for instance, failed to achieve efficient management and was forced to stop operation with a loss of about 65 million rupees. A few small companies have been successful in improving business results through privatization, but most of the companies failed in this area.

3.5 Problems with business results after privatization

The present state of privatization in the manufacturing industry points out the following problems.

Most of the privatized companies in the manufacturing industry are small in size, and not a few of them were forced to stop operation after privatization. Even in the automobile, cement and edible oil sectors where relatively large companies were privatized, the results vary according to company and sector. In the cement sector, for example, production, sales and profits have been improved in general with privatization, while edible oil companies show varied results and not all of the privatized companies have succeeded in improving management. The reasons for this can be explained as follows:

(1) Insufficient examination of financial state as well as management ability of purchasers

A preliminary examination system covering financial state, experience and management ability, and business and operation plans after privatization of private investors who make bids for state-owned companies, has not been established. Companies have thus been sold to businesses or employees' unions without appropriate business experience, that is the reason why they have not been properly managed. Sh. Fazal Rehman & Sons Ltd. is one such case.

(2) Absence of financial institutes supporting management after sale

Improvement in the investment environment with relation to financing is delayed in Pakistan. The financial sector largely depends on state-owned banks, and reform has not been realized yet. In this sector, two of the five state-owned commercial banks were privatized and about forty private banks including foreign ones are now in operation, but the amount of funds is still small and can not meet the growing financial demands of the privatized companies. In the meantime, the state-owned banks, holding more than 60% of total deposits and playing an important role in the financial market, do not have a sufficient systems or abilities to examine purchasers at financing and they are thus unable to extend loans based on fair and strict examination to meet financial demands.

(3) Absence of management consultation after sale

Management and operational state of privatized companies are not covered by the Ministries of former jurisdiction or the Privatization Commission. Thus, whether the companies are operated properly after privatization is not known, and it seems to lead to the government's feeling that the completion of sale (privatization) is the end of their job. The privatized companies do not have an organization to consult for help with their business policy. This condition partly prevents strengthening of production channels through privatization.

CHAPTER IV

FUTURE CHALLENGES FOR THE PRIVATIZATION POLICY

As has been discussed, the Pakistan government has privatized about ninety state-owned companies over the past five to six years, and some sectors such as automobile and cement have achieved good performance. Management of companies in these selected sectors has improved to a certain extent. Also, as the government obtained large amounts as proceeds from sales of state-owned companies and curtailed subsidies having been granted to these sectors, privatization has contributed to reduction in fiscal burden.

However, business performance of the privatized companies in general are not as favorable as expected and have not lead to efficiency gains within the economy or sustainable economic growth for the country. This is partly because the government sold the companies hurriedly to reduce fiscal burden and did not fully examine private investors as purchasers. As a result, many small companies in the edible oil sector and others remain in the red after privatization or have been forced to stop operation. Also, the Privatization Commission is faced with the problem of default by private investors who bought state-owned companies. Solving this problem is one of the important challenges facing future privatization policy.

In this chapter, problems with the incumbent Sharif administration preventing smooth privatization will be analyzed from the aspects of privatization procedures and support system after privatization.

4.1 Problems with regard to privatization procedures

(1) Securing of fair procedures for privatization

It is necessary to insure fairness in privatization procedures to obtain trust on the part of the market. For this purpose, the Privatization Commission should reinforce a legal system on procedures and disclose information such as that on bidders, and the choosing of a successful bidder throughout the process. As newspapers in Pakistan are relatively free to criticize governmental policies, they can function as a checking body after information disclosure.

At enforcement of an important privatization project, professional advisors should be employed to insure smooth and efficient operation. At the same time, those advisors should evaluate business situations of state-owned companies and guide their restructuring measures.

(2) Establishment of examination system for purchasers of state-owned companies

A system to pre-examine private investors making bids should be established and operated strictly. During the examination, experience and ability with the managing of a company and content of business and operation plans after privatization, as well as financial state, should be investigated.

One factor preventing such examination is said to be insufficient cooperation between the Privatization Commission and the relevant Ministries. In the electricity sector, for example, no platform was provided for a conference between the Privatization Commission and WAPDA, an enforcing and supervising organization in the power generation sector, in determining power plants to be privatized as well as the overall policy. Also, consultants to the electricity sector of the Privatization Commission do not include any members from WAPDA, and it seems difficult to formulate a privatization program incorporating actual state of management and operation of the state-owned companies.

In the process of privatization, it is mainly the outside consultants of the Privatization Commission who choose private companies without having enough knowledge regarding domestic private investors nor making full examination of such investors.

4.2 Problems of support system after privatization

Privatization would be promoted by securing fairness in procedures and establishing an examination system as mentioned above, but they are not fundamental solutions to efficient privatization. In order for the privatization policy to contribute to economic growth in Pakistan, attentive follow-up and support as detailed below are needed:

(1) Establishment of a system to monitor companies after privatization

A monitoring and follow-up system should be established for management and operation of companies after privatization. Neither relevant regulatory Ministries nor the Privatization Commission attempt to grasp situations after privatization. Thus, whether the company concerned is properly operated or not is not known, and this gives rise to the government's feeling that "sale (privatization) is the end of job," preventing realization of the most important target of leading privatization with strengthening of production channels.

A department in charge for the above mentioned follow-up could be created in the Privatization Commission. Or, as in the developed countries, financial institutions or auditing companies involved in management after privatization can assume such a role in the long run.

(2) Reinforcement of the financial sector

The ratio of domestic investment to GDP in Pakistan was 19% at the end of fiscal 1995, a little more than that of Bangladesh at 16%, but it is still low compared to India at 27% and Sri Lanka at 26%. To improve this investment environment, Pakistan grants preferential treatment measures to investing companies. New investors are exempted from tax for three to eight years, and import duties are lowered for machines and instruments.

Despite the introduction of preferential treatment measures related to taxes, improvement in financial conditions have been delayed. In the financial sector, two out of five state-owned commercial banks were privatized in 1991 and about forty private banks including foreign ones are now in operation, yet the amount of funds is still small and can not meet the growing demand of the privatized companies. State-owned banks holding more than 60% of total deposits and playing a significant role in the financial market, however have repayment in arrears due to a tremendous amount of bad loans and can not function effectively, to make funds available for lending. Domestic private banks are also facing the problems of insufficient funds together with the lack of know-how.

Taking these circumstances into account, a Pakistan Big Bang, focusing on privatization of state-owned commercial banks should be further encouraged, and reforms should be made in the areas of examination system, accumulation of operational know-how and human resource development.

(3) Vocational training and reduction of surplus staff

Decrease in indirect cost by reducing surplus staff has an immediate effect on management efficiency for privatized companies. However, an agreement was concluded between APSEWAC and the government to protect employees from easy dismissal, and management efficiency can not be improved by staff cuts. In the course of improvements in management after privatization, management and labor unions have sometimes had difficulties in reacting agreements related to employment adjustments.

In the case of Kot Addu Thermal Power Plant, negotiations with the WAPDA labor union were tough, and privatization was delayed for six months from the original plan. In the process, the government (Privatization Commission) come to an agreement with the Union on conditions much more compromised than that of the APSEWAC. In the Zeal Pak Cement case, shutdown lasted for more than six months due to an employees' strike. On the other hand, some companies fired large numbers of employees one year after privatization, following and taking advantage of the provision that employees may not be laid off for one year after privatization.

In this way, the agreement between the government and APSEWAC is a great hindering factor not only in management efficiency after privatization but even in privatization itself. The huge surplus of employees is one of the biggest problems of state-owned companies. As there is little employment opportunity in Pakistan, the most important thing is to promote smoothly further process of privatization by preventing opposition of public enterprise employees who were given vested interests.

Thus, in order to facilitate labor mobility, it is important to provide a vocational training system to enable surplus staff to find new outside jobs easily, and to create employment opportunities to absorb those surplus labor force.

4.3 Prospects for OECF operations

In this section, prospects for OECF operation will be discussed based on the above-mentioned problems in privatization.

(1) Indirect support for privatization policy

One of the objectives of the privatization policy promoted by the Pakistan government is improvement in economic efficiency. In order to lead the privatization with long-term economic growth, privatized companies should be run efficiently and achieve improvement in business performance. For efficient business activities, economic infrastructure should be provided.

However, as mentioned in Chapter I, about 50% of total expenditures of the Pakistan government are related to spending for the national defense and interest payments, and this suppresses development spending. The Sharif administration's "Prime Minister's Economic Revival Programme" gives the highest priority to reduction of fiscal deficits for economic recovery. With this however, the priority given to development spending may be lowered, and public investment in economic infrastructure as a vital element to induce economic growth would be restrained. To maintain the importance of economic infrastructure at a high level, OECF should give support mainly for the infrastructure. However, the actual order of priority for the projects to be funded should be carefully examined, and their position and economic and social effects should be also considered with respect to total development needs when extending OECF loan. Also, ability required to compile budgets and to operate, maintain and manage projects should be discussed in detail to avoid too great a burden on the Pakistan government.

(2) Support through the financial sector

In privatization in Pakistan, the urgent need to reduce fiscal burden sometimes led to sale of state-owned companies without full examination of private investors as purchasers. Also, some privatized companies are suffering from deficits or have even been forced to discontinue operation. In the meantime, the state-owned banks which hold more than a 60% share of the total banking sector deposits have repayment in arrears due to a great amount of bad loans, making effective funding operations impossible. Inadequate examination systems and lack of know-how as well as insufficient funds are also problems for domestic private banks.

These factors prevent the financial sector in Pakistan from meeting funding demands of privatized companies. In such situation, it would be effective for OECF to support privatized businesses through development loans. However, it is also important to examine the causes of fragility of existing financial institutions and to foster the Development Financial Institution (DFI), capable to play the role of an executing agency. That is to say, reform of the examination system of banks and support of management for end users can be reinforced by improving consulting services.

(3) Support for human resource development and employment creation

The fundamental problems in Pakistan are social, such as traditional and fixed social structure and insufficient elementary education represented by the low literacy rate of adults. It is hard to solve these problems quickly, but they should be worked out to promote human resource development for efficient management and growth of private capital. The World Bank and Asian Development Bank (ADB) have supported the Social Action Program (SAP) focusing on elementary education, health, hygiene and family planning.

But we would like to point out that investment in social programs and construction of social facilities only, will not solve the problem. As RIDA pointed out in its research of Brazil's low-income states,[1] many students quit school even though "they have schools and teachers." This is because there is no incentive for children to go to school. Children are an important labor force in poor farmer families, and even though they can go to school for free, the revenue from their work would be lost and the children therefore can not continue school education to its completion. Also, if there is no opportunity for employment with higher wages in

[1] The northeastern part of Brazil is the most underdeveloped area in the country. The average length of education in this area is 3.3 years, lower than the national average of 4.7. There is no big difference in facilities for elementary education, but opportunities for employment are fewer in the northeastern part and increasing the length of elementary education does not have a wage-raising effect. This is reported to be one of the reasons for the low average.

relation to school education, no incentive is made.

Thus, to efficiently improve the social sector, the restrictions on the demand side should be eliminated. For example, promotion of labor-intensive industries in rural areas could solve the problem. The labor-intensive industries could absorb surplus labor force and provide cash income, enabling poor families to send their children to school. As a certain level of education is needed to get a higher level job in such an industry, this would constitute an incentive for education as well.

This kind of support for employment creation seems to take a long time, but it is actually effective in many cases. The OECF loan has a longer reimbursement period than other funds, and a large amount of loan can be utilized at a lower interest rate. OECF should seek an approach based on solving the problem at its roots, making use of these characteristics.

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OVERSEAS ECONOMIC COOPERATION FUND

(Overseas Network)

HEAD OFFICE

Takebashi Godo Building, 4-1, Otemachi 1-chome, Chiyoda-ku, Tokyo 100, Japan

Telephone: +81-3-3215-1892 (Development Assistance Studies, RIDA)

Facsimile: +81-3-3215-4376

Telex: Call Number J28430, J28360, Answer Back Code COOPFUND

BANGKOK OFFICE

17th Floor,Thai Farmers Bank Building,
400, Phaholyothin Avenue,Bangkok,
10400,Thailand
TEL: +66-2-270-1001~3
+66-2-271-2035,2828,4682,1451
FAX: +66-2-271-3535
TLX: Call Number 8682968
Answer Back Code OECFBKK TH

JAKARTA OFFICE

SummitmasII 8th Floor,
Jl.Jenderal Sudirman,Kav.61-62
Jakarta Selatan,Jakarta,Indonesia
TEL: +62-21-522-0693,525-1350
+62-21-520-0226,520-0948
FAX: +62-21-520-0975

MANILA OFFICE

25th Floor,PACIFIC STAR BUILDING,
Makati Ave.cor.Sen.Gil J.Puyat Ave.,
1200 Makati,Metro Manila,Philippines
TEL: +63-2-810-4826~4829
+63-2-811-5956,5957
FAX: +63-2-815-1799

NEW DELHI OFFICE

2nd Floor, DLF CENTRE,
Sansad Marg, New Delhi,110001,India
TEL: +91-11-371-4362,4363,7090
+91-11-373-8389
FAX: +91-11-371-5066

BEIJING OFFICE

3102-31, World Trade Center,
No. 1 Jian Guo, Men Wai Avenue, Beijing,
The Peoples Republic of China
TEL: +86-10-6505-1196, 6505-1197
FAX: +86-10-6505-1198

KUALA LUMPUR OFFICE

22nd Floor,UBN Tower,
Letter Box No.59,Jalan P.Ramlee
50250,Kuala Lumpur,Malaysia
TEL: +60-3-2323255, 2322201, 2322202
FAX: +60-3-2322115

DHAKA OFFICE

Sonargaon Hotel (Room No.351~354)
107 Kazi Nazrul Islam Avenue,
Dhaka,Bangladesh
TEL: +880-2-811641~5, 811005, 812011
(Hotel Ext. 4351~4355)
+880-2-814081, 816700 (Direct in)
FAX: +880-2-813336
TLX: Call Number 632235
Answer Back Code SNHT BJ (Hotel)

ISLAMABAD OFFICE

House No.62,Ataturk Avenue,
G-6/3,Islamabad,Pakistan
TEL: +92-51-823116,812478,820119,822997
FAX: +92-51-822546
TLX: Call Number 9254528
Answer Back Code OECF PK

COLOMBO OFFICE

Level 13, Development Holdings No.42
Navam Mawatha, Colombo 2
SRI LANKA
TEL: +94-1-300470, 300471, 300472
FAX: +94-1-300473

HANOI OFFICE

5th Floor, 41-B,Ly Thai To Street
Hanoi,VIET NAM
TEL: +84-4-8248934~6
FAX: +84-4-8248937

PARIS OFFICE

8,Rue Sainte-Anne
75001 Paris,France
TEL: +33-1-4703-6190
FAX: +33-1-4703-3236

LONDON OFFICE

9-15, Sackville Street,
London, W1X 1DE, U.K.
TEL: +44-171-734-3565
FAX: +44-171-734-3569

NAIROBI OFFICE

6th Floor, International House
Mama Ngina Street
P.O.Box 49526 Nairobi,Kenya
TEL: +254-2-221420,221637
FAX: +254-2-221569
TLX: Call Number 98722094
Answer Back Code OECFNBI

CAIRO OFFICE

Nile Hilton Hotel Commercial Center,
No.30 Tahrir Square,Cairo,Egypt
TEL: +20-2-5748708,5748709 (Direct in)
+20-2-5780323~8
(Nile Hilton Ext.30,31)
FAX: +20-2-5741594
TLX: Call Number 9193148
Answer Back Code OECFUN

WASHINGTON OFFICE

2100 Pennsylvania Avenue,
N.W., Suite 535, Washington,D.C,
20037 U.S.A.
TEL: +1-202-463-7492
FAX: +1-202-463-7496

SOUTH AMERICA REGIONAL OFFICE

Edificio Torre Rio Sul, Rua Lauro Müller,
116/3505, Botafogo,
Rio de Janeiro-RJ-CEP 22290-160
BRASIL
TEL: +55-21-295-5942,8596,9691
FAX: +55-21-295-7840
TLX: Call Number 2130937
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