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Thesis on

**“A REVIEW OF PRIVATISATION PROGRAMME  
OF PAKISTAN-FROM LEGAL PERSPECTIVES”**

by

**Taj Muhammad Khan**

**LL.M (Corporate Law)**

**Reg. No.7-FSL/LLMCL/F04**

**Supervisor**

**Mr. Ali Asghar**

**FACULTY OF SHARIAH & LAW  
INTERNATIONAL ISLAMIC UNIVERSITY ISLAMABAD**



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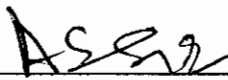
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**FACULTY OF SHARIAH AND LAW**

It is certified that **Taj Muhammad Khan** (Registration no. 07-FSL/LLMCL/F04) has made all the corrections in his dissertation entitled "A Review of Privatization Programme of Pakistan-From Legal Perspectives" as required by the viva-voce committee. Therefore, he may be allowed to submit copies of his dissertation.

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*Supervisor:*

  
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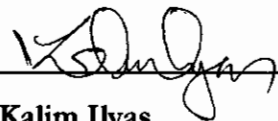
**Ali Asghar**

*Internal Examiner:*

  
\_\_\_\_\_

**Muhammad Younus**

*External Examiner:*

  
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**Kalim Ilyas**

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## LIST OF ABBREVIATIONS

ABL	Allied Bank Limited
BOI	Board of Investment
CCOP	Cabinet Committee on Privatisation
EOI	Expression of interest
FA	Financial Advisor
FDI	Foreign Direct Investment
GHS	Golden Hand Shake
GOP	Government of Pakistan
HBL	Habib Bank Limited
IPO	Initial Public Offering
ICP	Investment Corporation of Pakistan
KAPCO	Kot Addu Power Company
KASB	Khadim Ali Shah Bokhari
KESC	Karachi Electric Supply Corporation
LPG	Liquefied Petroleum Gas
MCB	Muslim Commercial Bank
MRTA	Management Right Transfer Agreement
NBP	National Bank of Pakistan
NEPRA	National Electric Power Regulatory Authority
NGO	Non-Governmental Organisation
NITL	National Investment Trust Limited
NWFP	Northern Western Frontier Province
OGDCL	Oil and Gas Development Corporation Limited
OGRA	Oil and Gas Regulatory Authority
PC	Privatisation Commission
PO	Public Offering
PPL	Pakistan Petroleum Limited
PSO	Pakistan State Oil
PTCL	Pakistan Telecommunication Com Limited



RFP	Request for Proposal
SNGPL	Sui Northern Gas Pipeline Limited
SOQ	Statement of Qualification
SSGC	Sui Southern Gas Company
UBL	United Bank Limited
VSS	Voluntary Separation Scheme
WAPDA	Water and Power Development Authority
SPA	Sale Purchase Agreement
CCA	Corrections Corporation of America
EOI	Expressions of Interest
RFP	Request of Proposal
SOQ	Statement of Qualifications
CCOP	Cabinet Committee of Privatisation
SOE	State Owned Enterprises
PST	Pakistan Steel Mills
NIT	National Investment Trust
HMC	Heavy Mechanical Complex
KESC	Karachi Electric Supply Corporation
IRG	International Resource Group
NEPRA	National Electric Power Regulatory Authority
KAPCO	Kot Addu Power Company
SHYDO	Sarhad Hydel Development Organisation
IPP	Independent Power Producer
CRCP	Consumer Rights Commission of Pakistan
PMI	Pakistan Manpower Institute

**Dedicated to my Parents who always  
encouraged me and appreciate me to do some  
good work**

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## **ABSTARACT**

The privatisation wave, which started with the launching of privatisation programme in the United Kingdom in early 1980s, has swept over the world, encompassing every continent, every system of Government and every sector of economy, interalia, the industrial, commercial , financial and infrastructure sectors. The lesson learnt is that the successful launch of privatisation programme depends on the extent of the government's strength and commitment. The next important aspect is to establish a transparent regulatory and legal framework for a successful privatisation programme.

Privatisation has different names i.e. denationalization, liberalization, deragulation and divestures. Developing countries draw this idea from developed countries. Globalization has become a mega-trend, with liberalization and privatisation at the heart of it. All over the world, governments have been privatising in a growing number of sectors - not just infrastruture industry, utilities such as energy, water and transport, but also health, education, media, pensions, even prisons, defence and social services.

Privatisation is a multidimesional and a very complex process which requires a comprehensive legislative support. In Pakistan process of privatisation was challenged by various stakeholders on different forums. Some judgments of Superior Courts have influenced the policy makers to re-asses the privatisation programme and to review the process. Various cases are pending adjudication in Pakistani courts on some basic legal issues.

My thesis compares and discusses various legal issues pertaining to the process of privatisation including the issues, which require legislation. In this study, my focus is on

the existing legal framework for privatisation in Pakistan, some proposals put forth within the Privatisation Commission for its improvement and also possible amendments which are required in the existing laws and regulations of privatisation covering the public interests, basic rights of citizens, constitutional guarantees and protection of investors.

I have divided my thesis into five chapters. Chapter one will provide an introduction of the word Privatisation and also some conceptual debate on topic. Chapter two explains legislation regarding privatisation in Pakistan including the historical background of the privatisation. Chapter three discusses the establishment of Privatisation Commission, different case laws in Pakistan and legal issues involve in the privatisation .Chapter four deals with some basic issues, which are controversial from the point of view of various stakeholders.

Chapter five is the conclusion of my research work which includes interalia, appropriate legislation in privatisation programme of Pakistan and some recommendations for implementation of a viable privatisation programme.

## CHAPTER 1

### INTRODUCTION

#### 1.1 Evolution of the privatisation

Though Privatisation is primarily considered as an economic issue yet the development of a large scale privatisation programme is also a highly political act. Almost by definition, privatisation represents an ideological and symbolic break with history of state control over a country's productive assets.<sup>1</sup>

Privatisation was common during the immediate post-World War II period, but it became a more dominant economic trend (especially within the United States and the United Kingdom) during the 1980s and 1990s. The trend of privatisation has often been characterized as part of a "global wave" of neo liberalism policies and some observers argue that this was greatly influenced by the policies of Ronald Reagan and Margaret Thatcher. The term "privatisation" emerged during the year 1948 and became more popular between the economists in the mid eighties.

The privatisation movement began in the United Kingdom and it began with vengeance. During the administration of Margaret Thatcher, the British prime minister, the government of United kingdom privatized gas, electricity, telephones, trains and many other state-owned companies in an effort to overhaul Great Britain's socialized and centralized economy, reversing the trend started by the post-World War II defeat of Winston Churchill by Clement Attlee. Attlee and his Labour Party took over the

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<sup>1</sup> Megginson, William, "Privatisation: Think again", Foreign Policy, No 118, Spring 2000, p. 14.

leadership of Britain's government and sought to sale and control the commanding heights of their national economies.<sup>2</sup>

Privatisation truly went global only in the mid-1980s, as dozen of governments in Western Europe, South and East Asia, Latin America and sub-Saharan Africa adopted comprehensive divestiture programs. Latin America alone accounted for about one fourth of the value of worldwide privatisations from 1988 to 1993, during the heyday of the region's market liberalization and economic reforms efforts. Japan also pursued privatisation as the first three Nippon Telegraph and Telephone offerings raised nearly \$ 80 billion for the Japanese government, with the second Nippon Telegraph and Telephone offering alone hauling in \$ 40 billion. And after the Collapse of European communism, Central and Eastern European economies also embraced privatisation, albeit with varying degrees of enthusiasm.

In the former Marxist economies of Eastern Europe, major privatisation efforts have taken place following the fall of the Berlin Wall in 1989. Privatisation in the West has been gradual and it has left the basic structure of the Western countries intact. In Eastern Europe, however, the social, political and economic infrastructure has been overturned; privatisation has been both a part and a cause of this dramatic change. Prior to the fall of the Berlin Wall the socialist state totally dominated each country's economy. The government dictated production, cost and the distribution of resources, goods, capital and labor. "We pretend to work while they pretend to pay us," was a common saying.

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<sup>2</sup>Ibid

Privatisation in Eastern Europe has changed all this while ushering in free enterprise and market determination of economic factors.<sup>3</sup>

In Pakistan, privatisation process has been accelerated since its inception in the late 1980s. The Pakistani left has been extremely marginal since the privatisation process began, having become progressively less and less influential amongst the organized working class since it reached its peak as a political force in the early 1970s. Private sector trade unions are almost non-existent due to the severe fragmentation of production processes that has been the dominant feature of the manufacturing sector over the past two decades. Trade unions still exist in some shape in the public sector, which includes the vast industrial powerhouses of railways, telecommunications, airlines, and public utilities such as water, electricity and gas. Traditionally, the trade unions in Pakistan have always been opposing the privatization process in the way or other, resulting in litigation and delay in privatization.

As a result, when the latest waves of privatisation began following the coup of October 1999 led by General Pervez Musharaff, it was likely that the state expected little in the way of resistance. Importantly, in the year 1990s, the international financial institutions increasingly pressured Pakistan to divest its more crucial assets, primarily because of poor economic performance and an accompanying decrease in the bargaining power of the state. Even so, the speed with which major state assets have been slated for privatisation since October 1999 speaks volumes about the ideological commitment of the present government to neo liberal orthodoxy.<sup>4</sup>

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<sup>3</sup> Marsh, David, "Privatisation under Mrs. Thatcher: A review of the Literature", Public Administration Vol 69, no. 4 Winter 1991 pp. 459-480.

<sup>4</sup> Hyder, S. N., "Privatisation, Employment and Productivity", PMI, Islamabad: 1992 pp. 14-32



## 1.2 Meaning of Privatisation

Privatisation is a fuzzy concept that evokes sharp political reactions. It covers a great range of ideas and policies, varying from the eminently reasonable to the wildly impractical. Privatisation involves partial or complete disposal of nationalized industries, land and other assets which have traditionally been owned, managed and controlled by the Government. Different economic theorists defined Privatisation in different ways. According to Megginson; "Privatisation represents an ideological and symbolic break with a history of state control over a country's productive assets."<sup>5</sup> On the other hand, Steve H. Hanke defined privatisation as the "transfer of assets and service functions from public to private hands".<sup>6</sup> In the words of Elliot Berg, privatisation is generally equated with the "selling of state-owned companies to private buyers, whether by sales of shares or by disposal of whole enterprises".<sup>7</sup>

According to E. S. Savas, Privatisation is the "act of reducing the role of government or increasing the role of the private sector, in an activity or in the ownership of assets."<sup>8</sup> Peter Self defined privatization as "privatisation is a basic means both of sliming the state and of increasing the competitive influence of market forces within the government. The former policy requires the wholesale transfer of functions and assets to the private sector, the latter involves contracting out the provision of public services".<sup>9</sup>

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<sup>5</sup> Megginson, William, "Privatisation: Think again", Foreign Policy, No 118, Spring 2000, p. 14-18.

<sup>6</sup> Hanke, H. S, "Privatisation and Development", International Centre for Economic Growth: California, 1986, p. 3.

<sup>7</sup> Berg, Elliot, "Policy Reforms & Equity: Extending the Benefits of Development", International Centre for Economic Growth: California, 1988, p. 185.

<sup>8</sup> Savas, E. S, "Privatisation: The Key to Better government", Chatham House Publishers: Chatham, 1987, p. 3.

<sup>9</sup> Self, Peter, "Government by the Market? The Politics of Public Choice", Westview Press: Boulder, 1993, p. 60.

In short, the privatization is given different meanings by different authors in the social sciences. Conceptually the meaning assigned to privatization range from shirking government to that of reducing government activities in sphere traditionally served by the public sector and the very essence and purpose of privatisation is greater citizens control and participation over the level and range of service delivery, business and production of goods.

### **1.3 Theories of Privatisation**

The roots of privatisation can be traced from the ideas of liberalism by J.S. Mill and the laissez concept of Adam Smith. Other economic theories, such as, property rights and public choice theory which are connected to privatisation, can also help to explain the rise of this phenomenon as a strategy in the economic and social development of a nation. Policy analysts view privatisation as a tool for the government to address problems of lagging productivity and alleges inefficiencies of the public sector in the provision of goods and services to its clientele.

When we see privatisation from economic perspective, it is one way of cutting down the inefficiencies associated with the monopolistic tendencies of government. The lack of motivation to reduce costs in government owned public utilities that are run on monopoly basis has contributed to high costs of production and inefficient allocation of resources.

#### **( i ) Privatisation as an ideology (liberal approach)**

From the perspectives of liberal thinkers, good government has a limited role in providing people the basic public goods such as defence and security that are collective in nature. They are of the view that the rights of individual to do what he wants to do should

be protected. Individuals are free to engage in whatever endeavors they want to undertake as long as they are within the confines of the law. Adam Smith explains that there should be some guiding principles as to prove that where minimum government intervention is good in ensuring that the private sector can do what it does best without any government intervention. The idea of leaving the private sector alone in carrying out its function is crucial in developing the concept of privatisation. Equally important fact is that the government limits its functions in areas where the private sector can best perform.<sup>10</sup>

**( ii ) Privatisation as policy approach**

In selecting its strategy for national development, government must choose from a number of strategies that fit its national agenda and the local conditions. Privatisation offers the means to achieve goals for the development of the country. By adopting such a policy option, the government can overhaul the system to meet its development goals. As a policy approach, the privatisation is founded on the basis that provision of goods and services by the public sector may not be the only way of getting those services to the public. Both the government and the private sector can share the two functions of “Provision” and “Production” of goods and services. Involving market forces in the process is one way of determining the efficient production and provision of goods and services to the public.

Kolderie differentiated the various mixes of provision and production of public goods and services. The four cases where the public and private sectors can be involved in production and provision of goods and services were enumerated. It is clear that both the private and public sectors can be involved in the process. In cases where the

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<sup>10</sup> Adam, Christopher, Cavendish, Williams, Mistry, Percy, “*Adjusting Privatisation*,” Heinemann Educational Books, Inc, Portsmouth, NH, 1992.

government decides to provide services to the public, they may not be directly involved in the production of such services. They can assign the private sector to produce and sell such services for the government. This mode of privatisation is known as “Contracting out”. It is popular among countries using privatisation as a policy approach as they are not involved in the production of such services and, therefore, they are not obliged to hire new employees that will eventually result in an increase in the number of public sector employees.<sup>11</sup>

Other possible reasons for the employment of this policy option can be seen in the objectives of privatisation as enumerated by Vickers and Yarrow (1988). These authors identify seven major objectives of privatisation programs, which include reducing government involvement in industry, improving efficiency in the privatised industries, reducing the public service borrowing requirements (PBSR), easing problems in public sector pay determination by weakening public sector unions, widening share ownership, encouraging employee share ownership and gaining political advantages. Each of these objectives is built upon the premise that change from a government to a private sector environment will contribute to achievement of a privatisation program and bring development to a country.<sup>12</sup>

### **(iii) Privatisation as an Economic Theory**

The intellectual roots of privatisation can also be evolved from the economic theory of public choice and property rights. Property rights arrangements provide the key to understand the behavior of private and public employees and the performance of

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<sup>11</sup> Kolderie, T, “Two Different concepts of Privatisation-*Public Administration Review*,” 43 (4), 285-292.

<sup>12</sup> Vinker J and G. Yarrow, “*Privatisation: An Economic Analysis*”, Cambridge, MA: MIT Press, 1988. p. 16-25

public and private enterprises. A private enterprise's assets are owned by individuals who are free to use and transfer their private property within the confines of law. Consequently, those who own private properties have residual claims on private enterprises assets. When private enterprises produce goods and services that consumers demand, at costs that are lower than market prices, they generate profits. As a result, wealth is created for property owners. On the other hand, if losses are generated as a result of the use of their property, the value of private assets declines and the owner's wealth is diminished. Therefore, owners of private property not only appropriate gains but also bear the costs that result from the way in which private property is used. In short, private property owners must ultimately be responsible for their actions and the consequences of actions under taken by them. They, therefore, have to face the bottom-line.

The incentives created by private property rights by the linkages between use of private assets and their owners' wealth have profound consequences. Private owners face significant incentives that make it desirable to monitor the behavior of private enterprise managers and employees so that they will supply what consumers demand and do so in the most cost-effective way. Consequently, private managers and employees find it difficult to engage in shirking behavior or behavior that is inconsistent with maximizing the present value of private enterprise (the owner's wealth). Therefore, private property puts in place incentives that will generate efficient performance by private firms.

By way of contrast, public enterprises are not "owned" by individuals who have residual claim on the assets of these organizations. The owners of public enterprises, the "taxpayer owners" cannot buy and sell public enterprises assets. Consequently, "taxpayer

owners” do not have strong incentives to monitor the behavior of public managers and employees. Public managers, like any other ambitious personalities, have their own agenda. Niskanen (1971) pointed out that public managers are responsible for the growth of government through their ever increasing demands for higher budgets for their organizations in order to fulfill their personal agenda.

De Alexi and Niskanen have argued that because the salaries of bureaucrats are related to the expenditures they control and they have limited job tenure, there will be a tendency for them to favor projects with large initial outlays.<sup>13</sup> Public employees, it is argued, will seek greater public expenditures either because it results in higher public sector wages or because an increase in the number of public sector employees increases their voting strength and future wage increase. If not properly monitored, the public sector will grow and this will add to the inefficiency of the government.<sup>14</sup>

Taxpayer owners can capture some benefits from increased efficiency of public enterprises through tax reductions. However, if realized, incremental benefits from improved efficiency would be spread over many taxpayers so that individual benefits will be rather small. In addition, an individual’s costs in obtaining the benefits of acquiring information, monitoring bureaucrats and organizing an effective political force to modify the behavior of public managers and employees would be very high. The consequences of public ownership are predictable.

Public managers and employees allocate resources (assets) that do not belong to them. They do not bear the costs of their decisions, nor do they appropriate the gains from efficient behavior. Since the nominal owners of public enterprises (the taxpayers)

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<sup>13</sup> Alexi, De. L, “*Implications of Property Rights for government Investment choices*”, American Economic Review, 59, 1969 pp. 13-24.

<sup>14</sup> Niskanen, W. A, “*Bureaucracy and Representative Government*,” Chicago, Aldine-Atherton 1971.

have little incentive to monitor public managers and employees (because of the high costs of monitoring), the cost of shirking to the public bureaucrat is very low.

Consequently, public managers and employees will probably engage in shirking activities and in acquiring various perquisites that increase production costs. After all, the costs of shirking and perquisites are borne by the taxpayers who have little incentive to make their activities, while the gains from them (more leisure and an easy life) all accrue to the public bureaucrats.

Private enterprises make plans based on what they expect consumers to demand and what they anticipate the costs to be. Private owners bear the costs and capture the benefits associated with implementing their plans. While public enterprises also plan, their plans are fundamentally different from private plans, because they are developed by bureaucrats who neither bear the costs of their mistakes nor legally capture the benefits generated by foresight.

Therefore, from a theoretical point of view, private and public managers and employees can be expected to behave in different ways and, as a result, private firms will be more efficient than public firms.

Principal agent theory seeks to explain the relationship between owners and managers in their quest to achieve their ultimate goals (profit making or welfare maximization). Principal agent approaches are characterized by asymmetrical information. When attempting to achieve his goals, the principal is handicapped by lack of certain information, which only the agent knows precisely. There may be particular parameters affecting efficiency, which only the agents know. The principal's knowledge is restricted to knowledge of distribution of parameters. Efforts of managers may be

difficult to observe and therefore impossible to monitor. Since the principal cannot directly observe the activities of the agent, he cannot influence his behavior. The agent has his own objectives therefore; he may choose an effort level that is not efficient. The particular situation must be taken into account by the principal when he defines the rewards of the agent. In comparing public and private firms, they are assumed to face the same economic environment, the same demand function, and the same technology. This is explained by the fact that the privatised firm is the same as the public firm after it has been sold to private owners.

Private owners are perceived to be clever investors who are well informed about economic realities. Their informational status compares favorably with that of the bureaucrat who is supposed to audit public enterprise. Privatisation, therefore, means that the agent faces a better-informed principal than before.

Privatisation is supposed to cause changes in the objectives of the firm and the extent of control. In a principal agent approach, the objective of the firm is articulated by the principal, that is, private owners of private firms or the government in the public sector. While the government as principal is interested in attaining the goals of high consumer welfare and not too high a deficit for the enterprise, private sector principal are interested in profit making. By privatising the public firm, the firm's goal will be focused solely on profit making.

The government's control over public managers is exercised through budgetary and oversight hearings by legislature. Private sector control is exerted through monitoring and incentive system. The fact is that poor performance by the management of the private firm will subject it to the threat of takeovers and loss of jobs. Since the goal of private



sector is making profit, the performance of private sector is more easily measured compared to the multiple goals of the public sector. Hence, a privatisation program is seen as a means of achieving better control over the organization's performance. In the public sector context, principal agent theory stipulates that the principal (taxpayer) have little or no information on the agent (public bureaucrats) who have an upper hand in dealing with taxpayer. Information asymmetry between the principal and agent favors the letter in dealing with the principal, and shirking in this connection is much more prevalent than in situations where monitoring and incentive structures can be used to check on activities of the agents (public bureaucrats and employees).

**( iv ) Privatisation as a mean of reducing government overload**

To get out from the clutches of bureaucracy that is rigid and full of procedural requirements, governments in both developed and developing countries have established public enterprises as a means of side stepping these problems and as a strategy for development. While there are many other reasons for establishment of public enterprises, the chief concern of government is to spearhead development using this method of reducing problems associated with bureaucracy. Public enterprises are free from the clutches of legislative wrangling, and they also have the freedom to decide certain business transactions with minimal intervention from the Treasury. Public enterprises, then, seem to be the answer to the woes of the government in cutting down bureaucratic red tape in order to improve the performance of government. They have the freedom to make business decisions that can help propel them to new heights of excellence in their performance. Establishment of these public enterprises is seen as a panacea to the problem of economic development of most developing countries. With this newfound

strategy, public enterprises tend to “crowd-out” development of private sector by competing with it for the limited resources in the economy.

Nevertheless, this strategy has its limitations, public enterprises began to outgrow their capabilities and produce losses to the government. In many developing countries, they failed miserably in bringing the necessary changes, which were expected of them. Public enterprises piled up heavy losses, thereby, increasing the debt of the government which had allocated them funds to operate.

As of the Eighties, the literature on public management was bombarded with articles and writings exposing the failure of public enterprises and explaining the possible causes for this failure. Reasons for such failure abound ranging from lack of business acumen to excessive freedom given to the management of public enterprises in conducting their business. Among the proponents of property rights theory the prominent cause given was the indirect linkage between ownership and the consequences of decisions made by the management of public enterprises.

Ownership of public enterprises is separate from the management. Therefore, there is a lack of incentive to perform since the outcomes of decisions taken by the managers will have little bearing on their financial gains. The separation of ownership from management was nevertheless the explanation given for the failure of public enterprises to excel in their performance. Scholars who espouse principal agent theory in their explanation for the failure of public enterprises seek to put the blame on “shirking” by managers since there is little monitoring done on them due to their “freedom” from legislative and Treasury control. Increasing perquisites and expanding budgets were the order of the day for public enterprises. Niskanen (1971) observed that public enterprises

managers were pursuing their personal agenda, which contributed, to the increasing costs of running public enterprises.<sup>15</sup>

The decade of the Eighties was the “Waterloo” from the most public enterprises. With increasing heavy losses incurred by most public enterprises, a new strategy for economic development had to be pursued. The era of privatisation had dawned with the ascension of Margaret Thatcher (1979) and Ronald Reagan (1980) to the political thrones of the United Kingdom and United States. New ways of reinventing and revitalizing government were explored.

Giving the private sector due place and reducing government’s role in the market seemed to be one of the answers to the problem of lagging performance of public enterprises. Activities that were not in consonance with the public sector were being phased over to the private sector while functions that can be performed by private sector were “contracted-out” to them. In the British context the government’s overload was the result of “Nationalization”. As a solution, the policy of “denationalization” which seeks to divest government entities to the private sector was pursued. A change in ownership of government entities was not pursued as much as the strategy of “contracting out” in the United States. In the American literature, contracting out is almost synonymous with Privatisation. In addition, the governments in most countries are pursuing a strategy of reducing government and shrinking it to a decent size.

In the era of privatisation, the government loads were being shed by means of divesture, contracting out, management buy-outs, leasing and-build operate and transfer programs of privatisation. Faced with increasing heavy losses, debt services problems and sluggish economic growth, the governments searched for new development

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<sup>15</sup> Ibid

strategies. The concept of privatisation began to penetrate in developing countries with some countries making slow inroads while others were committed to implement these programs to the fullest extent. Privatisation became the panacea for the problems of government overload as developing countries began to reduce their public sector's participation in business by allowing the private sector to lead in the economic development of their country.

#### 1.4 Types of Privatisation

As privatisation takes many forms and is more diverse in its usage, Savas introduces different types of privatisation strategies that can help us to understand the various techniques employed by government worldwide in implementing privatisation programs. These types will help to relieve us from the confusion caused by the multitude of literature on privatisation and diverse meanings ascribed to it. The taxonomy given by Savas divides privatisation of state-owned enterprises into three broad strategies; namely disinvestment, delegation and displacement.<sup>16</sup> These three broad categories are listed as under,

##### 1. Privatisation by Disinvestment

###### a. Sale

- i. Private Placement
- ii. Public Sale
- iii. Management buy-out
- iv. To employees
- v. To users or customers

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<sup>16</sup> Savas, E. S, "A Taxonomy of Privatisation Strategies", Policy Study Journal Vol 18 No. 2 Winter 1989-1990. pp. 27-35

- b. Donation
  - i. To employees
  - ii. To users or customers
  - iii. To the public

- c. Liquidation

## **2. Privatisation by Delegation**

- a. Contract
- b. Franchise
  - i. Public Domain
  - ii. Public Assets

- c. Grant

- d. Voucher

- e. Mandate

## **3. Privatisation by Displacement**

- a. Default
- b. Withdrawal
- c. Deregulation

While explaining the various types or techniques of privatisation individually, the countries implementing privatisation programs may employ a combination of these techniques to achieve intended goals or policy objectives. If complete withdrawal from an industry is contemplated by the government, this can be achieved by the outright sale of government assets to the public or to the highest bidder. At the same time, government

can lift entry barriers into the industry to a number of companies so as to create competition among newcomers in order to reduce the costs to the consumers.

### **1.5 Alternates to privatisation**

Privatisation may be carried out through other alternates also. These alternates enumerate the modalities employed by the government in its privatisation program. These alternates are discussed as under:-

#### **(a). The sale of equity**

This mode of privatisation applies to government companies and may result in the transfer of three organizationally related components namely, management responsibility, assets and personnel. Sale of equity can either be partial or complete.

#### **(b). Sale of assets**

This form of privatisation may or may not involve the transfer of all three components.

#### **(c). Lease of assets**

This method of privatisation involves the transfer of the rights to use assets for a specified period in return for specified payments. The lease period depends on the types of project. Leases are usually applicable to fixed assets particularly if those assets are large and strategic in nature such as seaports and airports. Lease rental rates are worked out based on future business prospects and not on the current value of the assets. Payments are calculated based on a stream of income and expenditure flows over the lease period. For corporatized entities, the lease rentals may be nominal and may only cover the quit rent and other relevant fees. The nominal rate is applicable for a specified period that may extend to 99 years or until the entity is privatised, whichever is earlier.

Upon expiration of of the specified period or when the entity is privatised, the lease rentals will be based on market rates.

**(d). Management contracts**

A management contract involves the contracting of private sector management expertises to manage government assets for a fee. A contract entails the transfer of management responsibility and may or may not involve the transfer of personnel but does not involve transfer of assets. The company managing the property pays a sum of money as compensation for the services rendered. The period for such contracts is normally subject to negotiations between the contracting parties.

**(e). Build-Operate-Transfer (BOT), Build-Own-Operate (BOO) and Build-Operate (BO)**

Build Operate and Transfer and its variants are applicable for privatizing new projects such as roads, motorway, water supply and power projects. This option involves the private sector contracting the facility using its own fund, operating it for a coession period and later transferring it to the government at the end of its concession period. Build-Own-Operate and Build-Operate are similar to Build-Operate-Transfer with the exception that such facilities are not transfered to the government. Both BOT and BO is accompanied by the grant of license and/or concession. The period for concession is to be worked out by the licensing agency based on the size of investment and the possibility of recovering the investment calculated on future income prospects of projects. The glittering example of this mode is construction of Motorway in Pakistan.

**(f). Sub-Contracting / Contracting out**

Privatisation, especially as implemented in the United States by local governing bodies, generally takes one of four forms. The first and probably the most prevalent form

is "contracting out", which can be described as public sector choice and public sector financing with private sector production of the selected service. Under contracting out, the citizenry makes elected officials aware of a collective need such as trash pickup. The government then generally chooses via competitive bidding a private contractor to provide the service.

The government is also responsible for financing these respective services generally through its taxing powers. Hence, the government finances the service while the private sector provides the selected services. The government determines the service level and pays the amount specified in the contract, but leaves production decisions to the private contractor. Although the service is ultimately paid by the taxpayers, the government makes the actual payment to the provider. This scenario usually happens when a municipal or state government for various reasons seeks to contract out, to the private sector, a service it has traditionally provided. Foremost amongst critics of contracting out are the state and city employee unions, which are contended with shrinking membership rolls, lessening of dues and angry dislocated members. For instance, one of the traditional government services being increasingly contracted out is the incarceration of criminals in prisons owned and operated by private corporations such as Corrections Corporation of America (CCA).

**(g). Public-Private Partnership/Ownership**

Under a public-private partnership, sometimes referred to as a joint venture, a contractual arrangement is formed between public and private-sector partners that can include a variety of activities that involve the private sector in the development, financing, ownership and operation of a public facility or service. It typically includes



infrastructure projects or facilities. In such a partnership, public and private resources are pooled and responsibilities divided so that the partner's efforts complement one another. Typically, each partner shares in income resulting from the partnership in direct proportion to the partner's investment. Such a venture, while a contractual arrangement, differs from typical service contracting in that the private-sector partner usually makes a substantial cash, at-risk, equity investment in the project, and the public sector gains access to new revenue or service delivery capacity without having to pay the private-sector partner.

### **1.6 Methods of privatisation**

Where some privatisation involves little more than the sale of shares on the stock exchange, most transactions are most complex. Privatisation is such kind of field that does not permit any lienent treatment. Every case must be examined on its own merits. The experience of developed and developing countries alike demonstrate that privatisation potential is not limited to strong performance SOEs. While privatising publis assets, regulatory aspect must be determined. For setting the objectives of privatisation programme, importantly allow for trade offer based on feasibility of techniques relative to a given set of objectives. It should be clear privatisation is not in all cases the sale of existing assets; it may be achieved through new investment and dilution of the state ownership.

The most serious hurdle while dealing privatisation are financial condition and excessive liabilities of a SOEs and in some countries, non availability of financial markets, political opposition and employment issues which need to be evaluated on proirity basis. Similarly, if the transaction hinges on long term commercial and fiscal

advantages beyond those that otherwise apply to competitive industries under market conditions, government economic policy in this respect should be certified before entering into transaction. The organisational capability and technical expertise must be there to initiate and implement the transaction. The emphasis is generally placed on centralisation, simplicity, flexibility, speed and transparency. The basic principles to implement the programme are clear standards of valuation, prequalification of buyers and competitive bidding or terms of finance offered etc. These standards should be adopted as to ensure orderly disposition to maximise the return to the state, to pursue a fair process for the general public and to assure that the purchaser is qualified to turn the acquired enterprise productively.

There are wide variation in the financial costs of various type of transactions or specific methods or procedure of privatisation. Cost include low pricing e.g to assure wide spread share ownership and the assumption of substantial portion of the liability of SOEs. Privatisation may not be consist of full budgetary relief and several cases are characterised by important residual liabilities for the state. Each State Owned Enterprise is required to be examined on its own merits.

The most common methods<sup>17</sup> of privatisation are as under:

- i. Public offering of share.
- ii. Private sale of share.
- iii. New Private Investment.
- iv. Sale of government or SOE.
- v. Reorganization of SOE into component part.
- vi. Management employment layout.
- vii. Lease and management contract.

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<sup>17</sup>Vuylsteke, Charles, *Techniques of Privatisation of State-Owned Enterprises-Methods and implementation*, Vol. 1, World Bank Technical Paper 88. Washington, D. C.

These methods can bring about divestiture or denationalisation or can be implemented partially or gradually as the government described its objectives and principles to implement this programme. There are some other methods of transfer to private control or ownership or other state actions towards liberalisation of economy, but these terms are not widely adopted for the privatisation. These procedures<sup>18</sup> are listed as under:

- i. Introduction of competitive features into an SOE (eg. Performance related incentive).
- ii. Economic policy reforms such as demonopolizing certain activities or liberalization or reducing regulatory constraints on business. These reforms may be combined with divestiture of state owned assets.
- iii. Increased use of private sector financing of new activities, such as contractor equity financial.
- iv. Revenue participation certificates or revenue bonds issued by the state or state bodies as issued in Pakistan by the Water And Power Development Authority (WAPDA) and the National Development Finance Corporation.
- v. Privatization by attrition (e.g. an SOE operating as quasi monopoly but not renewing investments, gradually permitting the private sector to invest in plants and related facilities and take over all or part of the SOEs operations).
- vi. Contracting out i.e. substitution of private contractors or services for production by the state or municipalities and franchising. Contracting out normally follows applicable governmental procurement techniques and procedures.
- vii. Full liquidation of an SOE with the asset ending up in the hands of private purchasers while the SOEs activities is wound up.

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<sup>18</sup>Heald, David, "*Privatisation of Monopolies*," World Bank, Country Economic Department, Public Sector Management and Private Sector Development Division, Washington, D. C, Public Expenditure (Oxford: Basil Blackwell Ltd, 1987).

### 1.7 The case of Pakistan and objectives of study

In the context of international developments in privatisation, Pakistan also took initiatives to launch an aggressive privatisation programme, which is going on in its full swing since its inception in 1991. Almost all the governments including the present government has been claiming that privatisation has achieved its objectives. Up to 2005, a very large number of government institutions have been privatised resulting in the reduction of liability of about one hundred thousand government employees who are now working with private sector.

In presenting his Annual Budget speech to the Parliament in June 2006, the Finance Minister claimed that high economic growth rate is the result of the success of privatisation policy of government of Pakistan. The Minister further added that privatisation contributes to government revenues through corporate income taxes paid by these agencies and the profits generated by these organizations due to better management and efficiency.<sup>19</sup>

In Pakistan, there has been no major study being done to evaluate the impact of privatisation policy, lacunas in laws and safeguards to the employees and consumers. In this study, an effort has been made to discuss the impact of privatisation programme from legal perspective. The objective is to analyse the impact of the policy on privatised government agencies, employees and customers. Most importantly, to determine whether the laws and regulations made by the framers of the policy are sufficient and meet the requirements to run a better privatisation programme and to explore some of the factors in the privatisation context that can improve productivity and efficiency.

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<sup>19</sup> Ziauddin, Muhammad, "Privatisation proceeds revisited", DAWN, Economic and Business Review, Islamabad, July 16, 2006, p. 1.

The study seeks to answer the following questions:

- i. Are the policies and legislation in Pakistan covering the privatisation programme adequately address the needs of all stakeholders?
- ii. What is the nature of legal issues in privatisation?
- iii. Is there any need for more legislation to provide safeguards to all stakeholders in privatisation?
- iv. What are some elements that cause to failure in privatisation process?
- v. What are the factors contributing to a successful privatisation programme?
- vi. What are the arguments in favour of and against the privatisation?
- vii. What kind of legislation require in the light of some recent case studies in Pakistan?
- viii. What are the recommendations for a successful privatisation programme in Pakistan ?

We will try to find out the answer of above mentioned questions in the next chapters of this study.

## **CHAPTER 2**

### **LEGISLATION RELATED TO PRIVATISATION IN PAKISTAN**

#### **2.1 Privatisation in Pakistan-Evolution and growth**

In Pakistan, the role of public and private sector has been determined by the political governments in different ways. During 1948-1958, the public and private sector worked together for economic and social development. In the next phase (1958-1971), the private sector was encouraged and role of public enterprises were limited. During 1972-77 the process was completely reversed by introducing nationalization under Economic Reforms Order, 1972 and other statutes. After 1977, the Government again restricted the role of public enterprises and framed a policy to restore the confidence of private sector.

In 1990s government of Pakistan was holding 250 separate enterprises with a total capital investment of about Rs. 87.00 billions with a net retained earning amount to Rs. 23.6 billion.

In 1960s, Pakistan initiated a significant programme of deregulation and decontrol. During that period this policy was not very much fashionable or common in much of developing countries. The Government published an "Industrial Investment Schedule" and partially deregulated the industrial sector. The private investors were allowed to set up industries, listed in the schedule without any prior permission of the government agencies. An import items list was also published which was much liberalised towards the importation of industrial machinery and raw materials. Even

foreign exchange regulation became less stringent under the “Export Bonus Scheme” as the exporters of manufactured goods were allowed to retain 30 percent of their earning in shape of Bonus Vouchers traded in the open market and used freely to import consumer and other goods. These economic policies produced very positive results and West Pakistan achieved an average annual GDP growth rate of 6.5 percent during 1960s. The industrial sector had growth of 12 percent and export had increased of 8 percent annually. The inflation rate was relatively low, an average of 5 percent. The sharp industrial output in GDP and manufactured export in the total export of late 1960s was higher in Pakistan than in countries like Korea, Thailand and Malaysia which had per capital incomes comparable at that time to that of Pakistan. This positive change in economic growth was the reflection of these economic policies and the economy showed visible structural changes.<sup>1</sup>

During 1951-70, the concept of privatisation was only restricted to those projects, which were established and successfully operated by Pakistan Industrial Development Corporation ( P.I.D.C ). The primary interest was not to privatise only sick units but to expand the base of industrialisation in the country. The performance of (P.I.D.C) for the expansion of Industrial base can be determined as the eight units were transferred with 51 percent share to the private sector and eight units were partly disinvested and transferred to the private sector.

These healthy trends in economic growth and liberal economic policies could not be carried on by the next Government due to the socialist concept/ideology of ruling party which also resulted in a debate on income distribution and concentration of income

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<sup>1</sup> Ibid

in the hands of the so called 22 families. The business leaders were publicly criticised for becoming too rich at the cost of the poor segments of the country.

This dominated issue was capitalised by Pakistan Peoples Party (P.P.P) led by Mr. Zulfikar Ali Bhutto. The new Government of P.P.P brought fundamental changes in economic policy to fulfill its election promises of expanding the role of public sector. The Government acquired 32 industrial units of ten basic items, interalia, iron and steel, basic metal, heavy engineering, heavy electrical machinery and equipment, assembly and manufacture of motor vehicles, tractor assembly and manufacture of heavy and basic chemical, petro chemicals, cement and public utilities including oil , gas and electricity through Economic Reforms Order of 1972. This process of nationalization was followed by acquiring Vegetable Oil units, Life Insurance, Shipping, Petroleum companies, Flour mills, Rice mills and Cotton ginning Mills.<sup>2</sup>

All these nationalised units were managed through respective Corporations as these were created under these statutes. These acquired establishments retained their corporate identities. Public enterprises utilised the autonomy and financial support from public sector financial institutions and they established new units in their respective sectors. In selected cases, the government compensated the previous management of these acquired establishment in shape of long term bonds after determining the cost by itself. Another major extension in public sector activities were nationalisation of banks in 1974. The government introduced this policy to utilise the capital concentrated in the hands of few rich bankers for rapid economic growth, to accomplish social welfare projects and to coordinate banking policy without eliminating healthy competition among banks. This nationalisation of strategic sectors of the economy left only textiles and sugar

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<sup>2</sup> Akhter, Sajjad, "Privatisation at Gun point", DAWN, Monthly review October 2005.



industries in the private sector. These economic policies forced many businessmen and industrialists to establish their business out of the country.

In 1977, the new Government of Mr. Zia ul Haq reviewed its organisational structure and policies to improve the investment environment for private sector, which was shrunk by the fear of nationalisation.

In 1978, desinvestment of government interest in public enterprises was undertaken for various reasons. The introduction of denationalisation regularise many manufacturing sectors along with others small units. The previous owners were debarred from making any claim for compensation of any nature against the Government and the provision was made for assumption by it of the net losses incurred after take-over until transfer back to the previous owners. Not many owners took advantage of this policy due to complex process like accounting, audit, valuation of assets at both time i.e. at the time of nationalisation and denationalisation. Only few enterprises were handed over to it's previous owners because of unnecessary long process and very low attractive advantages. The suitability in economic sector was achieved through exporting material by setting up labour intensive industries in public sector by improving the condition of private enterprise and growth of small industries. The Government had also impounded its regulation for the private investment like labour management procedure and control of the state, and the availability of foreign exchange.

a. **Consideration for privatisation.**

In 1980 the role of private sector and privatisation was justified by political leadership, the establishment and other agencies due to the following reasons:

- TH S205
- (a) The public sector was unable to control its losses which affects the social programmes of the Government. These losses has limited the Government investment in public enterprises and the necessary services to the public;
  - (b) The Government intended to open its market for foreign and private investors and to remove all unnecessary controls and interventions in the industrial sector;
  - (c) The government considered an effective and efficient management, necessary for profitability and survival of this unit itself;
  - (d) The Government laid down a strategy to provide basic infrastructure for healthy economic activities. This policy determined the direction of investment; in which Pakistan has a competitive advantages;
  - (e) The Government was required to invest more in one SOEs to improve their production capacity and the Government does not have finance to contribute as per the demand of each enterprise. The government prefer to sell off some assets and raise funds for the remaining projects;
  - (f) The Government also considered to change it's priorities as it prefer to invest in the small projects, which produce better yielding as compared to larger enterprises, which need long term investment and period to recover. This strategy perhaps effect the investment graph in the economy but Government has finance to invest for balancing Modernization, Rehabilitation and expansions in essential fields like energy, agriculture, water and other social sector. This policy attracted private investment in local market;
  - (g) Modern industialisation has shown that decentralization of power improve efficiency, distribution and investment. This fundamental point was also added in policy structure as the increase in efficiency on the production distribution of goods and services also achieved better results for enterprise and economy.<sup>3</sup>

The disinvestment or deregulation during 1977 to 1985 mostly consisted of denationalization of those establishment, which were acquired by previous Government. Some Ordinances were promulgated to deliver possession of a take-over establishment to its prevoius managements. The loss of interest on the value calculated under the Nationalization Act was again determined and paid to the effected persons and previous managements. This denationalization or return of acquired establilhments was also

<sup>3</sup> Economic Survey report, Economic Advisor's wing, Finance Division, Government of Pakistan, 1985-1986.

protected as no legal proceedings could be initiated against the financial interest of the Government and Pakistan Industrial Development Corporation (P.I.D.C). The disinvestment involving sale or transfer of more than 50 percent share holding of some P.I.D.C., Federal Government and provincial Government projects were also held in this phase.

Even during the fifth five years plan, (1978-83), the status quo in the public and private sector was maintained. Partial denationalization and the fields for private investment were also determined. To attract the private investments several incentives were introduced including tax holidays, export rebates and exemption of certain duties; with an object to improve the private investment and economic growth. In 1984, the Government disinvested three hotels and Restaurants situated in northern areas and were subsidiaries of Pakistan International Airlines Corporation Ltd. The main consideration in disinvesting these units was to transfer the hotels to an experienced party who could provide better management and obtain better results. The Government closed down operation of three establishments manufacturing cigarettes, textile looms, marble mining and processing, established and operated by the Federal Government in certain backward areas of Pakistan.

The third phase of liberalization or privatisation during 1985-90 further widened the scope of privatisation and certain guarantees were introduced by the Government against arbitrary government acquisition. Incentives for the purposes of export promotion and to encourage private investment in export oriented projects were introduced. To meet the requirements of modern technology and to attract capital as well as availability of raw material, the incentive and duty exemption were also offered in the import policy. The

government had also taken steps to streamline the procedural problems and bureaucratic hurdles in foreign investment. This process of privatisation was not limited to the sick units but extended to profitable units. The shares valuing Rs. 2.00 billion were also offered for sale to general public.<sup>4</sup>

Again in 1988, the Pakistan Peoples Party took over the Government with change in the leadership as Ms. Benazir Bhutto sworn in as the new Prime Minister. Such change brought some major changes not only in the party programmes, but also in the economic policies of the Government. The Government planned its privatisation programme and engaged M/s Rothschild as its consultants. The Consultant recommended 14 industrial units including utility and service sector for privatization through the sale of shares to small investors and workers without transferring the management. This policy could not attract big investors as the private sector was offering better dividends while the state owned enterprises had much problems like over employment and other hidden bad debts or other liabilities. The over employment in these establishments and price policies discouraged the potential investors. The success of the sale of 10 % shares of P.I.A. due to guaranteed dividend of 12.5 %, which after a year was paid by the Government as the Airline suffered loss and Rs. 35 million were due to small investors against dividend. This Privatisation programme also faced resistance from labour and particularly in the case of banks as the public sector was giving much benefits to its employees as compared to the private sector.

These unsuccessful experiments of privatisation between 1985 to 1990 also demonstrated that a privatisation policy, unless part of broader process of economic

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<sup>4</sup> Aziz, Sartaj, "*Privatization in Pakistan*", Development Centre of the Organisation for Economic Co-operation & Development: Paris, 1996.

reform can not go very far. The decisive factor changed in November, 1990 when new Government of IJI led by Mr. Muhammad Nawaz Sharif took over after the October general elections and prepared the ground for a comprehensive privatisation programme. The Government offered 108 out of 128 State Owned Enterprises (SOEs) for privatisation. During the period of six months, 66 SOEs were privatised, leaving 42 for the second phase. The Government also privatised two of the five nationalised commercial banks and initiated measures to sell in the next phase, some of the major infrastructure facilities, notably telecommunications and power stations.<sup>5</sup>

#### **The Institutional context for Privatisation**

In most of the developing countries of Asia and other part of the world, the preparatory phase of privatisation happened to be even longer than the execution of policy as they assess the complete process and fulfill all the conditions necessary for the privatisation. The comprehensive privatisation policy requires complete protection under prevailing law, through an Act of parliament, adoption or amendment of law or under legal statutes to transfer the ownership or control to the private sector. It requires evaluation of assets including audit of the accounts of the establishment and studies from both local and foreign consultants. It further includes the identification of enterprise to be privatised with recommendation for restructuring; and political and administrative effort to assess the reaction of employees and finally secure the cooperation of employees in implementing the programme of privatisation.

In 1991, the Government established the Privatisation Commission with all necessary authorities. The Commission evaluated the units to be privatised. The legal requirements for privatisation were fulfilled and cooperation of the employees were

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<sup>5</sup> Ibid

gained with mutual understanding and the same cases, with strong political pressure and political support from the top leadership. This effective and planned policy made it possible to privatise 66 industrial enterprises only in 18 months.<sup>6</sup>

## 2.2 Steps towards Legislations for Privatisation in Pakistan

The privatisation legislation is categorised as general and specific.

### Privatisation Legislation in General

There is little specific privatisation Legislation, which has been enacted to facilitate privatisation. To date, most of the privatisations have been carried out and implemented under various existing laws, including the laws under which public sector entities were nationalised in the year 1970s. Some of the important laws which facilitate privatisation are as under:

- a. The Transfer of Managed Establishment Order, 1978;
- b. The Hydrogenated Vegetable Oil Industry (Control and Development ) Act 1973;
- c. The Banks (Nationalization) Act, 1974;
- d. Pakistan Maritime (Shipping and Control) Act, 1974;
- e. The Protection of Economic Reforms Act, 1992;
- f. The Foreign Exchange Regulation Act, 1947;
- g. The Customs Act, 1969;
- h. The Income Tax Ordinance, 1979;
- i. The Transfer of Managed Establishment Order, 1978.

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<sup>6</sup> Hassan, Tariq and Azim Azfar, "Privatisation in Pakistan", Liberal Times, Vol. VIII, No. 2, 2000, pp. 28-74.

Although, there was no legislation (in the form of Ordinances promulgated by the President or Acts of Parliament) to constitute the Privatisation Commission and to define its scope of work and its powers and functions. The establishment of the Privatisation Commission under Article 173 (1) of the Constitution and its acts have been upheld by the Supreme Court in the case of M/s Calicon.

### **Privatisation Legislation in Specific.**

There is no specific co-ordinated legislation in Pakistan dealing with the privatisation of state-owned enterprises. The only case where some legislation in the actual sense of privatisation legislation enacted was the privatisation of the T & T Department. The privatisation of the T & T Department was achieved in the following manner:

- a. The Pakistan Telecommunication Corporation Act, 1991 ( The PTC Act) was enacted pursuant to which the T & T Department was converted into Pakistan Telecommunication Corporation Limited (PTCL) a statutory corporation owned and controlled by the Government. Under the PTCL Act, all employees of T & T Department stood transferred and all assets and liabilities of T & T Department stood vested in the PTCL;
- b. Thereafter, in January 1996, the Pakistan Telecommunication (Re-Organization) Act, 1996 (PTC Re-organisation Act) was enacted to provide for re-organization telecommunication system in Pakistan by establishing;<sup>7</sup>
  - i) The Pakistan Telecommunication Authority ( PTA) as successor to the PTC;
  - ii) The Pakistan Telecommunication Authority ( PTA) as a regulatory body;
  - iii) The Frequency Allocation Board (FAB) as Frequency regulator;
  - iv) The National Telecommunication Corporation (NTC) a corporation established for provisions of telecommunication

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<sup>7</sup> Pakistan Telecommunication Act, 1991. (PTC Act).

services within Pakistan on non-exclusive basis only to the armed forces, defence projects, the federal and Provincial Government and other Governmental agencies or institutions as the Federal Government may determine;

- v) The Pakistan Telecommunication Employees Trust, established for assuming the assets and liabilities of the PTC employees Pension Fund.

The PTC Re-organisation Act further provides for the regulation of telecommunication industry, transfer of telecommunication services to the private sector and for matters connected therewith or incidental thereto.

- 3) Through various vesting orders issued by the Ministry of Communication, the Government transferred certain assets of PTCL to PTA, FAB and NTC. All other assets of PTCL were, by operation of the PTCL Re-organisation Act, vested in the PTCL.
- 4) The Article of Association of the PTCL provides that its ordinary shares capital is split into A and B ordinary shares with the B shares to be sold to the strategic investors in the privatisation. The B shares carry enhanced voting rights in respect of the appointment of Directors of PTCL, which will allow the strategic investor to appoint the majority of directors and to assume management control. It should be noted here that PTCL especially override the Companies Ordinance, 1984 under which all shares of Pakistan company carry equal rights as to voting, dividends etc.
- 5) The government will continue to extract a significant influence over the future directions of PTCL mainly through the auspices of its agencies such as PTA and FAB and by continuing to promulgate policy and legislation for telecommunication sector generally.

It is noteworthy, that the PTCL legislation is the only instance where complex legislation has been enacted to facilitate the expeditious of a state owned entity.<sup>8</sup>

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<sup>8</sup> Butt, Rafique, "Constitution of Islamic Republic of Pakistan, 1973", Mansoor Book House, Lahore, 2002.



### 2.3 Constitutional efforts for Legislation of Privatisation Commission

The establishment and powers of Privatisation Commission to sell and/or dispose off properties owned by the Federal Government derive the force of law from Article 173 (1) of the Constitution of the Islamic Republic of Pakistan, 1973 which reads as under:

**(i) Art. 173. Power to acquire property and to make contracts, etc.**

Article 173 of the Constitution of Pakistan enumerates the powers to acquire property and to make contract in the following manner;

“The executive authority of the Federation and a province through an Act of the appropriate Legislature extend to the grant, sale disposal or mortgage of any property vested in and to the purchase of acquisition of property on behalf of the Federal Government or the Provincial Government for the making of contracts”.

1. All property acquired for the purpose of the Federation or of a Province vest in the Federal Government or in the Provincial Government.
2. All contracts made in the exercise of the executive authority of the Federation or of a Province be expressed to be made in the name of the President or the Governor of the Province and all such contracts and all assurances of property made in the exercise of that authority shall be executed on behalf of the President or Governor by such persons and in such manner as he direct or authorize. Although the power is primarily enjoyed by the President who is bound to act on the advice of Prime Minister.
3. Transfer of land by the Federal Government or Provincial Government be regulated by law. In case of sale, mortgage or disposal of property by the Federal or Provincial Government, no specific legislation is necessary for the exercise of executive authority for the purpose. If an act of the appropriate legislature holds the field, its provisions shall be followed by the executive authority in the matter of sale, mortgage or disposal of property vested in Federal or Provincial Government. However, the existence of an Act of the appropriate legislature is not a prerequisite for the exercise of the executive authority under Article 173.

The Constitution of Islamic Republic of Pakistan, 1973 enshrined and guaranteed various fundamental rights and in Article 18 gave the freedom of trade, business as every citizen has right to conduct any lawful trade or business. The Constitution framers guaranteed fundamental right but could not carry on the ideology of this concept and just after one year of giving this Constitution, they promulgated an Act which is called Bank (Nationalization) Act, 1974. It is very true that all the fundamental rights or provisions are always subject to law but this is clear negation of a fundamental right or requirement of Constitution by the same Government was an extraordinary example which does not have any precedent at all. This Government also had taken over all the major industries in Pakistan through Economic Reform Order 1972.

The establishment and the powers and functions of the Privatisation Commission have been challenged in the superior courts of the country. In *M/s Calicon (pvt) Ltd Vs Federation of Pakistan and 4 others (Unreported Case)*, the petitioner (Calicon Pvt. Ltd) filed a writ petition in the Honourable Lahore High Court, Multan Bench on the grounds, inter alia, that the Federal Government under Article 173 of the Constitution had no powers to make the sale of the properties owned by the Federal Government in the absence of appropriate legislation by the Parliament and, therefore, the acts of the Federal Government through the Privatisation Commission were invalid *ab initio*.

The arguments on behalf of the Federal Government was that the Privatisation Commission was constituted by the President of Pakistan pursuant to Article 173 of the Constitution. The function of the Privatisation Commission was specifically described in the notification of its Constitution. It was further contended that the executive authority of the Federal Government to sell its properties was not dependent upon any legislation.

The Lahore High Court, Multan Bench held as under:-

“No specific legislation is necessary for the exercise of executive authority under Article 173(1) of the Constitution for the purpose of sale, mortgage or disposal of the property by the Federal Government or, as the case may be, the Provincial Governments. Of course, if an act of the appropriate Legislature holds the field its provisions shall be followed by the executive authority in the matter of sale, mortgage or disposal of the property vested in the Federal or Provincial Governments. However, existence of an act of the appropriate Legislature is not a pre-requisite for the exercise of the executive authority under Article 173 (1) of the Constitution”.

In the Petition for leave to appeal against the judgment of the Lahore High Court, Multan Bench passed in the case of M/S Calicon, *supra*, the Supreme Court of Pakistan upheld the views of the Lahore High Court and dismissed the Petition.

**(ii) Role of Council of Common Interest under the Constitution of Islamic Republic of Pakistan.**

Council of Common Interests and its members are appointed under Article 153 of the Constitution of Islamic Republic of Pakistan. The CCI consist of following:-

- a) The Chief Ministers of all the Provinces.
- b) An equal number of members from the Federal Government to be nominated by the Prime Minister from time to time.

If the Prime Minister is a member of the council, he is the chairman of the Council but if he is not a member of the Council, the President appoints or nominates a Federal Minister, who is a member of a Council as Chairman of CCI.<sup>9</sup>

The Council is responsible to the parliament. The object of the Council of Common Interest is to strengthen and integrate federation and provinces, iron out their differences and provide relief to the provinces. The functions and powers of council of

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<sup>9</sup> Ibid

Common Interests are determined in Article 154 of the Constitution of Pakistan as under:-

1. The Council formulates and regulates policies in relation to matters in Part-II of the Federal Legislative list and if it is in relation to the affairs of the Federation, and also the entry in the concurrent Legislative List i.e. Electricity. The Council also exercises supervision and Control over other related institutions.
2. The decision of the Council is expressed in terms of the opinion of the majority. The Parliament issues direction to the Council of Common Interests through the Federal Government and these directions are binding on the Council. In case the Federal Government or a Provincial Government is dissatisfied with a decision of the Council, it refers the matter to parliament in a joint sitting and its decision in this behalf will be final. The words development and disposal of property being two different propositions having no nexus with each other and standing for different legal meanings, the Council of Common Interests has nothing to do so far as disposal of the property is concerned, which is governed by Article 173 of the Constitution. The Council law play advisory role if the Federal Government has intentions to develop a consensus of privatisation between the Federation and all provinces. This consensus brings stability and confidence in the economic policies and by this way the provinces start taking interest in the affairs of Federation, which develop better coordination between the federation and provinces.

### **Establishment of the Privatisation Commission**

In order to assist in implementing the privatisation policy, the Government constituted the first Privatisation Commission on 22 January 1991 pursuant to a notification of the same date issued by the Finance Division, Ministry of Finance and Economic Affairs, Government of Pakistan. This notification stated the composition and the terms of reference of the Privatisation Commission. Thereafter, the Privatisation Commission was reconstituted on 28 August 1993, and finally in March 1997 pursuant to similar Notifications. The terms of reference of the Privatisation Commission were

revised on 28 August 1993 and are currently applicable. These include, inter alia, the following :

- i) To undertake privatisation of all public sector enterprises in accordance with the privatisation policy of the Government;
- ii) To determine suitable modalities for carrying out privatisation transactions;
- iii) To appoint consultants ;
- iv) To invite offers from the private sector for privatisation of public sector enterprises, evaluate the same and formulate recommendations for approval by the Government ;
- v) To propose a regulatory framework for Government approval to ensure the smooth and efficient operations of the privatised units and protect the interests of the consumers ;
- vi) To recommend to the Government, a programme for the rehabilitation of the employees of the privatised units ;
- vii) Property on behalf of the Federal Government, or as the case may be, the Provincial Government, and to the making of contracts.

#### **2.4 Lack of enabling legislation-Complications in the process of privatisation**

To match the modern and liberal economic requirement, several laws were required to be amended to facilitate the process of privatisation swiftly and effectively. The transfer of Managed Establishment Order 1978 was the basic law for the privatisation but it required several changes as it was amended that it first enabled the previous owner of a nationalised enterprise to have the first right of refusal at the highest bid received for the unit, and the second made this right subservient to the right of the employees to match the highest bid.

To privatise the commercial banks, an amendment was required to be made in the Bank Nationalisation Act 1974. An amendment was made to transfer the management

with the sale of 26% of the shares and set up standards to establish new financial institution or commercial banks.

### **Collection of outstanding payment of privatised units.**

A big difficulty also arises in the collection of remaining/outstanding dues against privatised units. An amount of Rs. 2.34 billion is outstanding against 36 of the 84 units sold so far by the Privatisation Commission. Out of these 84 units, ten were sold by the government of Benazir Bhutto and rest by the government of Nawaz Sharif during his first and second tenure. Most of the defaulting units were sold by the government headed by Nawaz Sharif during his first tenure. The total amount was received by the Privatisation Commission, up to 2005, was not more than 16 billion rupees.

In the context of non-legislation support privatisation process suffered set back and losses in many cases. Some of the cases are listed below:-

#### **(i) Roti Plant Karachi**

The buyer was a defaulter and the bank guarantee would have to be invoked, if it is unconditional, it was doubtful, if the same was transferred to buyer to pursuance to Article 173(5) of the Constitution of Pakistan.

#### **(ii) A & B Oil Industries**

The sale agreement was insufficient to provide any legal protection against non payment of the balance price. The buyer instituted legal proceedings against the Commission and obtained a stay order from the Honorable Sindh High Court, Karachi.

**(iii) Pak China Fertilizers**

In this case the default was very substantial. The commission has to refer this matter for an arbitration by Federal Finance Secretary as the sale agreement do not help for taking action for breach of contract under common law due to the ambiguities in the same.

**(iv) Baluchistan Wheels**

The due date of the first instalment was 21-05-1993. The buyer had promised to make payment before 15-10-1993 which had not been kept.

**(v) Pak PVC Ltd**

The buyer had been declared defaulter and obtained an injunctive order from the court which is still pending and Commission has not been able to contest the case on its merits and to get national assets back from the declared defaulter.

**2.5 Legislation supporting the privatisation program in Pakistan**

Some important laws enabling the privatisation programme to proceed ahead are discussed as under:-

**(a) Pakistan Industrial Development Corporation Act, 1950**

This Act was promulgated for the purposes of promoting some industries which are the following:

1. Jute;
2. Paper;
3. Heavy Engineering other than Ship Building;
4. Ship Building;

5. Heavy Chemicals other than Fertilizers;
6. Fertilizers.

By the virtue of this Act the Government established a corporation to be referred as Pakistan Industrial Corporation. It was a corporate body with the share capital of 110 millions rupees, divided into one hundred fully paid up shares of 0.10 million rupees. The Corporation was empowered to increase the capital with the previous sanction of the Central Government. The general direction and administration of the Corporation and its affairs vested in the Board which exercised all powers and discharged functions of commercial and industrial interests as guided by the Central Government.

After the separation of the East and the West Pakistan, the government dissolved this Corporation and on 4<sup>th</sup> June, 1962, a new Ordinance was promulgated. The purpose of this ordinance was to provide the establishment of an industrial development Corporation to promote the economic and industrial development of the West Pakistan. Under this ordinance the corporation was responsible for the planning, promoting, organizing, and implementing the programs for the establishment of specified industries and for the exploitation of forest and fisheries. Similarly, the exploration, exploitation and development of minerals and mines or any material as entrusted by the Central Government to it, all remaining functions of Corporation were the same as it were provided in the previous Act of 1950.<sup>10</sup> Some other industries were also included in the purview of this ordinance. These were following:

- i. Sugar;
- ii. Cement;
- iii. Textiles Chemicals;

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<sup>10</sup> "Pakistan Industrial Development Corporation Act 1950" PLD Central Statutes 1950, Sec. 14 p 174.



- iv. Pharmaceuticals and Dyes-tuffs;
- v. Coal and Peat;
- vi. Exploitation of Marine Fisheries;
- vii. Industries based on forest products;
- viii. Cottage and Small scale industries.

To expedite the operation of Economic Reforms Order, 1972 an Act was promulgated on 24<sup>th</sup> April, 1974, referred as the West Pakistan Industrial Development Corporation Act, 1974 and under this Act a project was transferred to the Corporation specified in the Economic Reform Order, 1972. All the shares held by the principal corporation and its nominees in the capital of a managed company, transferred to the corporation specified in the Economic Reform Order 1972 which became the registered holder of such shares having the same rights under the Companies Act, 1913. This Act of 1974 acquired the shares of all the above mentioned Corporation and pace of economic growth was reversed by this Act of the Government in addition to the Economic Reforms Order, 1972.<sup>11</sup>

**(b) Economic Reforms Order 1972.**

The Government issued the Economic Reforms Order 1972 on 3<sup>rd</sup> January, 1972, with certain objectives as the Government considered appropriate under the changing economic conditions within and outside Pakistan. The first five years of seventies brought major changes in the economic policies of various countries including developing and under developed countries. To enhance the pace of economic growth, equitable distribution of resources and for better social services, the process of

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<sup>11</sup> Ibid

disinvestment, deregulation and privatisation had been completely estopped with the policy of nationalization.<sup>12</sup>

The basic objectives and features of the Economic Reforms Order 1972 were as under:-

- a. Islam enjoins equitable distribution of wealth and economic power and adhere their concentration in a few hand which keep the benefits of economic and industrialization development to privileged class and to detriment of common mind.
- b. The government is duty bound to ensure that the wealth and economic resources of the country are exploited to the maximum advantage of the common man and all those who control means of production are accountable to the people through their chosen representatives.
- c. The government also ensure to safe-guard the interest of all investors and provide redeeming the promises made by the various Governments since the creation of Pakistan.

Under the Economic Reforms Order 1972, the proprietary interest of the owner of the establishment were transferred to the Government. The previous owners were completely debarred from making any claim for any compensation against the Government and their right to sue in court of law was also taken away. The process of industrialization and economic growth had been further deteriorated by another step i.e. creation of Board of Industrial Management under Development of Industries (Federal Control) Ordinance, 1972. The Board had unlimited powers including to give instructions to the managing director of the establishment.<sup>13</sup>

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<sup>12</sup> "Economic Reforms Order 1972" PLD central statutes 1972, Sec. 12 p. 86

<sup>13</sup> Ibid

**(c) Foreign Private Investment (Promotion and Protection Act, 1976)**

The object of this Act was the promotion and protection of foreign investment in Pakistan. It applies to all the industrial undertakings in Pakistan having private investment established with the approval of the Federal Government after the first day of 1954. The Act provided that nothing in it shall be in derogation of any facility or protection specifically sanctioned by the Federal Government to foreign private investment in the case of a particular industrial undertaking or such facilities or protection as may be available to foreign private investment under a bilateral investment treaty.<sup>14</sup>

If the Federal Government take over the management of an industrial undertaking having foreign private investment or to acquire the ownership of the shares of citizens of Pakistan in the capital of such industrial undertaking any agreement approved by the Government relating to such undertakings entered into between a foreign investor or creditor and any person in Pakistan shall not be affected by such taking over or acquisition.

A foreign investor was allowed to repatriate the capital in the currency of the country from which the investment originated.<sup>15</sup> This repatriation facility was only extend in the following cases:-

- a) Foreign private investment to the extent of original investment,
- b) Profit earned on such investment and
- c) Any additional amount resulting from the reinvested profits or appreciation of capital investment foreign nationals employed in any

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<sup>14</sup> Foreign Private investment Promotion and Protection) Act 1976 PLD central statute 1976, Sec. 23 p 363.

<sup>15</sup> Ibid

industrial units having foreign private investment was also allowed to make remittances for the maintenance of their dependants.

**(d) Banks (Nationalization) Act, 1974**

The objective of this Act was to provide for the nationalization of banking business in Pakistan which took effect on the 1st day of January, 1974. This Act covered all the companies registered under the Companies Act, 1913 and transacting in or outside Pakistan, or a banking company incorporated by or under any law within the legislation competence of parliament including the State Bank of Pakistan, National Bank of Pakistan, Industrial Development Bank of Pakistan, and Agricultural Development Bank of Pakistan except a banking company incorporated outside Pakistan and transacting banking business in Pakistan, a Co-operative bank registered under the Cooperative Societies Act, 1925, Saving Bank under Government Saving Bank Act, 1873 or Corporation controlled by a province and carrying on banking business only within that province.<sup>16</sup>

This Act almost completed the process of Nationalization as all the major industrial enterprises and financial establishments came in the control and ownership of the Central Government. No room was left for the activities of private sector for the fear of Nationalisation of small private enterprises (which were taken in 1976 under three Ordinances whereby all rice mills and flour mills and cotton ginning mills were nationalized) and due to non availability of local capital market. The nationalized financial institutions preferred to invest in the government projects and private investor could not get any assistance from these banks to establish a private enterprise. Only those private sector investor could benefit, who had the right connection with the access to

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<sup>16</sup> Banks (Nationalization) Act 1974. Pakistan code vol 18, Second Amendment, Sec 3, 5-A and 5-B.1991 p 345.

lending authorities and this trend has resulted in Rs. 128 billion loss to the public money. Defaulters of loans of these nationalised banks were mostly belong to influential families of the country. The constitution of Pakistan Banking Council not only bypassed the authority of the State Bank but also proved to be a hurdle to the establishment of a better financial culture even in the days of deregulation, liberalisation and privatisation.<sup>17</sup>

**(e) Transfer of Managed Establishment Order 1978**

The purpose of passing this order was to transfer the management of acquired establishments to its previous owners with effect from 10<sup>th</sup> September, 1978. Under this order, the Federal Government was empowered to transfer the shares or proprietary interest of an acquired establishment under Economic Reforms Order 1972 through a public notice.<sup>18</sup>

This order has provided a step towards liberalization of the economy and market development. Although, some selected units were denationalized but it gave some confidence of an improved credibility of the Government to the private investors. The non-availability of local capital market and inequality among the acquired establishment could not produce very good results but it moved towards the process of liberalisation. The response of private sector improved by the passage of time as the Government took further measures to encourage deregulation, liberalisation which led to privatisation.<sup>19</sup>

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<sup>17</sup> Ibid

<sup>18</sup> Transfer of Managed Establishment Order 1978. Article 4, 6 and 8, Central statute. 1978 P 151

<sup>19</sup> Transfer of Managed Establishment Order (Amendment) 1991-92. Article 7-B Central statute. 1978 p.224

**(f) The Hydrogenated Vegetable Oil Industry (Control and development) Act, 1973**

This was an act to regulate the operation and future development of hydrogenated vegetable oil industry, so as to maintain at reasonable prices, supplies essential to the life of community while safeguarding the interest of the small investors in the industry. This Act clearly declared that all the industries would be carried on by the federal government, provincial government or by a corporation controlled by any such government to exclusion of all such persons except a foreign investor.<sup>20</sup>

This Act was a reflection of Economic Reform Order 1972 and the Government acquired all the managed establishments to accomplish the process of Nationalisation with the object to improve the economic growth and provide better services to its people, but the effect of this act along with other laws were framed for the nationalisation not only to establish the monopolies of the Government but also restrained the private and foreign investor to contribute in the economic development of the country. These steps failed to provide better services to the consumer as these acquired production and market demand was growing up, which resulted in shortage of the basic necessities in the market. The history also shows us long queues of the consumer to get their items of daily use and most of the time purchased in black market at much higher rate. The food stamp (Ration Card) scheme is an example, due to the steps towards Nationalisation.<sup>21</sup>

**(g) Hydrogenated Vegetable Oil Industry Ordinance/Act, 1991- 92.**

First amendment on 3<sup>rd</sup> September, 1991. The following sections<sup>22</sup> were inserted:

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<sup>20</sup> The Hydrogenated Vegetable Oil Industry (Control and Development) Act 1973. Sec 5-A, Central Statute. 1992 pp. 249.

<sup>21</sup> Ibid

<sup>22</sup> Hydrogenated Vegetable Oil Industry (Control and Development) Amendments Ordinance/ Act 1991-1992. Sec 5-A, p 248.

- i). Transfer of shares and proprietary interests etc. : The Federal Government was empowered under this Ordinance that if it considers it necessary in the public interest in respect of a managed establishment acquired by it under section 5, The Federal Government may through a public advertisement invite bids for the transfer of the shares or proprietary interests;
- ii). On receipt of bids in pursuance in an invitation under sub section 1 the Federal Government shall offer the transfer of the shares of proprietary interests to the previous management of such establishment on the highest bid so receipt and on such terms and conditions as it may deem fit;  
  
Provided that it is not necessary to make such an offer to the previous management in case the highest bid has been made by the management group of the employees of such establishment;
- iii). If the said previous management does not accept the offer made under earlier section within specified time, the Federal government enable to transfer the shares of proprietary interests to such persons and on such terms and conditions as it may deem fit;
- iv). The Federal government has discretion if it consider it necessary in the public interest so to do transfer the shares or proprietary interests in respect of such establishment to the management group of the employees of the such establishment at a price and on terms and conditions, settled between the federal government and such management group;
- v). When the proprietary interests or shares of a managed establishment transferred under earlier section the other provision of Act shall not apply to such establishment.

**(h) Protection of Economic Reforms Act, 1992**

This was an Act to provide for furtherance and protection of economic reforms with an objective to create a liberal environment for saving and investments or in other matters. It came into force on 28<sup>th</sup> July, 1992. The Government had introduced number of economic reforms to achieve a better environment for investment, and it was necessary to provide legal protection to those reforms in order to create confidence in the establishment and continuity of the liberal economic environment. It provided protection to all the reforms including policies, programmes, law and regulations announced, promulgated or implemented by the government on and after the 07-11-1990, relating to

privatisation of public sector enterprises and nationalised banks, promotion of savings and investments introduction of fiscal incentives for industrialization and deregulation of investment, banking, finance, exchange and payment systems, holding and transfer of currencies.<sup>23</sup>

This Law facilitated and unified investment regulations and introduced incentives and guarantees to both private local and foreign investment. It encouraged investors who wished to buy production units owned by the public sector, to establish share holding companies and buy public sector firms within the frame work of privatisation that has been protected under this Act. This Law provided protection to the interests of private, foreign investor and their assets.expropriation of privately owned assets.<sup>24</sup>

The impact of these laws are visible as the privatisation process has been accelerated in this decade and the flow of foreign investment is also reflected visibly in the economy of Pakistan.

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<sup>23</sup> Protection of Economic Reforms Act 1992. Central statutes Sec. 3, 5, 6, 7 and 11. p 250.

<sup>24</sup> Ibid



## CHAPTER 3

### LEGISLATIONS COVERING PRIVATISATION PROGRAMME.

#### 3.1 The Institutional arrangements for privatisation

The Government of Pakistan promulgated the Privatisation Commission Ordinance 2000, on 28<sup>th</sup> September 2000, which strengthened the status of Privatisation Commission as an independent corporate body for implementing the government's privatisation policy. This measure increased Privatisation Commission's accountability and independence and is expected to provide greater comfort to investors. It has also been specified in the ordinance that 90 percent of net privatisation proceeds would be allocated to debt retirement and 10 percent to poverty alleviation programs which also reflects the commitment of government to utilize the process of privatisation for a task oriented object. In November 2000, with a view to enhancing the status of privatisation and facilitating transactions, a Ministry of Privatisation was also created. The Chairman of the Privatisation Commission was appointed as Minister for Privatisation, while the Secretary of the Privatisation Commission became the ex-officio Secretary of the Ministry of Privatisation. This step of government was also seen as a confidence building measure for the investors as previously Privatisation Commission was under the administrative control of Finance Division.

The staff of the Privatisation Commission comprises of civil service officers and in-house consultants such as transaction managers, along with support staff. The staff reports to the Secretary. Certain policy and important decisions require approval of the Board of the Privatisation Commission, while a few key decisions require the approval of

the Cabinet Committee on Privatisation (CCOP), based on the recommendations of the Privatisation Commission Board.

**(a) The Board of the Privatisation Commission**

As provided under the Privatisation Commission Ordinance 2000, the Board of the Privatisation Commission is headed by the Chairman and comprises of nine other regular members. Eight of the regular members are prominent professionals from the private sector, all of whom are serving without remuneration. All the four provinces are represented on the Board of Privatisation Commission. The two government members include the Chairman and the Secretary of the Privatisation Commission. In addition, the secretaries of the respective divisions whose matters are being discussed at a board meeting are invited to be members for the issue under consideration as and when required.<sup>1</sup>

**(b) Cabinet Committee on Privatisation (CCOP)**

The Cabinet Committee on Privatisation was created in 1991. It has operated continuously except for the period of September 1998 to February 2000, when a Privatisation Board headed by the Prime Minister replaced it. This Committee of the Cabinet was headed by the Minister for Finance. Presently this Committee is headed by the Prime Minister and includes the Ministers for Commerce, Industries, Production and Special Initiatives, Information Technology and Telecommunications, Labour, Manpower and Overseas Pakistanis, Petroleum and Natural Resources, Ports and Shipping, Privatisation and Investment, Textile Industry, Water and Power and Adviser

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<sup>1</sup> Annual Privatisation Commission Report, 2005.

to the Prime Minister on Finance. It also includes the Deputy Chairman, Planning Commission.<sup>2</sup> According to its terms of reference issued in February 2000, the Cabinet Committee on Privatisation (C.C.O.P.) is created to:

- i. formulate the Privatisation Policy for approval of the Government/Cabinet;
- ii. approve the State Owned Enterprises to be privatised on the recommendation of the Privatisation Commission or otherwise;
- iii. take policy decisions on inter-ministerial issues relating to the privatisation process;
- iv. review and monitor the progress of privatisation programs;
- v. instruct the Privatisation Commission to submit reports/information/data relating to the privatisation process or any matter relating thereto;
- vi. take policy decisions on matters pertaining to privatisation, restructuring, deregulation, regulatory bodies and Privatisation Fund Account;
- vii. approve the reference price in respect of the State Owned Enterprises being privatised
- viii. approve the successful bidders;
- ix. consider and approve the recommendations of the Privatisation Commission on any matter;
- x. assign any other task relating to privatisation to the Privatisation Commission.

The above discussed institutional set up for privatisation in Pakistan reflects the commitment of government of Pakistan as Board of Privatisation Commission consisted of members from private as well as government sector and the Cabinet Committee on privatisation is the higher forum to decide matters related to privatisation, with the participation of representatives of some important ministries.

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<sup>2</sup> Ibid

Though the role of CCOP has been criticized in the judgment of Supreme Court in Pakistan Steels Mills case, yet its importance cannot be denied.

### 3.2 An overview of performance of Privatisation Commission

Starting from 1991, Pakistan has privatised as many as 143 public sector enterprises so far including seven banks. One major telecommunication corporation, one major power utility, 12 energy sector units, five newspapers, five hotels, one advertising agency and about 100 industrials units of various kinds.

Since January 2001, it has unloaded its shares and privatized 14 enterprises through the stock exchanges. This gigantic exercise spread over 15 years has earned for the state a paltry sum of \$7.28 billion, the bulk of which (about a little over \$5 billion) has come in the last seven years with more than half of these proceeds having been contributed by one single sale of Pakistan Telecommunications Corporation Limited (PTCL).<sup>3</sup>

Almost half of the remaining 40 Units in the public sector are scheduled to be privatized during the current financial year. Supreme Court's judgment in July, 2006 made the whole Privatisation process as doubtful. Infact, a total of about 41 units of various kinds including the Pakistan Steel Mills are still in the public sector. Of this, as many as 21 are scheduled to be sold during the current year starting with Pakistan State Oil (PSO) and OGDC in the first quarter, three (PPL, NIT, Services Hotel Land in Lahore) in the second quarter, eight (FESCO, Genco, Lasbella textile, Lyallpur Chemical fertilizer, Hazara Phosphate Fertilizer, HMC, HEC, PMTF) in the third quarter and as

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<sup>3</sup>Ziauddin, Muhammad, "Privatisation proceeds revisited", DAWN, Economic & Business Review, Islamabad, July 16, 2006, p. I.

many (SSGCL, SNGPL, IPC, PESCO, Morafco Industries Faisalabad, Tomato paste plant, PCPL and Sindh Engineering) in the last quarter.<sup>4</sup>

**(a) Steel Mills Case**

The Chief Justice of Pakistan in the petition filed under Article 184 (3) of the Constitution of Islamic Republic of Pakistan has asked the government agencies to provide all the documents regarding steel mills privatisation. In the Supreme Court, it was argued by the Government that:

“while any illegality in the process of privatisation was open to adjudication, the privatisation itself was not”.<sup>5</sup>

The Honorable Chief Justice of Pakistan rightly observed that the Constitution does not give unfettered powers to the executive authority and adequate checks and balances must be maintained among three branches of government in all sphere of their activity. If the Court has the power to strike down a law as ultra vires, then there is no reason why it cannot judicially review any government policy.

The Supreme Court’s decision neither struck down the privatisation law nor the privatisation policy, but Honorable Supreme Court only ruled on the legality of the privatisation transaction and in doing so it has forced to consider the Constitutional, legal and institutional framework for the formulation and implementation of privatisation policies.

The Supreme Court also reviewed the role of CCI (Council of Common Interest) and its importance in the matter of Common Interests including the privatisation. The

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<sup>4</sup> Ibid

<sup>5</sup> Wattan Party Versus Federation of Pakistan, SCMR 2006 918-921.

Supreme Court also directed the Federal Government to make it functional within six weeks of the said judgment.<sup>6</sup>

**(i) Constitutional requirement for privatisation**

Under the Constitution of Islamic Republic of Pakistan, the Council of Common Interests is required to formulate and regulate policies in relation to the matters provided in Part II of the Federal Legislative List. This list includes all undertakings, projects and schemes of such institutions, establishments, bodies, corporations and industries like the Pakistan Steel Mills, owned wholly or partially by the federation-notwithstanding the proposed exclusion of Pakistan Steel Mills from the purview of the Public Investments (Financial Safeguards Ordinance, 1960) via the Finance Bill, 2000.<sup>7</sup>

Beside this, the National Economic Council is required, inter alia, to formulate plans in respect of financial, commercial, social and economic policies. Neither of these constitutional requirements has been met in the formulation and implementation of the Privatisation Policy.

**(ii) Legal requirements for privatisation**

The Primary role for the establishment of Privatisation Commission is to implement the privatisation policy of the government and to implement its constitutive law. The Privatisation Commission Ordinance, 2000, (Privatisation Ordinance), mandates it to recommend privatisation policy and gives guidelines to the cabinet. The extent to which Privatisation Commission recommends privatisation policy guidelines to the

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<sup>6</sup> Baig, Hassan, "Impure Privatisation and development", THE POST, July 10, 2006, p. A-7.

<sup>7</sup> Hassan, Tariq, "Privatisation: need for a new approach", DAWN, Economic & Business Review Islamabad, July 8, 2006, p. 6.

cabinet and more importantly, the extent to which cabinet takes such guidelines into consideration while formulating the privatisation policy remain to be ascertained.<sup>8</sup>

The process of privatisation and deregulation are not harmonious with each other. What privatisation need is “deregulation” that is, more cost-effective and efficient regulation. Going from one extreme to another, from a publicly owned and controlled regime to a privately owned and controlled environment, is not desirable. Such laissez faire reforms create economic distortions and cannot be sustained in the long run.

**(iii) Institutional requirements for privatisation**

In the distribution of business among the various governmental divisions under the Government’s Rule of Business, the formulation of Business, the formulation of privatisation policies falls within the domain of the privatisation and investment division of the ministry of Privatisation and investment. What kind of useful role this division has been able to play in the wake of a more specific statutory role for the Privatisation Commission requires a deep analysis. There appears to be no valid reason for establishing and maintaining this administrative unit in the presence of Privatisation Commission.

Another confusion surrounding the privatisation policy lies in the division of functions and powers between the finance division and the privatisation and investment division. In terms of rules of business, the Finance Division has the overall mandate to advice on economic and financial policies. However it deals specifically with investment and regulation policies only, which appear to be more properly within the purview of the privatisation and investment division. While on the other hand, this division deals with the privatisation policies. However it does so independently of Privatisation Commission. Thus the main focus of the Supreme Court remained at:

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<sup>8</sup> Ibid

- i. That the valuation of the shares of Pakistan Steel Mills was not carried out in accordance with law;
  - ii. That certain concession was illegally provided by the Federal Government to the winning bidder after the completion of bidding;
  - iii. The Share Purchase Agreement was not valid as the assets of Pakistan Steel Mills were being purchased by an entity other than the winning consortium.
- (b) **Employees Management Group, Pak Saudi Fertilizers Ltd. and others Vs Government of Pakistan and others**

Before dilating upon the facts of the case it would be appropriate to highlight the background of the case.

The Employees Management Group, Pak Saudi Fertilizers Limited, had moved Constitutional Petition No. D-588 of 1996 before the Lahore High Court assailing the legality of the privatisation of Pak Saudi Fertilizer Project. Latter on case was transferred to High Court of Sindh as project was situated in the Province of Sindh. Thereafter, the plaintiff filed Constitutional Petition No. D-479/02 before this Court. Latter on this petition was converted into a civil suit.

The plaintiff Employees Management Group, Pak Saudi Fertilizers Limited, has filed suit with the following prayers:-

- i. Impugned Ordinance may be declared as repugnant to Constitution;
- ii. All steps taken by the respondent Government pursuant to impugned Ordinance be declared without lawful authority and be set aside;
- iii. Elimination of the petitioner group from the auction arena as per impugned memorandum be declared as an act without lawful authority.<sup>9</sup>

The Supreme Court of Pakistan, in its judgment dated 24<sup>th</sup> May, 2002 held as under,

- i. Impugned Ordinance be set aside;

<sup>9</sup> "Employees Management Group, Pak Saudi fertilizers Ltd. and others Vs Government of Pakistan and others". 2002 C.L.R. 1856.(Karachi)



- ii. Respondents may be permanently restrained from attempting any privatisation exercise unless a proper framework has first been set-up through permanent legislation by regular Parliament;
- iii. Respondent Government be permanently restrained even from setting up a legal framework which does not conform to Article 154 and other provisions which contemplates participation of the Provinces in formulation of policies and distribution of assets;
- iv. In the alternative, petitioner group be held entitled to exercise the right of first refusal on the basis of highest bid elicited through any auction process.<sup>10</sup>

In this case the learned Judge Mr. Justice Zahid Qurban Alvi, while deciding the case discussed the all issues rose by the plaintiffs and after perusing the record, he dismissed the application.

Beside other issues raised by the learned counsel for both the parties, the point of discussion was upon that whether the act of Privatisation is hit by the provisions of the Constitution of Islamic Republic of Pakistan, 1973 especially in relation to the Council of Common Interests?

Counsel of Pak Saudi Fertilizers, argued that there is a violation of the Constitution of the Islamic Republic of Pakistan, 1973. According to him all such actions which may directly or indirectly deal with the ambit of Council of Common Interests must be revised. In this respect Article 153 and Article 154 of Constitution of Islamic Republic of Pakistan were quoted. Article 153 deal with the CCI and Article 154 relates to the function of CCI, especially in relation to Part II of the Federal Legislative List. While deciding the case, Mr. Justice Qurban argued that “a fertilizer company located in Sindh does not necessarily come within the ambit of those matters which the CCI would

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<sup>10</sup> Ibid

be willing to look into or should look into as provided by the Constitution of Republic of Pakistan".<sup>11</sup>

### 3.3 Some other important legal aspects of privatisation programme

Legal issues permeate the whole privatisation process from preparation to implementation and follow up. Primarily, they are faced at two levels; the systematic level and transaction level. The existing legislation and the legal status of the State Owned Enterprises (SOEs) to be divested, analyzed to determine whether it permits privatisation and is compatible with the Government's objectives and whether it need to be amended. Certain laws need to be enacted to abolish a monopoly, regulate or deregulate the particular sector, strengthen the countries capital markets authorize the transfer of the particular SOEs to the private sector or organize the privatisation process itself some SOEs to the private sector or organize the privatisation process itself some SOEs may have legal status that does not allow or facilitate divestiture in which case a change in legal status will be required. If the ownership of assets is disputed, the right of contending parties should be clarified. All these factors required to be appropriately addressed before privatisation process of a unit starts.<sup>12</sup>

It is necessary to ascertain existing creditors, share holders, employees and other third parties rights. Loan, guarantees and agreement with development agencies and commercial banks routinely include provisions prohibiting the sale or other disposal of the government's interests or loss of control under a minimum percentage without the creditors consent. The reasons these clauses are used is that the state is often considered a

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<sup>11</sup> "Employees Management Group, Pak Saudi fertilizers Ltd. and others Vs Government of Pakistan and others". 2002 C.L.R. 1856.(Karachi)

<sup>12</sup> Geuslain, Pierre, "*Divestiture of State Enterprises*", An overview of the Legal Frame work, NH, 1992, p. 36

performance guarantor of the enterprise. Unless the SOEs or government guarantor is prepared to repay the outstanding loans, it is necessary to involve the creditors whenever such clauses are present a situation that frequently pertains to the privatisation of SOEs. Similarly, when assets are burdened with mortgages or no transfer of individual assets may be possible without the consent of creditors.

Another issue is government guarantees, which are commonly provided for SOE borrowing. What happens when the company is privatised? Will the guarantee be maintained? If the answer is yes, the creditors are offered an acceptable substituted private guarantee or the government assures repayment by the privatised enterprise. The government can also give assurance to the commercial banks for the repayment of the loans against special shares. The special share enable the government to ensure that certain decision affecting the operation of the enterprise are consistent with its policies, inter alia, to approve specific variations of existing provisions of the company charter such as dissolution, limitation on share holdings and etc.

These special shares are also used in cases where national interest so required and government wants to retain powers of approval over key actions by an enterprise after it has become a minority share holder or even after total privatisation. These special shares do not give right to the government to control over the management and operation of the enterprise. The rights of existing share holders also need to be considered and analyzed before offering the SOEs for privatisation.<sup>13</sup>

The charter of SOEs set up as mixed joint stock companies routinely contain restrictions on the transferability of all or certain class of shares, provide for pre-emptive

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<sup>13</sup> Sunita Kikeri, John Nellis and Mary Shirley, "*Privatisation: The Lessons of Experience*", The World Bank, 1818 H Street, N.W, Washington, D. C, 1992.

rights of existing share holders, and in similar categories. The exercise of pre-emptive or preferential rights of existing share holder is often difficult to reconcile with the justified requirement that share sales should be maximized through bidding or other competitive process. Either the shares are first offered on the basis of a predetermined price to the existing share holders or then exception to bidding requirement must be accepted. Or existing share holders are offered the first refusal at, or close to, a price resulting from the bidding in which case potential bidder might become substantially less interested in participating in the bidding.

Some jurisdictions it is prevailing practice that preferential of minority share holders could be exercised in accordance with the company's article of association, on the same conditions as the winning bidder would have acquired the stock being offered. In some cases, the government provides that the existing share holders may exercise their purchase option as provided by the article of association during a period of thirty days, from the on ward which the responsible ministry offers them at the purchase price, shares not so bought offered on the basis of bidding. Similarly, the government offers the preferential rights to enter into the bidding process, the existing private share holders, having participated in the bidding, are given the opportunity to match the highest outside bid, provided their own offer was not less than 90% of the bid to be equaled. Other commitments of the SOEs are also required to be fulfilled as contract with management and benefits of employees like pension, allowances and commitment to supplier's contractors and customers.

The identification of all these requirements as discussed above, is an essential preparatory step to the sale of an enterprise or its prior destructing. These requirements

should be fulfilled with the confidence of all parties i.e. Creditors, employees, and others before entering into the privatisation process. Satisfaction of all legal requirements is essential to avoid complications in privatisation or post privatisation phase.

## **CHAPTER 4**

### **ISSUES IN THE PRIVATISATION PROCESS - FROM LEGAL PERSPECTIVE**

#### **4.1 Stages of privatisation**

The privatisation process in Pakistan, which is aimed at selling government property in an open and transparent way with a view to obtaining the best possible price, varies on the basis of nature of asset being privatised, on the proportion of shares being offered for privatisation, and on whether the transfer of management is involved or not. The Board of Privatisation Commission decides as to what kind of process will be followed. These stages of Privatisation, which are common in major transactions, are as follows:-

##### **(i). Identification of the entity**

The first stage is the identification of the entity or list of entities to be privatised. In a typical transaction, the Privatisation Commission, in consultation with the relevant ministry, submits a summary of the proposed transaction to its Board. The summary justifies the need for privatizing the property, outlines the likely mode of privatisation, and sometimes seeks guidance on the issues relating to such matters as pricing, restructuring, legal considerations and the regulatory framework. Once endorsed by the board, it is submitted to the Cabinet or its subcommittee called as, the Cabinet Committee on Privatisation (CCOP) for approval.<sup>1</sup>

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<sup>1</sup> Annual Report, 2002 of Privatisation Commission of Pakistan. Government programme for transfer of public assets is unambiguously predicated on the principle of reducing its direct participation in commercial activities.

**(ii). Hiring of a Financial Advisor**

In major transactions, the process to hire a financial advisor is carried out by the Transaction Manager with the approval of the Board. Terms of reference for the Financial Advisor (FA) are finalized, expressions of interest (EOI) from prospective FAs are solicited, an evaluation team is constituted, and short listed firms are invited to submit technical and financial proposals. The evaluation team scores the technical proposals and the highest ranked firm based on both technical and financial scores is invited for contract negotiations and signing.

In November 2001, the Board of Privatisation Commission approved regulations for hiring a financial advisor in order to make more transparent the procedures that were largely being followed over the last decade.<sup>2</sup>

**(iii). Legal, technical and financial due diligence**

The next stage is to carry out the legal, technical, and financial due diligence. This is aimed at identifying any legal encumbrances, evaluating the condition of assets and examining the accounts of the company in order to place a value on the company. For most industrial units and some small transactions, this is done using in-house transaction managers and staff, or by sub-contracting out part of the work to a domestic legal, technical, or accounting firm.

However, for major privatisations e.g. in banking, infrastructure, or utilities, the FA carries out this function. Following due diligence, the FA finalises the privatisation plan. This may include recommendations on any needed restructuring and in addition specify the amount of shares or assets to be privatised. For major privatisations or when

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<sup>2</sup> Ibid

the proposed privatisation mode is different from the initial plan, the plan is then submitted to the Board, the CCOP or the full Cabinet for approval.<sup>3</sup>

**(iv). Enacting any needed regulatory and sectoral reforms**

For many major transactions, the ability to privatize and the expected amount of proceeds depend critically on the level of regulated prices for inputs or outputs of public enterprise and other sectoral or regulatory policies. For many monopolies or quasi-monopolies, the rule of game specifying the competition framework in the post-privatisation, the manner and type of regulation, and the institutions regulating them are key to investor's interest.

In addition to rules determining prices or tariffs, there may be rules determining standards, penalties for non-compliance, the extent, form and timing of any proposed deregulation, and evolving structure of the market following liberalisation. Clarifications of these rules and passage of required laws and regulations are necessary before taking transaction to market.<sup>4</sup>

**(v). Valuation of the property**

In order to obtain an independent assessment of the value of the property being privatised, the Commission depends primarily on external firms. The Financial Advisor, where engaged, carries out the valuation to obtain a "reference price" for the property. In other cases the Commission contract with an external valuation firm or accounting firm as specified in the rules on the valuation of property. The methods used for the valuation vary with the type of business and more than one method is used determining the value. These include the discounted cash flow method, asset valuation at book or market value,

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<sup>3</sup> Hassan, Tariq, "*Privatisation: need for a new approach*", DAWN, Economic & Business Review Islamabad, July 8, 2006, p. 6.

<sup>4</sup> Ibid



and stock market valuation. Despite using scientific methods, valuation remains more an art than a science.

The true value is dependent upon many difficult to quantify variables such as country risk, corporate psychology and strategy, investor specific synergies and perceptions of future macroeconomic performance. As the market forces can only determine the true value, therefore it is important to focus on designing appropriate transaction structure, on advertising in relevant media, in choosing and implementing appropriate pre-qualifications criteria for bidders, and in following an appropriate bidding process to obtain a fair price for the privatisation.<sup>5</sup>

**(vi). Pre-bid and post bid process**

Expressions of Interest (EOI) are invited by advertising in the relevant media. The Privatisation Commission Ordinance, 2000 spells out some of the advertising procedures. Depending on the kind of transaction, the EOI describes the broad qualifications criteria that potential bidders must possess. Those submitting an EOI and meeting the broad qualifications are provided with the Request for Proposal (RFP) package, containing the detailed pre-qualification criteria, instructions to bidders, draft sale agreement, and other relevant documents. Interested parties then submit a Statement of Qualifications (SOQ), which is evaluated to determine whether an interested party meets the requisite qualifications. Pre-qualified bidders are then given a specified period to conduct their own due diligence, following which they are invited to pre-bid meeting (s) where their questions and concerns are addressed.

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<sup>5</sup> Sultan, Ahmed, "Need for a robust privatisation", DAWN, Economic & Business Review Islamabad, September 24, 2006, p. VI.

The meetings are useful in determining the bidding procedure to be followed, for example open auction, sealed bids, or some combination and could even determine the proportion of shares that the Government may want to off load. The bidding itself is done openly with all bidders and media invited.<sup>6</sup>

**(vii). Post-bid Matters**

Following bidding and identification of the highest bidder, the Board of Privatisation Commission makes a recommendation to the CCOP as to whether or not to accept the bid. The reference price is a major determinant in the recommendation, although the Board may recommend the sale even if the offer price is below the reference price. Once the bid price and bidder are approved, the PC issues a letter of Acceptance or a letter of intent to the successful bidder, including the terms and conditions of the sale. Following Negotiations with the bidder, the PC then finalises the sale purchase agreement, collects the sale proceeds, and transfer the property. Under PC's current policy, privatisation proceeds are required to be paid upfront rather than over time, as had been the case for many earlier transactions. Within 30 days of sale, the PC is required to publish the summary details of the transaction in the official gazette.<sup>7</sup>

The above stages show that the privatisation process is lengthy for major transaction, mainly to assure transparency in the process. After receiving CCOP approval for privatisation, it typically takes about 18 months to close a major transaction, even when no major restructuring of the company is required. This includes about six or seven months to appoint a Financial Advisor and another three or four months for the FA to complete its legal, technical and financial due diligence and to propose a privatisation

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<sup>6</sup> Ibid

<sup>7</sup> Ibid

strategy. Following approval of the strategy, the marketing and bidding process may take five or six months, while it may take another two months after bidding to obtain approval, finalises sale documents and close the transaction. Additional delays in privatisation are often caused by waiting for the necessary regulatory framework and sectoral policies to be put in place for any needed restructuring to occur.

#### **4.2 Causes of failure in privatisation process.**

Some of the causes of failure of privatisation process are discussed below:-

##### **(a) Lack of transparency**

The transparency of the process is one of the major factors which may cause the failure of a privatisation process. There is no generally accepted definition of transparency and no privatisation process is wholly transparent. For example, government frequently retains the right to reject the bids without explanation and permit management and employees to bid, despite the huge information advantage they have. However, it is of course desirable to have as transparent a process as possible, subject to maintaining the efficiency of the programme.

##### **(b) Bidding process**

Bidding process has the big advantage of appearing transparent but already there has been a suspicion, in the auction of some hotels in Pakistan, that the pre-qualified bidders formed a cartel and agreed not to bid competitively. If bidder knows who they are bidding against, there will always be this risk. In essence bidding process must be transparent. Besides bidding is appropriate method in privatisation where they are appropriate in normal commercial business, for the sale of antiques, second hand cars,

liquidated stocks, etc but are generally not an appropriate method for sale of business or share.

To ensure a fair bidding process, conduct an arms-length relationship between the public entity administering the competition and the unit bidding on the contract. The particular bidder, whether a public or private entity, should be held to the same performance standards and be subject to the same financial penalties and incentives.<sup>8</sup>

**(c) Employees issues**

The restructuring of the companies to be privatised results retrenchment and perhaps unemployment or new owner may reduce the work force in the short term to lower the fixed expenditures. In certain cases the single most important issue or obstacle to privatisation is the impact on employment. Labour normally opposes privatisation because of the potential effect on jobs. Privatisation can be extremely difficult unless methods are adopted to counter these situations. It is pertinent to mention here that an SOE may not attract the private equity capital if excess employment issues are not resolved. The issue of unemployment resulting from privatisation along with question related to the transfer of employees from state to private sector labor regimes, measures should be adopted to minimize the negative effects on employment.

**(d) Constraint from the investor's side**

The investor in developing countries faces serious problems in buying enterprise. These difficulties may be in the following shapes:

- a. Capability of investor to buy;

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<sup>8</sup> Megginson, William, "Privatisation: think Again", Foreign Policy, No. 118, Spring 2000, pp. 14-63.

- b. The price of the enterprise;
- c. The right investor/buyer for the enterprise;
- d. Joint venture;
- e. The attractions for potential investors.

Capability of investor to buy the enterprises is very low as the local capital market is not available in most countries. In Pakistan the Water and Power Development Authority (WAPDA) has offered subscriptions to public sector in bonds with guaranteed interest, free dividend, and profit rate of 18%. Where the investor has enough funds to buy shares of public enterprise or to buy SOEs, the constraint of investor in regarding profit inefficiency, technology deficiency and production capacity.

The price of the enterprise is an important factor to work out the feasibility of the privatisation. If the government has fixed a price of the assets of an enterprise, then the Government and buyer will enter into negotiation which may end in favour of buyer. After privatisation, an enterprise lose government support and subsidies and the investor has to calculate these aspects like regulation, market strength, revenue prospects, incentive to the worker for better efficiency and earning capacity of enterprise.

Being public enterprise or SOE, various loans given to the enterprise were not utilized in revenue raising assets and the government also did not take any step towards financial restructuring. These liabilities make the private investor reluctant to finalize the sale transaction.

For the investor's purposes, if the cost of the unit is determined by a non-governmental agency and this figure after dividing on number of share will determine the value of each share. This technique of valuation, determine relatively low price which

benefited both i.e. the Government and the Investor. Most importantly, another factor is under-writing cost of privatisation. The higher these are, the lower would be the net price proceeds that the government gets.

**(e) Sale of national assets**

Another important issue regarding privatisation is that through privatisation a country can get money by selling the assets which are profitable, but on the other hand national assets are frequently decreased. This may be killing for a state, as state cannot show save reservoirs at any bad time.

**(f) Security risks**

Keeping in mind that asset of a country can be decreased; another hot issue in recent time is their security. Recently U.S government privatised her port to U.A.E based company. This make a big debate in the U.S and out side the U.S. Government officials declare it as very successful deal but Armed forces and intelligence in U.S is opposing this deal on the ground that now U.S cannot hide its security efforts, Armed forces equipments and its terrorist activities. The detractors in the UAE are saying 'see we told you so. The United States is lecturing us on opening our borders for goods, services, capital, ideas and people and yet at the very same time, there's a strong, let's say almost anti-Arab protectionist message coming out of Congress. This kind of security risk may fall in future when you're Telecommunication, Electricity and other assets come into the hand of a foreign company who is interested to earn more but not to secure your security.

**(g) Implementation**

The most and the final difficulty in privatisation process is effective and proper implementation of a comprehensive policy. Although in some countries the enterprises

have been identified but the pace of privatisation is not up to the mark as the final decision in several cases have yet to be made by the committee for privatisation or by the exchequer. The governments explain different reasons for this deadlock between policy enunciation and implementation. The reasons of this delay are also genuine as their rights are also affected by this mere policy of the Governments which need to be properly addressed.

As the basic argument of Union leaders is that the enterprise incurred losses entirely on account of gross mis-management and Government's wrong policies and that it was strived of technical know-how and finances. Labour unions give agenda to government to rectify these defects and always recommend not to privatize the enterprise.

On the other hand, politicians have always taken a different stand on these issues as it serves their political wishes and the agenda. But some times this agitation of political opposition is mere criticism, without any logic or strong argument.

The developing countries are deficient in different sectors like capital technology, market value, these factors can create monopolies of private enterprise, and some regulation may be adopted to curb this monopoly. The Governments while deciding the pace of privatisation is required to consider some important issues such as:-

- i. The enterprise should be fully privatised.
- ii. In case the enterprise is to be partly privatised, how much share is to be retained by government or as public holding.
- iii. The equity should be either held by the government or should be in the public sector.

- iv. The government should sell the profit making unit just to attract the investors or lower the burden of losing enterprise in beginning.
- v. Privatisation should be introduced in all fields or the public enterprises should be offered at some priority.

All the above factors make it a bit difficult for government to go ahead with privatisation or denationalization. The problem is not of indecision in developing countries, there is a great deal to be achieved by planning public enterprise on the basis of checks and balances between all necessary factors as well as balancing the interests of all stakeholders.

#### **4.4 Factors contributing to a successful privatisation programme**

##### **(i) Need for change.**

The objective of privatisation is to reduce the financial and administrative burdens on the government which had been increasing rapidly in developing countries. Inefficiency of public enterprises and low productivity requires a radical change in the management of public enterprise thus the private sector was called upon by the Government of Pakistan to undertake this exercise on the premise that they could operate in a more effective way without bureaucratic constraints.

Furthermore, the government believes that economic and social development of the country should not be its sole responsibility but more of a joint effort between government and the private sector. The shift in government policy was accepted by the private sector which has played a major role as the engine of growth. The co-operation between economic and social sectors have been resulted in positive economic development of the country, since the inception of privatisation programme in Pakistan.



**(ii) Realism**

The realization that practical steps have to be taken in the implementation of a privatisation program is important in ensuring its success. To encourage the private sector to participate in privatization, various concessionary terms have to be given, such as tax incentives and soft loans. These terms are to ensure a reasonable return on investment to investors so that projects become viable while tariff rates charged to the public are fair and equitable. Some projects may not be viable without government support but are necessary and required for the national interest; soft loans and other concessions will have to be given to the entities undertaking these tasks.

Concessionary terms are necessary in order to encourage companies to undertake social obligations to the public and because of the profit motivation of the private sector. In every privatization exercise, any increase in tariff is subject to government approval. In some cases, a privatized project is not viable unless it is linked with other government projects so that they can subsidize the whole privatization program. These realistic approaches can attract the private sector to participate in the privatization program more effectively and fruitfully.

**(iii) Determination and commitment**

The privatisation program of a country always symbolizes the government's determination to install a commercial spirit in the public sector so that the government is prepared to transfer its business to the private sector. The commitment and determination towards the privatization program by the both, the government and the people, is a basic factor to make it a successful program.

(iv) **Transparency of privatisation process**

Another important factor to contribute a successful program is its transparency. The key element for transparency is the system of checks and balances through inclusion of various sectors in the implementation process. For example having officials from the various ministries on the privatization Board, privatization task Force and Privatisation Commission and the Cabinet Committee on Privatisation reflects the intention of government for its commitment towards transparency.

(v) **Administrative separation**

Another factor contributing to the successful implementation of the privatisation program is the clear division of functions between Federal Government and ministries. In Pakistan, Privatisation Commission Board as being the central planning authority is directly under the Prime Minister and responsible for all matters concerning privatization. All privatization proposals have to be referred to the Privatisation Commission which coordinates the legal, financial and technical aspects of privatisation.

The government requires that all proposals initiated by the private sector be submitted to the Privatisation Board for further consideration. The ministries and departments are, therefore, required to send all proposals, received from the private sector to the Board of Privatisation Commission.

(vi) **Generous initial terms**

Generous initial terms should be taken to affected employees in private entities to ensure the success of the privatisation and also to provide added encouragement and attractions to employees who joined the private sector. Experience has demonstrated that privatization has not resulted in layoffs, but must result in wage increases. This can help

in changing employee's outlooks on privatization. By this way Labor Unions can become more supportive of the policy.

**(viii) Sovereign risk**

One of the most important factors in privatization policy hangs on political and social stability. Government must be clear and well-planned policy and action plan on privatisation, getting foreign investors and marketing the privatization policy should not be different tasks. The investment climate must be conducive to foreign investors and there should be no foreign exchange risk. There should not be any restrictions on repatriation of income and capital. Government must take measures to make the arrangements for high liquidity in the capital market.

In countries like Pakistan it is necessary that government should take measures to the continuity in the development works and in all mega projects. Investor will always invest the money in a country where investors are free to invest and there is stability in the governments.

**4.5 Arguments in favor of privatisation.**

Proponents of privatisation argue that government providers have no real incentive to hold down costs or to provide quality service. Private firms, on the other hand, are motivated by profit that depends on holding costs down. The lower the cost incurred by the firm in satisfying the contract, the greater the realized profit. Private providers are also motivated by competition from other potential service providers. Competition between potential private suppliers to win a contract generally results in the lowest cost to the government and the taxpayer for the specified level of service. Competitive markets are rooted in private property, and there is no way to stimulate

competitive conditions under conditions of government financing or government production.<sup>9</sup>

Privatisation, when correctly conceived and implemented, foster efficiency, encourage investment which causes new growth and employment and free public resources for investment in infrastructure and social programs. Privatisation is a complement to, not a replacement for the other aspects of the development of the private sector in many countries. Others arguments in favor of privatisation enumerate some lesson of experience which are as follows:-

- a. Private ownership itself makes a difference as some SOEs have been efficient and well managed for some periods but government ownerships on the other hand seldom permits sustained good performance over more than a few years.
- b. The process of privatisation, although not simple, can work and has successfully worked as proved from different enterprises in a variety of settings including poor countries.

Developing countries have created SOEs for many reasons i.e. to balance or replace weak private sector, to produce higher investment ratios and extract a capital surplus for investment in the economy, to transfer technology to strategic sectors, to generate employment, and to make goods available at lower costs. Although many SOEs have been productive and profitable, a large number have been economically inefficient which causes heavy financial losses and absorbed disproportionate shares of domestic credit. Some other argument in favor of privatisation are that privatisation companies grow more rapidly and are better able to contain their cost than before privatisation.

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<sup>9</sup> Starr, Paul, "*Limits of privatisation, in privatisation and deregulation in global perspective,*" New York Quorum Books, 1990.pp. 23-34.

The decision concerning what to privatize and what to reform should thus tend toward privatisation as the outcomes most likely to produce positive gains.<sup>10</sup>

#### **4.6 Arguments against Privatisation.**

It is argued that privatisation can have all of these benefits if skillfully done, but some governments have lost sight of primary objective and have pursued privatisation in name only, undermining the goals they wish to achieve. Ultimately privatisation is a political process and any move toward privatisation, no matter what ever the economic benefits, will have political repercussions especially if privatisation causes worker's displacement. The burden of privatisation falls heavily on the public workforce because their jobs and income are at risk, public employees and their unions strongly oppose privatisation.

In spite of accelerated growth at the local level as a result of privatisation, in many countries, there has been strong opposition from the labor unions. Consumer and institutional dissatisfaction with privatisation most often occurs when the service directly affects people's welfare as opposed to such services as trash pickup. The consumers complain about the higher and higher prices associated with various managed health care plans and for-profit hospitals. Also under attack is the privatisation of a wide variety of government services designed to help a country's poor citizens. In the countries like Pakistan, India and Bangladesh where there is no appropriate regulatory framework present, privatisation can hurt consumers and reduce public support for privatisation.

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<sup>10</sup> Sunita Kikeri, John Nellis and Mary Shirley, "*Privatisation: The Lessons of Experience*", The World Bank, 1818 H Street, N.W, Washington, D. C, 1992. pp 6-48.

Some critics argued that the privatisation could increase pollution. They argued that private enterprises may have more incentive to undertake polluting activities than co placement SOEs that do not have to worry if they make losses. Often SOEs leave idle valuable assets that private owners would exploit. Secondly private enterprises may be more likely to bribe regulators in order to evade pollution controls. They are more likely to have the money than SOEs and they may not have the scruples of the publicity employed manager.<sup>11</sup>

### **Report of Amnesty International**

Amnesty International in its annual report of 2005 has criticized the privatisation. In the said report Amnesty International stated that in recent years it has become increasingly common for states to pass on roles that they have been traditionally performed by them such as the provision and delivery of essential services, to non state actors. This includes the provision of water, electricity, educational and health care services.

Privatisation of essential services have become controversial in recent years due to concern regarding access, discrimination, cost, lack of transparency in awarding contracts and lack of state regulation. There is also an increasing reliance on privatisation, which is often recommended by international financial institution and donor countries. Recent work on different countries have shown that some human rights violation are directly linked to privatisation since the effect of privatisation may create hardship which may lead to social unrest and repression. In some cases, privatisation also

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<sup>11</sup> Ibid

alleged to impact negatively on economic, social and cultural rights through the denial of access to essential services to particular groups, especially the poor.<sup>12</sup>

Amnesty International does not support or oppose privatisation, just as it does not support or oppose state ownership. Amnesty International is concerned about human rights considerations regarding the delivery of essential services which are essential for enjoyment of full range of human rights. Amnesty International has highlighted a set of human rights considerations that governments should take into account when considering and implementing privatisation of services central to realization of human rights. These principles apply to state and private sector providers, while reinforcing the obligation of the state to regulate and to respect, protect, fulfill and promote human rights of the citizens.

#### **4.7 Possible outcomes of privatisation.**

The benefits from properly executed privatisation have proved considerable, as revealed by cases in Latin America, Africa, Asia and as well as in individual countries like France, Japan and the United Kingdom. In a research project report, it was found that privatisation significantly improved domestic welfare in ten of the twelve cases when analyzed. Productivity went up in nine of the twelve cases and stayed the same in the other three. Relaxation of the investment constraint and diversification into previously forbidden products and markets resulted in massive expansion in a number of cases. Workers in the firms were not worse off after sale and in all three cases were significantly better off. Buyers made money, but the other stakeholders in the process also gained. Consumers benefited or were no worse off in all but five cases.

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<sup>12</sup> Amnesty International report on Human Rights and Privatisation, 2005.

Other experience show that privatised firms tend to exhibit higher profits, faster growth and greater cost containment. Improved management, autonomy from political interference and greater access to investment capital was important factors to achieve a better outcome.<sup>13</sup>

Two main factors affect the outcomes, in terms of economic productivity and consumer welfare, of privatisation. If proper privatisation program is implemented there will be better outcome such as,

- a) A dramatic increase in investment;
- b) Improved productivity due to better labor-management relations, improved incentives, a reduce work force and internal reorganization;
- c) Output prices change due to competition and effective regulation.
- d) Satisfaction of consumers and investors.

This is not to say that privatisation always and only produces positive results; negative outcomes may also occurred. It is the basic task of governments and the agencies assisting them, including the foreign donor agencies such as World Bank etc, to provide the enabling enviorment for the transaction in such a way that the potential of privatisation is fully exploited.

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<sup>13</sup> Megginson, William, “*Privatisation: think Again*”, Foreign Policy, No. 118, Spring 2000, pp. 4-9.



## CHAPTER 5

### CONCLUSION

#### 5.1 An appropriate legislation

A successful privatisation programme requires a multidimensional strategy, enabling environment and a commitment of government with full confidence. In view of discussions held in previous chapters, we can identify following steps, which should be the minimum requirement for a successful privatisation programme.

Keeping in view the International perspective as well as practices in Pakistan as discussed in previous chapters an appropriate legislation is required to improve the efficiency of privatisation programme. These are as under: -

- i. The powers of privatisation commission should be strengthened and enhanced by establishment of a permanent Privatisation Board which should be empowered to virtually take all decisions relating to privatisation.
- ii. Laws may need to be enacted to abolish a monopoly, regulate or deregulate the particular sector, strengthen the country's capital market, authorize the transfer of particular SOEs to the private sector or organize the privatisation process itself.
- iii. A separate tribunal or special court should be created to handle the cases filed by or against the Privatisation Commission and those pertaining to the privatisation process to avoid delays in litigation in various courts of law such tribunals should be properly empowered.
- iv. There must be specific legislation for big privatisation units, particularly those pertaining to infrastructure.
- v. There should be a general legislation empowering the commission to frame schemes for privatisation of small and medium scale industries-subject to certain overriding criteria to assure transparency, fairness and competition.
- vi. Qualifications of bidders and their source of income must be given in detail in print media and an independent performa under Privatisation Commission must be submitted by the bidders. Any wrong information by bidders should be subject to penalty under Privatisation Commission Ordinance.

- vii. The Privatisation and Investment Division of Ministry of Privatisation should be abolished, as there is no administrative role of this Division in view of a more specific statutory role of the Privatisation Commission.<sup>1</sup>
- viii. Specific legislation should provide measures to discourage anti competitive behaviors i.e. cartels, collusive practices among bidders. The penalties for such practices should have legal cover.

## 5.2 Recommendations for a successful privatisation programme

There is relatively strong commitment to privatisation programme in Pakistan with the policy of Government to withdraw from activities which could better be performed by the private sector. However, this clear policy direction is not reflected in the methods of privatisation, adopted in the past. Privatisation process is one that is highly political in nature and must be carried out carefully by policymakers. The recent history of privatisation offers a great learning opportunity for future policy makers. Steps are required to ensure that privatisation methodologies are appropriately adopted to achieve the overall policy objectives more effectively.

### (i) Clarity in objectives of privatisation

A government may be tempted to sell off state-owned enterprises (SOEs) to raise money to pay off foreign debt, simultaneously it may also wish to encourage competition, extend private ownership, modernize old industries and replace timid bureaucrats with innovative entrepreneurs. Privatisation can have all of these benefits if skillfully done with clarity in objectives of policy makers. History shows that some governments have lost the primary objective and have pursued privatisation in name only. They lost the very goals of privatisation which they had wished to achieve. For example, governments have

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<sup>1</sup> Hassan, Tariq, "Privatisation: need for a new approach", DAWN, Economic & Business Review Islamabad, July 8, 2006, p. 6.

sold minority shares of fairly profitable SOEs to leading industrialists or friends of administration which were not subject to market forces, resulting in failure of programme.

**(ii) Categorization and privatisation**

The policy makers are required to categorize and prioritize the sectors and industries to be privatised on long term, medium term and short term basis. This privatisation process should be based on a genuine need assessment, survey of the whole sectors, market trends, international best practices, impact on consumers, the potential of investors and the capacity to manage the affairs in post privatisation phase.

**(iii) Mode of privatisation**

There are varieties of privatisation modalities as discussed in previous chapters. Different modes of privatisation will bear different outcomes. The effects of privatisation are largely a function of the privatisation modes which are used. Careful selection of these modes is a key factor in any successful privatisation programme. By this finding we can easily suggest that privatisation may have more positive effects if the modality of divestment is applied in cases where public agencies are to be privatised. Changing nature from the government department to a company owned by shareholders may be expected to produce significant changes within the organization as the pressure for profit making is greater.

**(iv) Distribution of wealth**

As privatisation may bring about wealth distribution problems, this issue needs to be addressed because it may lead to major income imbalances between and within ethnic groups. To address this problem, the government can allocate a certain proportion of the

money to the lower income group and set up a fund to help these people to acquire the shares allocated to them. This very necessary move will help to address problems of income distribution as well as to get this wealth into main stream investment.

This workers fund should be exclusively limited to families with a certain level of income. The proposal will not only help to reduce the gap between the rich and the poor but also help these poor and needy people to get involved in business sector.

Government also makes compulsion for new owners who purchased a company that special money will be given in a trust which not only help the poor but can finish gap between these two classes of people. The reduction in income disparity should be the concern of government since privatisation should be the concern of government agencies involving the sale of equity can transfer the ownership of profitable companies to a small group of individuals who have the financial capability to acquire the shares of these companies. If such a bad trend were to persist, it would be a grave mistake. If the government will create only a few millionaires while the majority remain below poverty line, this will result in widening of gap between the haves and the have nots.

### **5.3 Conclusion**

The Supreme Court's decision on privatisation of the Steel Mills and declaring it as "void and no legal effect" is a land mark judgment in the judicial history of Pakistan, wherein, the whole privatisation process has been thoroughly examined and various weaknesses in the system as discussed in previous chapters came into discussion. In the current wave of liberalization and privatisation, where markets have assumed a central role, the corruption and corrupt practices are common problems, yet to be addressed by governments in the developing countries. Good governance has become a rare

commodity in these countries. Good governance is one that is perceived and accepted as a legitimate commitment to improve the welfare and social condition of the citizens. A fundamental prerequisite of such governance is an independent, reliable and efficient judicial system as well as the honest law enforcing agencies that effectively carry out court decisions. History has witnessed that society without effective and impartial accountability is prone to corruption, maladministration and economic stagnation.

A well functioning legal frame work is very important for a successful privatisation policy. Creation of such a framework should have some important aspects of business legislation i.e. property law, competition law, corporate law, dispute settlement, enviroinmental legislation etc, defining property rights, modifying the legislation of SOEs to be divested and developing laws for organizing the privatisation process. In countries with market-friendly policy framework and relatively well developed institutional and regulatory capacity, privatisation will be both easier to undertake and more likely to yield financial and economic benefits.

Poorly managed privatisation has sometimes led to unfavorable out-comes as discussed in previous chapters. Poor macroeconomic conditions, combined with excessive sweeteners in the term and conditions of sale have reduced competition and efficiency. The distributional effects of privatisation have yet to be thoroughly analyzed, but the possibility that assets will be concentrated in the hands of small elite is a legitimate concern. Sales without competitive bidding, at predetermined concessionary price, or into a protected market have helped enrich well connected individuals. Even when the well connected were not given protection or a particularly discounted price, the

lack of open bidding may have meant that the best qualified people were not given an opportunity to acquire the enterprises and put them to productive use.

In recent years privatisation is considered to be the best possible solution for the governments to overload the burden. What privatisation need is a fair and reliable checks and balances. If this system works properly, no doubt, this would produce good results in coming years, but where this does not work properly, malpractices and malafides can be seen.

In view discussions in previous chapters, I would like to make some recommendations to make the privatisation process more efficient, more reliable and benefited to both, the Government and the people. The recommendations are as follows:-

- i. As the primary object of a private company is to earn more profit and not to provide to the public essential services such as water, electricity, strategic national assets, health and primary education at cheaper price thus these should not be privatised.
- ii. Before privatisation any asset, Government must take measures to built confidence between the government and the people. A comprehensive public awareness programme be initiated in printed media and other sources so that doubts in the minds of people be removed and transparency be seen by all stakeholders.
- iii. The criteria laid down for Privatisation programme in Pakistan be revisited and the clumsy or hasty manner as Pakistan Steel Mills was privatised be abolished. The observations of apex Court in its Landmark judgment declaring the privatisation of steel mills as “indecent haste” should be considered in letter and spirit by the Privatisation Commission and Government of Pakistan.
- iv. Government should ensure transparent privatisation, leading towards equity and development through strategic and long term vision.
- v. Corruption and corrupt practices be removed from the privatisation programme. This goal can only be achieved if we make free markets, free press, democracy and strong judiciary. These are the key elements which definitely help to curb corruption on large scale, which is the ultimate desirable goal.

- vi. Privatisation may have more positive effect if the modality of divestment is applied in cases where public agencies are to be privatised. Changing nature from the government department to a company owned by shareholders may be expected to produce significant results within the organization as the pressure for profit making is greater.
- vii. Government must ensure checks and balances to the whole of privatisation programme. A fundamental prerequisite of a transparent and reliable privatisation programme is an independent, reliable and efficient judicial system as well as the honest law enforcing agencies that effectively carry out Court decisions.

Though we have tried to cover important legal issues in privatisation process yet there are other areas which may be explored in future. Due to lack of time and resources, we cannot cover all areas but it made an opportunity for students to take guidelines to do some more work in this area. There are some important areas which I would like to be thrashed out in future study. These may be Stakeholders interests, Consumer interest, Pre-litigation phenomenon in privatisation, Introduction of Alternate Dispute Resolution in privatisation to avoid long litigation and interests of investors and what are possible suitable mechanism in privatisation as compare to developed countries.

Hopefully this can open the floodgates for research on the privatisation process in developing countries especially in Pakistan. Factors that contribute to the success of privatisation as discussed in previous chapters of the study can be enumerated and explored more and a model of privatisation can be developed by comparing different countries privatisation programme. The future holds bright prospects for these aspiring to undertake research in the field of privatisation.

In view of above recommendations, the Government of Pakistan is required to adopt a long, medium and short term privatisation programs with proper checks and balances and without any legal lacunas. This can only be achieved if all the stakeholders; Public, Investors, Privatisation Commission, CCOP, Media and Judiciary play their due role in the process of privatisation. The government should also ensure the effective delivery of privatisation objectives by the private investors in the Post-Privatisation era, specially laws/rules are required to be enacted to safeguard

consumer's interests and effective grievances redressal forums should be provided free of cost to the general public in the Post-Privatisation era and it would be a mistake to make privatisation an end point. It is only one step in the reform process.



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