

Privatization Predicament and Shari'ah Compliant Alternate Solutions³⁰

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Abstract

This paper proposes viable Shariah based alternate solutions to the privatization dilemma. Instead of privatization through outright sale of national assets, equivalent funds can be raised through long term Shariah structures without alienating national assets permanently. This will help safeguard public welfare and in the line with Maqsaid al-Shari'ah, Hifzal al-Mall, and Mamala fiqh Marsala. Privatization of national assets is generally a matter of great public interest. This paper reviews reasonable arguments which do exist on both sides of the divide. Nevertheless, once privatization has been done reversing the process would be neither fair, nor justifiable and hence the balance of convenience in this public policy matter tilts, somewhat in favor of not privatizing national assets, if reasonable alternates are available, or possible for achieving most, if not all of the objectives which the privatization process is expected to achieve without permanently alienating national assets.

Keywords: privatization dilemma, national assets, spectrum, family silver, public policy.

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1. Introduction

The matter of privatization becomes crucial when under developing countries are unable to manage their financial resources to meet the needs of their nationals through the national assets. However, national assets play a vital role for the development of any country in the world. Almost, in all developed countries national assets are the key factor for throughout the progress of these nations. This study invokes a wide spectrum of reactions. This may range from indignation at alienating national assets permanently as tantamount to selling the proverbial ‘family silver’. It is observed that most of national assets were working very well in several developing countries but some sudden economic shocks, political instability in that country, financial crises and most important lack of top management are unable to maintain the proper flow of revenue from these assets.

Whereas, “Merton and Bodie, (1995) facilitated the financial sector through the techniques of risk allocation in different segment such as firms and households sector. Another important comment about financial sector shared by Stiglitz (1994), where he identified some causes of market failure due to the intervention of state in financial sector of economy. Whenever the top management of national assets was facing these issues, they immediately contact to interest bearing institutions for financing in any terms and conditions for settlement of national assets through financial resources. Actually, in that particular position of top management must reduce extra funding programs internally or externally, focus on their entire budget and find out the core problem why they become victim and improve their weak areas Shabbir et al (2016). However, it is also noted that some of top management people criticized their fellow beings in that condition to safe themselves as an innocent person. These are the reason behind the privatization of national assets.

Now this study gives a snapshot, why government of Pakistan interested in privatization of national assets. Actually, Government promotes the private – ownership in accordance to the principle of free economic market and this principle was launched first time by Prime Minister (PM) Nawaz Sharif on 22 January, 1991. Whereas, the promotion of free economic market principles was revised again in 1999 by PM Nawaz Sharif and finally 80% - 90% of national assets shares were converted into private ownership by PM Shaukat Aziz in 2007 (Ministry of Finance, 2007).

The State Bank of Pakistan (SBP) rated Meezan Bank as the first largest Islamic bank in 2002, which provided financing to Sui Southern Gas Company (SSGC) of PKR two (2) billions of Islamic bonds (Sukuk) on 31

May 2007, to meet the liquidity requirement of SSGC for their new projects of Natural gas and different business of transmission and distribution (SBP, 2002). After this several times Meezan Bank and standard charter bank financing to SSGC in different projects. Actually, SSGC was formed in 1954 under company act 1913 and it reshaped on 30 March, 1989 under the company ordinance 1984. Sui Northern Gas pipelines limited (SNGPL) was started in 1963 as merged limited company and after some time this company converted into public company in January 1964 under company act 1913. Islamic Financial Institutions (IFI's) play a vital role in both two companies as well as in two provinces of Pakistan through offer a long term Sukuk in order to fill the liquidity issue between both companies. The both companies agree on corporate solvent guarantees, which makes some positive effects on all parties through risk adjusted return on capital (RAROC), where it increases the profit of both companies, risk registered on capital decrease, return on investment increase and an increased on risk registered returns. (Shiller, 2003) examined that sometimes the demand of higher returns lead the behavior of moral hazard and it badly effected on people to engaged in anti-productive activities of society.

In 1958, the both governments of Pakistan and Russia signed an agreement to launch a steel mill in Karachi through private and public corporation in order to meet the needs of irons in both countries. However, this steel mill became a national asset on 30 December, 1973 under the nationalization program by government of Pakistan. It is noted that from last more than one decade this national asset continuously faces financial crises and government has planned several times for the privatization of this asset but it had stopped through involvement and restrictions of supreme court of Pakistan. Islamic Financial Institutions (IFI's) give several shariah solutions of liquidity to government of Pakistan for this asset to safe from privatization but government denied all the times. In 1970s, the PM Zulifqar Ali Bhutto announced nationalization programs in Pakistan, where all the private, semi-public and all other companies and institutions became under the control of government. This short term nationalization program had badly affected the Pakistan economy.

Actually from last more than one decade, the internal and external environment of Pakistan was not fully supported our economy because the people which were ruled over Pakistan in that period most of them, they used it for their personal benefits and ignored the country benefits Shabbier et al (2015). In FY 2004-08, the average economic growth rate was 7.1% of Pakistan economy in that 5 years, while in FY2005 the growth rate was 9.0% the reason behind it stability of macroeconomic in Pakistan on justification of both inward and outward exposures (International Monetary

Fund, 2008). The main task for Government of Pakistan and Ministry of Finance were how they got the confidence of international investors and which types of benefits they provided to different investors according to their investment levels or shares in our markets, so they didn't withdraw their investments in our financial institutions and markets Shabbir et al (2016).

However, our study consists of two parts, the first part of paper describe why some national assets become victim of privatization in different forms and second part of our study provides some Shariah alternative solutions for our national assets in order to safe these assets from privatization. The core reason of privatization for national assets is shortage of liquidity, it also depends upon top management side that shortage of liquidity is a short time or continuously decline. There are three main ways of public private companies collaborations such as, Public limited companies to private limited companies, Private to public limited companies and programs of nationalization in Pakistan. The government of Pakistan has five national financial institutions names as National Bank of Pakistan, Habib Bank of Pakistan, Allied Bank of Pakistan, United bank of Pakistan and Muslim Commercial Bank of Pakistan in 1975 but now-a-day there is only one government financial institution” and rest of four banks become privatized due to several reasons but most important reason behind this issue was tussle among financial planning and policy makers.

2. Literature Review

It is observed that Most of public and private companies' management mainly depend upon Human resources (HR) and Finance department but especially on financial advisors of company. Financial advisors show its crucial role in the progress of any company in the world. “It is the primary objective of any company to maximize its profit every year and it is also noted that stakeholder's of company preferred those people, who makes company profit more and more every year, even most of stakeholders didn't know about what kind of sources they are used to make this revenue for company each year. Coffin, (2009) shared his views in such manners, Risk management is a golden strategy for the organizations in order to protect their assets, risk reduced, return on capital increased and if loss occurs then mitigating it. Risk management is further observed by Oldfield & Santomero, (1997) where they find that risk is converted into three categories, first one who loves with risk and preferred those financial transactions which are more risky, second one are those people who partially involved in risk and they mostly depend upon

condition and nature of the transactions and finally those people come who primarily decided that they eliminate the risk in every situation.

Several studies in existing literature such as El-Gamal (2006), El-Sheikh (2000), Karbhari *et al.* (2004) and Dar and Azami (2010) indicated the importance of Islamic finance and this system is quickly adopted as an alternative solution of financial system by conventional to come under the umbrella of Islamic finance. The conventional banks open “Islamic Windows” in order to meet the needs and wants of their customers because now customer demanded from conventional financial institutions that we want to finance our investment through shariah complaint modes of financing Derigs and Marzban, (2008); Grene, (2009) and Citi Islamic, (2012). It is observed that perceive of credit agreement is supplementary marginal grim in modern Islamic banking. Helliari and Alsahlawi, (2011); Kaleem and Wajid, (2009); Obaidullah, (2002) noted that Bai Salam as a shariah complaint product is widely accepted in agriculture transactions. However, another instrument of shariah “sale with deferred payment” (Bai al - arboun) is strictly not allowed in Gulf countries because it was postulated to bring Gharar in the spectrum of modern Islamic financial system Dali and Ahmad, (2005); Obaidullah, (2002); Salehabadi and Aram, (2002); Obaidullah, (1998).

Lutufullah et al (2016) dissects the effect of Sharī'ah Compliance Perception on Customer Satisfaction, in Islamic Banking Sector of Pakistan. Primary data was gathered from 242 record holders of Islamic banks and Islamic Banking Branches (IBBs) of conventional banks and broke down by relationship and relapse through self-regulated polls in light of SERVQUAL show. Huge directing impacts of Sharī'ah consistence recognition on the connection between benefit quality and consumer loyalty have been distinguished. As a cross sectional investigation with comfort inspecting confines generalizability, and since budgetary advantages offered by banks were excluded as a variable, the extent of this examination is constrained to benefit quality as it were. Future research may concentrate on the directing impact of Sharī'ah Compliance through longitudinal examination with bigger specimen measure in a multi-social condition. Aftereffects of this paper prescribe Islamic banks to concentrate on their center quality "Sharī'ah Compliance" while building up their service and building promoting techniques.

Kaleem and Wajid et al (2009) explored the possible application of Bai Salam contract (forward sale agreement) as an alternative financial

instrument in the agriculture sector of Pakistan. A survey was conducted in four districts of the Punjab with a specifically designed questionnaire. A convenient sampling technique was used to gather farmers' concerns related to crops inputs, output and credit requirements. Empirical findings conclude that agriculture income represents only up to 60 percent of the income of an average farm household. About 70 percent of farmers participate in the credit market. They need money to purchase crops inputs, to pay the labour and to hire rental machinery. Farmers believe that they can save up to 25 percent in costs if they purchase inputs on cash. The survey also discloses that middlemen are the larger financiers and buyers of crops in the rural economy whereby only 10 percent of transactions are conducted on a purely cash basis. Farmers usually return the money after the sale of the crop.

Shahid et al (2012) found determinants of growth of Islamic retail banking in Pakistan, and is tested in Pakistan. The quantitative methodology is adopted in this paper, through three-fold approach. In first method, growth of Islamic banks is compared with conventional banks through financial statements key statistics for a period of recent three (3) years; in second method an instrument is used through customers of Islamic retail banks and their perspective is assessed; and in third methodology, another instrument is used through bankers of Islamic retail banks. findings include good bank spread, customers' perspective of good returns on deposits and better services, part from religious cause of trend for Islamic retail bank; banks' perspective of better Islamic alternate to retail banking needs.

In his book "Economic health or illness" Dr. Mohammad Malkawi describes his views about the public and private company indexation in an international market through different worldwide standard of rating in these words" *the most important index of economic well-being under capitalism is the index that monitors the growth of the nation's health as a whole. DOW Jones, NASDAQ, NIKO, NYSE and other indexes monitor the status of the nation's most powerful companies. A steady increase of these indexes does not record, or reflect the status of the poor in the nation. In fact the overwhelming data shows that poverty and hunger persist despite the steady increase of economic indexes over the years". The daily report of the economic indexes proves one more time that capitalism is inherently concerned about the growth of products, rather than the satisfaction of the needs of the people.*"

Shari'ah Compliant Alternate Solutions about Privatization of National Assets

- Privatization of national assets is generally a matter of great public interest. It invokes a wide spectrum of reactions. This may range from indignation at alienating national assets permanently as tantamount to selling the proverbial 'family silver'. 'Its proponents on the other hand also have a wide range of supporting arguments which range from leaner government, and the numerous benefits and efficiencies to be obtained from free market economies. This study reviews reasonable arguments which do exist on both sides of the divide. Nevertheless, once privatization has been done, reversing the process would be neither fair, nor justifiable, and hence, the balance of convenience in this public policy matter tilts somewhat in favor of not privatizing national assets, if reasonable alternates are available, or possible, for achieving most, if not all, of the objectives which the privatization process is expected to achieve, without permanently alienating national assets.
- Valuation and pricing of free-hold land and assets, as well as long term lease hold assets is likely to and does yield similar results. This is primarily because most credible and reliable valuation and acceptable pricing models have cash flows based focus these take into account, inter alia, net present value of future cash flows etc. These are also reviewed. Long term lease of national assets can be done and some options are being proposed here as viable alternates to the privatization process. This includes long term Shariah with underlying Sale Lease Back or Diminishing Masharkaha (DM), which has an inbuilt Ijarah element in it.
- An outright sale permanently alienates the national assets. Whereas, credit enhancement options say by adding sovereign financial guarantee to a long term Ijarah Shariah structure and its near alternates can reduce the Risk Weighted Assets (RWA) due to the sovereign financial guarantee element and can improve the Risk Adjusted Return on Capital (RAROC), vis-à-vis an outright sale even for international investors seeking portfolio diversification. Alienating national assets permanently through outright sale in the privatization process may not be in line with safeguarding public welfare, Maqsa'id al-Shari'ah, Hifzal al-Mall, particularly, when the same amount of funds can be raised through alternate Shariah based structures, where the national assets also revert and are not permanently alienated in greater public interest & Mamala fiqh

Marsala. Tangible national assets amongst other benefits and uses help facilitate in raising Shari'ah compliant financing, if required by maintaining and managing debt generation capacity at a macro level for any Islamic Economy.

- Other aspects are also reviewed and addressed. For instance, why would an investor invest in a public utility which instead of being privatized is given on a long term lease? There are solutions to these issues as well Shari'ah compliant options are also available. Case-let of Sui Northern Gas Pipelines Limited (SNGPL) and Sui Southern Gas Co. Limited (SSGCL) is presented. These are duopoly gas utilities in Pakistan catering for two provinces each with Captive clientele, geographically covering north and south regions as their names suggest. Gas Development Surcharge (GDS) provides a fixed rental solution @ 17 % p.a. linked with their operating fixed assets. As long as their cost of financing is managed below this level, it provides a positive spread and an incentive to expand their network operating fixed assets and outreach even for remote villages without gas supply. In fact, an outright purchaser may have lesser incentive to reach remote villages, whereas, a long term Shari'ah structure using underlying lease or DM mode, 'lease of the company', rather than privatizing it in the first place along with addition of sovereign guarantee for credit enhancement and other incentives such as GDS would reduce RWA and simultaneously yield better RAROC than an outright sale. This will prevent the national assets to be sold and alienated permanently. Another important aspect which may only be ignored at peril to public policy interest is that some developing countries may not be able to ensure clean, transparent, corruption and commission free privatization process.
- The sale price of an asset or property may be estimated in terms of multiples of its Annual Rental Value (ARV) say even 10 to 12 times. Another Case-let covers instances where privatizations of financial institutions have been done at a pittance. Numerous instances exist where the profits being made each year are in double digits billions and each year's profits on its own for a number of financial institutions far exceed the total price obtained in the privatization process with full management control shift sale of companies with greater breakup value national assets being sold at a pittance at an 'ARV' of around one time only".
- In view of the foregoing, it is being proposed here that in greater public interest public policy on privatization warrants fresh reconsideration for Islamic economies. Instead of privatization

through outright sale of national assets equivalent funds can be raised through long term Shari'ah structures without alienating national assets permanently. This will help safeguard public welfare and is in line with Maqsa'id al-Shari'ah, Hifzal al-Mall, and Mamala fiqh Marsala.

3. Conclusion

The government and its policy makers clearly indicate through their policies and different interviews or program on social media show that there internals and personal matters are the key source of privatization of national assets. Recently, same activities were performed such as, privatization issue of Pakistan International Airline (PIA) by Pakistan Muslim Leagues Nawaz in the last and first quarter of 2015 and 2016 respectively. Whereas, some of Islamic and conventional financial institutions were ready to fulfill the liquidity issue of PIA, but government of Pakistan does not support them. This recent issue describes a worst example of governance. However, valuation and pricing of free-hold land and assets, as well as long term lease hold assets is likely to and does yield similar results. This is primarily because most credible and reliable valuation and acceptable pricing models have cash flows based focus these take into account, inter alia, net present value of future cash flows etc. These are also reviewed. Long term lease of national assets can be done and some options are being proposed here as viable alternates to the privatization process. This includes long term Shariah with underlying Sale Lease Back or Diminishing Masharkaha (DM), which has an inbuilt Ijarah element in it. Its proponents on the other hand also have a wide range of supporting arguments which range from leaner government and the numerous benefits and efficiencies to be obtained from free market economies.

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