

Privatization and Fiscal Deficit: a Case Study of Pakistan

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Abstract:
Privatization was started in many countries (Developed and developing) with a view that SOEs were not working efficiently and putting extra burden on government shoulders covering losses of state owned enterprises. Privatization in Pakistan was started with some specific objectives including reduction in government subsidies to public enterprises and increasing tax revenue from private enterprises. This study investigates the fiscal impact of privatization in Pakistan by comparing pre and post privatization subsidies as expenditure and taxes and sales proceeds as revenue. The findings reveal that privatization failed to meet the expectation having positive impact on fiscal deficit of Pakistan.
Keywords: SOEs (State owned Enterprises),NTN: (National Tax Number),NADRA:((National Database and Registration Authority),PPL:Pakistan Petroleum Limited,PARCO: Pakistan Arab Refinery Limited,KAPCO: Kot Addu Power Company limited,SLIC: State Life Insurance Corporation

Introduction:
Privatization process were started from the experience that in many countries particularly in developing countries like Pakistan SOEs were not working as expected for economic development of the country. During the 1990s debt problem become severe and it forced Pakistan to adopt structural adjustment program to obey the conditionality for future borrowing with international financial institutions.
In the start it was decided that 14 loss making units would be privatized first but later on it was extended to other sectors as well. A privatization commission was established in 1991 to insure selling of Government property in an open and transparent manner. The important objective of the policy among other was to reduce the fiscal deficits through privatization and generate revenue for the state. To finance budget deficit Government of Pakistan has sold 166 state Owned enterprises for Rs. 476.5 billion since 1990. Out of the Rs. 476.5 billion in gross receipts, 80% were turned over to Federal Government, 9.5% were paid for restructuring process like gold handshake and 5% were returned to companies on whose behalf shares were sold, and 4.5% were used for privatization process expenditures. How 80% of sale proceeds are used by Federal government, data is not available. As per economic experts views about result of these sales out is not satisfactory. Recently Privatization Commission of Pakistan has announced the future program of privatizing some state owned enterprises through capital market transactions to raise funds for meeting fiscal deficit. Under this program, sales of public shares will take place through Initial Public Offerings (IPOs) Secondary Public Offerings (SPOs) Global depository receipts (GDR) and follow on public offer (FoPo). The SOEs selected for plan are HBL, NBL, PPL, PARCO, KAPCO, SLIC, NICL, IESCO and FESCO. These all selected companies are paying dividends and contributing the non-revenue taxes. Sale of these selected companies will have positive impact on fiscal deficit for short period of time because of cash received but will have negative impact in the long run because of loss of dividend income flow to government. One of the main objectives among others of privatization of State owned Enterprises in Pakistan was to raise fund for meeting fiscal deficit of Pakistan. Dose privatization in Pakistan achieved the objective is research question of the paper?

Methodology: There are two methods for evaluation of privatization and its impact on fiscal deficit in the literature. **1: trend analysis and 2: theoretical model**. We have used trend analysis in this paper. Pre and post privatization data of fiscal deficit and its ratio with GDP is collected for both periods. Subsidies and tax revenue for both periods is collected to compare the impact of privatization proceeds on subsidies and tax revenue after privatization and its impact on fiscal deficit.

Literature Review:
It is generally believed that privatization will improve efficiency and improvement in efficiency will increase profitability that will leads toward increase in tax revenue. Alam (1989) Kemal (1993, 1996) Naqvi and Kemal (1991, 1994, 1998) Young, 1998; Davis et al, 2000. Bakhtiar, Sher kamal (2007) Microeconomic literature strongly supports that private firms are more efficient than those run by the state. This result is supported by several studies of firm-level performance in both developed and developing countries (Davis et al., 2000 megginson, Nettar 2001, Pinto, Belka, krajewski 1993, LaPorta, Lopez. De Silanes, Shleifer, 2000) as well as in transition economies (Havrylyshyn and McGettigan, 1999). For a government facing liquidity constraints, the privatization revenue could be used to finance an even larger deficit (Barnett, 2000)

An increase in the deficit through higher spending or lower taxes, financed by privatization proceeds would have similar effects to those resulting from a fiscal expansion financed by an increase in public debt (McKenzie, 1998). The consensus of the literature is that state owned enterprises tend to be inefficient due to the ''soft' nature of their budget constraint (Young, 1998, Pinheiro, Schneider, 2004). They require subsidies to stay operational, and act as drain on government treasury and the entire economy. Simply removing the inefficient firm from its book ought to improve the fiscal situation of the government (Young, 1998, Pinheiro, Schneider, 2004) Sale of SOEs can be seen as a potential solution to the problem (Mansoor, 1987, Przeworski, 1991). Privatization significantly improves the fiscal situation as subsidies would decrease because of privatization (Katsoulskos, Likoyanni, 2002).

Some of literature conclude that privatization had has little fiscal impact and privatization revenue were not enough to solve the problem of fiscal deficit (Hachette, Luders,1993, Mackenzie, 1998).

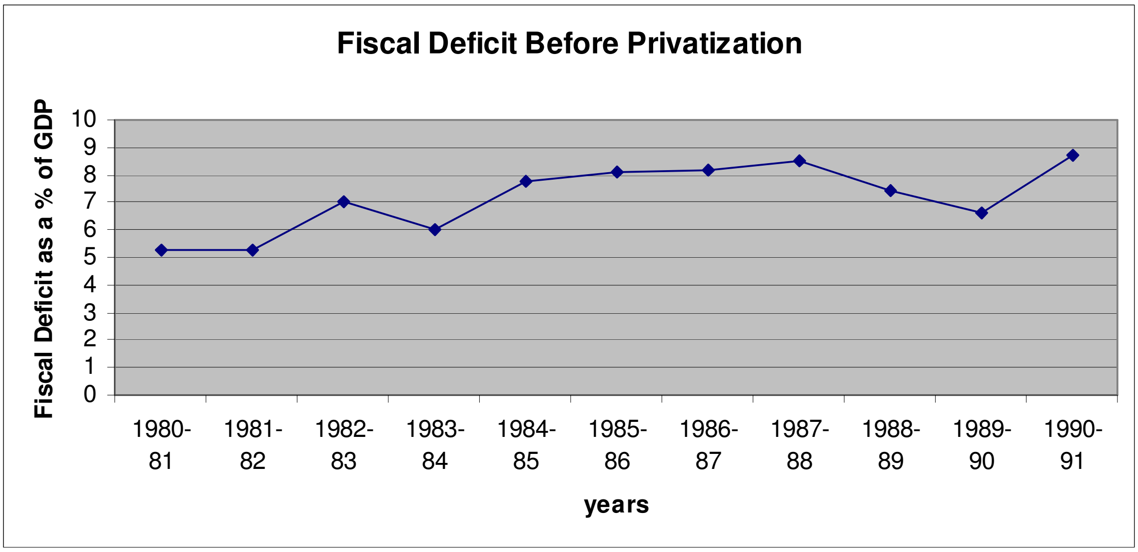
Collection of public revenue in Pakistan is not satisfactory and is major reason of fiscal deficit. Pakistan is recognized as a country of having narrow tax base, grossly inadequate tax to GDP ratio and low elasticity of tax revenue with respect to GDP growth rate. (Naeem akram *et al,* 2011). In order to increase the tax revenue in 2001 tax reforms were introduced, and numerous steps were taken by the Central Board of Revenue but as a percentage of GDP these tax reforms are failed. (Siddiqui, 2006). Pakistan being a developing country because of confined revenues and savings coupled with rising expenditures has caused the situation of persistent fiscal deficit over the years. (Naeem akram *et al*, 2011).

Fiscal deficit: Fiscal imbalance is not only macro economic problem of Pakistan but the problem of all policy managers of the world. Pakistan has been suffering with fiscal deficit problem for the last several years. Increase in public expenditure over public revenue creates many problems for appropriate functioning of the economy. Fiscal deficit represents the difference between the government expenditure and revenue for given period usually a one fiscal year. Pakistan is among those developing countries where expenditures are more than government revenue and cause a severe deficit problem. Government of Pakistan has failed to manage the difference and fiscal deficit become a major problem for economy. Fiscal deficit affects economic growth directly and indirectly. Pakistan is facing a severe deficit problem from last few decades. The history of Pakistan shows that state owned enterprises in Pakistan were performing poorly and tax revenue on their profitability was lower as compare to private sector enterprises, causing fiscal deficit. Government of Pakistan was unable to continue financing deficits in the state owned enterprises. The main source of generation revenue is tax while tax collection in Pakistan is very poor. Only employees of the government sectors are paying taxes because taxes are deducted from their salaries directly while politicians, businessmen, landlords, and other professionals in private sectors are using different techniques for avoiding tax payment on their incomes. Recently National Database and Registration Authority (NADRA) in collaboration with various departments have compiled data of some 2,376, 523 potential tax payers who do not have any NTN (National Tax Number). (The News International October 4, 2012). The important reason of collection of less tax revenue is corruption in tax collecting departments. The employees of income tax, custom, excise departments are rich in individual capacity but poor as a department. The ratio of direct tax is less than indirect tax and more than half population is not paying tax which is only source of generation of revenue. Tax base, tax system and complex tax law, tax exemptions and incentives are the causes of fiscal deficit in Pakistan. To tackle the issue government has decided to privatize the state owned enterprises to generate revenue and cover the fiscal deficit.

Discussion:
In this study we have collected the date of fiscal deficit of Pakistan for both pre and post privatization periods to compare the difference occurred because of privatization proceeds. The secondary data available in the economic surveys of Pakistan and statistical bureau of Pakistan for pre privatization period indicates that fiscal deficit as %

of GDP is little bit greater than post privatization period, but after comparing the revenue and expenditure for both periods it is cleared that this decrease in fiscal deficit is not because of privatization but due to decrease in gap between revenue and expenditure after privatization of state owned enterprises. The table 1.1, 1.2, 1.3 and 1.4 and figures 1.1, 1.2; 1.3 and 1.4 shows the reason of decrease in fiscal deficit.

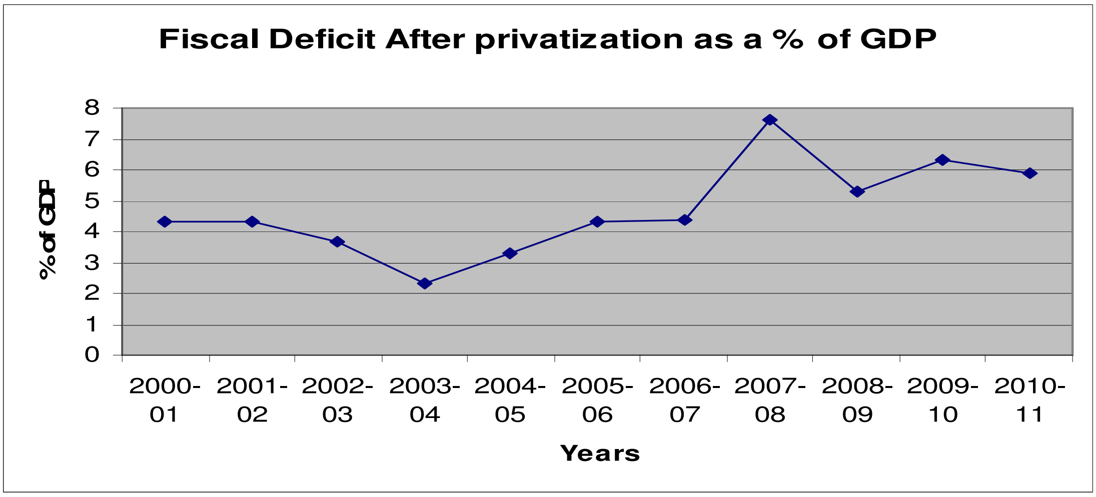
Figure.1.1



Source: Economic surveys of Pakistan for 1980-1991

Average fiscal deficit before privatization for 1980 to 1991 was 7.17 while in 1992-93, first two years of privatization budget deficit was 9.5 per cent to GDP which was more than average fiscal deficit for pre privatization period selected for the study. The fiscal deficit since 2001 to 2011 shows decrease and average deficit for the period is 4.7 % of GDP but this decrease is not because of privatization proceed but due to decrease in developmental expenditures. (Pakistan Economic Survey, 2010-2011). Tax revenue as % of GDP in Pakistan is lowest as compared to other developing countries. It has remained on average 9.2 per cent since 2000's as compared to around 15 percent in Sri Lanka and 16 per cent in India. (Naem Akram *et al,* 2011).Total expenditure in 1980-81 as a % of GDP were 22.9 and total revenue as a % of GDP were 16.9. In 1989-1990 last year of pre privatization period total expenditure were 25.7% of GDP but in 2010-11 total expenditure as a % of GDP were 19.2. Revenue as a % of GDP for said period was 16.1 remained nearly stagnant since 1990. (See table 1.4). Development expenditure of Pakistan is also the lowest among developing countries at the same development level. Total development expenditure has also shown a declining trend since 2000-01. Different internal factors have been stressing the fiscal balance. For example, large additional subsidies to the earth quack (2007-08), electricity sector and the catastrophic floods during summers 2010 put heavy pressure on the fiscal budget. See table: 1.2 and figure where fiscal deficit has started upward movement.

Figure:1.2



Source: Economic surveys of Pakistan for2010-11

Figure: 1.3

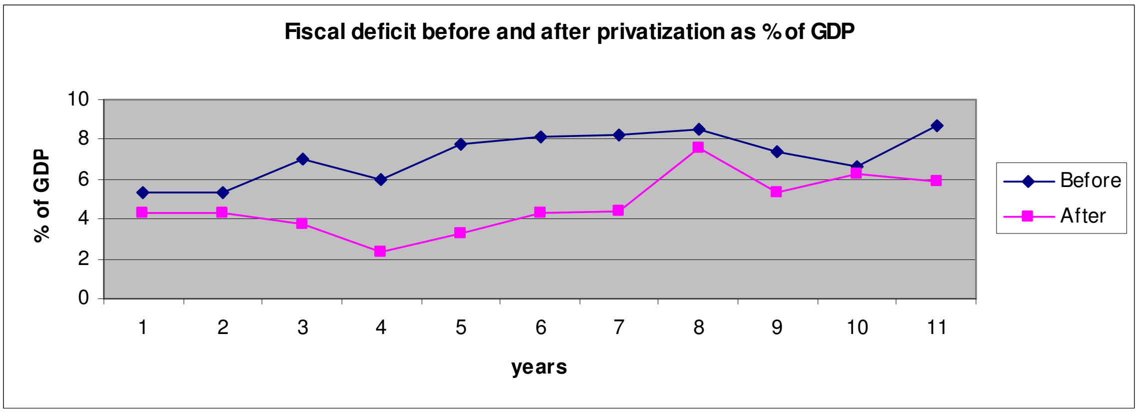
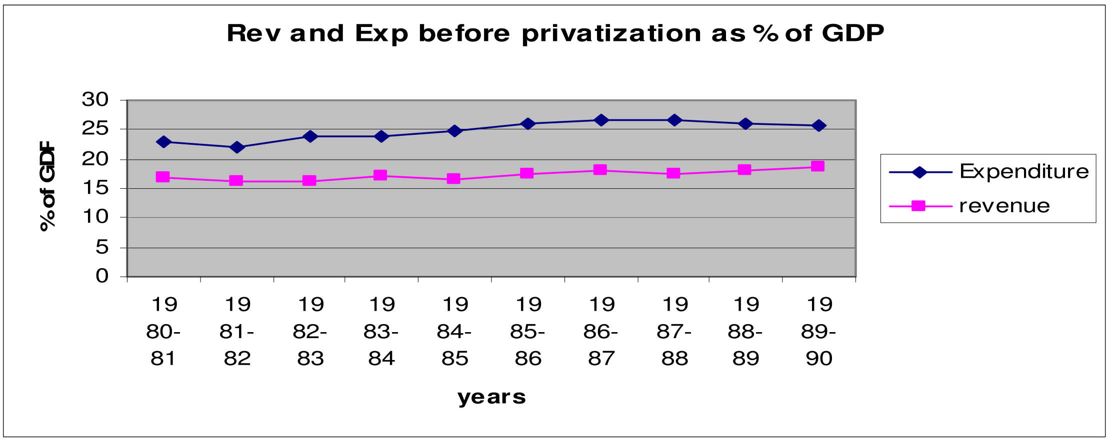
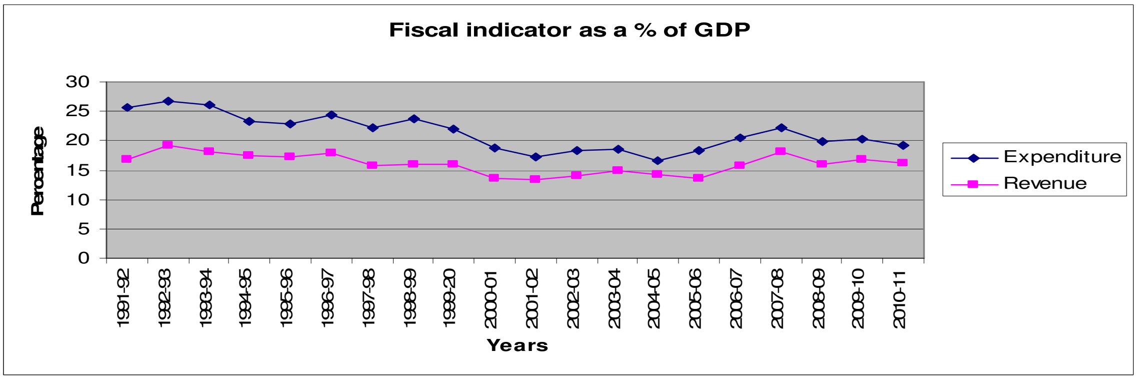


Figure: 1.4



Source: Economic surveys of Pakistan 1981-90

Figure: 1.5



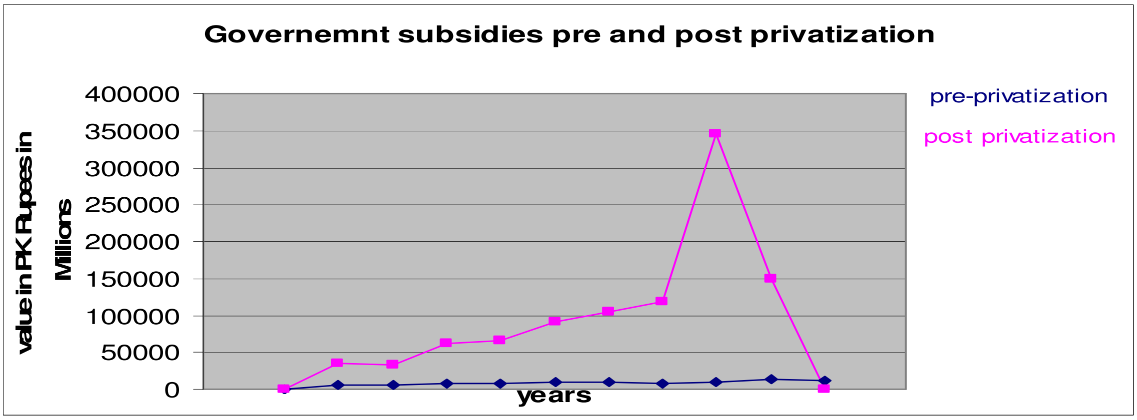
Source: Economic survey of Pakistan for1991 to 2011

Government Subsidies:

Generally accepted assumption about privatization is that privatization will decrease subsidies burden on the shoulder of state and tax revenue will be increased because of improvement in efficiency and profitability. To investigate the said assumption in Pakistan reference the data about subsidies and tax revenue for pre and post privatization period was collected.

The data reveals that subsidies after privatization period are greater than pre- privatization. The subsidy in 1990 was Rs. 12549 million while subsidy in 2009 was Rs. 149976 million showing upward trend. Government of Pakistan has sold some 166 state owned enterprises for Rs.476.5 billion but subsidy for SOEs is not decreased. Table 1.6 shows that there is no affect of privatization proceed on Government subsidy, and generally accepted assumption of privatization that sale of SOEs will remove subsidy burden from the shoulder of the state is not proved in Pakistan. Subsidy in 2008 was 346349 Million a highest one because of earth quake, flood and other natural disasters in Pakistan.

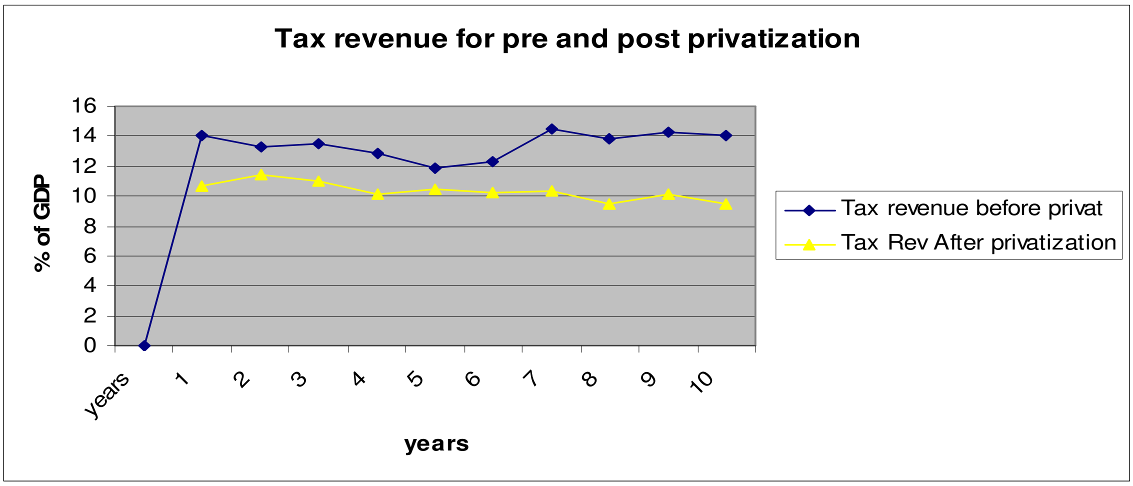
Figure: 1.6



Source: Statistical Bauru of Pakistan, 19980-2009

Tax Revenue: The second portion of the generally accepted assumption about privatization was that privatization gives birth to competition and competition will increase efficiency, efficiency will increase profitability that will lead toward increase in tax revenue. Each government has two options to finance the expenditure, to raise revenue through taxes or to borrow domestically or internationally. Pakistan has a narrow tax base and tax ratio to GDP is lower than similar developing countries. To check the assumption tax revenue for pre and post privatization was collected. The Tax revenue before privatization was 14% of GDP during 1990 while tax revenue in 2010 was 9.5% of GDP. This ratio is only for direct tax revenue while indirect tax revenue after privatization is greater than pre-privatization. The reason for decrease in direct tax revenue is that maximum direct tax payers are directly involved in politics and their prime objective of participation in political activities is to safeguard their income from taxes, while indirect tax is generally charged on lower class or middle class having no representation in assemblies to protect themselves from macroeconomic policies is showing upward trend. (See table and figure 1.7). Sources in Nadra claim that if potential tax payers in Pakistan are brought in the tax net would increase government revenue of over Rs.86 billion. It is worth mentioning here that FBR has approved two tax amnesty schemes one would primarily target the already identified million peoples who have enough resources, travel abroad, own properties and have bank accounts but still do not pay tax while in other tax amnesty scheme, existing tax payers and even others would be allowed to declare their hidden assets by paying only 1.25 to 1.50% of value of the assets declared by them and government could raised Rs.176 billion revenue through the amnesty schemes.(The News International, 2012)

Figure: 1.7



Source: Handbook of Statistics on Pakistan Economy 1981-2010

Conclusion

It is not easy to assess the impact of privatization on fiscal deficit of Pakistan because exact data is not available that how does privatization proceed is utilized by the government. Managing Fiscal deficit is the prime job of policy advisors of the country. Fiscal policy is recognized as a powerful mechanism to boost capital formation, economic growth, per capita income and level of employment. Pakistan was facing fiscal deficit problem just after creation, because as new country sources of revenues were not available but expenditure to operate the country affairs were necessary. Privatization was started in many developed and developing countries as a structural reform during 80s. Pakistan has started privatization program in 90s with variety of objectives including reduction in fiscal deficit. So for 166 state owned enterprises were privatized using different methods of privatization. Huge amounts were raised but objective of reduction in fiscal deficit could not obtain. The main reason of failure in attainment of above mentioned objective in Pakistan is that current expenditure is greater than developmental expenditure. Use of privatization proceeds for current expenditure will have no positive impact on fiscal deficit. No doubt that too much empirical work has not done on the topic but some empirical work by some researcher also prove that privatization receipts are not significantly correlated with budget deficit. (Yannis Katsoulakos and Elissavet Likoyanni 2002)

The objective of the paper was to establish the fiscal impact of privatization comparing subsidies to SOEs as expenditure and sale proceeds of SOEs and taxes of privatized state owned enterprises as revenue. An analysis and comparison of the data for pre and post privatization reveals that the efforts towards reduction in fiscal deficit through privatization of SOEs do not seem to have materialized.

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Table: 1.1 Fiscal Deficits as % of GDP before Privatization

Years	**% of Fiscal Deficit**
1980-81	5.3
1981-82	5.3
1982-83	7
1983-84	6
1984-85	7.8
1985-86	8.1
1986-87	8.2
1987-88	8.5
1988-89	7.4
1989-90	6.6
1990-91	8.7

Source: Economic surveys of Pakistan for 1980-91

Table: 1.2 Fiscal Deficits as % of GDP after Privatization

Years	% of GDP
2000-01	4.3
2001-02	4.3
2002-03	3.7
2003-04	2.3
2004-05	3.3
2005-06	4.3
2006-07	4.4
2007-08	7.6
2008-09	5.3
2009-10	6.3
2010-11	5.9

Source: Economic surveys of Pakistan for2001-11

Table: 1.3 Revenue and expenditure before Privatization

Years	Expenditure as% of GDP	Revenue as % of GDP
1980-81	22.9	16.9
1981-82	21.9	16.1
1982-83	23.9	16.3
1983-84	23.8	17.2
1984-85	24.7	16.4
1985-86	26.1	17.5
1986-87	26.6	18.2
1987-88	26.7	17.3
1988-89	26.1	18
1989-90	25.7	18.6

Source: Economic surveys of Pakistan for 1980-90

Table: 1.4 Revenue and Expenditure as % of GDP after Privatization

Years	Expenditure as % of GDP	Revenue as % of GDP
1991-92	25.7	16.9
1992-93	26.7	19.2
1993-94	26.2	18.1
1994-95	23.4	17.5
1995-96	22.9	17.3
1996-97	24.4	17.9
1997-98	22.3	15.8
1998-99	23.7	16
1999-20	22	15.9
2000-01	18.7	13.5
2001-02	17.2	13.3
2002-03	18.3	14
2003-04	18.5	14.8
2004-05	16.7	14.3
2005-06	18.4	13.6
2006-07	20.6	15.8
2007-08	22.2	18.1
2008-09	19.9	16
2009-10	20.3	16.8
2010-11	19.2	16.1

Source: Economic surveys of Pakistan 1991-2011

Table 1.5: Fiscal deficit as % of GDP before and after privatization

Years	Before Privatization	After Privatization
1	5.3	4.3
2	5.3	4.3
3	7	3.7
4	6	2.3
5	7.8	3.3
6	8.1	4.3
7	8.2	4.4
8	8.5	7.6
9	7.4	5.3
10	6.6	6.3
11	8.7	5.9

Source: Economic surveys of 1981-2011

Table: 1.6 Government subsidies before and after Privatization (Pakistani Rs. In Millions)

Years	**Before Privatization**	**After privatization**
1	5197	34040
2	5434	32775
3	7512	61751
4	8104	65496
5	9303	91359
6	9992	104399
7	7374	118970
8	10130	346349
9	12754	149976
10	12549	NA

Source: Handbook of Statistics on Pakistan Economy

Table 1.7 Tax Revenue before and after privatization

Years	Before privatization as % of GDP	After privatization as % of GDP
1	14	10.7
2	13.3	11.4
3	13.5	11
4	12.8	10.1
5	11.9	10.5
6	12.3	10.2
7	14.5	10.3
8	13.8	9.5
9	14.3	10.1
10	14	9.5

Source: Handbook of Statistics on Pakistan Economy 1981-2010