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PRIVATIZATION IN THE LAND OF BELIEVERS: The Political Economy of Privatization in Pakistan[1]

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Abstract

Despite theoretical justifications and empirical evidence that state owned enterprises have played an important role in late development, as well as over three decades of evidence that privatization programmes since the 1980s have had mixed results at best, international financial institutions continue prescribing privatization as panacea for developing countries. Pakistan is an interesting case to understand why privatization is still embraced, because it is one of a set of developing countries that have whole-heartedly implemented Washington Consensus policies. In this context, we analyse privatization in two key economic sectors in Pakistan, energy and banking. Using qualitative and quantitative data, we describe the motivations behind these privatizations, the process by which they were carried out, and analyze the post-privatization performance of these organizations and sectors. We find that in both cases a) the privatizations failed not only with respect to their stated aims, leading to a decline in national productive capabilities, but also had adverse distributional consequences, shifting the rewards to the buyers while the risks and costs remained with the public sector, and b) the suboptimal outcomes of the privatizations went largely unchallenged aided by a prevalent neoliberal view amongst the country's economic policy makers and intelligentsia. Our analysis sheds new light on the process by which privatization in the absence of a state with the capacity to discipline business interests, has enabled these interests to obtain state-sponsored rents without bringing any of the associated benefits for economic development.

Introduction

It is widely recognized that many successful late developing countries have boasted, and benefited from, a substantial state owned sector during their rapid growth periods. Amongst the 'East Asian Tigers', for instance, Taiwan has had one of the largest public sectors in the developing world outside the oil producers, and achieved one of highest growth rates in the postwar period[2]. Similarly, Korea had a very large state owned sector with crucial intermediate inputs such as steel, oil, coal, gas, electricity, and fertilizers having been supplied by public enterprises. Singapore's government owns controlling stakes in a host of highly efficient and profitable enterprises called 'government-linked companies' which extend to sectors beyond public utilities and infrastructure such as shipbuilding, aviation, engineering, shipping and banking[3]. Finally, China has refused to close down its State-owned enterprises (SOE), choosing instead to opt for greater managerial autonomy and larger scale[4].

These countries have been emulating Western models where SOEs historically played a key role. Post-war growth in many European economies including Austria, Norway, and Italy, was achieved with large SOE sectors often being at the forefront of technological modernization, until at least the 1980s. France and Finland are two notable examples. In France, well-known firms such as Renault, Alcatel, Usinor, Thomson, Thales, and Elf Aquitaine led technological modernization and industrial

[2] H-J. Chang, and I. Grabel, *Reclaiming development: an alternative economic policy manual*, Zed Books, London, 2004.

[3] J-S. Shin, 'Globalization and challenges to the developmental state: A comparison between South Korea and Singapore', *Global Economic Review*, 34 (4), 2005; H-J. Chang, *State Owned Enterprise Reform*, United Nations, Department for Economic and Social Affairs (UNDESA) 2007 p.9.

[4] P. Nolan and X. Wang, 'Beyond Privatisation: Institutional innovation and growth in China's large state-owned enterprises', *World Development*, 27(1), 1999, pp. 169-200.

development under state ownership in the areas of automobiles, telecommunications, steel, electronics, defense, and oil and gas[5]. Similarly, in Finland, SOEs led technological modernization in forestry, mining, steel, transport equipment, paper machinery and chemical industries[6].

However, following the 1970s oil shocks and economic crisis in the developed world, the social democratic 'mixed-economy' model and Keynesian aggregate demand management was increasingly questioned, ushering in the rise to prominence of monetarist, public choice and property rights theories, or what has been termed 'neoliberalism'. An overall change in development thinking amongst IFIs and local policy makers was seen, with trade, financial, and labor market liberalization and deregulation now dominating the agenda. These views were codified in the late 80s in the now infamous 'Washington Consensus'[7].

As part of this wider shift, a spate of privatizations was pushed through. The campaign was particularly noticeable in developing countries where desperate economic circumstances and dependence on loans from international financial institutions (IFIs) left little choice but to sell SOEs[8]. Thus, across many Latin American countries state assets in sectors ranging from manufacturing, finance and mining, to social services were sold off, with Chile taking the lead, followed by Mexico, Argentina, Bolivia and Brazil[9]. In Sub-Saharan Africa, although few governments explicitly adopted an SOE divestment strategy, there was still a significant amount of privatization, especially in countries like Mozambique[10] Ghana and Nigeria[11], while privatization in East Asia lagged behind[12]. In South Asia, Pakistan and India led the proceedings, but while India generated revenue largely from minority share sales, retaining strategic control, Pakistan handed over strategic control in a wide variety of sectors[13].

After more than three decades of privatizing SOEs, however, the outcomes have been mixed at best. In fact, much research has shown how privatization has not yielded the expected outcomes[14] and state-owned enterprises are not detrimental to economic growth[15]. Still, unvarying privatization advice is continuously dished out by

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[5] M. Berne, and G. Pogorel, 'Privatization Experiences in France', Paper presented at *CESifo Conference on Privatization Experiences in the EU*, Cadenabbia, Italy, November 2003; These firms were privatized at various points between 1986 and 2000.

[6] J. Willner, 'Privatization and State Ownership in Finland' *CESifo Working Paper*, no. 1012, Ifo Institute for Economic Research, Munich, 2003.

[7] J. Toye, 'Changing Perspectives in Development Economics', In *Rethinking Development Economics*, H-J. Chang, (ed), Anthem Press, London, 2003.

[8] W. Megginson and J. Netter, 'From state to market: A survey of empirical studies on privatisation' *Journal of Economic Literature*. June 2001; S. Kikeri, and A.F. Kolo, 'Privatization: trends and recent developments' World Bank Policy Research Working Paper No 3765, 2005.

[9] Although most of these countries have recently made policy reversals in this regard ; A. Estache, and L. Trujillo, 'Privatization in Latin America', in *Privatization: Successes and failures*, G. Roland (ed), Columbia University Press, New York, 2008, pp. 136-167.

[10] C. Cramer, 'Privatization and adjustment in Mozambique: A 'Hospital Pass?'', *Journal of Southern African Studies*, Vol 27, Issue 1, 2001.

[11] P. Bennell, 'Privatization in sub-Saharan Africa: Progress and prospects during the 1990s', *World Development*, 25(11), 1997, pp. 1785-1803; S. Kikeri, and A.F. Kolo, 2005.

[12] W. Megginson and J. Netter, 2001; Although a high percentage of privatization proceeds came from China, it has privatized mainly its public SMEs, leaving most large scale SOEs intact.

[13] S. Kikeri, and A.F. Kolo, 2005.

[14] A. McDonald, and G. Ruiters, eds. *Alternatives to privatization: Public options for essential services in the global South*. Routledge, 2012.

[15] H. Jalilian, and J. Weiss, 'Policy Arena: Bureaucrats, Business and Economic Growth', *Journal of International Development*. Sep 1997 pp. 877-85.

multilateral agencies such as the World Bank and IMF as panacea for economies characterized by fiscal crises and underdeveloped markets. Even within developing countries, there appears to be little resistance to it except from labor unions.

This trend is not confined to academic scholarship. At a more popular level, it is interestingly captured in a 2012 issue of the Economist magazine, an unabashed evangelist of free markets. In its 21 January 2012 issue, the Economist magazine[16] wrote:

> State capitalism is on the march, overflowing with cash and emboldened by the crisis in the West. State companies make up 80% of the value of the stock market in China, 62% in Russia and 38% in Brazil. They accounted for one-third of the emerging world's foreign direct investment between 2003 and 2010 and an even higher proportion of its most spectacular acquisitions, as well as a growing proportion of the very largest firms.

The magazine went on to declare that state capitalism increasingly looked like "the coming trend". It wrote[17]:

> In the 1990s most state-owned companies were little more than government departments in emerging markets; the assumption was that, as the economy matured, the government would close or privatize them. Yet they show no signs of relinquishing the commanding heights, whether in major industries (the world's ten biggest oil-and-gas firms, measured by reserves, are all state-owned) or major markets.

The magazine then goes on to suggest various reasons why despite their global success these SOEs might still be bad for national competitiveness because of the way they distort markets. It is this contradiction between advice and evidence that we explore in this paper. Specifically, we look into how the welcome mat for privatization continues to be rolled out even when the results are suboptimal. In particular, how does this process take place in developing countries characterized by increasingly neoliberal regulatory environments? We focus particularly on how privatizations are carried out to create rent-seeking regimes[18] and ponder why there is little resistance.

We illustrate these dynamics in the context of two major privatizations in a South Asian country, Pakistan. Pakistan is an interesting empirical site to learn about ways in which privatization, despite its numerous failures, is still cherished, because it is one of a set of developing countries that have whole-heartedly embraced neoliberalism and extensively implemented Washington Consensus policies. In the 50s and 60s, Pakistan was held up as the poster-child for late development and considered at par with South Korea[19]. Since then, the two have followed markedly different development trajectories with Korea surging ahead and Pakistan losing its competitiveness drastically[20]. Since privatization drives have been a key plank of Pakistan's economic policy, it is pertinent to analyze their antecedents and consequences. Furthermore, Pakistan's experience with mass privatization is generalizable to many other developing countries that have followed 'Washington

[16] A. Wooldridge, 'The visible hand: Special Report on State Capitalism' *Economist*, January 21, 2012.
[17] Wooldridge 2012.
[18] W. Glade 'Privatization in Rent-Seeking Societies', *World Development*. May 1989 pp. 673-82.
[19] O. Noman, *Economic and Social Progress in Asia: Why Pakistan Did Not Become a Tiger*, Oxford University Press, Karachi, 1997.
[20] M. Khan, *The Political Economy of Industrial Policy in Pakistan 1947-1971*, SOAS, University of London, London, 1999.

Consensus' policies[21].

Our cases include privatization of national banks, and introduction of private producers in the energy sector. Using a mix of painstakingly collected primary and secondary data, we analyze the outcomes of these privatizations and analyze why there hasn't been more questioning of these suboptimal results. Specifically, we describe how the decidedly neoliberal policy regime and regulatory environment have allowed the socialization of losses and the privatization of profits. Our findings shed new light on the way in which privatization of SOEs is implicated in a South Asian country's underdevelopment and the neoliberal environment that provides the rose tinted lens through which these reforms are viewed.

All Carrots and No Sticks: Private profits, Socialized risk

State Ownership of Corporations

Why should the state own any corporations? After all, at least in theory, private companies operating under a combination of government regulation, tariff control and/or a subsidy scheme, could undertake most of the functions of SOEs[22]. This combination should be sufficient to ensure the appropriate incentives to control investment and prices. However, in practice, solutions involving regulation and subsidies often prove difficult to manage for developing countries lacking adequate resources and regulatory capacity. Moreover, provision of subsidies requires tax revenue, which many developing countries with weak states find difficult to raise[23]. Enforcement of complex regulations similarly requires dealing with legal maneuvering and political lobbying by powerful firms, which are often subsidiaries of well-resourced multinational corporations (MNCs)[24].

The writings of classical development theorists, such as Gerschenkron (1962)[25], Nurske (1953)[26], Rosenstien-Rodan (1943)[27], and Hirschman (1958)[28], make a case for SOEs involvement during certain stages of development. According to the Gerschenkron hypothesis, for instance, the later a country industrializes the more government involvement is required, because the state is the only institution with the resources to help overcome the difficulties of late industrialization. The argument is simple: private investors have an inherent bias towards short-term gains, and are especially risk averse in developing countries. These 'capital market failures' mean that the state needs to step in to finance large-scale, capital intensive projects which might be risky, and have long gestation periods, especially in key sectors of the

[21] M. Andrews, "State-owned banks, Stability, Privatization, and Growth: practical policy decisions in a world without empirical proof." *International Monetary Fund working paper* no. 5-10. 2005.

[22] H-J. Chang, *Bad Samaritans: The myth of free trade and the secret history of capitalism*, Bloomsbury Publishing, USA, 2007.

[23] J. Di John, 'The political economy of taxation and tax reform in developing countries' *Research Paper (No. 2006/74), UNU-WIDER*, United Nations University (UNU), 2006.

[24] Indeed, the difficulties advanced countries are facing today in getting their banks to provide loans to the real economy, rather than indulging in speculation, illustrates how even those with a high degree of state capacity can encounter these problems; Chang 2007.

[25] A. Gerschenkron, *Economic backwardness in historical perspective*, Harvard University Press, Cambridge, Mass, 1962.

[26] Nurkse R. *Problems of Capital Formation in Developing Countries*, Columbia University Press, New York, 1953.

[27] P.N. Rosenstein-Rodan, 'Problems of Industrialization of Eastern and South-Eastern Europe', *The Economic Journal*, 1943, pp. 202-211.

[28] A. Hirschman, *The strategy of economic development*, Yale university Press, New Haven, 1958.

economy, which are expected to initially make losses. This can often the be case in the manufacturing sector, where such market failures are even more acute due to the large scale of investment required, and difficulties in technological upgrading, but which historically has been considered necessary for economic development[29].

The weight of historical evidence is certainly behind such arguments. As mentioned earlier, many successful late developers such as Korea, Taiwan and Singapore have had a substantial state owned sector during their rapid growth periods. Rather than inhibiting growth, evidence show that SOEs have played a crucial role in state-led development strategy [30]. Finally, SOEs have been used to deal with 'natural monopoly' situations, as well as equity issues – to make sure that essential services are provided to all citizens. Examples abound of SOEs that have gone on to become global leaders in their industries[31].

The Tide Turns

In the 1970s and 80s, with the oil crisis and economic recession in the US, this trend began to reverse. Liberalization of trade, financial sector and labor markets was ushered in. Institutions such as the World Bank and global and local policy makers justified and legitimized this shift that came to be known as the 'Washington Consensus'[32]. The consensus derived its legitimacy from the collapse of the Soviet Union and the domino effect that followed in Eastern Europe. With Thatcher in the UK and Reagan in the US, a paradigmatic shift took place away from Keynesian thinking and the free market mantra was preached with evangelical zeal.

A spate of privatizations followed around the world, in particular Eastern Europe. The privatization campaigns were accompanied by a host of justifications. Some of the prominent ones included improving efficiency in the privatized industries, reducing the fiscal deficit, easing public sector pay determination by weakening public sector unions, and widening share ownership[33].

These privatizations had to typically face a lot of resistance from unions and bureaucracies. While such resistance was quelled it did little to legitimize privatization as a desired strategy. This was acknowledged by the chief evangelist of privatizations, the World Bank, in its 1995 Bureaucrats in Business Report[34] in which it stated that in order to push these privatizations through, an approach other than direct force needed to be taken.

This approach turned out to be primarily discursive, where privatization was constructed to be an unquestionably desirable strategy whatever the conditions. By

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[29] N. Kaldor, 'Strategic Factors In Economic Development', New York, Ithaca, 1967; A.P. Thirlwall, *The Nature of Economic Growth: A Alternative Framework for Understanding the Performance of Nations*, Edward Elgar, Cheltenham, 2003; H-J. Chang, *Kicking away the ladder: development strategy in historical perspective*. Anthem Press, 2002.

[30] Chang and Grabel 2004; R.Wade, *Governing the market: Economic theory and the role of government in East Asian industrialization*, Princeton University Press, New Jersey, 1990; A. Amsden, *Asia's next giant: South Korea and late industrialization*, Oxford University Press,1989; Shin 2005; Chang 2007

[31] H-J. Chang, 'Public Investment Management', *National Development Strategy Policy Guidance Note*, United Nations Department of Economic and Social Affairs and United Nations Development Programme, 2006; Amsden 1989.

[32] Toye 2003.

[33] J. Vickers and G. Yarrow, *Privatisation: An Economic Analysis*, MIT Press, Cambridge MA, 1988.

[34] World Bank, *Bureaucrats and Business: The Economics and Politics of Government Ownership*, Oxford University Press, Oxford, 1995.

the mid-90s privatization was presented as an unquestionably beneficial end in itself, and a panacea for all sorts of economic problems, including alleviating short-term fiscal problems, improving competition in privatized industries, maximizing domestic private sector development, increasing domestic ownership of productive assets, and even reducing income inequalities[35]. It was argued that SOEs contributed to increased deficits and inflation, which reduced economic growth[36]. Finally, it was claimed that privatization would reduce corruption and bureaucracy, and could even provide a solution to improving social services such as health and education[37].

The Elimination of Sticks and Proliferation of Carrots

The move to present privatization as a panacea was contextualized in a larger rise of neoliberal economic policies, including financial, trade, and labour market deregulation and liberalization. This often meant a re-presentation of economic history. Thus, India and China's rising competitiveness was entirely attributed by eminent economists to the rise of the private sector (see for example Naughton 2007[38]; Bhagwati and Panagariya 2013[39]) and the 'roll back' of the state. The broad based industrialization that took place in both countries prior to liberalization was portrayed not as the foundation on which subsequent progress took place but as 'lost years' where inefficiency and corruption impeded the progress that could have been made.

During the 1950s, 60s and 70s, successful developmental states used a carrot and stick policy with business interests[40]. This almost always involved the creation of rents[41], or 'carrots' for capitalists by the state, in return for the capitalists performing a certain economic or social function (the 'stick'), and withdrawal of the carrots if they did not[42]. For example, in Korea, some 'carrots' provided by the state included government guarantees, soft loans, tax breaks, export subsidies, while the

[35] O. Bouin, 'The Privatization in Developing Countries: Reflections on a Panacea', *OECD Policy Brief* 3, 1992. http://www.oecd.org/dev/1918716.pdf [accessed, 20 March 2015]; A. Galal, L. Jones, P. Tandon, and I. Vogelsang, *Welfare Consequences of Selling Public Enterprises: Case Studies from Chile, Malaysia, Mexico, and the UK*, World Bank, Washington, 1992; S. Kikeri, J. Nellis and M. Shirley, *Privatisation: The Lessons of Experience,* Washington DC, World Bank, 1992.

[36] World Bank 1995.

[37] K. Bayliss and B. Fine, 'Beyond Bureaucrats in Business: a critical review of the World Bank approach to privatization and public sector reform', *Journal of International Development*, 10(7), 1998, pp. 41-855; K. Bayliss and C. Cramer, 'Privatization and the Post-Washington Consensus: in between the lab and the real world', in *Development Policy in the Twenty-First Century: Beyond the Post-Washington Consensus,* B. Fine, C. Lapavitsas and J. Pincus, Routeledge, London, 2001.

[38] B. Naughton, *The Chinese Economy: Transitions and Growth*, MIT Press, Cambridge Mass, 2007.

[39] J. Bhagwati, J. N. Bhagwati, and A. Panagariya, 'Why growth matters: How economic growth in India reduced poverty and the lessons for other developing countries'. *Public Affairs*, 2013.

[40] Amsden 1989; Wade 1990; M. Woo-Cumings, *The developmental state*. Cornell University Press, 1999; Chang 2002; L. Weiss. *States in the global economy: Bringing domestic institutions back in*, Cambridge University Press, 2003; A. Kohli. *State-directed development: political power and industrialization in the global periphery*, Cambridge University Press, 2004.

[41] Defined by Khan 2000 p. 1 as 'excess income' which may take the form of f higher rates of return in monopolies, the extra income from politically organized transfers such as subsidies, or the extra income which comes from owning scarce resources, whether natural resources or specialized knowledge.

[42] M. Khan, 'Rents, Efficiency, and Growth' in *Rents, Rent-Seeking and Economic Development: Theory and Evidence in Asia,* Khan, M.H. and Jomo K.S. (ed) Cambridge, Cambridge University Press. 2000; V. Chibber, 'Building a Developmental State: the Korean case reconsidered'. *Politics and Society*. 1999 Sep 1;27:309-46; A. Amsden, *The rise of the rest: challenges to the west from late-industrializing economies*. Oxford University Press, 2001.

corresponding 'sticks' included state direction of investment decisions, meeting export quotas and performance standards, etc[43]. Strong states, that had the ability to enforce this 'disciplinary mechanism'[44] on business, had the most economic success.

Privatization, in the absence of a state with the capacity to 'discipline' business interests, has only created fresh opportunities for private profits, while shifting the bulk of associated risk to the public sector, and therefore to the taxpayer. Carrots have proliferated while sticks have been eliminated. According to Harvey (2007)[45] the primary aim of privatization in the neoliberal era "has been to open up new fields for capital accumulation in domains formerly regarded off-limits to the calculus of profitability"[46]. Put another way, it seems to have become easier to privatize the profits while socializing the risks.

It is in this context that we seek to examine privatizations in a South Asian country with a state that is widely perceived to be weak. The case of Pakistan allows us to explore how after the change from a developmentalist economic model to a neoliberal one[47], the state is able to privatize profits while socializing the risks. The aim of the study is to see how the socialization of risks and privatization of profits is carried out in the course of privatization, and how the context and discourse facilitates it. The study is important because systematically collected empirical evidence on privatizations in developing countries is rare simply due to the unavailability of information that one takes for granted in developed countries. Indeed, much of the evidence is collected and presented by multilateral agencies that have been the chief proponents of privatization in the first place. We hope that our empirical analysis of two of the most significant privatizations in Pakistan will provide an alternative view that challenges some of the orthodoxies in economic reform packages and sheds new light on the process by which privatization has enabled private interests to obtain state-sponsored carrots, without receiving any of the associated sticks.

Methods

Research Context

Both of our studies of privatization are situated in Pakistan. There are at least two reasons why we think Pakistan provides a fertile empirical site to study the antecedents and consequences of privatization in the third world. First, given the 'neoliberalization' of Pakistan's economy[48], it offers an excellent context in which to study the dynamics that facilitate and encourage the privatization of profits and socialization of risk in privatizations. Secondly, sufficient time has elapsed since the privatization of the two sectors under study to allow us to examine the effects on performance of the firm as well as on the economy.

Data collection and analysis

[43] Amsden 1989; H-J. Chang, 'The political economy of industrial policy in Korea'. *Cambridge Journal of Economics*, 1993, pp. 131-157.
[44] Amsden 1989; 2001.
[45] D. Harvey, 'Neoliberalism as creative destruction.' *The Annals of the American Academy of Political and Social Science* 610.1, 2007, pp. 21-44.
[46] Harvey 2007 p. 35.
[47] A. Zaidi, *Issues in Pakistan's Economy, second edition,* Oxford University Press, Karachi, 2005.
[48] A. Zaidi 2015, *Issues in Pakistan's Economy: A Political Economy Perspective*, Oxford University Press, Karachi, 2015.

In this section, we briefly describe how data was collected and analyzed for the two studies.

Privatization of the energy sector

Until the mid-1980s, Pakistan's energy needs were met by the Water and Power Development Authority (WAPDA) and Karachi Electric Supply Company (KESC), the two public sector organizations responsible for the generation, transmission, and distribution of electricity. Both were faring quite well[49]. Electricity was produced primarily through hydropower projects, keeping the production cost minimal. Since the cost of production and demand were low, so inevitably were the subsidies in absolute terms.

By the mid 1980s, increasing demand for electricity and WAPDA's inability to keep pace with it began to result in energy shortages and load shedding. Entering the 1990s, Pakistan was planning to increase its existing generation capacity for power production. However, instead of increasing public investments in energy, the World Bank encouraged the Pakistani government to privatize the sector before increasing capacity. In 1994, Pakistan announced its privatization policy, and since then, many private sector power projects have been installed. Despite this, however, the country faces chronic shortages and increasing tariffs.

The first author started investigating this case in collaboration with a highly experienced professional who had managed power projects in Pakistan and other countries. He had been involved in some of these privatization deals as an investment banker as well. Our examination of this case soon took us to a variety of stakeholders including senior figures in WAPDA, the National Transmission and Dispatch Company (NTDC), distribution companies (DISCOS), and various bankers who had been involved in structuring the deals. Much information was also gleaned from secondary sources including reports published by various aid agencies, multilateral agencies and the government. Early empirical findings were published with another collaborator and comments on those helped us refine our analysis further.

Privatization of the banking sector

Until the 1980s, Pakistan had a typically 'repressed' financial system, with a system of credit planning, lending targets, directed credit schemes, and regulated interest rates. Development Finance Institutions (DFIs) and specialized banks existed to provide the bulk of long-term credit and credit to neglected sectors, while five large nationalized commercial banks (NCBs) played a supporting role, providing mainly trade and working capital finance[50]. Financial liberalization and deregulation began in earnest in 1988 under IMF's structural adjustment program. Gradually, all major nationalized banks were privatized with only National Bank of Pakistan (NBP) left in the public sector[51].

We set out to examine how the role of the banking sector in the economy changed

[49] A. Malik, 'Power crisis in Pakistan: A crisis in governance?', *PIDE Monograph Series*, Pakistan Institute of Development Economics, Islamabad, Pakistan, 2012 p. 2.

[50] Zaidi 2005 pp. 263-270; A. Janjua, *History of the State Bank of Pakistan (1977-88)*, State Bank Printing Press, Karachi, 2003.

[51] Zaidi 2005 pp. 336-345; A. Janjua, A, *History of the State Bank of Pakistan (1988-2003)*, State Bank Printing Press, Karachi, 2004.

after privatization. This involved utilizing both firm level and macroeconomic data, as well as 33 semi-structured interviews with policy makers, regulators, senior and junior level private bank employees, and ex-DFI employees. The interviews were used to triangulate our findings, as well as to shed light on causality in some cases. While previous studies on bank privatization usually compare the firm level performance of public versus private banks in terms of profitability, efficiency, and capital adequacy ratios, we use different assessment criteria. Given that the function of the national financial system is to provide credit, at adequate levels and prices to the relevant sectors of the economy, rather than to create profits for a small number of shareholders, firm level performance according to shareholder criteria is, at best, of secondary importance when assessing the banking sector's contribution to the economy. Therefore, we compare the behavior of the five largest privatized commercial banks pre and post privatization in relation to their effect on the wider economy, in terms of their loan maturity, the sectorial distribution of their lending, and their cost to the taxpayer.

The historical firm level data (from 1972 till 1996) was collected from company accounts in the State Bank of Pakistan (SBP) archives, where it was only available in hardcopy. From 1996 onwards data was more easily available on the SBP and company websites. Various financial ratios were calculated and analyzed using this data. Any anomalies in the data were understood using the relevant notes from the company accounts, and SBP annual reports from the relevant time periods. Macroeconomic or aggregate bank level data all comes either from the SBP, in some cases from their publicly available online data base, and in others through contacts at the SBP, from the World Bank Development Indicators, or from the Pakistan Economy Survey. Parts of our analysis appeared in the *Economic and Political Weekly* and were circulated widely to policy makers and bankers, who personally agreed with our analysis, if not with our implied policy conclusions.

Findings: Privatization of Energy and Banking

The 'neoliberalization' of Pakistan

Before we delve into the two particular cases of privatization, it is important to note the sea change that came about in Pakistan the late 1980s and early 1990s. As mentioned above, following the fall of the Berlin wall and disintegration of the Soviet Union, free market policies swept across the globe. Pakistan was no exception. Its dependency on the IMF further acted as a catalyst in this process with the IMF's structural adjustment program (SAP) enforcing dramatic changes in various parts of the economy[52]. Around 1989, Pakistan started on a road that led to reductions in public expenditure, more open trade, liberalization of the economy, and privatization[53].

The free market paradigm, which did not allow for any state interference in trade or domestic industry, and which was actively pushed by multilateral agencies, gradually came to be entrenched in Pakistan. Both academic and policy making circles soon came to reflect this new consensus. The ascendancy of neoliberal thinking in Pakistan's policies becomes clearly visible if one takes a look at the changes in key positions in government. In the central bank, the State Bank of Pakistan (SBP),

[52] Zaidi 2015.
[53] Ibid p. 457.

between 1947 and the late 1970s, the first six governors had had a domestic banking or civil service backgrounds. The next five governors had loose affiliations with the IFIs, for instance, holdings consultancy assignments, or attending training courses. From 1993 to 2009, however, the next three appointees, Muhammad Yaqub, Ishrat Hussain and Shamshad Akhtar had previously made their careers in the IMF, World Bank, and Asian Development Bank respectively, showing a clear pattern. This was followed by the appointment of international investment bankers as governors. An examination of the backgrounds of finance ministers reveals similar trends. Before the 1980s, Finance Ministers tended to be domestically educated career civil servants or lawyers. From the 1990s onwards several ministers were appointed with World Bank or Citibank backgrounds, including Citibanker Shaukat Aziz who went on to become Prime Minister.

This transformation of the policy regime had already started when privatizations began in Pakistan in the early 1990s, and was further consolidated throughout the 2000s. This essentially meant that privatization was coming to be seen as an end in itself rather than a means to an end. This becomes clear from how the two privatizations that we describe were conceived, carried out, and evaluated. Below, we detail our findings into the two cases of privatization.

Privatization of the Energy Sector

Pretext for Privatization

With encouragement and financing from the World Bank, Pakistan took the first step towards privatizing its energy sector in the 1985[54]. A committee was formed by the Economic Coordination Committee of the Cabinet (ECC) in July 1985, which strongly recommended private sector involvement in expanding energy capacity as a solution to the ongoing energy shortages. It was explicitly stated in their report that power generation was seen as a convenient area for private sector participation, in order to further the broader agenda of increasing the role of the private sector, and decreasing that of the public sector in the economy[55].

In the years that followed, a number of influential reports by transnational organizations, such as the World Bank and USAID, contributed to further portraying WAPDA and KESC as inherently inefficient, poorly managed, and overly complex SOEs. According to the 2010 Poverty Reduction Strategy Paper (PRSP), these public sector oligopolies were "large, monolithic, vertically integrated utilities with overstaffing, financial and technical inefficiencies, and a lack of competitive spirit"[56]. According to an article in the Dawn newspaper in 2002, WAPDA and KESC "continue to bleed financially despite regular pumping of billions of rupees into them by successive governments"[57]. The public sector was portrayed as inherently unable to carry out infrastructure development on the required scale due to resource constraints, lack of sufficient institutional capacity and lack of technical expertise[58].

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[54] J. Fraser, 'Lessons from the independent private power experience in Pakistan', *Energy and Mining Sector Board Discussion Paper* No. 14, Washington, DC: World Bank Group, 2005.

[55] A. Saleem, *The State Under Trial: An Institutional Analysis of a Policy Decision in the Pakistan Electricity Sector*, Dissertation submitted to Lahore University of Management Sciences, 2014.

[56] International Monetary Fund. 'Pakistan: Poverty Reduction Strategy Paper'. *IMF Country Report No. 10/183*. 2010. Washington DC.

[57] Dawn, 'Wapda, Kesc draining resources', *Dawn*, 2002, http://www.dawn.com/news/51138/wapda-kesc-draining-resources [accessed 01 Feb 2016].

[58] Saleem 2014.

Specifically, it was argued that the current generation and provision mechanism was marred with inefficiencies and corruption, which necessitated provision of subsidies in order to make power affordable to consumers. Privatization would (i) lead to better, wider, more reliable service delivery and (ii) free up government resources to spend on health and education. It was also argued that cutting subsidies would be good because they were not helping the poor anyway as they were mostly not connected to the grid[59]. Finally, the involvement of private sector IPPs was also justified on the basis that this would boost "competition for and in the market for electricity supply"[60]. Government guarantees for these IPPs were justified as necessary to "help to gradually develop competition in the power sector by creating the necessary environment for attracting investment"[61].

The Privatization Process

Pakistan's privatization experiment with the energy sector began with the new 1994 Power Policy. The terms on which investors were invited to set up generation capacity in the country were some of the most generous in the world. Structurally, it was built on a cost-plus-return[62] basis in US dollar terms. Investors were to be provided a US dollar-based internal rate of return of 15 to 18 per cent per year over the 25 to 30-year-period of the power purchase agreement after covering for operational costs. This was further backed by sovereign guarantees from the Government of Pakistan. The Independent Power Producers (IPPs) were to be paid every month in two parts, i.e., a 'capacity payment' and an 'energy payment'. The 'capacity payment' reimbursed the IPP for all the fixed costs of the power plant, including debt servicing (which at an allowance of 80:20 debt-equity ratio proved to be very high) and provided the investor's equity return on top. These payments were to be made irrespective of whether or not the IPP was asked to produce electricity. The 'energy payment' reimbursed the IPP for all variable costs of production, e.g., fuel costs, regardless of the type of fuel employed and its market price. All payments were indexed (if relevant) to the USD/PKR exchange rate and inflation (local or foreign) changes.

Furthermore, IPPs were exempted from corporate income tax, customs duties, sales tax, and other surcharges on imported equipment. Permission was also granted for power generation companies to issue corporate bonds and shares at discounted prices (Fraser 2005). It was no surprise that the then United States Secretary of Energy, Hazel O'Leary, described it as "the best energy policy in the whole world"[63].

Three things were noticeable about this policy. First, though it offered highly generous returns, it provided no incentives to make the plant design efficient. In fact, since the government paid for all operational costs, many thermal IPPs understated their efficiency. Second, the policy was fuel blind, which meant investors were free to set up furnace oil based thermal IPPs (the most expensive fuel option) with the government still covering the cost of the fuel. Finally, with the government guaranteeing returns to investors, there was effectively no competition in the market,

[59] Fraser 2005.

[60] International Monetary Fund. 'Pakistan: Poverty Reduction Strategy Paper'. *IMF Country Report No. 04/24*. 2004. Washington DC p. 44.

[61] Ministry of Water and Power, 2008, cited in IMF 2010 p.138.

[62] This means the government promised to cover all expenses in addition to guaranteeing a generous profit on top.

[63] C. Hill, 'Power failure' *Institutional Investor*, November, 1999.

again engendering inefficiency. How this policy got adopted was explained by a leading banker involved in the deal:

> We had been trying for years but the WAPDA people and bureaucrats had been resisting us. Then the World Bank leaned on the government, basically telling them that any loans would be conditional on privatization. That's how we got moving again[64].

Outcome

The outcome of the privatization policy was perhaps predictable. The highly generous deals that the government offered to investors meant that for every hypothetical but typical 100 MW thermal (oil-fired) power plant in the private sector, the government would end up spending US $21.42 million more than it would in the public sector over the life of the power project (for a detailed analysis see Munir and Khalid 2012[65]). With most of the investors setting up thermal units, the country became hostage to rising oil prices – this led to massive debts that had to be cleared through more borrowing.

A longer term and highly damaging consequence of the private power policy was the fuel mix it engendered. In the 1980s, the country's electricity generation relied on a fuel mix of approximately 60:40 in favor of hydropower versus thermal. This changed dramatically over the next decade with the fuel mix going to 30 per cent hydropower and almost 70 per cent thermal by the end of 2010.

As Munir and Khalid (2012) show, contrary to claims of inefficiency in the public sector power plants, the average blended cost of public sector plants was actually lower than the IPPs. Unfortunately, as a result of the policy, 52 per cent of power came to be purchased by the government from IPPs (supplying at a higher cost). The downstream effect of shortages and higher tariffs was significant. By 2011, industrial output was down by up to 37 percent[66] with numerous factories and businesses closing down due to shortages and the excessive cost of deploying small generators.

Privatization of Major Banks

Pretext for Privatization

In the late 1980s, the pre-reform financial system in Pakistan came under criticism by both domestic policy makers and IFIs (see for example Hussain 2005[67]; State Bank of Pakistan 2002[68]; Ul Haque 1997[69]) for a number of reasons. These included crowding out of the private sector, causing a large budget deficit, low bank profitability and

[64] Interview with first author.

[65] K. Munir and S. Khalid, 'Pakistan's Power Crisis: How did we get here?' *Lahore Journal of Economics*, September 2012, pp. 73-82.

[66] R. Siddiqui, H. Jalil, M. Nasir, W.S. Malik, and M. Khalid, 'The cost of unserved energy: Evidence from selected industrial cities of Pakistan', *Working Paper No. 2011:75*, Pakistan Institute of Development Economics, Islamabad, Pakistan, 2011.

[67] I. Hussain, 'Why privatisation is necessary for economic growth in Pakistan?', Address at the 11th Get Together of the Overseas Universities Alumni Club and the 21st Century Business & Economics Club, Karachi, 12 August 2005. http://www.bis.org/review/r050829c.pdf [accessed 20 March 2015]

[68] State Bank of Pakistan Research Department, Pakistan: *Financial sector assessment 2001-2002, 2002* http://www.sbp.org.pk/publications/fsa-2001-2002/index.htm [accessed 20 March 2015]

[69] N. Ul Haque, 'Financial market reform in Pakistan', *The Pakistan Development Review,* 36:4 II, 1997, pp. 839-854.

efficiency, a high degree of concentration in the banking sector, inadequate provision of credit to small and medium enterprises and 'political lending' leading to a high number of non-performing loans. Some of these criticisms were justifiable, especially those related to concentration and SME lending, however, on the whole, the financial sector was functional, providing adequate amounts of credit to key sectors such as manufacturing and agriculture at reasonable cost[70].

In line with the overall policy direction, privatization of banks was recommended as a remedy for all of these problems. It was argued, amongst other things, that privatization would lead to greater competition in the banking sector, improve firm level performance, and improve savings mobilization[71]. Following privatization and the dismantlement of interest rate controls and credit ceilings, greater bank level efficiency and profitability would not only be a good in and of itself, but also improve the governments' fiscal position. It was argued that this would free up resources for spending on physical and social infrastructure[72].

Apart from this, according to interviews with senior SBP officials and ex officials, it was argued that private banks would reduce 'political lending' and as a result non-performing loans (NPLs) would decrease, leading to a better risk assessment and more optimal allocation of resources. Furthermore, it was argued that private investment would increase as the public sector withdrew, reducing 'crowding out'. The nationalized commercial banks (NCBs) had to hold 30 per cent of their portfolio in government debt at a fixed, low interest rate. According to a retired senior SBP official, it was argued that if these controls were lifted, the banks would reduce their holdings of government debt, which were making them unprofitable, and instead increase lending to the real economy and especially to neglected sectors such as agriculture and SMEs.

The Privatization Process

The privatizations began with the sale of Muslim Commercial Bank (MCB), which was sold for Rs. 2.4 billion (US $ 97million[73]) in 1991 to a group led by industrialist Mian Mansha, a close ally of then Prime Minister Nawaz Sharif. That this was a 'fire sale' was evident from the fact that only after a few years MCBs profits were higher than its sale price[74]. Next came the privatization of Allied Bank Limited (ABL), sold first in 1991 to the Employees Management group, and after going into negative equity and being re-nationalized, re-sold to a private group for Rs. 11 billion (US $ 185 million) in 2004[75].

Next, 51 percent of United Bank Limited's (UBL) shares were sold in 2002 to a consortium of foreign investors including UK based cash and carry chain Bestway and the Abu Dhabi group, a UAE private equity fund. Rather than generating a windfall for the government, the sale resulted in a net drain of Rs. 8.65 billion (US

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70 Janjua 2003.

71 I. Hussain, 'Policy Considerations before Bank Privatization - Country Experience Presentation', World Bank, International Monetary Fund and Brookings Institution Conference, *The Role of State-Owned Financial Institutions: Policy and Practice*, Washington D.C., April 27, 2004

72 Hussain 2004.

73 All figures are converted to US dollars using the relevant end of year exchange rate for the year in which the sale took place.

74 A. Khan, *The impact privatization in Pakistan*, Ferozsons, Karachi, 2012.

75 Dawn, 'Two banks in run to buy 51 pc ABL shares', *Dawn*, 2004. http://www.dawn.com/news/350620/two-banks-in-run-to-buy-51pc-abl-shares [accessed 20 March 2015]; Khan 2012.

$148 million) - even though the bank was sold at Rs. 12.35 billion (US $ 212 million), the government had previously injected Rs. 21 billion (US $360 million) in equity in order to improve its performance in preparation for sale. Furthermore, the bidding process was not transparent, as parties were allowed to raise their bids after the initial round[76].

UBL's privatization was followed by that of the country's largest bank, Habib Bank Limited (HBL). HBL was sold in 2003 for Rs. 22.4 billion (US $390 million), after giving it an equity injection of Rs. 18 billion (US $ 313 million). Moreover, benefits worth Rs. 18.84 billion (US $320 million), including income tax refunds and a transfer of bad debts to the government owned Corporate and Industrial Restructuring Corporation (CIRC), were announced after three bidders had already been shortlisted, violating the auction rules[77]. In effect, the oldest, largest, and most established Pakistani bank - which accounted for over 20 per cent of Pakistan's total banking operations and boasted an extensive international network of branches in 26 different countries - was privatized at a loss of Rs. 14.44 billion (US $251million)[78]. To top it off, it was given to the Agha Khan Fund, a non-corporate entity with no expertise in banking.

Outcome

The few empirical studies that have been done on bank efficiency pre-and-post privatization show no clear improvement in efficiency[79]. However, as shown by Munir and Naqvi (2013)[80], bank profitability increased dramatically post-privatization even when overall economic growth was sluggish.

As Munir and Naqvi (2013) point out, a closer look at the sources of bank profitability reveals that this increase came at the expense of the real economy. An examination of the data on net interest margins for the large five banks shows that profitability coincided with an increase in interest rate spreads following interest rate deregulation; a factor independent from bank efficiency or risk assessment. Lending rates doubled for the big five banks from seven per cent to 14 per cent between 2004 and 2007. Deposit rates however, remained low, with the interest rate spread (difference in lending and deposit rates) in Pakistan between 2004 and 2010 averaging over 6 percent compared to 2per cent in Korea and 3per cent in Malaysia for the same period[81].

Despite high lending interest rates, banks made such large profits not through

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[76] Dawn, 'UBL Sale not really transparent', *Dawn* 2002. http://www.dawn.com/news/56315/ubl-sale-not-really-transparent [accessed 20 March 2015].

[77] Dawn, 'Court issues notices on petition challenging HBL privatization', *Dawn*, 2004, http://www.dawn.com/news/355258/court-issues-notices-on-petition-challenging-hbl-privatization [accessed 20 March 2015]

[78] Dawn, 'AKF buys HBL for Rs. 22.409 bn' *Dawn*, 2003, http://www.dawn.com/news/131655/akf-buys-hbl-for-rs22-409bn [accessed 20 March 2015]; Khan 2012.

[79] A. Burki, and S. Niazi, 2003. 'The Effects of Privatisation, Competition and Regulation on Banking Efficiency in Pakistan, 1991-2000', *CRC Conference on: Regulatory Impact Assessment: Strengthening Regulation Policy and Practice*, University of Manchester, UK; D. Hardy, and E. Patti, 'Bank Reform and Bank Efficiency in Pakistan,' *IMF Working Paper -1/138,* International Monetary Fund, 2001; R. Khan, and S. Aftab, 'Assessing the Impact of Financial Reforms on Pakistan's Economy,' *Pakistan Journal of Applied Economics*, 10:1, 1994, pp. 99-116.

[80] K. Munir and N. Naqvi, 'Pakistan's Post-Reforms Banking Sector', *Economic and Political Weekly* 48, no. 47, 2013.

[81] World Bank. *World Development Indicators*, online database. http://data.worldbank.org/indicator [accessed 20 March 2015].

increased lending to the real economy based on improved risk assessment ability as had been predicted, but through dramatically increasing their investment in high yielding government debt. This was confirmed during interviews with three separate high-level policy makers at the SBP in charge of regulating the banking system. This is all the more ironic given that one of the reasons for privatization was that it would reduce bank holdings of government debt. Whereas in the pre-reform system, NCBs had to hold 30 per cent of their assets in government bonds at a low fixed rates of four to six per cent[82], long after privatization, the same banks held even more government paper, only, at much higher interest rates of about 12 to 13 per cent. The SBP noted that at the end of 2012, the share of government securities in total investments of the banking sector was 88.7 per cent[83].

According to the CEO of one privatized commercial bank in April 2012 "the Treasury Department [which deals with investment in government securities] is currently the most active department in the whole bank, and this is not a good thing [for the Pakistani economy]". Interviews with privatized commercial bank (PCB) senior employees indicated that high investment in government bonds were justified as a result of a 'lack of demand for corporate loans' from firms, due to the general post-2007 economic downturn, as well as the negative economic impact of the energy crisis. For example, one PCB CEO noted that the rationale behind such high levels of investment in government securities was that "due to the lack of other investment opportunities, we have lots of excess cash. The risk for the bank is exactly the same if we hold cash, or T-bills, so it makes sense to hold T-bills which give a much higher return".

Given the unproductive investments made by banks, it is unsurprising that post-privatization lending fell dramatically to its lowest level since 1963[84]. As of 2014, Pakistan's financial institutions only provided 49 per cent of domestic credit (up from a low of 42.7 per cent in 2011), compared to 143 per cent in Malaysia, 110 per cent in Brazil, and 163 per cent in China[85]. What little lending there was took the form of working capital or trade finance, rather than long term finance for investment in improving productive capacity[86]. According to figures released by the SBP, out of the total amount of lending as of May 2015, about 61 per cent is extended for short term working capital or trade finance, and only 1.5 per cent for long term investment finance, with the rest going towards small loans or lending for the purpose of purchasing and discounting bills[87]. According to a senior PCB executive "there is very little long term finance available because no bank is willing to take the risk in this environment".

Furthermore, the sectorial distribution of credit also worsened with agricultural lending falling as a percentage of GDP. Lending to manufacturing, which is vital for industrial development, which had been at almost 50 per cent of total lending in the

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[82] The fixed rate was four and a half per cent until 1973, five per cent in 1974, six per cent until 1986. It was gradually raised thereafter until, 1991, when rates were instead determined through public auction (Janjua 2003; 2004).

[83] State Bank of Pakistan, *Financial Stability Review – 2nd Half 2012, 2012* http://www.sbp.org.pk/FSR/2012/pdf/2ndhalf/index.htm [accessed 20 March 2015]

[84] World Bank, *World Development Indicators*.

[85] Ibid.

[86] In the pre-reform system state-owned specialised Development Finance Institutions were responsible for the majority of long-term development financing, but these have since been phased out (Zaidi 2005 p. 267).

[87] State Bank of Pakistan. *Online Economic Database*. http://www.sbp.org.pk/ecodata/index2.asp [accessed 20 March 2015].

1970s[88], declined as well, with the exception of a brief spike in lending to textiles, which resulted in many NPLs[89]. The financial sector reforms did not do much to improve competition either, despite this being one of their major stated aims. The banking sector still remained highly concentrated, with the five largest commercial banks accounting for 60 per cent of deposits and 80 per cent of profits in the banking sector at the end of 2012[90]. Lack of competition was exemplified by the fact that rather than raising deposit rates to compete for customer deposits, the large five banks were able to keep them low, earning high spreads[91]. According to a senior SBP policymaker, the SBP had to partially reverse liberalization reforms due to PCBs' 'ridiculously low' deposit rates, and impose a deposit floor of five per cent in 2008. Discussions with senior SBP policymakers also suggest that the large five commercial banks were able to form a 'cartel' to squeeze government during auctions in order to keep yields high as they were the primary dealers.

Discussion: Privatization of Profits and Socialization of Losses

In both the cases described above, it is clear that privatization was carried out in a way which led to the privatization of profits but socialization of losses. Particular interests were advanced in the name of universal ones, and carrots extended without corresponding sticks. The case of energy is straightforward. A rent-seeking regime was set up in the name of privatization. All risk remained with the taxpayer while lucrative returns were guaranteed to the investors. Given that most of the new capacity was furnace oil based, and oil prices went from US $20 to US $120 in this period, the government had to keep buying power from private producers at higher and higher prices. This expense was passed on to the consumer through higher tariffs and taxes (imposed on various goods to generate revenue to pay). Ordinary citizens also paid indirectly when rampant energy shortages caused by the state's inability to buy expensive power from the IPPs became one of the major drags on economic growth.

The case of banking was similar. The interest banks charge borrowers is supposed to be a reward for the risk the bank takes in case of possible defaults, while a bank's profits are justified on account of the risks banks take in selecting good projects to which to lend to. In the case of the privatized commercial banks, it is clear that the shareholders of privatized banks (including foreign investors) were profiting from investment in risk-free government bonds, rather than through making risky investments in the real economy.

While one of the main arguments for privatization and liberalization was that reforms would reduce the government's fiscal burden, by providing 'market

[88] Ziadi 2005 p. 264.

[89] The textile sector expanded capacity in preparation for the termination of quotas of textiles imports by industrialized countries following the termination of the Multi Fiber agreement, in the expectation that exports would increase. However, following the termination of quotas, Pakistani exports actually decreased due to competition from China. Dawn. 'Pakistan In Quota-Free Textile Trade.' Dawn, 2005. http://www.dawn.com/news/381526/pakistan-in-quota-free-textile-trade [accessed 20 August 2015]

[90] D. Hussain, 'Banking Sector Performance', *Dawn*, 2013, http://www.dawn.com/news/799275/banking-sector-performance [accessed 20 March 2015].

[91] Munir and Naqvi 2014.

discipline', the data indicates that the reforms have contributed to just the opposite[92]. As a result of the government shifting to market-based borrowing in the 1990s, as part of the process of interest rate liberalization and bond market development, yields on government securities increased dramatically, as mentioned earlier. While high interest rates made banks profitable, they also contributed to bringing the government further and further into debt. The government became trapped in a vicious circle post-2007, where it borrowed from the commercial banks in order to fund interest payments, which went back mainly to the commercial banks themselves (commercial banks owned 70 per cent of government securities at the end of 2014, while domestic interest payments made up 92 per cent of all interest payments[93]. The government was stuck in a vicious circle, where it was now forced to borrow from the commercial banks in order to fund its interest payments, which went back to the commercial banks themselves. As debt service was prioritized over other expenditures by policymakers and IFIs, state capacity to undertake long-term public investment, and spending on social and physical infrastructure suffered. The ultimate loser was the taxpayer, who not only funded banks profits, but lost out on the economic advantages banks were supposed to bring in exchange.

Apart from direct costs, indirect ones were also inflicted on taxpayers through power shortages and drying up of credit. The World Bank Investment Climate Survey (2007) listed electricity as the most serious perceived constraint, followed by macroeconomic and political instability[94]. The Global Competitiveness Report 2014/15 ranked Pakistan 133 out of 144 in terms of quality of electricity supply, even below its overall infrastructure rank of 113[95]. About 95 per cent of manufacturing firms reported power outages, and figures for financial losses due to outages almost doubled between 2002 and 2007[96]. A high percentage of firms were forced to rely on privately owned, oil based generators though the unit cost of power from a generator was much higher than that from the public grid[97].

In contrast, during the same period the governments of countries like India and China were drawing their power from coal (which comprised about 70 per cent and 60 per cent of coal in the energy mix respectively). Pakistan, on the other hand was using only 6.5 per cent coal (despite possessing one of the largest reserves of coal in the world), relying heavily on oil instead[98].

Privatizing the major banks dried up the long-term finance needed for the upgrading of the productive structure. Historically, countries that have developed rapidly, including Korea, Taiwan, China, and Brazil, have mobilized their financial sectors to service development by directing them to provide large amounts of credit for those sectors deemed important for long-term economic development. The post-

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[92] Here it is important to note that the major state owned commercial banks were profitable from as far back as our data goes (1973), up until the mid 90s. This means that the banks were not the permanent drain on the government deficit they were presented to be (Munir and Naqvi 2014).

[93] State Bank of Pakistan, 'Public Finance', *Statistical Bulletin*, March 2015, http://www.sbp.org.pk/reports/stat_reviews/Bulletin/2015/Mar/PublicFinance.pdf [accessed 20 March 2015]

[94] cited in World Bank, 'Pakistan's Investment Climate: Laying the Foundation for Renewed Growth, Volume I: the main report', *World Bank Report No. 46435-PK,* World Bank Washington DC, 2009 p. 19.

[95] World Economic Forum, *Global Competitiveness Report 2014/15*, World Economic Forum, Geneva, 2014.

[96] World Bank 2009 p. 37.

[97] ibid.

[98] ibid.

privatization financial sector in Pakistan played exactly the opposite role. The inability of the financial sector in Pakistan to provide credit to the productive sectors of the economy, while diverting resources instead to unproductive investments in government bonds and consumer finance, posed a severe constraint on economic development. The 2013 Investment Climate Survey shows that Pakistani manufacturing firms finance 86.5 per cent of investment through retained earnings, and only 2.4 per cent through banks, far lower than the regional average of 20per cent[99]. Interviews conducted with industrialists, policy makers and bank officials unanimously suggest that the situation has become especially dire after the bursting of the post-9/11 bubble in 2008. According to the owner of a large industrial conglomerate "Even for me it is difficult to get a loan, the banks are only giving loans to large blue chips [companies] that are already customers, or to the military".

On the whole, industrial growth was much higher in the 1970s and 80s than it has been in the post-reform era, even during the boom period of 2001-2008[100]. Although GDP growth in Pakistan has been comparable with other developing countries, investment in the manufacturing sector has been low in comparison[101]. High energy costs and lack of availability of finance led to a lack of industrial investment, which contributed to the stagnation of manufacturing, the erosion of Pakistan's heavy industrial base, and a decline in export competitiveness after the 1980s[102]. Pakistan's share of manufacturing in GDP now pales in comparison to the Newly Industrialized Asian countries (South Korea, Taiwan, Malaysia and Indonesia), which started industrialization in the same time period (1960s) as Pakistan[103]. Manufacturing growth rates have fallen to an all-time low in the post 2007 period, at about two per cent per year[104].

Evaluating Privatization in the Land of Believers

But all this is not what the privatizations were evaluated on. In both cases, any opposition at the intellectual or policy level was conspicuous by its absence. To be sure, there were numerous popular protests against privatization, especially from unionized workers in both the public banks and utilities companies. Public employees accused the banks of sacking thousands of lower ranking workers, while hiring highly paid senior management (often from foreign banks) at the same time[105]. In the case of energy, public sector utilities workers expressed their anger during various protests, demanding that privatization be cancelled, trade union activities be restored, and

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99 *Investment Climate Survey 2013* http://www.enterprisesurveys.org/data/exploreeconomies/2013/pakistan#finance [accessed 20 March 2015]

100 A. Burki, A., K. Munir, M. Khan, U. Khan, A. Faheem, A. Khalid, and T. Hussain, *Industrial Policy, its Spatial Aspects, and Cluster Development in Pakistan*, Lahore University of Management Sciences, Lahore, 2011, p. 15.

101 Ibid.

102 ibid.

103 ibid p. 15-16.

104 Ministry of Finance, *Pakistan Economic Survey*, various issues, 1973/74-2013/14 http://www.finance.gov.pk/survey_1314.html [accessed 20 March 2015]

105 Dawn. 'Retrenchment of bank workers condemned', *Dawn*, 2006 http://www.dawn.com/news/194461/karachi-retrenchment-of-bank-workers-condemned [accessed 20 March 2015]

contractual employees be given permanent contracts[106]. According to the protestors, privatization was being pushed through by the IFIs, but was against the interests of low-income Pakistanis, as it would result in a rise in the price of basic utilities and the loss of thousands of jobs[107]. However, although they sometimes caused delays, these popular protests were ultimately not strong enough to halt the tide of privatizations, and privatization had the effect of further weakening the labor movement between the 1990s and 2000s[108].

In spite of opposition by the unions, banking sector privatization was presented as a resounding success. The IFIs were unanimous in their praise for Pakistan's banking sector's successful transformation. In Ishrat Hussain's 2004 report on the banking sector for the World Bank and IMF, the banking reforms were hailed as a success that was 'very rare among developing countries'[109]. The IMF claimed that "An important achievement in the last decade has been the transformation of a largely state-owned and weak banking system into a healthier, primarily privately-owned system"[110]. According to the 2010 PRSP the Pakistani banking sector was regarded as "one of the fastest growing and best performing sectors in the region" which has made it into "one of the top three destinations [within Pakistan] for foreign investment inflows"[111]. Despite all evidence to the contrary, former Prime Minister Shaukat Aziz repeatedly described the post-reform banking sector as a 'vibrant private sector industry' and an 'engine of growth for the economy'[112]. According to recent press releases by the SBP, the performance of the banking system sector 'remains impressive', based mainly on profitability indicators and capital adequacy ratios[113].

The IMF's assessment of the post-reform situation seemed to be completely out of touch with reality. The 2010 PRSP's assessment of the situation when lack of long-term finance was at its peak was that "ongoing financial sector transformation has helped in meeting the growing financing requirements of the productive sectors, while generating consumption demand through increase in consumer financing that… provided a major stimulus to real sector growth in the country"[114]. According to a 2014 assessment by the IMF, credit growth from a "healthy financial sector" reflects "declining SBP fiscal financing, easing structural bottlenecks, and NFA growth"[115]. Blatantly ignoring the government's fiscal burden caused by interest payments to commercial banks, the 2010 PRSP states that while the pre-reform system was

[106] Dawn, 'KARACHI: KESC men refuse to call off strike: Privatization', *Dawn*, 2005, http://www.dawn.com/news/401396/karachi-kesc-men-refuse-to-call-off-strike-privatization [accessed 01 Feb 2016]

[107] Dawn, 'Workers of Wapda stage rally', Dawn, 2005b, http://www.dawn.com/news/381944/rawalpindi-workers-of-wapda-stage-rally-kesc-privatization. [accessed 01 Feb 2016]

[108] K. Munir, N. Naqvi and A. Usmani. The Abject Condition of Labor in Pakistan. *International Labor and Working-Class History*, 87, 2015, pp 174-183.

[109] Hussain 2004.

[110] IMF 2004 p. 5

[111] IMF 2010 p. 280-1.

[112] Dawn, 'Banking sector gains strength says PM', *Dawn*, 2006, http://www.dawn.com/news/198303/banking-sector-gains-strength-says-pm. [accessed 20 March 2015]

[113] Imadudin, 'Performance of Banking Sector Remained Impressive: SBP', *Business Recorder*, 2014, http://www.brecorder.com/pakistan/banking-a-finance/206047-performance-of-banking-sector-remained-impressive-sbp.html [accessed 20 March 2015]

[114] International Monetary Fund, 2010 p. 261

[115] International Monetary Fund, 'Pakistan', *IMF Country Report No. 14/357*, 2014, http://www.imf.org/external/pubs/ft/scr/2014/cr14357.pdf [accessed 20 March 2015]

intermediating savings "primarily to fund the fiscal deficit and the losses of the public sector", the "continuous restructuring [of state-owned banks] has reduced the burden on the government and has left few minor areas to concentrate"[116].

The reigning supremacy of a neoliberal logic and the appointment of free market economists to important policy making positions means the evaluations are heavily biased. There is a complete refusal to accept that privatizations could have suboptimal outcomes. In fact, the most prevalent line of criticism against the financial system is that it is not liberalized enough. The government (encouraged by the IMF) believes that in order to "sustain a high rate of economic growth, a second generation of [liberalization] reforms will be needed"[117]. Comparisons with other late developers are studiously avoided. Thus, the underdevelopment of the capital markets is uncritically presented as a major problem without considering that most of today's successful late developers, including Korea, developed without any kind of stock or bond markets, not to mention the many well known risks and negatives associated with capital market development. Rather than institute reforms which force the banking system to make productive long-term investments, measures such as development of the institutional investor base, including mutual and private pension funds, and the introduction of complex new financial products such as index futures contracts are made a priority[118].

Conveniently, rather than assessing privatization according to its initial aims, success was measured merely by the speed of privatization reforms themselves, the high level of bank profitability, and firm level risk and efficiency indicators. Forgotten is the fact that the function of a banking system is to channel financial resources to those areas most productive for economic development, not purely to make high profits for private shareholders. Similarly disregarded was the initial hope that bank profitability would both reduce the government debt, and increase competition - neither of which have been the case.

The case of energy was similar. Despite continued protests over rampant load-shedding[119] and tariff increases[120], policymakers remained visibly wary of questioning the policy framework that produced these conditions. By the late 1990s, the worsening of the energy situation was explained away by local policymakers and IFIs as a result of privatization reforms not being implemented quickly enough. For example, in a 1998 Policy Framework Paper prepared by Pakistani authorities in collaboration with the IMF and World Bank Staff, although problems in the energy sector are presented as one the key structural issues facing Pakistan, the blame is placed on the slow pace of privatization of public sector utilities WAPDA and KESC[121]. According to this report, the poor condition of public utilities is purely the result of 'deteriorating operational efficiency' and slow implementation of pricing reforms aimed at removing subsidies to households and agricultural tube wells. The government's medium term plan to address these problems was based around

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[116] IMF 2010 p. 259 and 264.
[117] IMF 2010 p. 261.
[118] IMF 2010 p. 276.
[119] Due to power shortages, entire cities into darkness for over 12 hours a day and rural areas for 18–20 hours a day, with the electricity shortfall reaching 7,000 MW in peak periods (M. Vaid, and M. Tourangbam, 'Pakistan's energy crisis', *Foreign Policy*, August, 2014).
[120] Dawn, 'Wapda workers protest privatisation, *Dawn*, 2014, http://www.dawn.com/news/1082113 [accessed 01 Feb 2016]
[121] International Monetary Fund. *Pakistan: Enhanced Structural Adjustment Facility Policy Framework Paper, 1998/99–2000/01*, 1998.

"accelerating the reform programs in order to achieve efficiency improvements in the medium term", which includes 'completing the corporatization process' by establishing new commercially oriented power producers, implementing theft reduction programs and intensifying bill collection, and raising tariffs to 'restore financial viability'[122].

In the 2004 Poverty Reduction Strategy Paper (PRSP), difficulties in the energy sector are blamed on the "global downturn in the power sector" (IMF 2004b p. 44). By 2010, the PRSP was forced to note the, by then severe, energy crisis, but once again stopped short of questioning the policy framework that led to it. Despite the crisis, the Pakistani energy sector was praised on the basis that it "has one of the most advanced Public Private Partnership programs in the power sector... It has also gradually expanded the scope of this program…the response of the private sector continues to be positive" (IMF 2010 pg. 126). Major news agencies also saw the main problem as the continued presence of public sector utilities. According to an article in the Business Recorder, "certain monopolies must be broken to get out of the power sector mess… K-Electric[123] is a present day success story, why not replicate it?"[124].

The questionable outcomes of privatization and the policies leading to them were never questioned, reflecting a consensus at the top. While labor unions and the occasional progressive civil society group put up some resistance, Op-eds in major newspapers and the overall policy discourse were almost unanimously behind privatization. Economists heading important policy institutions ranging from the ostensibly autonomous State Bank to the Planning Commission never challenged the arguments presented by the government in favor of privatization.

In short, neoliberalism is not just marked by policy and ideology favoring the private over the public sector, but this has been institutionalized within government capacity itself and the commercial pressures to which it responds[125]. This institutionalization takes a number of forms at global, regional, and national levels. At the global level, the key role is played by the IMF and the World Bank, and especially the World Bank's arm dedicated to financing the private sector, the IFC. At the regional level, the Asian Development Bank has been pushing this agenda, and finally, at the national level, the various people appointed to important positions in the government and economic institutions have been zealously pursuing this course.

Conclusion

We show clearly in this paper how privatization in these cases has not only not lived up to its multiple claims, including but not limited to reducing the government deficit, improving competition and firm efficiency, improving the allocation of resources, reducing corruption, and leading to increased overall economic growth, but has in fact

[122] Ibid.

[123] KESC was renamed 'K-Electric' after being bought by Dubai based private equity firm Abraaj Capital (Business Recorder, 'KESC: a success story for privatization', *Business Recorder,* 2013. http://www.brecorder.com/br-research/44:miscellaneous/3392:kesc-a-success-story-for-privatisation/ [accessed 01 Feb 2016]).

[124] Business Recorder, 'In the whirlpool of power shortfall', *Business Recorder,* 2014. http://www.brecorder.com/br-research/44:miscellaneous/4392:in-the-whirlpool-of-power-shortfall/ [accessed 01 Feb 2016].

[125] B. Fine and D. Hall, 'Terrains of neoliberalism: Constraints and opportunities for alternative models of service delivery', in A. McDonald, and G. Ruiters, eds. *Alternatives to privatization: Public options for essential services in the global South*. Routledge, 2012.

made matters worse in almost all of these aspects. The outcome has been neither economic efficiency nor improved services to the taxpayer but simply the privatization of profits and socialization of losses. Resources or ‘rents’ have been transferred from the public purse - which could redistribute it to even out social inequalities - to selected private hands. While such rents have historically played a part in economic development, in the case of Pakistan, they have not been accompanied by the corresponding ‘disciplinary mechanism’, which forced business interests to carry out their developmental functions in successful developers such as the East Asian Tigers.

What has enabled all this to go unchallenged and largely un-scrutinized is the hegemony of the neoliberal paradigm in Pakistan. ‘Neoliberalization’ has swept across the world and Pakistan has not been immune to it. While privatization of public assets has been a prominent feature of the neoliberal project everywhere, in some countries, such as Brazil or India, strong traditions of nationalism or socialist currents have tempered the neoliberal turn. In Pakistan, on the other hand, the hegemony of neoliberal thought appears complete amongst intellectuals and policymakers. It is of course always difficult to prove the absence of something, but from what we could tell from our extensive search, there was a distinct lack of debate around privatization in Pakistan. The dominant discourse among policy makers showed a zealous commitment to the private sector, even when competitive forces were absent, and a state strong enough to regulate economic activity missing. The private sector’s superiority was deemed to be inherent, and private enterprises above all suspicion, while SOEs were seen to be inefficient, corrupt, and market distorting. This is not to imply that SOEs are a good in and of themselves; public ownership can, and has, served elite and corporate needs, while marginalizing the poor[126]. Indeed public banks and energy companies in Pakistan suffered from real problems, as detailed above. Our argument however, is that uncritical and blanket privatization is not the solution.

In short, while the neoliberal project has facilitated privatization, the complete entrenchment of this paradigm has created a situation in which privatization has come to be seen as an end in itself. While even economics textbooks describe specific conditions under which privatization may be the way forward, in Pakistan, any constraints have now been discarded. If the belief in markets is sufficiently firm, privatizations become the only alternative, superior to the public sector under all conditions. It is this transformation that we have sought to highlight in this paper. We hope that our analysis, based on primary data, of the two privatizations and the description of the entrenchment of a neoliberal paradigm in Pakistan, will lead to further explorations of this transformation both at macro and micro levels.

[126] Macdonald and Ruiters 2012.