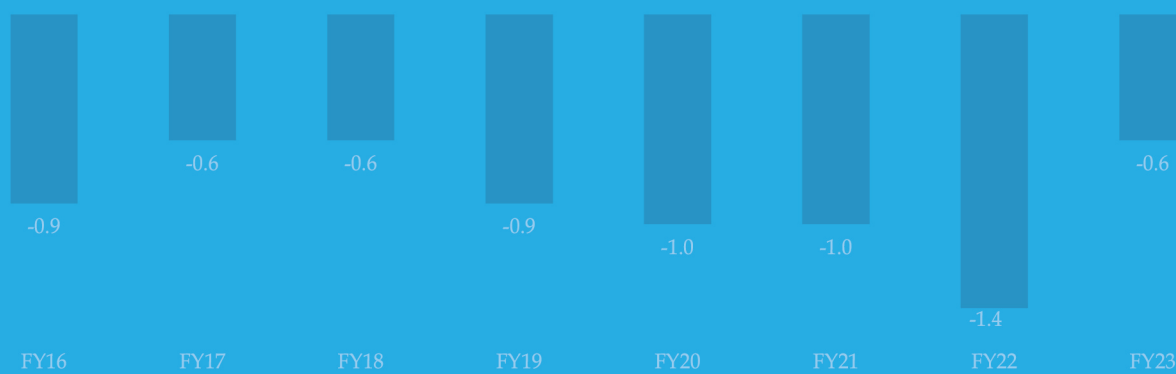


Reforming State-owned Enterprises in Pakistan

State-owned Enterprises (SOEs) have been reformed around the world since the 1980s, driven in part by their unsustainable fiscal impact, as well as deteriorating service delivery. In Pakistan, the SOE reform process began in late 1970s, with a focus on privatisation. However, the process remained inconsistent, with short spells of progress punctuated by long periods of stagnation. This was a result of various factors with the biggest hurdle being an overemphasis on change in SOE ownership rather than critical SOE reform components: good corporate governance, strengthening of competition, effective regulation, political consensus and addressing labour concerns. As a result, the country's federal commercial SOEs – that are the focus of this Chapter – continue to burden the government finances, with losses concentrated in two broad sectors: (a) power, and (b) infrastructure, transport & ITC. In recognition of this, the government has recently initiated the first comprehensive set of legal and institutional measures for reforming SOEs' corporate governance, and is in process of taking SOEs' ownership decisions (i.e. whether to privatise or retain entities). Insights from Pakistan's earlier SOE reforms and global best practices suggest that an integrated and well-sequenced approach is needed to achieve desired results from the ongoing efforts. Specifically, it requires necessary focus on sectoral policy, competitive environment and effective regulations, supported by political consensus.

Net Fiscal Impact of Commercial SOEs
(percent of GDP)



7.1 Introduction

State-owned enterprises (SOEs) are as old as the state itself. However, with the Great Depression and the post-World War-II developmental needs as the major impetus, SOEs gained significance for accelerated economic development by establishing industrial base and undertaking large infrastructure projects.¹ SOEs were also set up to provide critical services, such as utilities, that the market was unable to deliver universally and sustainably due to limits to private sector's ability to generate funds for large capital expenditure projects.²

These trends emerged in the backdrop of a general mistrust of capitalism, and ensuing nationalization in several economies, in part driven by the economic ideology that pursuit of social and other national objectives do not align with profit-maximization of private firms. This was particularly visible in sectors that provided basic public goods. Many industrial SOEs were also set up under import substitution policies with high tariffs, exchange controls and other forms of trade protection. Governments also used SOEs as a tool to meet their social and political objectives, such as job creation.³

However, when left in their original set up, SOEs have also been a huge burden on economies, both because of their unsustainable fiscal impact, as well as poor service delivery. This is why SOEs started going out of vogue after the 1980s. Financial statements of SOEs during the 1970s and 1980s suggested that SOEs significantly underperformed compared to private firms, partly because of the difficulty in reconciling their multiple policy goals. There was also a growing realization that some SOEs

existed as monopolies, unexposed to market competition, with relatively easier access to finance.⁴

Even in sectors where SOEs were not monopolies, their presence was still a major concern because of their ability to influence policy and competition through their privileged access to government. As a result of this, SOEs remained inefficient, and struggled to offer innovative and quality goods and services. Consequently, the financial performance of many SOEs deteriorated, leading to frequent government bailouts, especially in developing countries, where SOEs became a burden on the national exchequer, a source of fiscal risk, and weakened the financial system. Research suggests that government support to inefficient, loss-making commercial SOEs also adds to inflationary pressures, whereas addressing structural challenges as part of SOE reforms leads to increased competition, which in turn, can reduce inflationary pressure.⁵

In cognizance of these challenges, governments began reforming SOEs since the 1980s. With SOE reforms gaining traction across Advanced Economies (AEs), International Financial Institutions (IFIs) also played a significant role in driving the SOE reform agenda in Emerging Market and Developing Economies (EMDEs). For instance, the International Monetary Fund (IMF) often linked its financial support to SOE reforms, whereas other IFIs supported privatisation and other SOE reforms by helping governments to develop strategies, implementing plans, and appropriate supervisory and institutional frameworks.

¹ For example, in France, technological modernization and industrial development was led by SOEs like Renault, and Alcatel. In Finland, it was led by SOEs in steel, mining, transport, paper, and chemical industries. Similarly, South Korea's most rapid economic growth was driven by SOEs in steel, oil, gas, electricity, fertilizers and others. Source: Berne, M. & Pogorel, G. (2006); Willner, J. (2006); Rashid (2022).

² Bognetti, G. (2020); ADB (2020); Obinger et al. (2016)

³ Habir, M. (2021)

⁴ Roland, G. (2008); Habir, M. (2021)

⁵ Campillo, M. & Miron, J. A. (1997)

Three other factors influenced this trend. First, financial crises forced countries to reform SOEs. For instance, the sovereign debt crises of the 1980s led many countries in Latin America, and Eastern Europe to reform their SOEs. From the 1990s onward, the former Soviet Union countries in Central and West Asia reformed their SOEs since they could not sustain them without Soviet-era subsidies. Likewise, following the Asian Financial Crisis of 1997, many East Asian economies carried out SOE reforms to lower their fiscal burden. In China, which still has some of the world's largest SOEs, about two-thirds of the country's total SOEs were privatised between 1995 and 2005.⁶

Second, some governments explicitly pursued policies to promote export-led growth and internationalisation through state capitalism for which they needed to reform SOEs. This, for instance, included exposing SOEs to domestic and international competition, and empowering their boards to make major decisions, such as cross-border mergers and acquisitions. Third, the SOE reform agenda across the world was driven by growing public demand for reliable, cost-effective, and quality delivery of public service. This contributed to corporatisation and retention of SOEs as wholly-owned public firms or as SOEs under public-private partnerships (PPP).⁷

Whilst change of ownership, notably through privatisation,⁸ has been the most common instrument of reforms across the diverse global SOE reform experiences, evidence suggests that competitive markets; transparency and monitoring; effective regulation; and sectoral policy reforms, along with good corporate governance are more important than change in

ownership. Indeed, there have been several instances where privatisation failed or otherwise did not yield the desired results. At the same time, some of the world's largest companies are effectively under state control, where the trend of cross-border investments by multinational SOEs owned by EMDEs is also notable. These exceptions notwithstanding, research suggests that SOE reforms, which began in the 1980s and peaked in the 1990s, were largely settled by the early mid-2000s in most countries and regions around the world. However, in some countries, including Pakistan, SOE reform is still an unfinished agenda.⁹

The history of SOEs in Pakistan is not very different. Between 1972 to 1977, the country implemented a nationalization program aimed at reversing concentration of wealth developed under the private sector-led growth of 1960s, and driven by then prevailing economic ideology of meeting socio-economic and industrial development through SOEs. In addition to the existing SOEs, several basic industries were nationalized during this period. These included vegetable ghee companies; flour mills; cotton ginning factories; rice husking units; a large number of educational facilities; all domestic private sector banks and insurance companies; and petroleum marketing and shipping companies.¹⁰ Moreover, several new SOEs were established in various sectors including heavy industries, energy and mining.¹¹

While some SOEs indeed contributed to industrial, economic and social development, over the years, they started suffering from the classic ills now associated with SOEs around the world. These included production inefficiencies,

⁶ Gan, J. (2009); ADB (2020)

⁷ Habir, M. (2021).

⁸ Privatisation transactions include whole/majority stake sale, minority stake sale with management control, capital market transactions, and others. Retention of SOEs include retention as wholly or majority owned by the government, or under public-private partnership (PPP) models.

⁹ Phi et al. (2021); ADB (2008); Majumdar, A. & Ochieng, W. (2003); Mroczek, J. & Bałtowski, M. (2022)

¹⁰ ADB (2008); Jones, D. E. & Jones, R. W. (1977)

¹¹ Examples of SOEs that existed prior to the nationalisation era include WAPDA, Pakistan International Airlines, Pakistan Industrial Development Corporation, National Bank of Pakistan, whereas examples of those created during the era include DFIs like Pak-Kuwait Investment Company, Peoples Steel Mills, Pakistan State Oil, and Heavy Mechanical Complex.

mismanagement, over-staffing, mounting losses and rising debt. Many enterprises survived only due to preferential policies, such as tariff protection, special access to credit, government guarantees, tax exemptions, and subsidies.¹² These challenges forced policymakers to rethink the role of the state vis-à-vis the private sector in the economy as early as 1978, and rolled out various reform measures including denationalisation, decentralisation, and disinvestment (i.e. privatisation).¹³

The country underwent a major reform process during the 1990s to transform the system from an over-regulated and inward-looking into a more open, deregulated, and market-oriented economy. Consequent to the privatisation program initiated under the Seventh Five-Year Plan (1989-93), a number of SOEs were privatised, a process which continues to date. However, the privatisation process has been punctuated and delayed mainly due to anti-privatisation labour unions; lack of political consensus; and the state's inability to rollout market reforms in several sectors including power, gas, infrastructure and transport.¹⁴

By the end of FY23, there were 121 federally owned SOEs in Pakistan,¹⁵ of which 73 percent were commercial and the rest were non-commercial for various types of sectoral development needs. The federal commercial SOEs – that are the focus of this Chapter – are mainly categorized in finance; oil and gas; power; infrastructure, transport and Information Technology & Communication (ITC); manufacturing; and trading and marketing sectors. While these entities contribute to government's revenues and generate employment, they also require frequent

government assistance, affecting fiscal sustainability. On a net basis, these SOEs had posted consistent losses between FY16 and FY23.¹⁶

In this backdrop, this chapter underscores the need for urgent SOE reforms in Pakistan, given their large economic footprint, particularly the fiscal impact (**Section 7.2**). To this end, the government has recently introduced promising measures to reform the SOEs' corporate governance, and is in process of taking decisions on SOEs' ownership. Drawing on lessons from Pakistan's earlier experience of grappling with SOE reforms (**Section 7.3**) as well as insights from global best practices (**Section 7.4**), the chapter finds that whilst change in SOEs' ownership and improvements in corporate governance are important instruments of successful SOE reforms, the sequencing of the reforms; clear objectives for retaining SOEs; strengthening of competitive environment along with necessary sectoral reforms; and effective regulation are as important as fixing corporate governance and more important than changes in ownership. **Section 7.5** illustrates some of the key findings discussed in Sections 7.3 and 7.4 through brief case studies on major loss making SOEs. **Section 7.6** summarizes and concludes the chapter.

7.2 Economic Footprint of SOEs in Pakistan

Pakistan's federal SOEs are broadly categorized into commercial and non-commercial entities. Commercial entities are expected to be profitable as opposed to non-commercial entities that are made for social and developmental reasons e.g. sectoral development or education

¹² ADB (2008)

¹³ Ibid

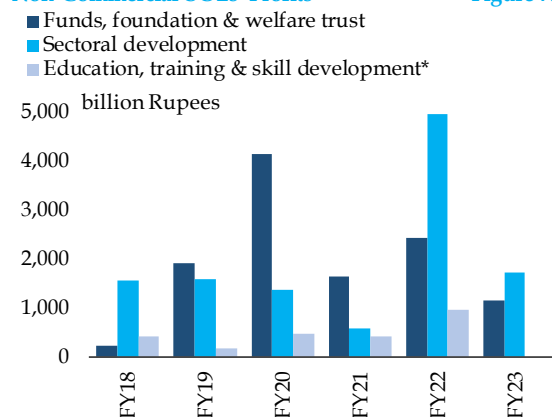
¹⁴ Faraz, N. & Samad, G. (2022); Jafarey, V. (1992); ADB (2022)

¹⁵ Until FY22, there were 133 SOEs reported in SOEs Federal Footprint (SFF) reports of the Ministry of Finance. However, in FY23, 12 entities, earlier classified as non-commercial SOEs in 'education, training & skill development' sector, were excluded from SFF reporting.

¹⁶ Consolidated data for federal SOEs is only available for the periods FY14-FY19 and FY21-FY23, as published in various SFF reports available at: <https://finance.gov.pk/cmu.html>. There have also been changes in categories/classifications in these reports over this period. Consolidated data for provincial SOEs is not reported; hence provincial SOEs are not discussed in this chapter.

Non-Commercial SOEs' Profits

Figure 7.1



*sector excluded from reporting in FY23

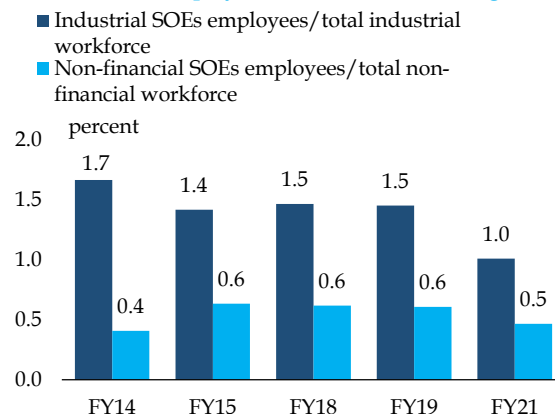
Source: Ministry of Finance

and training. Therefore, greater focus ought to be placed on commercial SOEs, especially considering that they comprise 73 percent of total SOEs; hold 98 percent of SOE assets; and account for nearly all SOE losses.¹⁷ This view is further reinforced by the fact that non-commercial SOEs, have been largely profitable (**Figure 7.1**).¹⁸

With the exception of SOEs' share in total employment, the overall economic footprint of federal commercial SOEs is quite high.¹⁹ The share of total employees of non-financial SOEs in Pakistan's non-financial employed workforce was about 0.5 percent in FY21, whereas that of industrial sector SOEs as percentage of total industrial employment in the country was around 1.1 percent – both having witnessed a decline in recent years (**Figure 7.2**). This is much lower than estimates of non-financial SOEs' employment contributions in other countries, such as China (4.3 percent in 2017), and select

SOEs' Share in Employment*

Figure 7.2



*data for certain years not available

Sources: Pakistan Bureau of Statistics; Ministry of Finance

emerging economies (5 percent during 2014-2016).²⁰ Similarly, the Organisation for Economic Co-operation and Development (OECD) countries with the highest contribution of SOE to total employment ranged from 2 to 9 percent from 2008 to 2009.²¹

On the other hand, high economic footprint can be seen in total revenues of the 88 commercial SOEs as percentage of GDP. This was about 14 percent in FY23 (**Figure 7.3a**). By comparison, total revenue of 415 companies (excluding SOEs) listed on the Pakistan Stock Exchange was 17 percent of GDP in FY23.²² This high footprint is mainly reflected in industrial SOEs in comparison to manufacturing SOEs (**Figure 7.3b & 7.3c**). This is on account of large-size industrial SOEs in energy exploration & production and power sectors. Despite a decline in recent years, revenues of industrial SOEs as a percentage of industrial GDP is still high at about 58 percent in FY23.²³ Another area of high

¹⁷ MoF (2021); MoF (2023)

¹⁸ The 'profits' in non-profit organisations are usually called surplus income or net assets. However, this chapter uses the term 'profit' in line with the usage in SFF reports.

¹⁹ SBP staff calculations based on various Labour Force Surveys of Pakistan Bureau of Statistics (PBS). Non-financial SOEs includes all SOEs except for the financial sector, whereas industrial SOEs are SOEs in the following sectors: oil & gas, power, industrial estate development and manufacturing, mining and engineering sectors in line with PBS's classifications.

²⁰ Borkovic, S. & Tabak, P. (2020). The paper categorised the following countries as emerging economies: countries in Central Europe and Baltics, South-eastern Europe, Eastern Europe and Caucasus, Egypt, Kazakhstan and Türkiye.

²¹ Borkovic, S. & Tabak, P. (2020); Zhang, C. (2019); OECD (2011)

²² SBP staff calculation based on data available at Capital Stake.

²³ SBP staff calculations based on classification of SOEs as per international definitions of industrial and manufacturing activities adopted by Pakistan Bureau of Statistics (PBS). Industrial sector comprises Mining and Quarrying, Manufacturing, Construction

Total SOE Revenue to GDP

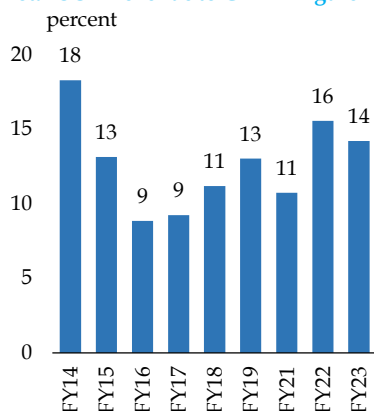


Figure 7.3a Industrial SOE Revenue to Industrial GDP

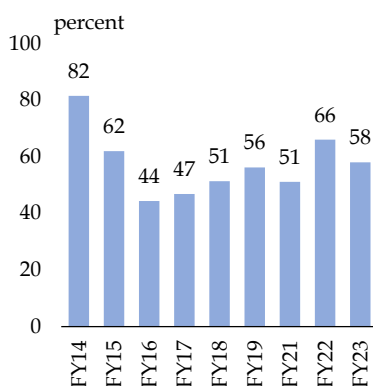


Figure 7.3b Manufacturing SOE Revenue to Manufacturing GDP

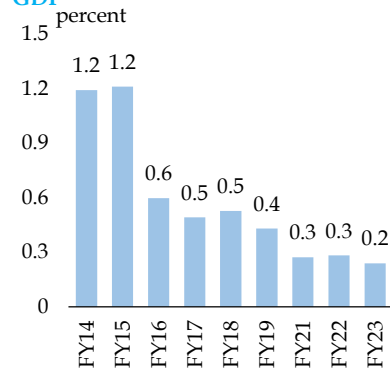


Figure 7.3c

Note: SOE data for FY20 not available
Sources: PBS and Ministry of Finance

footprint is bank financing, where SOEs' share in total bank loans to non-government sector has also remained high at an average of 15 percent between FY14-FY23 (Figure 7.4).

The fiscal impact of SOEs has been quite large. Net losses of commercial SOEs have been increasing in recent years. Net fiscal support to SOEs has generally grown as a percent of GDP, and averaged at around 21 percent of the budget deficits during FY16 and FY23 (Figure 7.5 and 7.6). The fiscal impact of SOEs emanates from

their unsustainable, inefficient business operations, as well as politically influenced sectoral policy decisions, such as untargeted subsidies in power sector.²⁴ Owing to these, many entities rely on the government to provide financial support through subsidies, equity injections, grants and loans. Analysis of federal government's gross outflow to SOEs, and SOEs' payments to the federal government shows that the size of the former more than offsets the latter (Figure 7.7 and 7.8). Moreover, contingent liabilities²⁵ (e.g. government guarantees) are

Trends in SOE Loans

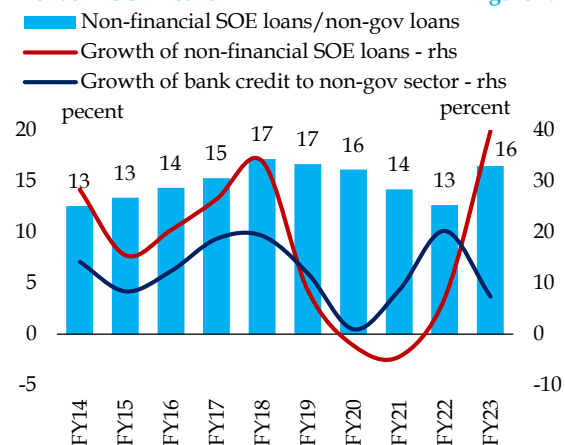


Figure 7.4

Source: State Bank of Pakistan

Net Fiscal Impact* of Commercial SOEs

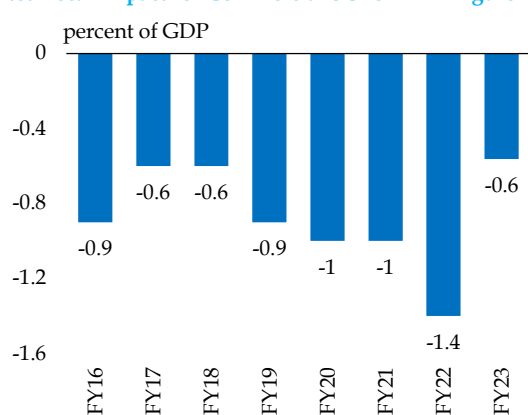


Figure 7.5

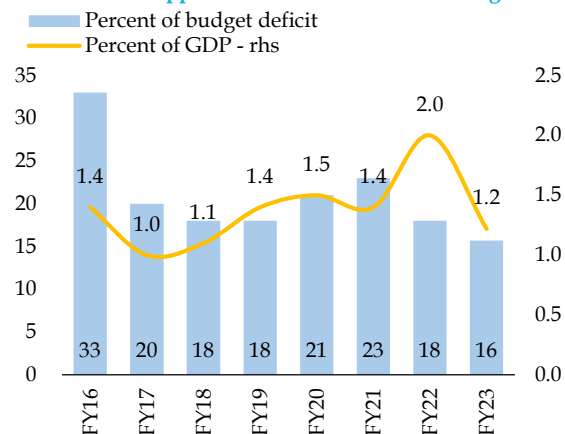
*net fiscal impact is total SOE profits minus losses
Sources: World Bank, FY23 from Ministry of Finance

and Electricity, Gas and Water supply, whereas its manufacturing sub-sector comprises Large Scale Manufacturing, Small Scale Manufacturing and Slaughtering.

²⁴ Malik, A. (2012)

²⁵ These liabilities are contingent on one or more uncertain future events. For instance, federal government's guarantee SOEs debt, enabling them to borrow at favourable terms.

Government Support to all SOEs Figure 7.6

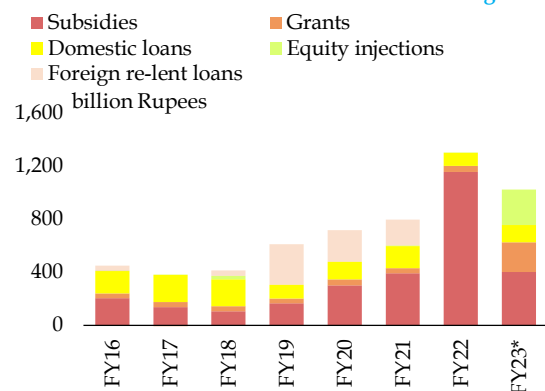


Sources: World Bank, FY23 from Ministry of Finance

hidden risks that exacerbate these leakages. The extent and recurring nature of these losses coupled with required fiscal support, points to the urgency of course correction.

Sectoral analyses of SOEs reveals that the bulk of losses is concentrated in two main sectors: power, and infrastructure, transport & ITC.²⁶ Losses in these two sectors have been offsetting profits of other sectors, including the oil & gas sector that contributes the most to total SOE profits. Government outflows to these two sectors are mainly comprised of loans and

GoP Outflows to Commercial SOEs Figure 7.7



*all loans categorised as domestic loans due to unavailability of disaggregated data

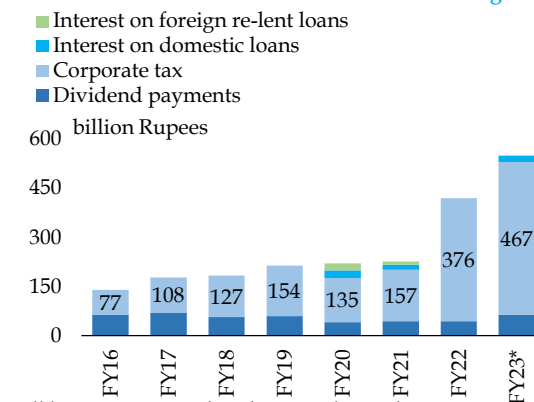
Sources: World Bank, FY23 from Ministry of Finance

subsidies (Figure 7.9 and 7.10). The power sector alone, which accounted for about 25 percent of total commercial SOEs in FY23, posted combined losses of Rs. 208 billion which is around 29 percent of total SOE losses in FY23 (Figure 7.11 and 7.12). In fact, amongst the highest loss-making entities of FY23, five were power distribution companies (DISCOs) (Figure 7.13). Infrastructure, Transport & ITC sector accounted for 69 percent of SOE losses in FY23, with large losses posted by National Highway Authority (NHA), Pakistan International Airlines (PIA) and Pakistan Railways (PR) (Figure 7.13).

These losses are driven by a number of policy and governance challenges,²⁷ evidenced by the two biggest loss-making SOE sectors (discussed in detail in Section 7.5). Even profitable sectors like, oil & gas, are susceptible to risks as they may take a hit in profitability after the implementation of relevant international accounting standards.

Furthermore, the unique nature of certain SOEs means that simple financial statement analysis ignores nuances, such as market dynamics and government involvement. For example, many enterprises benefit from sizable contracts from

GoP Inflows from Commercial SOEs Figure 7.8



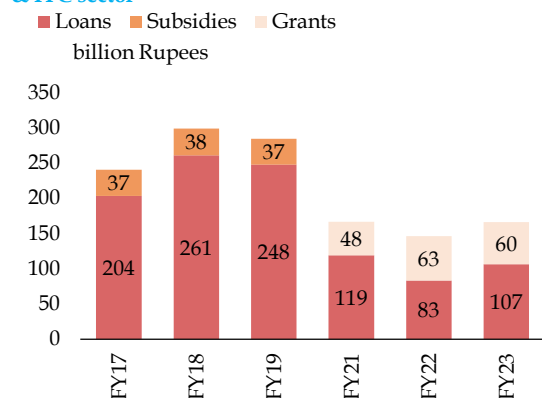
*all loans categorised as domestic loans due to unavailability of disaggregated data

Sources: World Bank, FY23 from Ministry of Finance

²⁶ As classified by SFF reports, sub-sectors of 'Infrastructure, Transport & ITC' sector include: Ports & Shipping, Railways, Roads & Highways, Aviation, and Communication. Sub-sectors of power sector include: Distribution Companies (DISCOs), Generation Companies, Transmission Companies, and Power Management Companies.

²⁷ Hussain, I. (n.d).

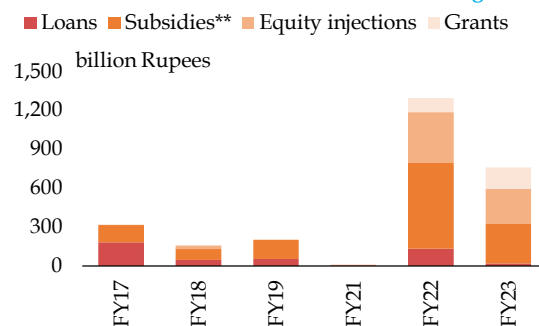
GoP Outflows to Infrastructure, Transport & ITC sector* **Figure 7.9**



*data for FY20 not available
Source: Ministry of Finance

government entities, implying that even profitable entities may not emerge to be truly efficient when tested in competitive markets. Similarly, some SOEs, such as in the petroleum and power sector, operate monopolistically, and there has rarely been any comparative analysis and benchmarking of such companies.²⁸ These inefficiencies may not necessarily result in financial losses but they do translate into implicit welfare losses for consumers and opportunity costs for the state. On the other hand, these entities may also undertake many actions that fall outside general business

GoP Outflows to Power Sector* **Figure 7.10**



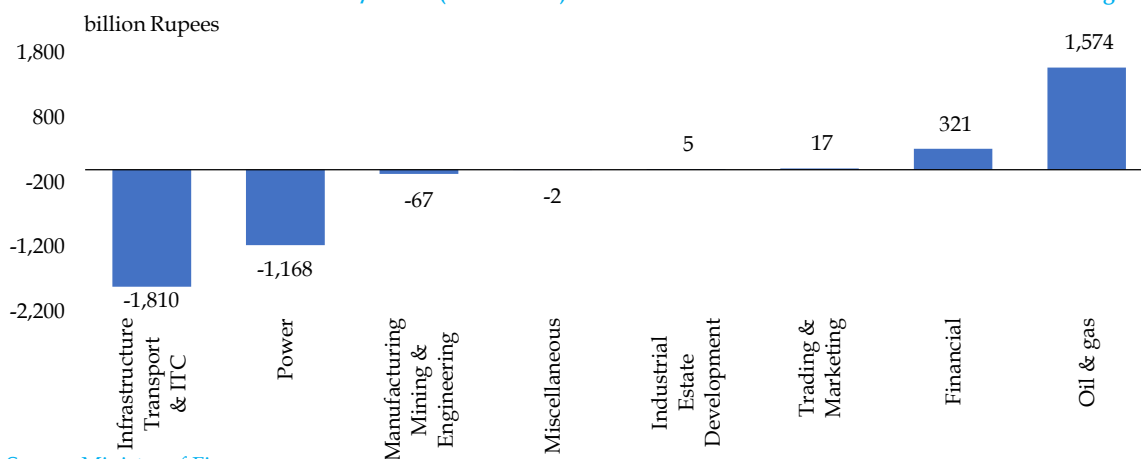
*data for FY20 not available
**tariff differential subsidies are included as outflows to the sector but are not necessarily financial support to power SOEs as they are intended for end consumers
Source: Ministry of Finance

considerations. Such public service obligations negatively impact the operations and profits of these entities.

Historical Issues across Commercial SOEs²⁹

In addition to the aforementioned sectoral issues, SOEs across the board have also been affected by several other problems, including: (i) lack of corporate governance; (ii) poor business plans and (iii) partial implementation of modern accounting standards and practices. These risks

Commercial SOEs Cumulative Profits/Losses (FY18 - FY23)



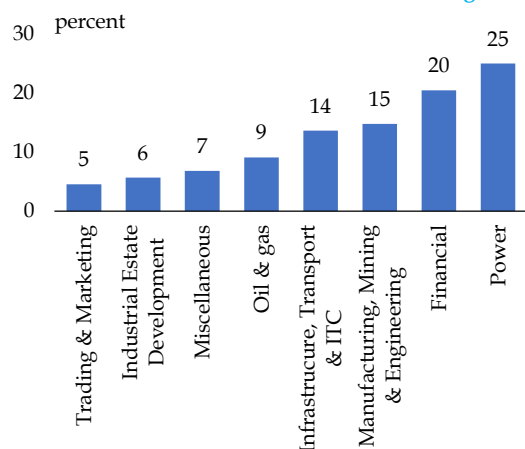
Source: Ministry of Finance

Figure 7.11

²⁸ Iftikhar, N (2022).

²⁹ This sub-section draws on insights from Ministry of Finance's latest report on SOEs, MoF (2023). The report, released on 24th June 2024, summarises problems related to federal SOEs as of FY23. It is the latest available consolidated update on SOEs.

Classifications of Commercial SOEs - FY23 **Figure 7.12**



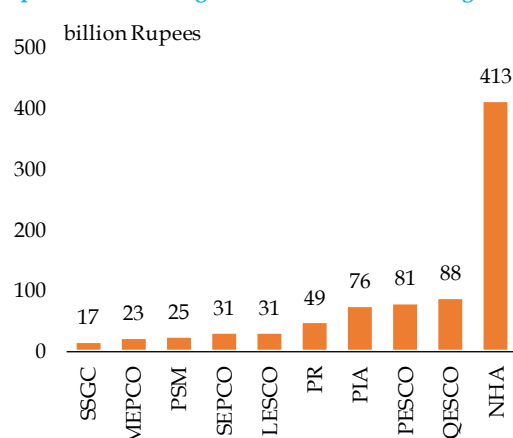
Source: Ministry of Finance

have existed in SOEs in varying degrees, and have long manifested the need to reform the modus operandi of all entities regardless of policy decisions on the ownership of SOEs.

There are multiple issues in SOEs' corporate governance. Amongst the biggest ones, has been the lack of empowerment and independence of the board of directors (BoD). Independent directors formed a minority in the BoD of SOEs, which was exacerbated by the presence of ex-officio members appointed by the government. These boards were further weakened by the presence of government appointed CEOs, breaching corporate governance practices of separation of board and management. There were also problems with monitoring and evaluation (M&E) mechanisms to objectively judge board performances.

SOEs' business plans were found to lack comprehensiveness and did not adequately focus on financial sustainability. Business plans were also found to be unresponsive to changes in the economy or sector, preventing them to take advantageous decisions or mitigate unfavourable circumstances. This was because of two main reasons. Firstly, many entities, such as Pakistan Railways, have relied on government bailouts and support. Secondly,

Top Ten Loss-making SOEs - FY23 **Figure 7.13**



Source: Ministry of Finance

structured and holistic analysis of business threats and opportunities was often not conducted to strategise on future direction.

Moreover, there have been serious lapses in financial reporting in federal SOEs' publications, disclosures, and audits. For instance, audits of some SOEs show material misstatements or departures from accounting standards, highlighting a lack of accuracy or reliability of financial reports. Some SOEs, such as Pakistan Post, Karachi Port Trust and Lahore Electric Supply Company did not prepare audited financial statements for FY23. These issues with data and financial statements reflect a major challenge to data driven decision making for SOE reforms.

In addition, several SOEs had not adopted modern accounting standards, essential to accuracy and transparency. These include International Financial Reporting Standards 9 (IFRS-9) that mandates the use of an expected credit loss (ECL);³⁰ IFRS-15 for the principles, the nature, amount, timing, and uncertainty of revenue and cash flows arising from a contract with a customer; International Accounting Standards 19 (IAS-19) for recognition of all employee benefits, including pensions, as liabilities on their balance sheets;³¹ and IAS-20

³⁰ For SOEs with circular debt receivables on its books, for instance, power and gas sector, this means factoring in provisioning for potential defaults into its ECL calculation.

³¹ This is in particular important for large employer SOEs, such as Pakistan Railway (PR), which has significant pension obligations.

for recognizing government grants only when there is reasonable assurance that the grants will be received.³²

The various lapses in SOEs reflect the historical failure of the SOE reform process in Pakistan. Despite several attempts over the past decades, many of these fundamental issues continued to recur. These shortcomings can be rooted in various issues, such as rushed reform processes without the necessary consensus building and due diligence. The following section will analyse the lapses in Pakistan's SOE reform processes across decades and identify common hindrances to past reform programmes.

7.3 Review of SOE Reform Efforts

Reforming SOEs is a complex process. It involves five broad types of reform measures: (a) fiscal and public financial management reforms (e.g. stocktaking of SOEs); (b) strengthening competition and regulation; (c) taking decisions about SOE ownership; (d) corporate governance reforms; and (e) improving business and operations.³³ These measures are not necessarily taken in the sequence listed above, although some literature and global best practices do seem to suggest that. Indeed, there is no single pathway to SOE reform, since much depends on country context. However, global experience suggests that strengthening of competition, regulation, and corporate governance are critical measures, which are advised to be taken before or alongside the decisions on SOE ownership. Similarly, governments also need to take steps to create political consensus, garner public support and manage labour related issues to enhance public buy-in of the reform process (Figure 7.14).

While literature on Pakistan's SOE performance and reforms is scant and dated, a review of the country's historical SOE reform attempts suggests that the reform process has been slow, punctuated and without a well-designed pathway to sustainable SOE reform. The overall policy stance shifted from nationalisation to reforming SOEs as the global trends of privatisation and liberalisation took hold in the 1980s. However, with the exception of some sectors, such as banking and telecom, the country's approach was skewed towards privatisation, rather than implementing wholesale sectoral policy reforms, corporatization, and a robust governance framework to support a competitive economy (Figure 7.15). Reforms focusing on corporate governance, and strengthening of competition and regulation was by and large neglected.³⁴ This has been one of the key reasons why reform efforts failed repeatedly in turning SOEs into profitable entities, improving efficiency, and fixing the fiscal burden problem. This underscores the view that ownership decisions, such as privatisation and retention, are not itself a panacea for the challenges faced by SOEs.

Some attempts at SOE reforms involved improving the business operations of individual SOEs to revive them. Even when such efforts were undertaken with full political support, the lack of good corporate governance and other enabling reforms led to a deterioration of SOEs' business operations, profitability, assets and service delivery, such as in PIA and PR. As a result, bailout packages were provided, and a vicious cycle ensued.³⁵

Moreover, the efforts to privatise and other SOE reforms were interrupted by a myriad of underlying challenges, including a lack of political consensus in the absence of which SOE reforms were perceived as the agenda of multilateral agencies. This was because of two

³² This will effect SOEs like the NHA and PR that are large recipients of government grants.

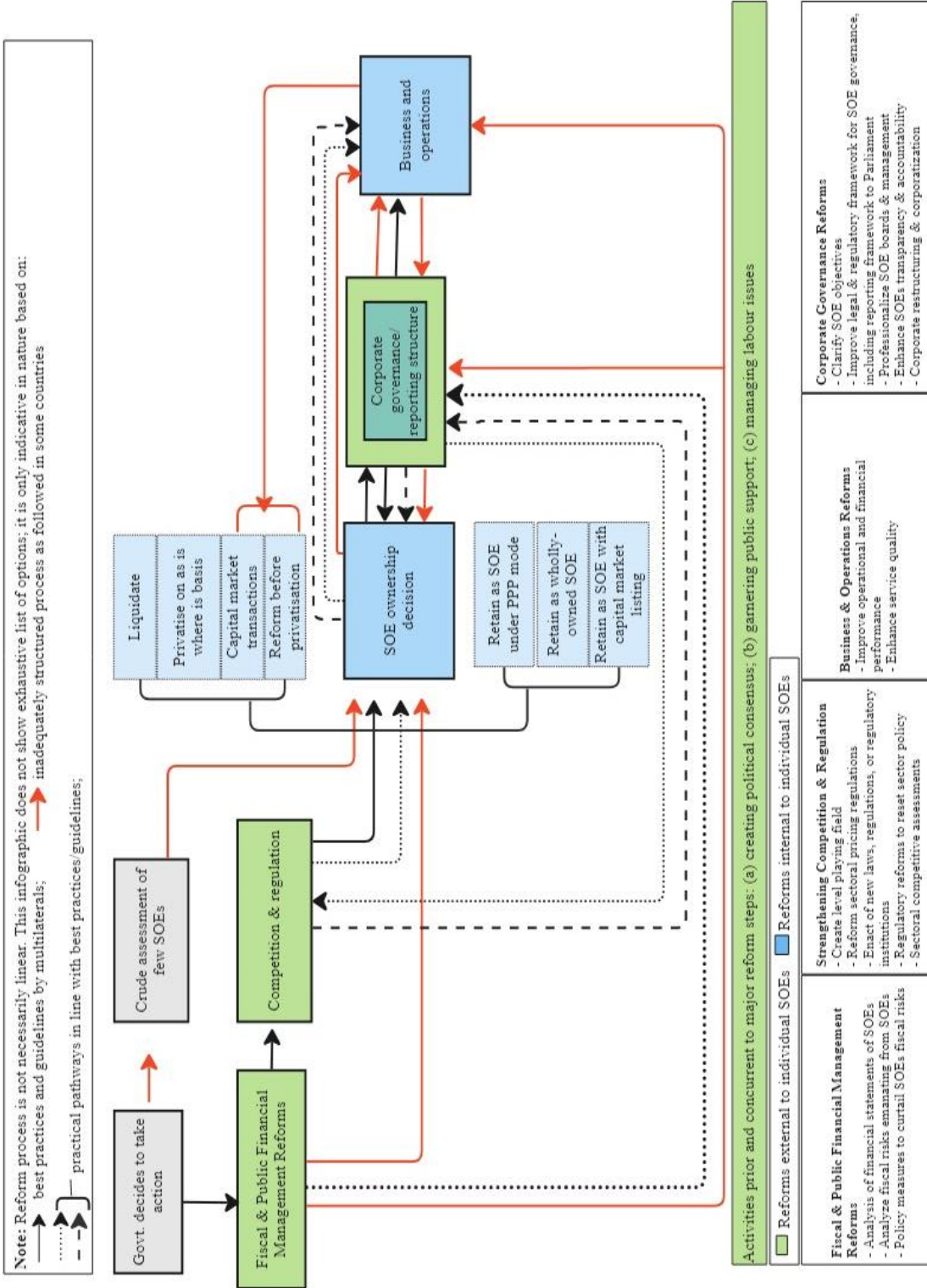
³³ This chapter excludes discussions on liquidation, which is a one-time transaction, and therefore falls outside the scope of this discussion. SOEs reform in this chapter has been analysed in the context of five broad reform measures mentioned above.

³⁴ Iftikhar, M. N. (2015).

³⁵ ADB (2008); PC (2011)^a; Iftikhar, M.N. (2015).

Figure 7.14

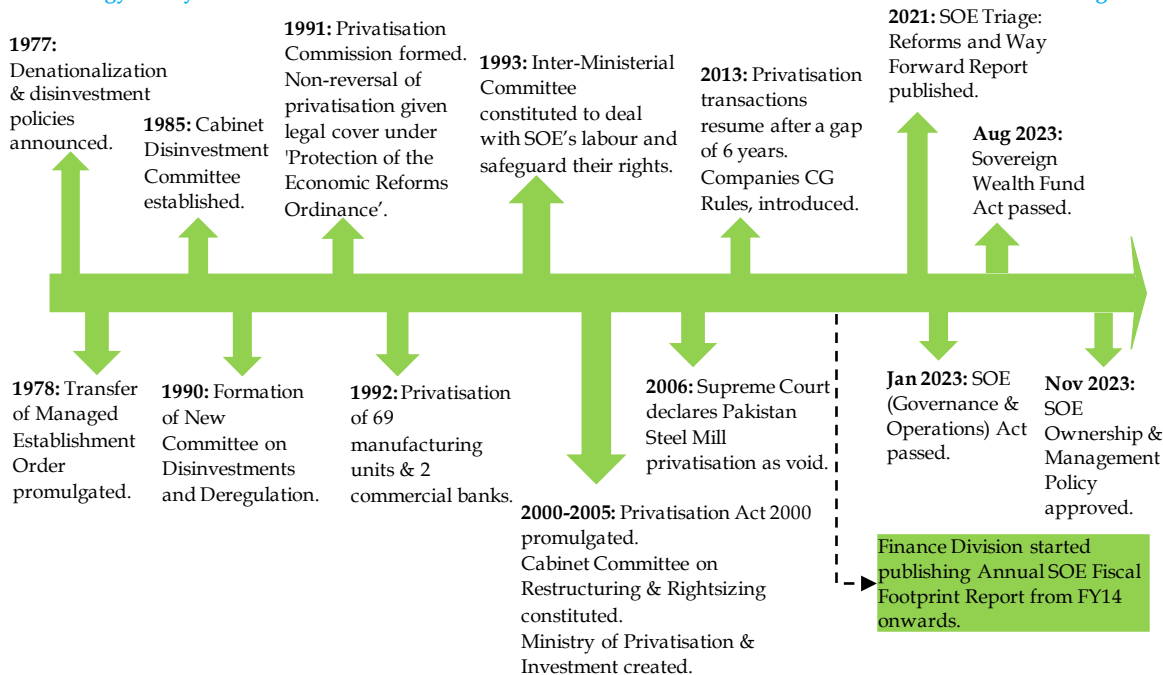
Categories and Sequence of Major Types of SOE Reforms



Sources: SBP, based on World Bank (2020), and Kennedy and Jones (2003)

Chronology of Key SOE Reform Measures in Pakistan

Figure 7.15



Sources: G. Yoganandan (2010); M. Zubair et al. (2022); S. Anwar, (1998).

main reasons. Firstly, clientelism through the management of SOEs continued to undermine SOEs' economic competitiveness. Moreover, political instability and uncertainty stalled both the introduction of required legislation and institutional framework, and privatisation transactions itself. Secondly, during the 1980s and onwards, IMF programs spelled out privatisation as a condition for the multilateral's support. This often hastened the privatisation process, bypassing the recommended phased approach and the legal and institutional reforms needed to reap the benefits of privatisation.³⁶

Privatisation

Following global trends, Pakistan has gone through major privatisation since the 1990s. The Privatisation Commission (PC) was established in 1991 as a subsidiary of the Finance Division to

implement the privatisation programme. Since then a total of 182 privatisation transactions have been completed. These transactions were mainly concentrated during 1991-95 and 2001-2006 as the process was frequently interrupted due to the aforementioned factors. The 2008 Global Financial Crisis was also a significant setback for the privatisation process in several countries including Pakistan, due to weak investor appetite.³⁷

The modalities of privatisation in Pakistan have predominantly involved: (a) the sale of majority stakes with management control in sectors; (b) capital market transactions; and (c) minority stake sale with management control.³⁸ Other types of privatisation transactions, such as concessions and mutualisation, better suited for low-income countries, have not been executed.³⁹

³⁶ Iftikhar, M. N. (2015); PC (2011)^b; BTI Index 2024; Bokhari, S.A. (1998); Breen, M., & Doyle, D. (2013); Hussein et al. (2018); Tahir, P. (2014)

³⁷ IBA speeches (2009); Privatisation Commission website.

³⁸ Privatisation Commission website.

³⁹ Concessions involve giving a private company usage rights over SOEs assets (or invest in new assets) to provide certain public services for a specified period, against the right to charge for those services. These arrangements are best suited for privatising SOEs

Sector-wise review of privatisation transactions reveals that the process has been very slow – taking about 6 to 16 years to complete a transaction – even in small sized and less complicated entities such as Roti plants. Further, the large size transactions, mainly related to banks, telecom and energy sectors, were executed through the capital market after 2001 and onwards. This is in line with global experiences, which suggest that privatisation through capital market listing is a better option when the market is relatively developed, whereas whole or majority stake sale is more common when the market is underdeveloped (**Annexure**).⁴⁰

In some sectors, such as telecom and banking, these transactions were executed alongside efforts to improve competition and strengthen regulation. However, as the ensuing discussion shows, the nature and scope of reforms was not holistic, as the success of SOE reform was seen with a limited yardstick. Moreover, the privatisation process was marked by several legal and institutional weaknesses, whereas some privatisation deals also faced transparency and procedural issues due to which public confidence in the process waned.

Limited criteria of success

One of the major shortcomings of SOE reforms undertaken in Pakistan, is the overemphasis on privatisation as the single most important yardstick of success, with limited focus on strengthening of competition and regulation. Moreover, monitoring and evaluation mechanism for ensuring post privatisation service delivery is weak, which is particularly pertinent for SOEs operating in public goods

and services sectors. Also, there have been limited efforts to diagnose and improve the sectoral regulatory frameworks to mitigate such recurring issues.⁴¹

For instance, the privatisation of Karachi Electric Supply Corporation (now K-Electric), resulted in improvements in service delivery and profitability of the entity. However, its consumers still face high cost of electricity and frequent power outages on account of a host of unresolved sectoral policy and governance issues. Similarly, the capital market transactions of Sui Southern Gas Company (SSGC) and Sui Northern Gas Pipelines Limited (SNGPL) helped the government to raise non-tax revenues amid hopes that stock market listing would enable stronger checks and balances through stringent corporate governance. However, the unresolved sectoral and business policy issues continue to be a burden on these SOEs' operations and finances. This is unlike the banking and telecom sectors, where privatisation of SOEs came alongside a series of policy and governance reforms.⁴²

Similarly, it is pertinent to note that while denationalization and privatisation began since the late 1970s and gathered pace during the 1990s, the enabling regulatory environment was not put in place until much later. For instance, several key regulators, such as Securities and Exchange Commission Pakistan (SECP), Pakistan Telecommunication Authority (PTA), National Electric Power Regulatory Authority (NEPRA), Competition Commission of Pakistan (CCP), and Oil and Gas Regulatory Authority (OGRA), were set up more than a decade after the start of the privatisation and reform process.⁴³

with monopolistic characteristics, and helps governments mitigate investment/operational risks. Mutualization fosters social cohesion through co-ownership of SOEs by broad group of stakeholders (e.g. employees and customers). Such modalities enhance efficiency and service quality, and also avoid overburdening private sector liquidity. Source: NCP (2022); Jafarey, V.A. (1992)

⁴⁰ Megginson, W. L. and Netter, J. M. (1999).

⁴¹ Exceptions include diagnostic study for power sector in 2014 as part of IMF's loan conditionality. However, these were neither made public for stakeholder deliberation, nor implemented. Source: IMF (2014).

⁴² SBP (2024); IPS (2023); CCP (2018); Asghar, S. and Mohsin, H. (2023); Kalhor, S. A. (2022); Hussain, I. (2004); Khan, B. (n.d.)

⁴³ SECP was set up in 1997. PTA was established as a body corporate in 1996. NEPRA was established in 1997. CCP was formed in 2007. OGRA was formed in 2002. (Source: *Respective websites*)

As a result of this delay and overall regulatory underdevelopment, market dynamics have remained uncompetitive with a weak private sector that undermines broader economic progress. Even the sectors that were privatised in the early years – such as cement, cooking oil/ghee, and fertilizer – are not fully competitive amid recurring instances of cartelization; production inefficiencies; barriers to entry; and low quality standards.⁴⁴

Weak legal and institutional framework

Pakistan's weak legal and institutional framework has affected privatisations in at least four different ways. First, the process of putting the policies and institutions in place took more than a decade. The country introduced policies of denationalization, disinvestment and decentralization in 1978 through the Transfer of Managed Establishments Order (TMEO) 1978. This empowered the government to offer former owners of some of the nationalized industries, the shares of propriety interest in acquiring their formerly owned establishments.

Legal cover was granted under TMEO that the denationalized units would not be nationalized again. Despite this cover, very few nationalized industrial units could be returned to their former owners. This was because the SOEs had deteriorated financially owing to which previous owners had little incentive to invest, especially amid lack of adequate legal provisions to counter the vehement opposition by SOEs' workers and middle and lower management.⁴⁵

The denationalization efforts that began in 1978-1979 soon lost steam and did not advance further until 1985, when a Cabinet Disinvestment Committee (CDC) was set-up to identify units for disinvestment. However, despite setting up this high level ministerial

committee which devised the rules and procedures for disinvestment, the overall progress remained negligible for the very same reasons of legal and institutional bottlenecks. In 1988, a National Disinvestment Authority was created with powers wider than the CDC but the institution could not make progress due to a change in government soon after. More than ten years after the start of the process, the PC was eventually established in 1991, along with the Cabinet Committee on Privatisation (CCoP) to institutionalize privatisation efforts. The PC's mandate was initially restricted to industrial transactions. However, by 1993 it had expanded to also include power, oil and gas, transport, telecom, and banking and insurance.⁴⁶

Second, weak stakeholder engagement mechanism has been a major constraint. The mechanisms through which stakeholder interests are aggregated, addressed and mediated are largely absent or limited in their functionality. This undermines the efficacy of the SOE reform process, which requires broad stakeholder ownership. For example, the Pakistan Steel Mills (PSM) was approved for privatisation in 1997 by the Council of Common Interests (CCI), but it was not pursued. However, at the time of privatisation of PSM in 2006, the CCI was not functional, and the government had no active platform to garner a fresh consensus among the federating units.⁴⁷

The third facet of weak institutional capacity revolves around autonomy of regulators. Despite regulatory efforts and the creation of autonomous regulators, elite capture weakens the institutions, whereas the adhocism in decision-making regarding some of the regulators has undermined their autonomy. For instance, the transfer of administrative control of regulatory bodies⁴⁸ to their respective line ministries, compromises their independence. Similarly, the lack of consistent capacity

⁴⁴ PC (2011)^b; CCP (2011); CCP (n.d.)

⁴⁵ Kennedy, R. M. and Jones, L. P. (2003); ADB (2008); Ramanadham, V.V. (1994).

⁴⁶ Bokhari, S.A. (1998); Ramanadham, V.V. (1994); ADB (2008).

⁴⁷ BTI Index 2024; Constitution Petition No. 9 of 2006 & Civil Petition Nos. 345 & 394 of 2006, Pakistan Steel Mills Judgment

⁴⁸ NEPRA, OGRA, PPRA, PTA and FAB

building of the PC has also acted as a bottleneck for successful privatisation in Pakistan. For example, within a single year in 2006, the PC was under the helm of three different ministers and four different secretaries, whereas the turnover rate of its consultants was also very high. This kind of environment dampens investor confidence.⁴⁹

Lastly, while in 2006, the Supreme Court recognized that it is not the function of the Court to interfere in policymaking domain of the government, many privatisation transactions have been brought before the Court on the broader pretext that they relate to enforcement of fundamental rights. For instance, one of the cases brought for judicial review was whether the privatisation of an entity was undertaken due to IMF's conditionality. Moreover, senior officials of the PC have also frequently faced litigation and investigation from both private citizens and official investigative agencies. These cases deterred them from taking decisive actions, and undermined their willingness to take ownership of crucial decisions, impeding the privatisation process.⁵⁰

Transparency and procedural issues

During the country's history of privatisation, there have been some transactions where due procedures have not been followed amid a lack of transparency. For instance, in the case of PSM's privatisation in 2006, the Supreme Court found that the final terms offered to the buyers' consortium were not in accord with the initial public offering, on the basis of which the court declared the transaction as void. Similar procedural issues have also affected otherwise successful privatisation deals. For instance, in the case of PTCL's privatisation, more than 3000 properties were committed to the buyer, owned by provincial governments and Pakistan

Railways,⁵¹ which were never a part of prior consultations before signing the transaction deal. Likewise, in the case of privatisation of a cement sector SOE, the buyer had agreed to a condition on reviving the industrial unit. However, the industrial unit was converted into a housing society, without knowledge of the PC. These instances, albeit few, undermine the transparency and credibility of the privatisation transactions, and damage the prospects of wider public support for the process.⁵²

SOE Corporate Governance Reforms⁵³

Pakistan's most serious attempts at SOE's corporate governance reforms have been undertaken as recent as 2023. These measures are built on the back of two key fiscal and public financial management reform initiatives: first, the reporting of annual SOEs' financial statements through Federal Footprint reports since FY14; and second, stocktaking of the fiscal impact of SOEs under a 2021 report titled 'SOEs Triage: Reforms & Way Forward'.

Prior attempts at SOEs corporate governance reforms have been few; limited in range and scope; and incomplete. For instance, in 2013, the Public Sector Companies Corporate Governance (PSCCG) Rules were introduced; but they were not effectively implemented. Similarly, in 2012 and in 2019, attempts were made to create a holding company and bring all SOEs under its umbrella. While the 2012 attempt remained mainly at ideation stage despite its hype, the 2019 attempt resulted in the creation of holding company by the name of Sarmaya-e-Pakistan (SEP). However, the SEP did not materially progress beyond incorporation.

PSC Corporate Governance Rules 2013

In response to governance challenges, Pakistan

⁴⁹ Naseem, F., & Ghulam, S., (2022); Sherani, S. (2017); ADB (2008).

⁵⁰ PC (2023); Hussein et al. (2018).

⁵¹ Naseem, F., & Ghulam, S., (2022).

⁵² ADB (2008); Tahir, P. (2014).

⁵³ This sub-section only sheds light on key corporate governance reforms and its baseline documents. However, the evolving nature of ongoing reforms prevents its exhaustive analyses.

introduced the PSCCG Rules in 2013, later amended in 2017 and 2019. A review of the Rules (as amended up to July 2019) informs that it was a step in the right direction, the first such reform measure in the history of Pakistan's SOEs. Its salient features included the requirement for at least one-third independent directors in SOEs board with competencies relevant to the respective SOEs who are subject to a fit and proper criterion; have a secure term of office;⁵⁴ and are appointed under performance contracts. It also mandated the preparation of business plans; internal and external audited reports; publication of annual financial statements as per IFRS on SOEs' website; publication of status report on compliance with the Rules; as well as a penalty for non-compliance or contravention of the Rules.⁵⁵

However, as flagged in **Section 7.2**, these Rules were not effectively implemented, with a compliance rate of a mere 37 percent; incomplete boards; lack of independent directors; improper accounting records; and non-transparent and vague business plans. In fact, the SECP often found it challenging to hold the board, which included government functionaries, accountable. Moreover, the Rules notified were only applicable to SOEs registered under the Companies Ordinance 1984 - later Companies Act 2017 – and not on SOEs established under special enactments or attached departments. This kept several SOEs outside the ambit of corporate governance.⁵⁶ However, following the passing of the SOE Policy 2023 under SOE Act 2023, the PSCCG Rules 2013 are no more applicable.⁵⁷

SOE Federal Footprint Reports and the Triage 2021

The Triage report was a review of existing SOEs portfolio, undertaken in consultation with the IMF, the World Bank and the Asian Development Bank to categorize the SOEs for retention, privatisation and liquidation. The Triage report was intended to serve as the foundational policy guideline for all the concerned ministries, divisions and other stakeholders to take appropriate action plans within the detailed timeframe stipulated in the report. Originally initiated in 2019 as a part of the IMF Extended Fund Facility, this was the first comprehensive review of the federal government's existing SOE portfolio to categorize SOEs and to help assess SOEs' fiscal footprint. This was done on the basis of Federal Footprint SOE Performance Review reports by the Ministry of Finance, which mainly collected and compiled the financial statements reported by SOEs after the PSCCG Rules 2013. Beginning with FY14 report, this was the first time that annual financial statements of SOEs were released publicly.⁵⁸

However, like the PSCCG Rules 2013, the Triage has not been effectively implemented. For instance, power sector DISCOs' bidding process for privatisation was slated for 30th June 2024, whereas that of other SOEs was 30th June 2023. But both timelines have lapsed and progress on both accounts has been rather slow. Moreover, the Triage lacked fundamental aspects, such as an unambiguous criterion for retention of SOEs. Furthermore, the Triage did not shed light on the need for essential policy reforms, sectoral competitive assessments, and other actions to reduce market imperfections before initiating

⁵⁴ Under Section 13 of the SOE Act, a director cannot be removed unless an inquiry proves non-compliance, misconduct, and other things such as indulging in a professional or personal conflict of interests' situation, receiving gift or other benefits from sources external to the SOEs offered to him.

⁵⁵ Public Sector Companies (Corporate Governance) Rules, 2013, amended upto July, 01, 2019

⁵⁶ Ifitikhar, M.N. (2015).

⁵⁷ Unless otherwise notified as an exception. Source: SECP (2024); section 8 SOE Ownership and Management Policy 2023

⁵⁸ Whilst the footprint reports offered useful insights, the data in those reports is often patchy because several SOEs did not share data as flagged elsewhere in this section. Moreover, the reported data was often inconsistent with changes in sectoral classifications, data revisions, whereas the data itself was not easily comparable due to non-interactive reporting formats.

privatisation. Whilst the Triage serves as a baseline document, the SOEs are to be re-categorized under the SOE Act and SOE Policy 2023, which spells out a new criteria and process for categorization.

Sovereign Wealth Fund Act 2023

In August 2023, Sovereign Wealth Fund (SWF) Act 2023 came into effect as part of the government's SOE reform process. The objective of the SWF is to contribute to economic development through strategic fund management with capital sourced from the federal government; the SBP; transfer of assets of SOEs; borrowings from financial institutions; and transfer of government shareholding in SOEs. The SWF Act mandated the transfer of ownership of seven entities including several large energy sector SOEs to the Fund.⁵⁹ However, this initiative seems to conflict with the SOE Act and Policy, which, as discussed below, emphasize consolidated reporting and independence of SOEs Boards over their actions. The SOE Policy was approved after the SWF Act. However, the SOE Act and the Policy do not align with the SWF, which creates an additional layer of governance framework.

SOE Act & SOE Policy 2023

The recently passed SOE Act 2023 and the SOE Policy 2023 (drafted in accordance with the SOE Act) introduce a broader governance framework for all SOEs including those established under special enactments. It is the most comprehensive corporate governance framework so far in Pakistan and has several important aspects. The SOE policy also spells out specific criteria for categorization of SOEs as strategic or essential

for retaining SOEs indefinitely. If a commercial SOE does not meet the criteria for strategic or essential, it will either be (a) privatised without reforms; (b) privatised after restructuring/reforms; or (c) retained in the medium term, after restructuring/reforms. While these decisions are to be proposed by the line ministry in consultation with the SOEs' board, the decision rests with the Cabinet Committee on SOEs (CCoSOEs).⁶⁰

The creation of CCoSOEs with defined responsibilities is another salient feature of the latest SOE legislation; earlier CCoSOEs were not a permanent feature of every cabinet and did not have specific rights and duties defined by any legislation. One such role of CCoSOEs is to review the board of directors of SOEs recommended by the line ministry, before final approval of federal government. The SOE legislation and the SOE Policy also requires a professional board of directors with a majority of independent directors (**Figure 7.16**).⁶¹

The SOE Act and policy gives autonomy to the SOE boards, with clear provisions that the line ministry shall not micromanage the SOE nor give direction to SOEs to perform public service obligations (PSOs) unless mutually agreed and funded for, and monitored.⁶² Moreover, the board is to appoint a CEO on a performance-based contract.⁶³ The law and policy also requires performance review of its directors under a criteria defined by the Central Monitoring Unit (CMU), set up under Finance Ministry.⁶⁴

The formation of the CMU is another defining feature of the SOE Act, which gives it sufficient powers to monitor and evaluate the

⁵⁹ IMF (2023); The seven entities include: Oil and Gas Development Company Limited, Pakistan Petroleum Limited, National Bank of Pakistan, Government Holdings (Private) Limited, Mari Petroleum, Neelum-Jhelum Hydro-Power Company and Pakistan Development Fund Limited

⁶⁰ Sections 9, 11, 12, & 13 of the SOE Ownership and Management Policy 2023

⁶¹ Sections 15 & 23 of SOE Ownership and Management Policy 2023

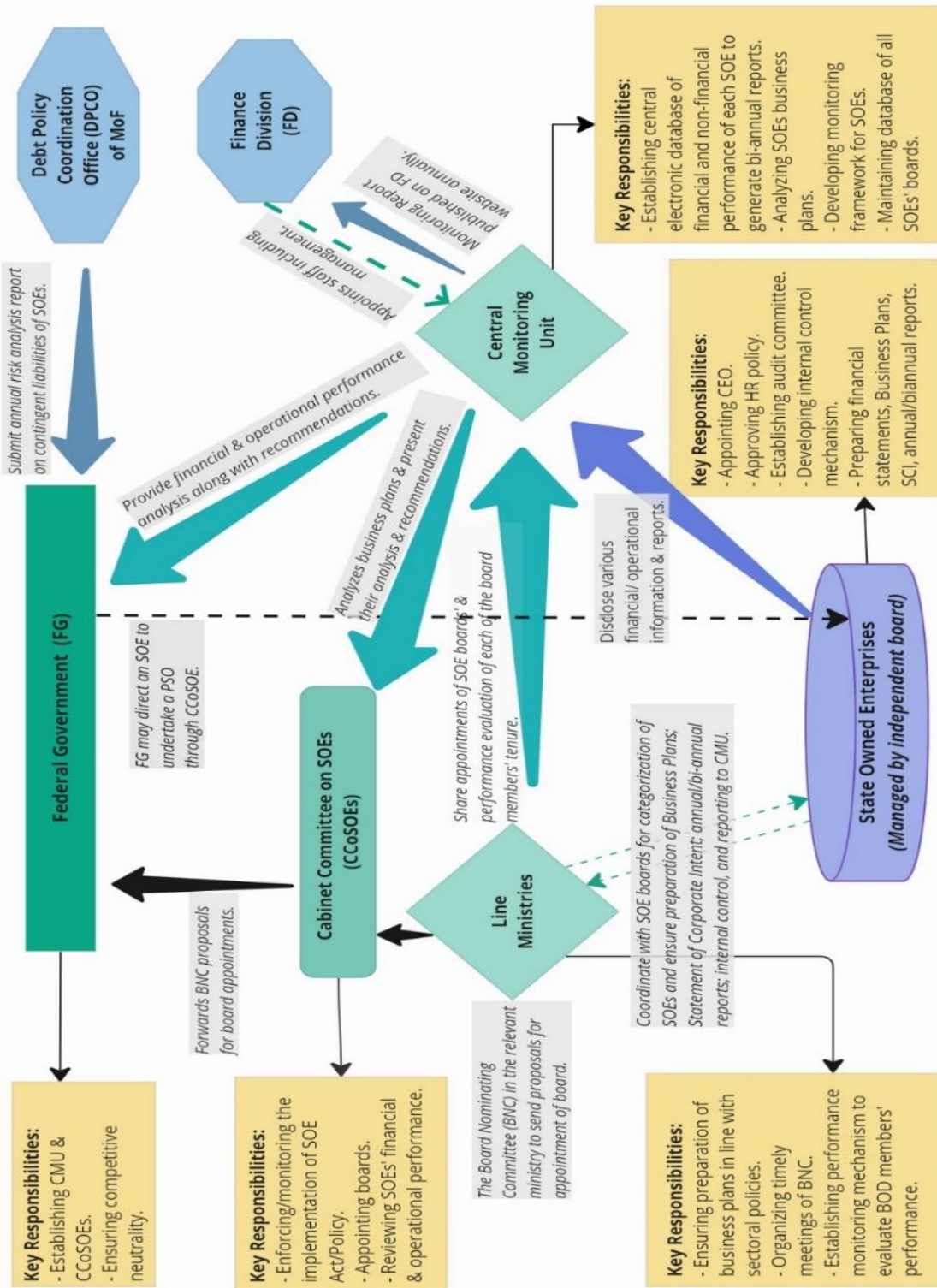
⁶² Under section 7(4) of the SOE Act, 2023, the federal government may direct a commercial SOE to undertake a PSO. As per section 32 of the SOE Ownership and Management Policy 2023, the federal government should compensate the SOE appropriately, in case it is directed to undertake a PSO, to the value of services provided.

⁶³ Section 18 of the SOE Act 2023; and Section 26 of SOE Ownership and Management Policy 2023

⁶⁴ Section 18 of the SOE Act 2023; and Section 26 of SOE Ownership and Management Policy 2023

Figure 7.16

SOE Governance Framework Under SOE Act and Policy 2023



Sources: SBP, based on SOE Act 2023 and SOE Ownership and Management Policy 2023

performance of SOEs, including their business plans, annual reports, and agreements on PSOs.⁶⁵ In addition, the Act also states that each SOE Board is to ensure preparation of annual reports as per IFRS, business plans, statement of corporate intent; as well as other aspects of corporate governance, such as drafting code of conduct; and establishment of an audit committee.⁶⁶

Another key feature of the ongoing reform measures is that the SOE law and policy allows SOEs to have their own HR policy with preference for contract hiring and autonomy over hiring and firing, based on performance evaluation.⁶⁷ Moreover, under the new legislation, the SOEs are generally exempt from the Public Procurement Regulatory Authority Ordinance, although exceptions to this may apply.⁶⁸ These are important features if retained SOEs are to be run as efficient organizations.

Lastly, the latest SOE framework requires the federal government to ensure competitive neutrality of the state, such that no SOE benefits from any unfair competitive market advantage or dominant position by virtue of being an SOE. The SOE policy also directs the federal government to set up accountability mechanisms in place to support and monitor the framework for ensuring competitive neutrality.⁶⁹

7.4 Strategies for Successful SOE Reforms: Lessons from Global Experience

With the introduction of the SOE Act and SOE Policy in 2023, the foundations for comprehensive SOE reforms seem to have been

laid. These measures seem broadly in line with global best practices and guidelines on corporate governance that emphasize on professional management of SOEs under an independent board, clarity of objectives, continuous monitoring, competitive neutrality, and legal room for business and operational reforms.⁷⁰

However, the success of the recently launched ongoing corporate governance reforms, as well as the subsequent SOE ownership decisions will depend on their implementation, especially with respect to their alignment with other facets of SOE reforms. In this context, the absence of clearly defined penalties for non-compliance with the SOE Act & Policy is noteworthy.

The success of the ongoing SOE reforms will also depend on the degree to which the gaps in earlier SOE reform efforts are addressed. These gaps, briefly highlighted in **Section 7.3**, include the strengthening and adequate sequencing of competition and regulation; clarity of objectives; effective management of political and labour issues; and further improvements in corporate governance. Accordingly, this section draws on global experience to shed light on: (a) importance of some of these key reforms areas; and (b) different pathways to address those gaps.

Strengthening of Competition and Regulation

Evidence suggests that more than the change in ownership, it is competition that determines quality of service, improved output and efficiency of SOEs. Without ensuring competitive environment, neither retention nor

⁶⁵ Section 31 of SOE Act 2023; & Section 19, 20 & 21 of SOE Ownership and Management Policy 2023

⁶⁶ Sections 8 & 21 of the SOE Act 2023; and Section 34 and Annexure 1A of SOE Ownership and Management Policy 2023

⁶⁷ Sections 29 & 30(d) of SOE Ownership and Management Policy 2023

⁶⁸ As per Section 17 of the SOE Act, 2023, SOEs shall maintain independent procurement policies which complies with the Chartered Institute of Procurement and Supply's Global Standards of Procurement and Supply, unless the Federal Government specifically directs a SOE to comply with the provisions of Public Procurement Regulatory Authority Ordinance 2002

⁶⁹ Section 5(f) of the SOE Act 2023; and Section 27 of SOE Ownership and Management Policy 2023

⁷⁰ For details on good governance of SOEs, see OECD (2015).

privatisation will create adequate incentives to improve services and enhance productivity. Thus, greater attention needs to be paid to promote competition by eliminating barriers to entry.⁷¹

Literature suggests that there are different pathways to inducing and strengthening competition. One way is to liberalise a sector which is a substitute. This was done in the United Kingdom in the 1980s when bus services were liberalised to increase competition for state-owned rail companies. Another way, which particularly suits sectors with large monopolies, is to make them export-oriented and by virtue of that expose them to competition in international markets. This was seen in the Republic of Korea's Pohang Iron and Steel Company's transformation during late 1960s and 1980s, where exposure to global competition along with good governance enabled it to become one of the most cost efficient producers of low-grade steel in the world.⁷²

Moreover, inducing competition does not only include allowing the private sector to compete by removing barriers to entry, but also the government itself can prioritise competition in case the private sector is unable to step up. For example, the Republic of Korea established a new state-owned telecommunication company in the 1980s, albeit with competitive neutrality, to create competition in the provision of international call services.⁷³

Aside from increasing competition within and between sectors, the government needs to undertake private sector development as part of long-term SOE reforms to signal a preference for

an economy led by the private sector. This was successfully done by the Republic of Korea during the 1980s and 1990s where the government moved from direct and explicit intervention to diminishing its role focusing more on innovation and coordination.⁷⁴ Similarly, between 1990 to 1994, Colombia promoted private sector development in monopolistic conditions by permitting open competition between public and private operators in ports. By providing a level playing field, the performance of the public sector entities also improved.⁷⁵

Increasing competition, however, requires effective regulations to encourage new entrants, prevent monopolistic practices, ensure customer protection; enforce quality standards; and promote good corporate governance practices, accountability and investor confidence. These need to be made on the principles of predictability, proportionality, and non-discrimination,⁷⁶ which may be facilitated through regulatory sandboxes that facilitate regulatory innovations. For instance, Germany's power sector regulatory transformation is a pertinent case in point.

Germany's electricity sector until the late 1990s was a non-competitive market. Customers had no right to choose their supplier and were bound to regulated tariffs. State authorities controlled electricity prices. However, when Germany liberalized its electricity market, it established an independent regulator, the Federal Network Agency (FNA). A legal framework was established that spelled out clear roles and responsibilities of market participants and the FNA. Procedures were designed by regulator to effectively implement

⁷¹ ADB (2020).

⁷² Ibid.

⁷³ Ibid.

⁷⁴ Ibid.

⁷⁵ Montenegro, A. (1995).

⁷⁶ Non-discrimination implies that regulators do not discriminate between either service providers or within customer categories. Regulations should be fair to all firms with no favouritism and interference from government, neither for any owner of privatised entity nor for managers of retained SOEs. Regulations should be proportional to the nature of business, risk profile, state of competition; minimum level of regulatory control to achieve desired objectives; and should be incentive based where needed. Ensuring level playing field for all stakeholders and encourages competition which subsequently improves the SOE performance.

the regulations, such as rights of information and investigation. Customers rights, such as freedom of choosing suppliers, were strengthened and expanded. Only the electricity grids remained in a regulated natural monopoly. Grid related departments were separated from generation, trading and sales, all of which were now open to competition. This led to a more cost-effective power sector, with a lasting reduction in generation and transmission costs.⁷⁷

Decisions regarding strengthening of competition and regulatory framework require undertaking of competitive sectoral assessments. This provides policymakers an opportunity to develop a comprehensive understanding of the competitive landscape of each sector, its potential challenges and opportunities. It also allows for benchmarking against global best practices, identifying areas for improvement, making informed decisions about SOE ownership, and tailoring regulatory framework for each sector. Moreover, sector-specific competitive assessments allow for targeted interventions for reform failure, recognizing the value of a nuanced approach to regulatory reform, which is important for critical decisions such as deregulation of pricing.

For instance, Germany's privatisation of Deutsche Telecom in the 1990s followed after a detailed sectoral competitive assessment that considered global trends, technical advancements and market changes. The assessment revealed that competition was the preferred mode of market organization due to its ability to adapt to technical and demand shifts, reducing the importance of consideration like economies of scale and sunk costs. The transition included regulatory advancements, ensuring a phased approach to competition addressing the disadvantages the SOE had in the face of competition worldwide in the sector.

This had a transformative impact on the German telecom sector demonstrating the efficacy of thorough sectoral assessments in guiding reform decisions.⁷⁸

In this context, the principle of competitive neutrality spelled out in SOE Policy 2023 under guidance of the SOE Act 2023 is a step in the right direction. Under the framework for ensuring competitive neutrality, the SOE Policy states that the federal government shall carry out competitive assessments that identify and revise regulations that restrict competition.⁷⁹ However, timelines, policy principles, and institutional responsibilities to this effect also need to be spelled out and followed through as part of the government's commitment to SOE reforms. Pakistan can draw from international best practices to design an effective mechanism for ensuring competitive neutrality; for instance, the Australian Government Competitive Neutrality Complaints Office (AGCNCO). The AGCNCO is a separate unit within the country's treasury department empowered to investigate complaints of unfair competition stemming from non-compliance with competitive neutrality obligations by Australian SOEs, providing unbiased recommendations to the parliament.⁸⁰

Setting Clear Objectives and Performance Benchmarks

Objective setting is indispensable in the SOE reform process as it helps in aligning stakeholder expectations and risk mitigation. It is especially important for the setting of clear goals for the SOE management. Well defined objectives for foreseeable future prevents SOEs' managers from chasing the often multiple and ambiguous government objectives that have the tendency of changing from one administration to another.⁸¹

⁷⁷ Agora Energiewende (2019).

⁷⁸ Vogelsang, I. (2003).

⁷⁹ Under Annexure 4 of the SOE Ownership and Management Policy 2023

⁸⁰ Australian Government Productivity Commission website

⁸¹ Roland, G. (2008).

For instance, the experience of Lithuanian Railways (LR) underscores the importance of clearly defined objectives. For decades, LR's poor performance hid behind the vague objective of fulfilling its social functions. However, the reforms initiated in 2000 centred around well-defined objectives for its freight, passenger transport, and infrastructure operations and ensuing change in ownership structure. This led to creation of three SOEs – each for different LR operation – under a single LR holding company, each having separate books of accounts. This enabled LR to gain efficiencies, and maximise profits in freight carriage operations. LR also continued to fulfil the loss-making passenger transportation obligations in public interest, where the losses were compensated by the government. The clarity of objectives, therefore, helped LR align its operations with public and commercial interests, leading to a successful transformation in a transparent and cost-effective manner.⁸²

Objectives are also important for ensuring accountability of management as the performance of the board and management can be better assessed by linking performance evaluation systems with the clearly defined goals. For instance, under the transformation program for its SOEs in 2005, the Malaysian government set objectives to guide and enhance the performance of the SOE's management. It publicly released a guidebook on Key Performance Indicators (KPIs) on financial, organisational, operational as well as non-financial metrics that were benchmarked with comparable international peers and were audited annually. The achievement of KPIs in light of objectives was linked to remuneration of SOEs managers. This enabled benchmarking of the incentives of SOEs management with that in the private sector.

In Pakistan, the primary objective of commercial SOEs under the SOE Act 2023 is to operate in an

“efficient manner” and be financially sustainable, achieving the objectives spelled out in their respective Acts or memorandum of association. Moreover, the SOE Policy 2023 also requires the SOEs boards, in coordination with the relevant line ministry, to publish a statement of corporate intent (SCI) for three years. The SCI is to include SOE's objectives along with business goals and performance measures and benchmarks. The latest SOE legislation also requires that the CEO is to be hired on performance-based contracts.⁸³

To further cement these positive developments, the government may also consider preparing specific quantitative and qualitative performance evaluation on both financial and non-financial parameters. These may be aligned with the objectives of SOEs in different sectors for better monitoring and evaluation as well as performance assessments of board and management. For instance, financial metrics may include labour productivity, transparency of budget, project cost overruns. Similarly, non-financial parameters may be number of beneficiaries served, compliance with international quality standards, comparisons with industry performance, and timely submission of reports to regulators.⁸⁴

Managing Labour Issues

Labour issues are one of the most complex and politically challenging elements of SOE reforms. This is understandable because the short term human cost of labour rationalisation is often more visible than the potential gains of efficiency, productivity, and competitiveness in the medium to long term. Regardless of whether an SOE is privatised, or restructured and retained as a public company, rationalisation of human resources is essential considering that workers' inefficiencies are often one of the key reasons behind the poor performance of SOEs.

⁸² ADB (2020); Kikeri et al. (1992).

⁸³ Sections 7(1), 7(3), and 8(4) of SOE Act 2023

⁸⁴ OECD (2016).

Global best practices, therefore, suggest that labour issues can and should be resolved as early in the reform process as possible. This not only helps smooth privatisation or restructuring of SOEs but also allay labour's concerns before they become politically challenging or otherwise become a barrier to reform.⁸⁵

Even if hiring and firing of labour is not done immediately, which is the recommended strategy in some cases – such as in privatisation transactions on 'as is where is basis' – best practices suggest that communication and consultation with labour starts early in the reform process, with openness and transparency as important confidence building measures. This needs to be accompanied by public awareness campaign to help garner wider public support.

Whilst there is no best measure for mitigating labour issues, most instruments of labour management revolve around the following: (a) voluntary retirement scheme including severance and pension payments; (b) worker counselling before and after restructuring; (c) training for new skills that may be utilised within the SOEs or elsewhere in the job market including self-employment schemes; and (d) other benefits, such as unemployment benefits or other social safety nets. Experience suggests that of these options, counselling and training are difficult to manage operationally and do not necessarily have the level of acceptance as much as voluntary retirement which is the costliest option.⁸⁶

In this context, a review of Pakistan's recent SOE legislation and policy suggests that there is room for further reform. While SOE Policy 2023 tasks SOEs' boards to draft regular human

resource review mechanism with the view to rationalize workforce, it does not have policy principles and guidelines on labour management framework with its implementation timelines. This, along with clearly stated government commitment to support new managers – of both retained and privatised SOEs – in worker rationalisation is a key gap that the government needs to address in order to prevent derailing of the reform process.⁸⁷

Creating Political Consensus

The lack of political consensus is one of the recurring roadblocks to SOE reforms in Pakistan. While in part this originates from differing economic ideologies, it also stems from labours' concerns, as discussed in the preceding sub-section. Many countries including Pakistan have often backtracked on SOE reform measures due to the public pressure and scrutiny faced by the government, which attempts to extricate itself from the SOE reforms due to political considerations. This stop-start process negatively impacts state credibility, casting doubts on the earnestness of the government's reform efforts. In light of these issues, it is of utmost importance that the government proceeds in a way that maintains political buy in and improves credibility.⁸⁸

There are three major ways through which political roadblocks to SOE reforms may be removed. The first relates to consensus building, where the government can garner support by conducting extensive consultations with multiple stakeholders so that all parties understand the objectives and rationale of the reform process. For instance, lessons may be

⁸⁵ ADB (2006).

⁸⁶ Jones, L.P. & Kennedy, R.M. (2003).

⁸⁷ Government commitment in this regard is critical to increase investor confidence. Despite successful voluntary separation schemes (VSS) such as in the case of PTCL, anecdotal evidence suggests that riots and burning of vehicles outside the head office of KESC (now K-Electric) following its VSS announcement as part of post-privatisation restructuring in 2011, damaged investor confidence. (Source: Nadeem, S. & Aziz, A. (2018); KESC (2012))

⁸⁸ The lack of political consensus also originates from the fact that staffing of workers and management of SOEs are often used as endowments by political actors for various types of support provided to them. However, addressing of such issues is usually outside the scope of economic policymaking, hence not discussed in this chapter; Fedrico, Q. (2019); Kuzman, T. (2018).

learnt from institutions like National Social Dialogue Forums, such as in Türkiye. At such forums, the government engages a variety of stakeholders, including workplace representatives, provincial and national authorities as well as private sector participants, trade unions, special arbitrators, civil employers' committees.⁸⁹

Second, clear government communication can play a key role in influencing the outcome of SOE reforms. For example, by illustrating how the state's resources can be better employed in targeted social safety nets rather than poorly performing companies or their few employees. In this context, the shaping of wider public opinion can be carried out through media campaigns that sensitise citizens and emotively appeal to their values.⁹⁰

Third, relates to the right approach to reforms, which depends on the context. For instance, in some cases initiating SOE reform with smaller and relatively easier firms will create the necessary momentum, whereas in other cases starting with the larger and relatively important entities shows the seriousness of the government. In both cases, both political and wider public support for reforms will increase when the public sees tangible improvements in service delivery. For example, in Cote d'Ivoire there was strong support for the overall privatisation programme after there was notable improvements in electricity services post-privatisation.⁹¹

Improving Corporate Governance

A strong and independent board of competent professionals, free from political pressures, is a crucial success factor in SOEs. As discussed in **Section 7.3**, developments in Pakistan are positive in this regard as the recent SOE

legislation has legally enshrined autonomy to SOEs and their boards, and considerably insulated them from potential intervention of line ministry or the federal government. However, two aspects may be explored for further strengthening of SOEs' corporate governance: composition of SOEs' board, and SOE's reporting structure to the government.

In terms of board composition, there are three areas of improvement worth considering. First, while the presence of SOE's CEO on its board under the SOE Act and Policy 2023 is in line with global practices, it is not well aligned with the best practices of separation of board and the management, which requires that the CEO should report to the board.⁹²

Second, the recent SOE legal framework warrants a majority of independent directors on SOEs board, it also directs line ministries to select ex-officio board members with relevant expertise who can contribute meaningfully to board deliberations.⁹³ Considering that line ministries are not necessarily staffed with specialised bureaucracy with subject matter expertise, the government may revise corporate governance framework to allow line ministries to appoint a specialist as their nominee director in place of ex-officio director, if need be. Third, there is a need to expedite the development of a database of prospective board members by the CMU to curate the right mix of professionals with diverse and complementary skill sets, in light of SOE Policy.⁹⁴

In terms of SOEs' reporting structure to the government, the SOE governance framework introduced last year is in line with global experience but not necessarily in line with the most recommended practice. For context, an important step in ensuring SOEs' autonomy is to

⁸⁹ ADB (2020); Araújo, S. and Menese, M.P. (2020).

⁹⁰ ADB (2020); Rentsch et al. (2020).

⁹¹ Jones, L.P. & Kennedy, R.M. (2003).

⁹² Under section 12(1) of SOE Act 2023; Marks, S.G. (1999).

⁹³ Ibid.

⁹⁴ As per SOE footprint report released on Jun 2024, the database of prospective board members was not complete.

create adequate distance between the SOEs and political agents.

Globally, there is a spectrum of ownership models between two broad characteristics of centralised and decentralised ownership. In the centralised model, the ownership is consolidated in a single entity which is either independent or under the authority of a single ministry.⁹⁵ In the decentralised model, ownership rests with respective line ministries without any monitoring by any centralised body. This was the case in Pakistan before the introduction of SOE Act & Policy last year. In between this spectrum is a dual or hybrid model, where ownership is vested with the line ministry but another ministry – such as Ministry of Finance – has a central coordinating and monitoring function. After the introduction of SOE Act & Policy 2023, Pakistan falls under the dual/hybrid model (**Figure 7.16**). Whilst this model offers better monitoring compared to a decentralised model, the monitoring agency lacks capacity and executive authority to roll out reforms as is possible in a centralised model.⁹⁶

There is no one-size-fits-all solution for ownership models. Moreover, these models are somewhat fluid, as there are country arrangements where elements of more than one model have been combined to create a corporate governance system. However, generally, international practices illustrate an inclination of moving towards centralised ownership models, where a single body assumes ownership functions. This preference stems from the fact that line ministries' ownership of SOEs tends to be susceptible to political intervention and relatively lower oversight and accountability since line ministries are both owners of SOEs and their regulator. By comparison, centralisation is considered a better practice because it helps further separate state ownership and regulatory functions - minimising political

interference, facilitate uniform corporate governance, improve management and enhance efficiency in administration. Additionally, changing ownership from line ministries minimises political interference and allows ministries to focus on core functions like sectoral development and governance.⁹⁷

In light of this, and the fact that reforms ought not to be a one-time exercise, the government may consider moving towards a centralised model for retained SOEs over the medium term. A centralized model can take different forms. For instance, a central advisory/coordinating body like in India, New Zealand, Norway, South Africa, and Sweden. Another type of central ownership model has central agencies within the government structure, such as in China, France, and Indonesia. The third type of centralised model has holding/investment company that owns and monitors all the SOEs, such as that in Gulf countries, Hungary, Malaysia, Singapore.⁹⁸

The determination of suitability of different centralised models in Pakistan will need to be based on a detailed assessment of the legal framework, political and institutional context, and public deliberations thereof. In the absence of such assessment and deliberations, the acceptability and practicality of attempts toward that model may meet the fate of the now defunct Sarmaya-e-Pakistan or otherwise unnecessarily complicate governance as is being done by the creation of Sovereign Wealth Fund.

Ensuring Appropriate Planning and Sequencing of Privatisation

While privatisation is the logical conclusion for most commercial SOEs operating in an industry that can be easily serviced by private sector, assessing the appropriate sequencing and speed of privatisation is critical. Academic consensus

⁹⁵ OECD (2018).

⁹⁶ Cheema, F.S. (n.d.).

⁹⁷ Aftab, S. & Shaikh, S. (2013); WB (2014); Salem et al. (2023); Jones, L.P. & Kennedy, R.M. (2003); ADB (2020).

⁹⁸ Aftab, S. & Shaikh, S. (2013).

on the subject does not exist on account of diversity of context. However, three lessons from global experiences warrant consideration. First, from the perspective of timing of privatisation, there is clear evidence that careful assessment of the industry's market conditions is important. Rapid privatisation in a market that does not have enough liquidity, or sufficient economic growth prospects may not lead to successful transactions or otherwise exhaust the available capital too soon. This risk is especially common in developing economies with weaker capital deepening, which may not be able to cope with simultaneous divestiture of many major SOEs.⁹⁹

Second, interlinkages between industries, where changes in one sector may impact allied sectors, ought to be considered. For instance, if a country's steel industry depends on SOEs for supply of raw materials and machinery, then unplanned privatisation of upstream SOEs, such as iron ore mining and refining, alongside liberalisation of their exports, could affect the entire domestic steel value chain. This underscores the importance of careful sequencing of the privatisation transaction to minimize disruptions and maximize efficiency by considering the backward and forward linkages within the sector.¹⁰⁰

Third, appropriate sequencing of sectoral regulatory frameworks is critical; it should be undertaken as soon as reform decisions are taken to prevent market inefficiencies. For instance, U.K.'s privatisation of British Telecom in 1984, despite its continued monopolistic position for a number of years after privatisation, was promptly regulated by Office of Telecommunications, ensuring a smooth transition. In contrast, the privatisation of Telmex in Mexico was not accompanied by immediate competition or regulatory reforms.

The reorganization of the telecom ministry into a telecom regulatory agency was considerably slow paced which hindered market efficiency.¹⁰¹

Implementing Hard Budget Constraints

Hard budget constraints can be found as a feature in a plethora of SOE reforms around the world, with various countries, such as Spain, Peru and Brazil, implementing the concept for improved performance of SOEs. SOEs are often inefficient because of their reliance on state support. By ending this constant support and imposing hard budgets, SOE are forced to be financially disciplined or risk going out of business. In fact, the closure of such firms is an objective of this policy because by driving out inefficient firms, fiscal space is freed up for more productive ventures. Additionally, it also signals the seriousness of the state's SOE reform process.¹⁰²

The existing SOE legislation in Pakistan, which does not explicitly mention hard budget constraints, may benefit from this policy to minimise fiscal risks and improve financial sustainability of SOEs. However, this would need to be enforced carefully. Literature suggests that even if governments attempt to enforce this policy in earnest, SOEs may still default on payments to the government, sell assets, take advantage of underdeveloped financial systems for loans or craft mutually beneficial arrangements with other SOEs. For instance, in Eastern Europe firms overcame hard budget constraints by purchasing on credit from entities which knew that the buyer would default but still continued with the practice because of prior relationships. By selling to these entities, many firms survived longer than they otherwise would have.¹⁰³

⁹⁹ Ramanadham, V.V. (1994); Jafarey, V.A. (1992)

¹⁰⁰ Ahuja, G, and Majumdar, S.K. (1998).

¹⁰¹ Ibid.

¹⁰² Jones, L.P. & Kennedy, R.M. (2003); ADB (2020); Lam, W. R. & Schipke, A. (2017); Musacchio et al. (2015)

¹⁰³ Jones, L.P. & Kennedy, R.M. (2003).

7.5 Case Studies on Major Loss-Making SOEs

As highlighted in **Section 7.2**, the country’s loss making SOEs are concentrated in two sectors: (a) power, and (b) infrastructure, transport and ITC. Losses in the former mainly stems from DISCOs, whereas losses in the latter are driven by PIA, Pakistan Railway and the NHA. Together the losses of these entities accounted for 91 percent of total losses of loss making commercial SOEs in FY23.¹⁰⁴ Moreover, the quality of public services offered by these SOEs has also been substantially poor.

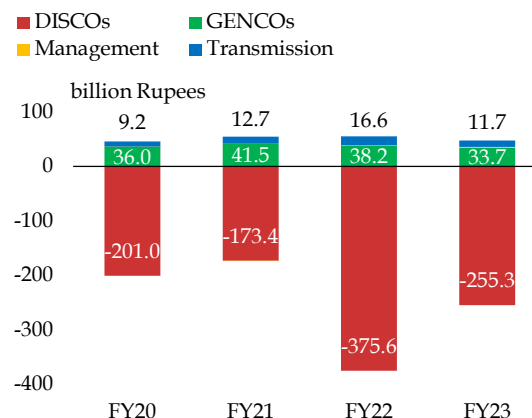
In consideration of these stylized facts, this section sheds light on major sectoral policy and governance issues behind the losses of these SOEs. While the nature of issues faced by these SOEs may differ from one sector to another, there is a common underlying message emerging from these brief case studies: decisions related to ownership (privatisation or retention) and governance of SOEs alone will not address the issue of losses and poor public service in these sectors, as past experience with reforms has shown quite evidently in the case of each of these sectors and SOEs.

Power Sector: Need for Competitive Markets and Effective Regulation

The SOEs in Pakistan’s power sector exist in power generation, transmission, distribution, and power management. While power sector losses are concentrated in DISCOs (**Figure 7.17**), the entire sector faces several challenges ranging from increasing capacity payments to over-reliance on imported fuel, under-utilization of power plants, rising circular debt, transmission constraints, untargeted subsidies by the government, and operational inefficiencies. The primary driver of these challenges is inadequate

Net Profit/Loss of Power Sector

Figure 7.17



Source: Ministry of Finance

policy direction and weak governance across various stages of planning, operations and accountability.¹⁰⁵

In the power generation sector, a major issue relates to capacity payments, which stems from power generation policy’s ‘take or pay’ pricing model under which the government, being the single buyer, has to pay capacity charges to producers irrespective of actual purchases of electricity. In other words, the government must pay for unutilized power capacity, which increases the per unit cost of production.

This means that when power demand is lower than generation capacity, the capacity payments are added to the tariffs paid by existing customers. And when tariffs rise, the demand shrinks further, leading to additional increase in capacity payments creating a vicious cycle.¹⁰⁶ Moreover, two other factors have contributed to this cycle. First, the government policy to encourage solar power usage has led to a reduction in power demand from ‘paying customers’, leading to further rise in capacity payments. Second, capacity payments have also grown substantially in tandem with new

¹⁰⁴ During FY23, NHA posted a loss of Rs 413.5 billion, followed by loss-making power sector DISCOs with a loss of Rs 285.2 billion (Ministry of Finance 2023)

¹⁰⁵ NEPRA (2023)

¹⁰⁶ Ibid.

generation capacity added into the national grid every year.¹⁰⁷

In addition to capacity payments, there are also several challenges related to operational inefficiencies, such as aging infrastructure due to which several plants are inefficient that raise the cost of power generation. Further, most of the electricity generation in the country is thermal based (mainly oil and gas), which is relatively expensive.¹⁰⁸ These issues are compounded by high operational losses in power generation due to aging infrastructure, whereas several new plants are not connected to the grid.

The challenges weigh on the performance of DISCOs, as higher tariffs due to uncompetitive and inefficient production and transmission system, lead to suppressed demand, high levels of theft and unpaid receivables. In addition, DISCOs also have their own operational inefficiencies, such as old meters, inefficient distribution lines due to which power distribution losses are much more than peer economies. The governance issues at DISCOs affect the overall performance of distribution segment and cost structures. Although power sector SOEs have been established as corporate entities, their governance, accountability, and operational management remains weak.¹⁰⁹

Moreover, lower revenue collection, reduced affordability of consumers due to high tariffs, and increase in theft and line losses add to the growing circular debt, which remains a critical challenge for the power sector. Delayed payments between power generation companies, DISCOs, and fuel suppliers lead to cash flow crisis, affecting the operational capacity of the entire sector. The growing

circular debt placed a significant financial strain on power sector SOEs, limiting the sector's ability to invest in necessary upgrades and maintenance.¹¹⁰ As a result, public sector DISCOs are particularly cash-strapped, triggering liquidity issues across the supply chain, which necessitates additional financial costs in the form of commercial borrowings and late payment charges.

The DISCOs combined as a sub-sector are the largest employer, compared to all other sectors in which SOEs exist in Pakistan, with more than 139,000 employees as of June 2022.¹¹¹ This is part of the historical legacy of unwarranted political interference, overstaffing and bureaucratic delays in handling routine matters in these public utilities, and low quality services, which negatively affected the sector's financial and operational health.¹¹²

These are some of the reasons why privatisation or improvements in corporate governance alone may not adequately address economic issues stemming from the power sector SOEs in Pakistan. A case in point is the privatisation of KESC (now K-Electric). Although the firm's profitability improved after the privatisation,¹¹³ which included corporate restructuring and worker separation schemes, its customers are still paying high tariffs due to sectoral pricing and purchasing arrangements discussed above. Moreover, while average duration and frequency of power outages of KE is better than several DISCOs, it still frequently breaches regulatory benchmarks.¹¹⁴

Apart from the privatisation of KESC, there have been other attempts at power sector reforms, including the amendments to NEPRA Act in 2021, which empowered the regulator to

¹⁰⁷ Capacity payments are projected to reach Rs 2.1 trillion for FY24 (NEPRA (2023))

¹⁰⁸ As of June 30, 2023, around 52 percent of the total electricity generation in Pakistan was thermal based. (NEPRA (2023))

¹⁰⁹ ADB (2021)

¹¹⁰ Ministry of Finance (2023)

¹¹¹ Ibid.

¹¹² Malik, A. (2015)

¹¹³ K-Electric, annual financial statements FY00-FY23

¹¹⁴ Source: NEPRA, Performance Evaluation Report of Distribution Companies FY 2020-23

determine and notify quarterly tariff adjustments. However, while there is little disagreement about the types of reforms that are needed in the power sector, their implementation has been wanting. This reflects a lack of broad political ownership, considering that poorly targeted power subsidies still exist.¹¹⁵

Therefore, in addition to corporate governance and SOE ownership reforms, there is a need for sectoral policy overhaul and a political consensus for the same. The former includes opening up the power market and fostering competition and efficiency by replacing the existing arrangement of single buyer model with multiple buyer model.¹¹⁶ In this regard, power wheeling is a part of a larger shift in the power sector of Pakistan that has been underway since the approval of NEPRA's (Wheeling of Electric Power) Regulations in 2016. This shift also entails replacing the existing single buyer model to a competitive, multiple buyer model, supplemented by a transition from the primitive system of fixed pricing formula for capacity payments to capacity auctions.

National Highway Authority: Need for Clarity of Objectives and Corporate Restructuring

The NHA has been in severe financial distress with accumulated losses of Rs 1.5 trillion since FY14 and an outstanding loan portfolio of Rs 3.1 trillion. This hinders the entity's ability to invest in operations and upkeep of roads. In fact, the NHA often features as one of the highest loss-making entities in the SOE space. The entity is largely financed by cash development loans (CDLs) irrespective of commercial viability of

projects. These loss-making projects, on the behest of the state, are often necessary for social or developmental reasons, and fall outside the parameter of commercial considerations.¹¹⁷ As part of the repayment mechanism of CDLs, the federal government makes compulsory deductions at source from NHA's budgetary allocations which have caused further shortfalls, delays and cost overruns.¹¹⁸

Moreover, because of the accumulated debts, the NHA has to pay high interest costs to the government of Pakistan. It is also exposed to foreign exchange risks due to the issuance of foreign re-lent loans.¹¹⁹ Additionally, the high depreciation costs that the NHA bears creates a large non-cash expense that drags down its books. However, these non-cash accounting expenses and CDL loans exaggerate the financial and operational concerns of NHA. As a result of these concerns, NHA was excluded from the Triage Report of 2021 (**See Section 7.3**) and the government has initiated the restructuring process. Potentially the NHA's restructuring may include renegotiation of loan terms, debt refinancing options, and optimization of operational efficiency and revenue diversifications.¹²⁰

The profitability of motorways and national highways can broadly depend on four factors: operation costs, maintenance costs, actual toll traffic, and revenue. Further assessments are also made on metrics such as: projected traffic volume, proposed toll, projected rate of return on a given project, concession period and project financing. Therefore, categorisation of projects is conducted on a case to case basis with comprehensive analysis on financial, technical, ecological, economic and other such grounds.

¹¹⁵ IMF (2022); IMF (2011)

¹¹⁶ Competitive Trading Bilateral Contract Market (CTBCM) is a Competitive Wholesale Electricity Market wherein multiple buyers and sellers of electric power can participate by entering into bilateral contracts to purchase and sell electricity at wholesale level (Source: NEPRA website)

¹¹⁷ CDL is a type of domestic debt given by the federal government to the provincial government, SOEs or any other body, against a mark-up that may be revised every year.

¹¹⁸ MoF (2023); Hussain, I. (n.d)

¹¹⁹ Foreign re-lent loans are foreign loans taken by the federal government and re-lent to the provinces, SOEs and other bodies.

¹²⁰ Hussain, I. (n.d); MoF (2021); MoF (2023)

Alternatively, some projects may be unsuitable from commercial standpoint and therefore fall under the ambit of developmental projects. Such projects preclude the profit motive with goals, such as increasing market access, infrastructure connectivity and other positive externalities, weighing more heavily.¹²¹

The NHA serves as an example of an entity that requires clear objectives and performance benchmarks – as stated in **Section 7.4**. As in the case of Lithuanian Railways (LR), it may be useful to split NHA's corporate structure into two distinct entities, one which undertakes commercial projects, and the other for developmental and public service obligation projects. Breaking the NHA's into two separate entities will mean that the commercial side can remain a commercial SOE and be accountable to make a profit, whereas the non-commercial section can be classified as a non-commercial entity and can focus on the government's developmental imperatives. Both may report to a NHA holding company that can offer shared services.

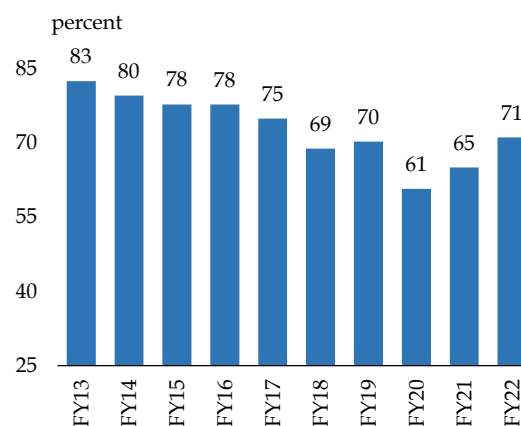
The splitting of NHA into two separate entities may also allow the commercial arm to focus on profitable ventures and create alternative means of financing projects on the merit of its balance sheet, for example, capital markets, commercial bank loans, public-private partnerships (PPP) etc. This would be in line with growing trends of private sector participation in road infrastructure projects.¹²²

Globally, several countries, including Spain, Portugal, Italy, France, the USA and Latin America, have witnessed increased private sector participation in road infrastructure. This shift has also come about due to public sector's financial difficulties; successful experience with privatisation of other public services like electricity and water; attempts to lower the cost of highway infrastructure; and reverse

underinvestment in road network. The involvement of the private sector has some advantages that help in the construction and operation of such infrastructure. For example, the private sector is less prone to political interference, can be more innovative with pricing and construction and have suitable long term financing coupled with long term revenue needs (e.g. insurance and pension funds). However, there are mixed outcomes in terms of efficiency, and there needs to be a strong regulatory and monitoring presence of the public sector to avoid quality lapses and monopolistic pricing concerns.¹²³

In this regard, the inclusion of three BOT (build, operate and transfer) projects in NHA's development plan for 2023-24 is promising. In addition to PPP mode, the NHA may also diversify revenues by developing land on the sides of the road as commercial property, as was done successfully in India. This will supplement toll income and right of way charges,¹²⁴ to mitigate any losses as a result of lower tolls or vehicle volumes, and attract more private investment. In the absence of detailed financial statements, the falling share of NHA's toll revenue as a percent of its total revenue seems

NHA Toll Revenue as a Percent of Total Revenues* Figure 7.18



*data for FY23 not available

Source: Auditor General of Pakistan, various reports

¹²¹ Mohamed et al. (2018)

¹²² Hussain, I. (n.d)

¹²³ Small, K.A. (2009); SBP (n.d)

¹²⁴ Right of way charges include charges on petrol pumps, CNG stations, restaurants, sign boards, bill boards, etc.

to indicate a shift in this direction (**Figure 7.18**).¹²⁵

Lastly, the government may also take a holistic view, and, where possible, create healthy competition between rail, roads and air transport networks to offer more choices, improved service delivery, and better pricing. As discussed in **Section 7.4**, creating competition between substitute industries helps SOEs become more efficient and enhance service delivery.¹²⁶

Pakistan Railways: Need for a Strategic Rethink Beyond Corporate Governance Reforms

The financial and operational performance of PR has been worsening over the last ten years (**Table 7.1**) These losses have had a huge fiscal impact with federal government grants in FY24 alone standing at Rs 55 billion, from Rs 47.5 billion in FY23. However, PR's performance is not a recent phenomenon. The entity has been witnessing consistent losses for the last three decades, with the trend emerging since the 1970s-80s, especially in the wake of the Afghan

War when PR starting losing its dominance as the preferred mode of freight transport.¹²⁷

In part, these losses stem from the fact that despite having an extensive rail network, which required funds for its maintenance and upgradation, the government's focus began tilting heavily towards road transport since the 1970s. This preference was reflected in both various policy documents for inter-city and intra-city transport as well as public investment in rail (as percentage of total public investment) reduced by around 70 percent between 1973 to 1993.¹²⁸

The lack of successive governments' commitment and inadequate administrative and budgetary support is also the reason why some multilateral-funded PR reform plans did not bear fruit. These include reform attempts for Open Access Policy (OAP) in 1996, PR's privatisation in 1997, and other operations improvement programs during 1990s. The bias continues even today, with highways and motorways dominating the infrastructure development for supply chain corridor under the China-Pak Economic Corridor and Central

Pakistan Railways: Key Financial Indicators Over the Last Decade

Table 7.1

	Locomotives (numbers)	Freight Wagons (numbers)	No. of Passengers carried (millions)	Freight Carried (million tonnes)	Freight Tonnes (millions)	Gross Earnings (million Rupees)	Net Loss (million Rupees)	Operational Expenses (million Rupees)	Grants (million Rupees)
FY13	493	16,635	41.9	1.0	419	18,070	30,504	48,535	33,366
FY14	421	16,179	47.7	1.6	1,090	22,800	32,527	39,892	33,500
FY15	458	15,452	52.9	3.6	3,301	31,924	27,247	42,117	37,000
FY16	460	15,164	52.2	5.0	4,773	36,582	26,994	41,944	37,000
FY17	455	16,085	52.4	5.6	5,031	40,065	40,702	50,192	37,000
FY18	478	16,159	54.9	8.4	8,080	49,570	36,622	35,627	38,400
FY19	472	14,327	60.4	8.3	8,304	54,508	32,769	53,851	37,000
FY20	473	14,448	44.3	7.4	7,369	47,584	50,017	37,295	NA
FY21	467	14,448	28.4	8.2	8,179	48,649	47,232	56,413	47,500
FY22	466	13,900	35.7	8.0	8,070	60,257	47,486	67,699	47,064
FY23*	461	13,448	22.6	4.3	4,270	39,950	48,534	74,413	47,500

*provisional. NA: Not Available.

Sources: Ministry of Railways and Finance Division, CMU Reports

¹²⁵ MoF (2024); SBP (n.d)

¹²⁶ ADB (2020)

¹²⁷ Haque, N. and Anwar, S. (2024); Qamar, U. & Saeed (2017); GoP (2024).

¹²⁸ Qamar, U. & Saeed (2017); Imran, M. (2009); Tahir, N. & Tahir, P. (2020).

Asia Regional Economic Cooperation.¹²⁹ This underscores the importance of conducting sectoral competitive assessments to identify and address the sector's competitive challenges and the under-prioritisation of PR.

Moreover, inconsistent approach to private sector engagement in PR, and abrupt suspension of initiatives like OAP at different points in time, coupled with a dysfunction regulatory framework,¹³⁰ highlights the need for appropriate sequencing of privatisation process as discussed in **Section 7.4**. Such an approach would have also encouraged private sector to invest in rail transport. Instead, the private sector has invested in road transport for both passenger services and freight.¹³¹

The lack of private sector involvement and competition in rail sector and policy focus towards road transport has led to suboptimal outcomes for consumers. For instance, railway's share in Pakistan's freight transport decreased to 6 percent in 2020 from about 86 percent in 1950s. By comparison, freight share of Germany rail was around 19 percent in 2021, while the number stood at over 25 percent in several other European countries. Considering that a single freight train can replace 100 trucks, with rail moving goods at 250 miles per gallon of fuel compared to just 90 miles by road,¹³² the overall economy suffers from this policy misalignment.

In addition to these challenges, PR faces four major issues. First of these relates to operations and skewed business priorities. The business model reform of PR may entail adopting a dual-focus model by aligning public and commercial interests, with clarity of objectives to ensure effective reform. Despite the critical role of

freight services in railway business, PR has largely remained a passenger-oriented operation, with 70-75 percent of train-km devoted to provision of passenger services. The reliance of cross-subsidization of passenger traffic from freight earnings masks PR's inefficiencies and distorts the economic rationale for effective resource allocation. Inefficient and decaying performance of PR's freight business is reflected in the fact that freight forwarders do not use PR freight services primarily because of the non-reliability of their services. The cost of using rail is also high due to a lack of competition in contrast to road transport operators. Moreover, PR's freight rates are fixed and not market-oriented which further undermines its competitiveness.¹³³

Second, PR has also been burdened by rigid civil service regulations that are incompatible with the demands of an efficient commercially-oriented organization. Some of these are low salary levels, restrictions on hiring and firing processes, and absence of performance-based remuneration, all of which have prevented PR from attracting top-tier managerial and technical talent and have undermined PR's ability to innovate and adapt to the rapidly evolving transport sector. Yet, on an entity level, PR has the highest number of employees among all the federal commercial SOEs in Pakistan – 61,713 – whose pay and pensions significantly contribute to the ballooning of PR's operating expenses.¹³⁴

Third, corporate governance challenges have also contributed to PR's weakening performance. For instance, the practice of appointing the senior most BPS-21 officer as the CEO of PR, just months prior to retirement leads to a vacuum of motivation, energy and incentive

¹²⁹ Open access policy (OAP), was introduced for effective utilization of railway infrastructure through "unbundling" railway services. Private sector bids were to be solicited to transport fuel oil by rail on behalf of Pakistan State Oil (PSO) to private power stations. In 1997, to complement the OAP, the government also decided to privatise the PR; WB (1999); PC (2018).

¹³⁰ Despite the enactment of Railway Regulatory Authority Ordinance 2002, the Railway Regulatory Authority (RRA) remained dysfunctional, leaving the government as the de facto regulator of the sector. (Source: ADB (2008))

¹³¹ ADB (n.d.); Imran, M. (2009).

¹³² Qamar, U. & Saeed (2017). Ministry of Communication (2020); Qanita et al. (2014).

¹³³ Faiz, A. (1993); Looney, R. E. (1998); Haque, N. and Anwar, S. (2024); CAREC (2021).

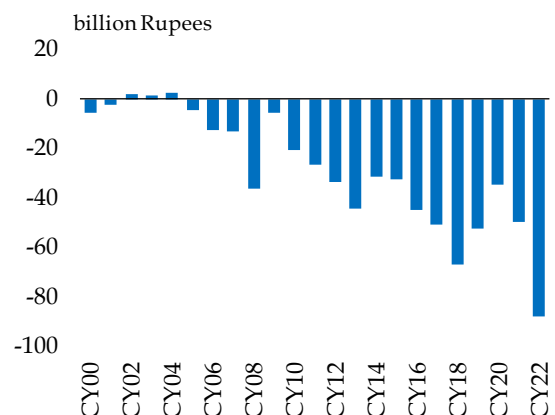
¹³⁴ Looney, R. E. (1998).

difficult reforms. Similarly, non-monitoring of PR's board performance, and inadequate number of independent board members are also some issues that need resolution, to which end the implementation of recent SOE Act & Policy is of paramount importance.¹³⁵

The lack of effective corporate governance has historically translated into excessive losses, project delays, law suits, and further discouragement of private sector participation in rail transport. Numerous reform attempts have been undertaken to revitalize PR. These include projects relating to procurement of new bogies and carriages; implementation of Track Access Agreements 2010 under Track Access Policy;¹³⁶ Restructuring of PR (2001); setting up of project management offices to structure deals with private sector rail operations; and the efforts under National Transport Policy of Pakistan (2018). This serves a pertinent example of how in the absence of good corporate governance, the reforms to restructure the entity and introduce private sector players, have not yielded fruits.¹³⁷

Fourth, PR's legislative umbrella, the Railways Act 1890, and allied legislations are archaic and fails to meet the modern demands of Public-Private Infrastructure partnerships.¹³⁸ For instance, PR has struggled to commercialize its vast land holdings, primarily due its outdated legal frameworks and internal inefficiencies. The Railways Act 1890, lacks adequate legal cover for the commercialization and redevelopment of railway land, creating significant barriers to generating market-based revenue streams. Internally, PR is hampered by unprofessional administrative practices, procedural misconduct, and inability to protect its land

PIA - Net Profit/Loss (After Tax) Figure 7.19



Sources: PSX, financial statements of PIA (2005-22)

from encroachment. Unlike global practises, where railways leverage their land to drive economic activity, PR's underutilized assets, such as land leased at suboptimal rates for residential purposes, reflect a missed opportunity to generate significant revenue and revitalize the organization.¹³⁹

Pakistan International Airlines: Management of Labours' Concerns is Critical

PIA's financial losses have been consistently growing for about two decades (**Figure 7.19**). These losses stem from a host of business and operational issues, as well as regulatory and policy constraints amid challenges posed by the SOE's labour union.

The airline has encountered a host of business and operational challenges, including mismanagement, operational inefficiencies, alleged corruption, deterioration in quality of

¹³⁵ Hussein, I. (2018-2021); CMU (2023).

¹³⁶ Track Access Policy was based on private sector involvement in the management and operation of terminal facilities. (Source: Economic Survey of Pakistan (2013))

¹³⁷ Various attempts have been made to reform PR. For instance, in 1997, the GoP announced its strategy to privatise PR. In 2001, a report of the Committee on Restructuring & Rightsizing of PR deliberated to engage and regulate private sector rail industry on rail network of Pakistan for freight business and an increased focus was to be placed upon last-mile connectivity to ports, industrial zones and within urban areas. AGP (2023).

¹³⁸ ADB (2008).

¹³⁹ Aslam, A. M. (2023).

services,¹⁴⁰ aging fleet, and poor safety ratings (Table 7.2). For instance, during a special audit of the PIA, some irregularities were observed in the procurement and contract management, asset utilization, and financial operations of the airline, which led to a substantial loss to the national exchequer.¹⁴¹ Similarly, due to safety concerns, the European Union (EU) imposed bans on PIA flights to Europe in 2007 and later in 2020, which dented PIA's profitability. Not only did instances like these have a direct impact on revenues from the EU but it also had an indirect impact through reputation losses that led to changes in customer preferences. The airline has also struggled with more than one thousand court cases and stay orders that have consumed its useful financial and managerial resources.¹⁴²

In addition, PIA has one of the highest employees per aircraft ratio, compared to other airlines, as the airline faces the issue of ghost employees, many with fake degrees. A significant increase in human resource burden in PIA is attributed to politically motivated

inductions.¹⁴³ The government has been cognizant of this, and has been able to somewhat reduce the number of PIA's employees through voluntary separation schemes in recent years. However, addressing of labour concerns remains a major challenge. The activities of PIA's highly organised anti-privatisation labour union and its politics have frequently hampered business and operations reforms aimed at improving the airline's performance. This is both due to their interference in management decisions and general non-cooperative behaviour.¹⁴⁴

From the perspective of policy challenges, PIA's downturn started after the announcement of open skies policy (OSP) in the 1990s. Although the OSP typically aims to liberalize rules and regulations of the international aviation industry based on reciprocity, in Pakistan's case, unilateral open skies agreements with cities like Dubai, Abu Dhabi, Doha and Istanbul caused considerable damage.¹⁴⁵ This hurt PIA the most, since in the 1990s Pakistan's private sector airlines were in infancy, whereas PIA had the

PIA vis-à-vis Selected Foreign and Local Airlines: Main Operational Indicators

Table 7.2

average fleet age in years; fleet size and employees per aircraft in number; safety rating out of 7

Airline	Country	Average Fleet Age ^a	Fleet Size ^b	Employees per Aircraft ^b	Safety Rating ^{*c}
Sri Lankan Airlines	Sri Lanka	10.8	23	237	7
PIA	Pakistan	16.8	34	230	1
Emirates	UAE	10.6	260	192	7
Qatar Airways	Qatar	9.3	284	187	7
Air India	India	15.4	128	94	4
Etihad Airways	UAE	8.3	95	87	7
Turkish Airlines	Türkiye	8.9	440	75	7
Serene Air	Pakistan	14.9	7 ^a	NA	NA
AirSial	Pakistan	15.4	5 ^a	NA	NA
Fly Jinnah	Pakistan	8.7	5 ^a	NA	NA
Airblue	Pakistan	10.2	12 ^a	NA	NA

*a rating of 1 is the lowest, and 7 is the highest. NA: Not Available. Data as of August 2024.

Sources: ^awww.planespotters.net; ^bMinistry of Aviation, websites and latest available financial statements of respective airlines; ^cwww.airlineratings.com

¹⁴⁰ Senate of Pakistan (2020)

¹⁴¹ AGP (2018)

¹⁴² MoA (2015).

¹⁴³ SBP (2011).

¹⁴⁴ MoA (2015); MoA (2021); MoA (2023)

¹⁴⁵ Asghar, S., & Mohsin, H. (2023)

largest operations, and still has the largest fleet size, translating into a relatively higher fixed cost.

At the same time, the government prioritized PIA while allocating the international traffic rights. This absence of competitive neutrality results into unequal treatment of the airlines, which distorts competition by putting more efficient players at disadvantage, and has led to deterioration of PIA's quality of service due to insufficient competition. For instance, as per policy, user airlines were required to pay navigation charges to the Civil Aviation Authority (CAA) for the services it provides. Despite occasionally defaulting on its payments, PIA continued using the services, which is preferential treatment by the regulator.¹⁴⁶

PIA is also affected by a number of regulatory issues that directly and indirectly affect the airline's operations and profitability. For instance, while PIA is in competition with the private sector airlines, it is governed by public sector rules, such as Public Procurement Regulatory Authority (PPRA) rules. Such a bureaucratic process in an industry that is increasingly fast, competitive, liberalized and deregulated globally, inhibits efficient working of any airline. This challenge is particularly pronounced when the management cannot capitalise on an opportunity and make prompt business and operational decisions.¹⁴⁷

In particular, two regulatory challenges stand out: airport regulation, and taxes. In Pakistan, a single authority, the CAA, has had three roles until 2023: (i) it served as the regulatory body responsible for certification and oversight of all air carriers in Pakistan; (ii) it was owner and operator of airports, and (iii) it was responsible

for the provision of air navigation services.¹⁴⁸ This left users of airport infrastructure, PIA and other private domestic airlines, unprotected from the CAA's role as monopoly operator while being a regulator at the same time. In terms of taxation, high levels of taxes on domestic flights have contributed to higher airline ticket prices, leading to suppressed demand for air travel, which affects the profitability of both PIA and other airlines.¹⁴⁹

A critical part of reforming PIA, therefore, would entail reforming the aviation sector as well. To this end, lessons may be learnt from the success of Turkish Airlines. Since 2000s, Turkish Airlines has seen host of reforms including deregulation of domestic market and fostering competition; liberalization of ticket prices; improving international competitiveness of Turkish Airlines; and increasing the number of international civil aviation agreements. In addition to increased air traffic, these measures improved the quality of service and lowered fares.¹⁵⁰ To this end, the rolling out of National Aviation Policy 2023, is a step in the right direction, whereby Pakistan aims to rectify several issues including the unilateral open skies policy.¹⁵¹

In the context of entity level reforms, however, immense efforts will be needed for the implementation of frameworks for management of labour issues (as discussed in **Section 7.4**), in the absence of which PIA's reform process may be at risk. The government has made several unsuccessful attempts to introduce reforms in PIA in the past. For instance, in 2015, the government endeavoured to introduce reforms. However, PIA employees made a Joint Action Committee and went to strike resulting in

¹⁴⁶ WB (2019).

¹⁴⁷ Asghar, S., & Mohsin, H. (2023); MoA (2015)

¹⁴⁸ The CAA had three roles until the passing of the Pakistan Civil Aviation Act 2023, and Pakistan Airports Authority Act 2023 that separate the roles of regulatory functions from commercial and operational aspects of airports Source: PCAA (2023); PCAA (2023); CCP (2012);

¹⁴⁹ Senate of Pakistan (2020); CCP (2016)

¹⁵⁰ Asghar, S., & Mohsin, H. (2023). Dursun et al. (2014)

¹⁵¹ National Aviation Policy 2023

withdrawal of reforms in 2016.¹⁵² This, alongside lack of political will, structural inefficiencies and poor financial health of the airline, created obstacles to PIA's privatisation efforts in past.¹⁵³

These kind of challenges are not unique to Pakistan's state-owned carrier. For instance, in the case of Türkiye's aviation reform, political interventions, both in consideration of labour union and the historical state subsidy, hindered the reform process¹⁵⁴. However, with political consensus and effectively addressing of labour's concern, reforms were eventually made possible.

7.6 Final Remarks

In their original form, state-owned enterprises around the world have proved to be inefficient and a burden on government resources. As a result, they have been reformed significantly since the 1980s, alongside transformational shifts in their ecosystem. The foremost lesson that global experience demonstrates, is that SOEs' ownership reforms, frequently done through privatisation, is not a panacea. The success of SOE reforms, whether through privatisation or retention, mainly hinges on foundational reforms to SOE ecosystem with focus on strengthening of competition and deregulation; transparency and accountability; and a robust corporate governance framework.

Pakistan trails far behind other countries in the crucial pursuit of successful SOE reforms. The reforms have followed an intermittent path, with the process either rushed due to external push, or frequently stalled due to lack of political consensus. As a result, it remains a work in progress. At present, the SOEs in Pakistan pose a significant challenge, consistently posting net losses for the last eight years, requiring steady fiscal support from the government. Between FY16 and FY23, the accumulative fiscal support, including subsidies,

grants, loans, and equity injections, reached a whopping Rs 5.7 trillion, about an average of 1.4 percent of GDP over this period. Furthermore, contingent liabilities in the form of government guarantees, are creating additional veiled risks to fiscal sustainability.

The untenable nature of this dependency as well as the deteriorating quality of goods and services of several SOEs makes their reform imperative for economic stability.

Understandably, reforming SOEs is a long drawn, complex and difficult process, including management of labour issues, such as redundancies, and implementation of hard budgets. However, the daunting challenges that SOEs pose can potentially be a germinating point for garnering political consensus on home-grown push for SOE reforms, especially as potential rationalising of SOEs workforce may not be large given their relatively small share in total employment. To this end, creating awareness, open and transparent deliberations on policy options in parliament and media, can potentially allay public concerns and help remove the roadblocks to reforms.

It is, however, essential that policymakers frame SOE reform within the broader context of ensuring well-functioning competitive markets, effective regulation and improvements to the institutional environment. Conflating stand-alone privatisation with SOE reforms, risks repeating the mistakes of Pakistan's historical reform efforts when the aforementioned essential elements of SOE reforms were ignored in the pursuit of short-term privatisation goals. Indeed, without addressing the foundational reforms to SOE ecosystem reduces SOE reform to a mere ownership swap, leaving end consumers to bear the brunt of continued inefficiencies.

In this regard, the recent government initiatives, namely the enactment of the SOE Governance

¹⁵² Asghar, S., & Mohsin, H. (2023)

¹⁵³ ADB (2008)

¹⁵⁴ Dursun et al. (2014)

and Ownership Act 2023 and SOE Ownership and Management Policy 2023, marks a notable shift from the government's earlier approach to SOE reform efforts. The establishment of a permanent Cabinet Committee on SOEs with clearly defined terms of reference; the formation of a Central Monitoring Unit for evaluating SOEs' performance; the directives to conduct competitive sectoral assessments, ensuring competitive neutrality, mitigating the role of line ministry in micromanaging the SOEs; and adopting best practices for SOEs' corporate governance, are some of the important steps in the right direction.

The impact of these positive measures depend on the degree of commitment with which these are implemented. To this end, adding penalty clauses in SOE Act for non-compliance with the latest SOE legislation and policy may be helpful. In consideration of the fact that reforms are not a one-time affair, the ongoing efforts may be cemented by spelling out policy principles,

institutional responsibilities, timelines and right sequencing for strengthening of competition and effective regulation. In addition, instead of existing dual/hybrid governance model where the SOEs are still owned by line ministries, a centralized model may be explored in line with emerging global best practices, to help completely separate SOEs from the influence of line ministries and avoid the mixing of ownership and regulatory roles. Lastly, strengthening institutional arrangements to generate political consensus and wider public support alongside preparation of mitigation framework for managing prospective labour issues are paramount lest the absence of these may stall the SOE reform process again.

Annexure

Privatisation Transactions in Pakistan by Sector and Transaction Type (million Rupees)

■ Minority stake sale with mangement control ▲ Capital market Transaction ■ Whole/majority stake sale — Unknown



Source: SBP staff assessment based on privatisation data for Feb-91 to Jan-24, available on Privatisation Commission website

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