

THE IMPACT OF PRIVATIZATION ON PERFORMANCE AND ECONOMY IN PAKISTAN

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ABSTRACT: Privatization has assumed an unprecedented pace in Pakistan in the last few years. This paper analyzes the impact of privatization on the performance of State Owned Enterprises (SOEs) and the economy. The impact of privatization on profitability of firms was found to be positive but not significant while the increase in efficiency was more appreciable. There was a significant decrease in employment following privatization. The relationship between investment and privatization was positive and moderately strong while it was negative and moderately strong between employments.

Key words: Privatization, State of Owned Enterprises, Profitability

1. INTRODUCTION

Privatization is one of the most polarizing issues that elicit some of the most emotive responses from its detractors and supporters alike. The study aims to analyze the impact of privatization on performances of SOEs and on the economy. Privatization has been defined as transferring the right of the state to other agents to influence directly allocation of capital resources to non-state entities, to whom the residual or net profits of sale accrue. The Planning Commission has defined privatization as, "Any shift of activities or functions from the state to the private sector; and, more specifically, any shift of the production of goods and services from public to private sector".

The global push for privatization since the 1970s has changed the face of governance. In general, the objectives of governments in privatizing have been: -

- i) Raising revenue.
- ii) Raising investment capital for the industry or enterprise being privatized;
- iii) Increasing productivity of the enterprise;
- iv) Greater competition in the economy; and
- v) Decrease government expenditure. [1]

Jones et. al [2] found that privatization led to increase in output, profitability, efficiency, and capital investment while there was no decrease in employment. Salej [3] studied privatization in Brazil and found that privatization led to direct benefits for the consumers where it led to competition while where there were no gains so far as the consumers were concerned where after privatization there was no increase in competition.

La Porta and Shlifer [4] in an exhaustive study of 92 countries found that government ownership was significantly more in the developing countries and that it retards the development of financial systems and slow down the economic growth.

Agarwal and Harper [5] compared the first and second wave of privatization in Czech Republic. It was found that while the first wave of privatization yielded poor results leading to lower efficiency and productivity the second wave of privatization was much more successful.

In Pakistan, there has also been some research on the issue. For instance, Kemal [6] has studied privatization and its evolution through 12 governments (Six regular and six caretaker) in Pakistan. He has pointed out that through privatization around there thousand five hundred employees moved out of the public sector out of which over 60% opted for the golden hand scheme.

Hakro and Akram [7] listed six performance indicators (profitability, efficiency, capital investment, output, employment, and leverage) and found no significant changes in found no significant changes in them pre & post privatization.

Mehmood and Faridi [8] have analyzed the impact of privatization on economic performance in Pakistan. They have opined that privatization is a useful tool for extracting extra revenue yet after selling SOEs the government loses its revenue receipt and control of strategic assets.

Khan [9] has comprehensively studied the process of privatization in Pakistan and has pointed out that it in being carried out on the behest of IFIs to plug holes in the balance of payments. Moreover, Khan, who has himself headed the privatization commission states that there have been instances of crony capitalism with the ruling elite doling out favors.

The objectives of the study are:

- i. To analyze the impact of privatization on efficiency, employment, and profitability of enterprises.
- ii. To analyze the impact of privatization on economy of Pakistan.
- iii. To propose the way forward and recommend policy matters

2. MATERIAL AND METHOD

For analyzing the impact of privatization on productivity of firms, data was taken for three years before privatization and for three years after privatization excluding the two years following privatization. For the cement industry the data has been taken from APCTMA, for edible oil from Pakistan Vanaspati Association as well as Privatization Commission, and from survey of Industrial Production and Employment conducted by the Punjab Government. For analyzing the

impact of privatization on the economy, data was collected from the privatization commission and macroeconomic indicators from 1991-2015.

The methodology for analyzing the impact of privatization on productivity of firms is:

Profitability = Return on Sales

- Return on Sales (ROS) = $\frac{\text{Net income}}{\text{Sale}}$
- **Operating Efficiency = Sales Efficiency**
- Sales Efficiency = $\frac{\text{Sales}}{\text{Labour}}$
- **Employment**
- Total no. of employees

Median before privatization and median after privatization are calculated and Wilcoxon signed-rank test is used to test the difference between the means. The null hypothesis is that the median difference between pairs of observation is zero.

For analyzing the impact of privatization on the economy, data was taken from the privatization commission and macroeconomic indicators from 1991-2015.

Privatization is taken as the independent variable and correlations are calculated. .

Correlation is calculated by the following formula: -

$$\text{Cov}(Y, PRIV)$$

$$\text{Pearson product-moment} = \frac{\text{Cov}(Y, PRIV)}{\sigma_{PRIV} \sigma_Y}$$

COV is the Covariance

σ_Y is the standard deviation

Y is the dependent Variable and may be GDP, GCE, CPI, and UNEMP.

PRIV is the independent variable and PRIV = amount raised by privatization in a year. GDP = Gross Domestic Product. CPI = Consumer Price Index. UNEMP = No of unemployed.

3. RESULTS AND DISCUSSION

Since 1991, a total of 172 public sector enterprises have been privatized and have raised an amount of Rs.648.9 billion. The largest sources of proceeds have been from the Banking and Capital Market 53%, Telecom sector 29%, Energy sector 8% and Industrial and others 10%.

Table 1: Characteristics of PSEs Privatized - 1991-2015.

Sector	Percentage (%)
Banking and Capital Markets	53
Telecom	29

To test the profitability of public sector enterprises and the impact of privatization on them, return on sales were calculated the net income was divided by the number of sales. In the cement sector, the ROs was 0.027 before privatization. The median change was 0.017 to test the significance of this median change the wilcoxon test was carried out, the median change in cement industry was found to be statistically insignificant. In the edible oil sector, the return on sales before privatization was 0.02 and after privatization was 0.0023. The median change was 0.0177 which was statistically, so far so as the automobile sector is concerned, the return on sales was 0.061 before privatization and 0.059 after privatization. The median difference was 0.002 and this was also not statistically significant. Hence, the profitability of cement industry and edible oil industry increased more than in this automobile industry. The results concur with those of Khan [10].

Table 2: Analysis of the impact of privatization on the productivity of PSEs – Return on Sales

Type	Cement	Edible Oil	Automobile
Pre-Privatization	0.027	0.020	0.061
Post-Privatization	0.010	0.0023	0.059
Change	0.017	0.0177	0.002
Z-Statistic	1.598	1.58	0.05
Probability	0.110	0.11	0.92

To analyze the efficiency before and after privatization sales efficiency was calculated to be total sales as a ratio of the total employment. In the cement industry, sales efficiency before privatization was 602 and it was 1400.1 after privatization. The median difference was 800 and this was statistically significant at 0.01% in edible oil sector, sale efficiency was 7215 before privatization and 10,731 after privatization the median difference was .416 but was not statistically insignificant in the automobile sector, the pre-privatization sales efficiency was 1541 while after privatization 4031.

Table 3: Analysis of the impact of privatization on the

Type	Cement	Edible Oil	Automobile
Pre-Privatization	602.1	7215	1514
Post-Privatization	1400.3	10,731	4031
Change	800	3516	2517
Z-Statistic	-4.01	1.32	-2.31
Probability	0.00**	0.20	0.06**

productivity of PSEs – Operating Efficiency

The median difference was 2510 the z-statistic was -2.51 which is significant at 0.06%. The increase in efficiency after privatization was more pronounced in cement and automobile sectors.

The employment in privatized enterprises has decreased afterwards. In the cement industry the privatization median employment was 790 but it decreased to 623. The median change was 67, with the value of Z-Statistics being 0.9 and statistically insignificant in the edible oil sector, the employment before privatization was 781 and after privatization 438. The median change was 343 and this was statistically significant at 0.05% in the automobile sector, the pre-privatization median employment was 201 and post-privatization was 173.

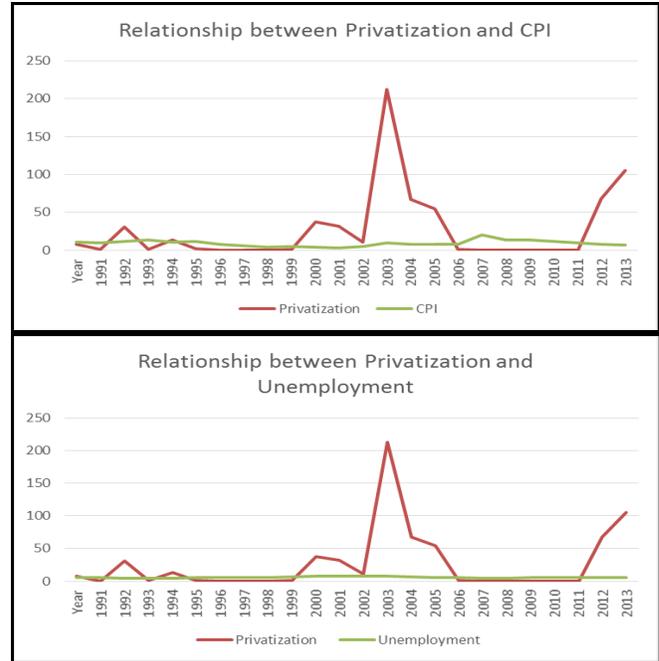
Table 4: Analysis of the impact of privatization on the productivity of PSEs – Employment

Types	Cement	Edible Oil	Automobile
Pre-Privatization	790	781	201
Post-Privatization	623	438	173
Change	67	343	28
Z-Statistic	0.9	2.51	0.29
Probability	0.37	0.029*	0.81

The z-statistic was 0.29 and insignificant. The change in employment was most pronounced in the edible oil sector. These results concur with Boardman, Laurin, and Vining [11] who compared average post-privatization financial and operating productivity and efficiency with pre-privatization ratios and found that profitability more than doubled while efficiency and sales also increased. Employment, however, decreased appreciably.

Table 5: Correlation between privatization and development indicators

Correlation	Privatization
Privatization	1
GDP	0.21
Investment	0.35
Inflation	-0.21
Unemployment	0.36

**Figure 1: Relationship between privatization and un employment****4. CONCLUSION**

The aim of the research was to discuss issues in privatization and propose a way forward. The study has reached the following conclusions. The majority of privatized enterprises are from banking and capital markets followed by the Telecom sector. The profitability of privatized SOEs increased but the change was not appreciable. The increase in efficiency after privatization more pronounced and was statistically significant in cement and automobile sectors. The decrease in employment was most pronounced in the edible oil sector. The relationship between investment and privatization was found to be moderately strong and positive. The relationship between unemployment and privatization found to be moderately strong and negative. The present regime of PML(N) has launched one of the most ambitious privatization programmes. However, it has been observed that most of the upcoming transactions have been of healthy and profitable, PSEs privatization has described as the selling of family silver by its detractors. Below are some recommendations to improve the privatization process in Pakistan. Market sale of profitable shares such as PPL or PSO is inadvisable.

- Sales to strategic investors need to follow a specified criterion.
- A proper legal framework needs to be laid down in detail.
- The regulatory framework needs to be strengthened The interests of employees of privatized enterprises need to be protected.

- Focus on post privatization service delivery for more complicated sectors.
- The sale proceeds from privatization need to be used for development activities or to pay off loans.

Transparency in the process of privatization needs to be ensured.

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