WHY PRIVATIZATION IS NECESSARY FOR ECONOMIC GROWTH IN PAKISTAN?

ISHRAT HUSAIN[1]

The decade of 1970s in Pakistan witnessed a massive redistribution of national assets from the private owners to the state. The reason underlying the then Government's thinking for this extremely radical action was that the national wealth was being concentrated in the hands of few families and the rich were getting richer and the poor getting poorer. It was asserted by the proponents of this strategy that the state control over allocation of the resources would promote the best interests of the poor. The intellectual support for this strategy was drawn from the success of the Soviet Union and the socialist economic model practised in that part of the world.

Two decades later it turned out that these assertions and assumptions that drove this particular line of action i.e. nationalization was not only unrealistic and flawed but the consequences were exactly opposite to what the intentions were. The collapse of the Soviet Union and the bankruptcy of the socialist model eroded the ideological underpinning of this strategy and the actual results on the ground in Pakistan and almost all the developing countries shattered the ideal and utopian dreams of the proponents of this philosophy. Pakistan's public enterprises including banks became a drain on the country's finances through continuous hemorrhaging and leakages and a drag on the economic growth impulses. The poor instead of benefiting from the state's control over these assets were actually worse off as almost Rs. 100 billion a year were spent out of the budget annually on plugging the losses of these corporations, banks and other enterprises. These public enterprises became the conduit for employing thousands of supporters of political parties that assumed power in the country in rapid succession and a source of patronage, perks and privileges for the ministers and the favoured bureaucrats appointed to manage these enterprises. These employees and managers had neither the managerial expertise nor technical competence to carry out the job. Instead of providing goods & services to the common citizens at competitive prices efficiently, the public enterprises

[1] Address of the State Bank Governor delivered as Chief Guest at the 11th Get Together of the Overseas Universities Alumni Club and the 21st Century Business & Economics Club on August 12, 2005 at Karachi.

turned into avenues for loot and plunder, inefficient provision of services and production of shoddy goods. It was a common knowledge that getting a telephone connection in Pakistan required years not months and that too with the help of sifarish and exchange of bribes. No wonder the country was able to install less than 3 million telephones in the entire 50 years of its history while under a deregulated and private sector driven environment an additional 6 to 7 million mobile phone connections were given to Pakistanis from all walks of life without any favour or discrimination in one year alone i.e. 2004.

The hangover of the past in general and the lingering fascination for the socialist model among some of our intellectuals in particular continue to have a dominant influence on our thinking. Some of the resentment against private profit making is also quite legitimate and understandable. In the past, private entrepreneurs in Pakistan did not make 'profits' in the real economic sense of the word by earning a return on their investment in a competitive world. On the contrary, they earned 'rents' through the maze of permits, licences, preferred credit by the banks, subsidies, privileges, concessions and specific SROs granted to the favoured few. Naturally when one sees people becoming rich not through the dint of their hard work and enterprise but by manipulation, back door entry, connections, reciprocity, paying bribes, adopting extra legal means, bypassing the established rules and laws, getting scarce foreign exchange quotas, evading taxes, defaulting on bank loans and rigging the markets etc., we should not be surprised to see the venom against the so called 'private profits'.

The policy reforms introduced in Pakistan by the Nawaz Sharif Government in 1991 and more importantly followed by that strong citadel of socialist raj – India – were a watershed reflecting the new realities of economic life. These reforms, though quite extensive and diverse, could be summed up for the sake of simplification in three words – Liberalization, Deregulation and Privatization. The results of Indian reforms are quite evident before us. During the first 45 years of its independence until 1991, India was hardly able to achieve per capita income growth of 1 percent per year and the incidence of poverty remained persistently high. In the 12-year period since 1991, India's average per capita income growth has been 4 percent per year, poverty has been declining ever since and has fallen below 25 percent. Pakistan, unfortunately, could not follow through these reforms in a continuous and consistent manner despite the fact that both Benazir and Nawaz Sharif governments were fully committed to these reforms. For example, 12 percent shares of PTCL were first sold to the general public in 1993-94 and it has been on the privatization agenda of every successive government since then. The short term political expediency may dictate a different behaviour at present, but I am quite sanguine that the PPP and PML(N) would have pursued the same path were they at the helm of the affairs. Thus, there is a broad political consensus in the country that privatization is in the larger national interest of the country.

Privatization has to be seen in the overall context of the respective roles of the state and markets. The State has to be strong to combat the excesses of the market and cope with market failures. It is not that the state should play a lesser or reduced role but a different role in so far as it provides an enabling environment for equitable development and creates necessary conditions for growth through investment in human development and infrastructure. The government's effective role in regulating and monitoring the market has to be strengthened to promote healthy competition and avoid the rigging of the market by a few. Markets are the best known vehicle for efficient allocation and utilization of resources and thus the decisions as what goods and services to produce, how much to produce, distribute and trade can be done well only by the private sector and not by the bureaucrats. This division and redefinition is also essential to reduce corruption and generate sustained and equitable growth in the country. Market-based competition, privatization of public banks and a strong regulator have successfully reformed the banking sector in Pakistan during the last several years and this model should be replicated elsewhere in the economy. It is not ideology but pragmatism and learning from the past mistakes that should drive our economic policies and strategies. Growth takes place only when productivity from the existing resources keeps on rising. The global experience shows that by and large, productivity actually declines or remains stagnant when the businesses are managed and operated by the government thus slowing down or hurting the pace of growth.

I will now turn to the economic rationale of privatization that is not fully understood by many. In particular, there is a popular view that it is okay to sell the loss making enterprises but retain the profit making entities such as PTCL and PSO in the public sector. It is true that the budgetary stress and commercial bank borrowing factors are not valid in such cases but there is a larger economic case for the divestiture of even such profit making enterprises. The main logic behind this divestiture is that it will promote efficient allocation of scarce resources, optimal utilization of resources, making sound, timely and market responsive investment choices, winning and retaining customer's loyalty through better service standards and lower product prices or user charges and contributing to the expansion of the economy through taxes, dividends etc. I would take the most debated example – that of the PTCL – as an illustration of the general point I am making about the economic rationale for privatizing profit making public sector enterprises.

The most oft pronounced arguments against privatization of profit making enterprises are (a) why fix it when it ain't broke? (b) Protection of workers (c) a better and more professional management can bring about the same results as under privatization. The basic reason for privatizing these enterprises is that the government should not be in the business of running businesses but regulating businesses. The role of the government should be that of a neutral umpire, who lays down the ground rules for businesses to operate and compete, to monitor and enforce these rules, to penalize those found guilty of contraventions and to adjudicate disputes between the competing business firms. If the government owned firm itself is one of the players in the market, there is a strong conflict of interest and the other market players lose confidence in the neutrality of the umpire. Under these circumstances, the market becomes chaotic, disorderly and unruly as there is no neutral 'person' to monitor and enforce the rules. The economy thus pays a heavy price for this loss of the market mechanism in the production, sale and distribution of goods and services. The present controversy between the PIA and private airlines is a manifestation of this tendency. If the 'umpire' favours its owned enterprise i.e. PIA and discriminates against the rival private airlines, the ultimate result would be the winding up of these airlines. The growth of aviation industry would suffer as the present competition is cutting down the prices and stimulating demand for air travel in the country. In absence of such competition, the PIA would have the sole monopoly and the planes would fly with empty seats as the ticket prices would not be market based but arbitrarily high. The consumers of airline industry – existing and potential – will be the loser in this bargain.

The same argument can be applied in case of PTCL. If the Government had continued to own and manage PTCL, the private sector competing firms would have felt that they would always remain at a disadvantage in relation to the PTCL. The constant fear that the government's coercive powers and full force of policy making ability would always be used to safeguard and enhance the interests of PTCL. This would have kept the private firms away from investment in the fixed telephone or wireless loop segments. If this may not be true under one particular set of rulers, the apprehension that such an eventuality may happen at some time in the future keeps prospective investors away from that field of business. The growth of a dynamic private sector in the economy is thus stifled. The PTCL would under that scenario preserve its monopoly, pass on its inefficiencies to the customers, charge exorbitant prices and resort to seeking concessions of various kinds from the government. The result would be stagnation in the growth of fixed telephony in the country and poor service to the customer. So while the PTCL is not broke and is indeed profitable it needs to be privatized to provide a level playing field for fostering competition, stimulating demand, expanding telecom customer base, improving service delivery and contribute to rapid economic growth. None of this will happen if the PTCL remains a public owned and managed firm.

A lot is being made of the fact that the PTCL was making huge profits for the exchequer and these profits will now be diverted to the private owner. The facts are quite contrary to this assertion. The Government of Pakistan will still retain 62 percent of the shares while the private operator will have only 26 percent. Thus out of each billion rupees of profits earned by PTCL, the GoP will receive Rs. 620 million while the private operator only Rs. 260 million. In addition, the PTCL will continue to pay the corporate tax on its income. The burning desire to transfer the management to a private investor was that the profits earned by the PTCL were largely derived not from its own efficient operations but from its monopoly status as the sole provider of fixed telephony in the country. In the coming years, the PTCL will have to compete for its market share as it has lost its monopoly and it was quite likely that the public sector ownership will act as a serious constraint and the level of profits will be eroded over time.

Since the private sector competitors of PTCL will have more flexibility, agility and capacity to respond and seize the opportunities for expansion and improved customer service, they will give a hard time to rule bound, inflexible and slow moving public sector owned PTCL. However, competent and able top managers and the Board of Directors may be, they have to follow set procedures, prior clearances and approvals by multiple ministerial bodies before they can make any operational decisions of significance. U-Fone lost 18 months' valuable time facing various inquiries into its procurement while its competitors were enhancing their market share at its cost. Such a scenario is likely to recur once a government owned PTCL is pitted against several private competitors.

The fears about employment losses in the industry as a result of privatization are also, by and large, unfounded. The example of the banking industry privatization controverts those who claim that privatization means jobs are lost. In 1997 when the restructuring, down-sizing and privatization of the nationalized commercial banks picked up speed there were 105,000 employees working in the financial sector. After privatization was completed, the banking industry has expanded and the work force has expanded to 114,000. It is true that the pattern of employment has changed and more productive and skilled workers have been taken in at the expense of low skilled or unskilled. There is no doubt that the PTCL will also expand under its new owners and employ more people but in the skilled category. This upgradation of skills will raise productivity of the firm as well as of the industry.

The skill mix of the staff employed by the PTCL and its numbers at present are inappropriate to meet the new challenges of providing high standards of value added services and new product development. One of the difficulties faced by the public sector businesses is that they cannot pay market based remunerations to their executives or highly technical manpower. If the PTCL is not allowed to pay more than MP1 scale to its

Chief Executive i.e. Rs. 200,000 per month which is a fraction of what senior executives in the rival private firms get, should we expect the PTCL to attract, retain or motivate high performing manpower. The field gets tilted against a public sector company as it has skill gaps and redundancies and is unable to provide value added services of the same quality as provided by the private sector rivals.

The process of hiring and firing of employees in a public sector company such a PTCL is highly convoluted, complex and cumbersome. Those found guilty of infractions or negligence of duties or even corruption can only be dispensed with after a protracted process of disciplinary proceedings that sometimes take several years to complete. In the meanwhile, the employee continues to stay put in service and receives all the emoluments and perks. In a rare case, a departmental inquiry comes up with a guilty verdict, the employee can appeal to the Federal Services Tribunal and if he is unsuccessful, then all the way to the Supreme Court. Why will any right minded boss choose to go through such an ordeal?

The alarm of employment losses after privatization is also unjustified for another reason. Telecom sector has already generated, after deregulation, hundreds of thousands of new jobs through public call offices, calling cards and pre-paid card companies, Internet Service Providers, mobile phone companies, broad band services, and other value added services under the private sector. As the penetration ratios in Pakistan are still quite low, there is going to be a large expansion in the telecom sector.

The losses of redundant jobs in PTCL, if any, will be more than offset by new productive jobs in the Local Loop, Wireless Loop and LDI companies being set up in the private sector. Industry estimates that 100,000 new jobs will be added during next 3 – 5 years. The substitution of unskilled jobs in the PTCL by the skilled jobs in the telecom industry as a whole will raise the productivity of the sector as well as that of the user companies and institutions. Those among the unskilled who can be retrained or redeployed could be retained minimizing the overall loss of jobs within the PTCL itself. If the PTCL itself is able to expand its services and operations, the manpower that is surplus to its present requirements can be productively employed. Thus the fears of workers losing protection under a privatized entity appear to be misplaced. After all, the PTCL is the only telecom company that has been in the business for the last 58 years.

The oversight, monitoring and guidance capabilities of public enterprises are ridden with the aggravated problems of principal – agent relationship. As the Board Members, however able and honest they may be, have no direct personal stakes in the well-functioning of a public enterprise, they cannot be expected to devote as much time or energy to the Board's affairs as the private strategic investors would. Thus, the PTCL's governance structure would always remain second best to its private sector competitors and put it at a comparative disadvantage. If a more callous Minister is unfortunately appointed to chair the Board, the appointments, award of contracts and transfers and postings will do further damage to the performance of the PTCL.

The temptation by the elected political leaders or other rulers to interfere in the affairs of the public sector companies is not only high but natural. They are constantly accosted by their constituents for jobs, contracts, postings and transfers and it is not possible for them to keep on saying no to everyone all the time. In some cases, they have to yield to pressures. It is, therefore, necessary to sever the connection between the government and the business.

How can a public sector company then be expected to show same results as its private sector competitors whose compensation structure is driven by performance, whose managers enjoy full powers of hiring and firing without any restraint, their Boards have direct stakes in ensuring good governance and the political interference is almost non existent?

The legacy of PTCL inherited from the culture of the Post and Telegraph Department cannot therefore be washed away if it operates under these constraints. This culture can only be replaced by a dynamic competition-oriented culture under the leadership of a private sector operator.

As a government entity, PTCL is considered a rich cash cow to meet the fiscal needs rather than a business enterprise that requires funds for its own maintenance and operations and more important for its investment needs. The compulsions of extracting as much profits and cash for meeting fiscal deficit will always predominate and the imperatives of expanding the network, infrastructure and services through retained earnings will be neglected. Even assuming that a perceptive government does allow PTCL the funds to make investment, it is not obvious if these will be used in an efficient and cost-effective manner. The World Bank has recently blacklisted 200 firms for padding contracts and bribing officials in public sector procurement awards in a number of developing countries.

It must once again be stressed that private sector ownership and efficient functioning of market mechanism require certain legal and regulatory institutions. In absence of these institutions, private monopolies or oligopolies can surface, market distortions can accentuate and markets can be rigged for the benefit of few. Strong legal and regulatory institutions would be able to counter these evils forcefully and provide a level playing field for all market participants. We have to strengthen these legal and regulatory institutions in the country.

Public policy should also be geared at removing preferential treatment or granting of concessions or privileges to a particular segment of the population. During the last five years, the Government has endeavoured to move in this direction and act in an even handed manner. No firm specific SROs have been issued to favour a particular enterprise at the expense of others. Under these circumstances, private sector will earn true 'profits' through competition and not 'rents' and the justified grudge against the private sector will be minimized.

CONCLUSION:

Privatization contributes to economic growth through productivity gains, efficient utilization of resources, better governance and expansion in output and employment. Profit making enterprises under the public sector may be making profits due to the unique market structure such as monopoly or other privileges or concessions conferred upon them by the government but it does so at the expense of the consumer who has to pay higher than market price for the product or the services. The ordinary consumer gets a benefit only through competition among private sector firms in form of lower prices and better services as has been demonstrated in the cases of banking, telecommunications and, more recently, air travel.

In a deregulated market environment, public ownership becomes a serious constraint as the rule – bound procedures and the rigidity in the structure do not allow public sector companies the flexibility to respond promptly to dynamic market conditions. Furthermore, the government's role as a regulator and neutral umpire becomes questionable once it is itself a participant in the game through its own company. This stifles competition and subverts expansion and growth by the private sector companies.