

Privatization of DISCOs in Pakistan - Navigating in uncharted waters



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Pakistan's power sector is undoubtedly in a quagmire. The total circular debt amounts to Rs. 2.4 trillion, of which nearly Rs. 1.8 trillion carries an interest cost *(Source: The Express Tribune, 21 November 2024)*. NEPRA estimates that this sector is causing huge financial losses to the country, exceeding Rs. 690 billion last year. Over half of this loss, according to NEPRA, was due to heavy system losses in areas controlled by DISCOs and the inability of these companies to fully recover revenue. As NEPRA states, "The primary driver of the power sector's stress is poor governance, spanning from planning to execution and subsequent operation, coupled with lack of accountability" (NEPRA, 2024).

DISCOs are the face of the power industry and its "cash cows" as well. Any deficiency in their performance has a ripple effect, not just in the power sector, but across the whole economy. A glaring example of their poor performance is the "circular debt" that continues to grow rapidly. No business or industry can survive, let alone thrive, with such inefficiencies.

Every few years, we hear from the sitting government about its resolve to shift the control of DISCOs to their respective provinces and its determination to privatize them. This seems to reflect a defeated mindset. Moving DISCOs' control to provincial governments will merely shift the burden from the federal government to the provinces. Privatizing them and hoping that private interests will resolve the DISCOs' current issues and turn them around is also a futile hope.

The term **"privatization"** is commonly understood to mean a business or industry completely run by private interests with minimal or no government control or interference. In reality, it encompasses a broad set of techniques and practices, ranging from managerial or service contracts without losing state ownership or control, to outright divestitures with minimal or no state ownership or control.

As a business concept or governance approach, "privatization" has roots in two schools of thought. One believes that the public sector is inherently inefficient, lethargic, and wasteful, and therefore business and commercial activities should avoid any state involvement, allowing markets to regulate these sectors. The opposing school of thought holds that the private sector is inherently greedy, rent-seeking, and exploitative, and should therefore not be given free rein.

The first school of thought (frequently termed **"neoliberalism"**) received a major boost when the Berlin Wall fell and the Soviet Union dissolved. This led to a shift in development thinking that emphasized the liberalization, deregulation, and privatization of trade, financing, and other prominent markets. These views were reflected in the policies and programs of International Financial Institutions (IFIs) and Multilateral Development Banks (MDBs), which further promoted this thinking (also known as the "Washington Consensus") by embedding it in their aid, financial support, and bailout packages for the developing world.

In the same vein, a new paradigm for institutional reforms was introduced in the late 1980s by IFIs and MDBs, aimed at reforming the power sectors of developing countries. It emphasized the functional unbundling of vertically integrated power utilities by encouraging private sector participation, promoting competition in contestable parts of the industry, and establishing regulators to guide, oversee, and regulate the restructured entities.

Pakistan also boarded the bandwagon around 1989 and embarked on a journey with reductions in public expenditure, more open trade, liberalization of the economy, and privatization as its milestones. Anything even remotely linked to the state was to be shunned, with development programs and projects, as much as possible, entrusted to the private sector. However, the real world does not function on such dichotomies; it operates using countless other principles that fall between these two extreme points of view.

Pakistan's governments have been particularly docile in following the dictates of international donors and lenders. It blindly followed the above philosophy, which often came alongside financial support and bailout packages for which our governments always had to rely, regardless of their economic and political costs.

There are examples of high-performing electric utility companies under public control, as well as bad ones under private hands. South Korea, Taiwan, and Singapore are living examples that state institutions, if properly designed and managed, can successfully develop infrastructure and industries. In our own country, we have well-performing distribution companies like IESCO, LESCO, and GEPCO.

We must realize that organizations, whether public or private, do not function in a vacuum. They are integral parts of a dynamic system that is influenced by both internal environments and external forces. Therefore, the real causes of the power sector's problems should not be attributed solely to the state's ownership or control. The government must address the core issues in the power sector to resolve them, rather than shifting parts of the sector's functional components to provinces or privatizing them. This misadventure could easily turn into another IPP-type fiasco. Our government must tread carefully into these uncharted waters.

NEPRA aptly notes that poor governance is at the root of the power sector's interminable crisis. Our political leadership and decision-makers must introspect and identify the causes behind the poor governance in the power sector. Once this is done, they will need to eliminate bad governance and replace it with good governance, which generally includes the following ingredients: accountability, consensus, efficiency, effectiveness, equity and inclusiveness, participation, responsiveness, the rule of law, and transparency (METU 2020).

We don't know what specific mode of privatization the government has in mind for the local DISCOs. Will it involve a gradual and phased entry of the private sector via managerial or service contracts, leases, or concessions? Or does the government plan to make a quantum leap directly to divestiture? Each mode has its own dynamics, prospects, and constraints, which must be carefully evaluated in the context of each DISCO. The suitability and practicability of different strategies should be assessed individually or jointly for achieving the desired performance improvements in these DISCOs.

The list of reform objectives should be compared with the results of the diagnostics, and the features of each contract type—its advantages and disadvantages, likely outcomes, and prerequisites—should be identified. From this analysis, it will be possible to determine which option is most likely to succeed in meeting the greatest number of (or the most critical) objectives (LSE 2018).

The data and information required to perform such diagnostics may not be readily available. Typically, we only see aggregate statistics from NEPRA showing company-wise performance for a few selected parameters, the accuracy of which the Authority itself has questioned (NEPRA, 2018). Even if these data were correct, they obscure the causal variation that might exist due to the peculiar differences in their power systems and the factors contributing to their specific performance.

Performance parameters will need to be contextualized for each distribution company because multiple factors influence the overall planning, design, operation, and performance of an individual distribution company. Aggregate losses for a largely dense DISCO like LESCO or GEPCO may not be the same as for a geographically spread-out company like QUESCO or MEPCO. They can vary widely due to both natural and anthropogenic reasons. These factors must be removed from the performance parameters by normalizing them, such as calculating technical losses per circuit-km, O&M expenses per employee or GWh delivered, and similarly for other parameters. The causes of variations in a DISCO's performance from the norm must be investigated and included in the diagnostics.

It will be important to compare the objectives of the privatization of each DISCO with the results of its diagnostics and assess the suitability of a potential privatization strategy, its pros and cons, and the likely outcomes. From this analysis and assessment, it will be possible to determine which option is most likely to succeed in meeting the greatest number of (or the most critical) objectives set for the privatization of a particular distribution company.

Like many other developing countries, the privatization of the electricity distribution function in Pakistan, though listed in the original restructuring plan, has not received any considerable interest except for occasional verbal rhetoric or promises by our political leaders. Even though considerable potential exists for improving the performance of many local DISCOs, investors generally shy away because they don't perceive that they will have the freedom to apply their standard managerial techniques and skills that they routinely use in their private enterprises. Their reluctance is perhaps due to the high risks involved and the perception of low, distributed, and uncertain rewards.

Admittedly, the "privatization" of DISCOs, in theory, can provide multiple benefits to the DISCOs as well as to the power sector and the country's economy, provided it's planned and implemented properly.



For instance, it can enhance resource efficiency, increase investment value, promote the adoption of new technologies and techniques, ensuring reliable economic service delivery to consumers. However, if not planned properly or implemented clumsily, it can easily lead to undesirable consequences, such as downsizing of staff, avoiding the requisite investment to extend access to new consumers, and exploitation of existing consumers.

A comprehensive evaluation will be needed that must consider not only the potential benefits but also the pitfalls and limitations observed from other countries that have undertaken the privatization of their distribution systems. Such lessons of experience would help identify what has worked, what has not, and why. This insight will ensure that the privatization of DISCOs in Pakistan is planned properly and implemented effectively to achieve the desired objectives (SDPI, 2024).

Before jumping into the uncharted waters that the privatization of DISCOs will bring, it's important to consider the reform objectives, policy landscape, legal, regulatory, financing frameworks and resources of the country, as well as the political constraints and stakeholder concerns. Privatization of DISCOs may be effective in addressing some of the issues specific to these companies, but not all of the power sector's problems (ADB, 2008).

Unlike generation, privatizing DISCOs is expected to focus mostly on the existing systems with a view to improving their operational and financial performance. DISCOs are currently suffering high network losses and pilferage, low productivity, inadequate maintenance, poor reliability, substandard quality of service, and low revenue recovery. This will arguably be a daunting challenge.

Almost 25% of Pakistan's population does not have access to electricity supply at present. Finding adequate private finances to manage these issues and extending the distribution grid to new consumers will be another big challenge. Private parties may not undertake such investment without government or regulatory mandates.

It would be wise if the privatization plan is made comprehensive and documented properly, and a roadmap is also devised identifying the various milestones, responsibilities, and accountabilities of relevant stakeholders. The roadmap will provide the context, set out how a proposed private participant is expected to help achieve sector goals, and describe the steps to be taken to prepare for and implement the plan. A well-defined roadmap and a well-managed process will provide a degree of certainty and reassurance to all participants. The roadmap and the privatization process will incorporate a timetable that should be adhered to as closely as possible. Decision-makers and participants must be made aware of the key dates and milestones (LSE, 2018).

A recent World Bank study, conducted to critically review the outcome of the Bank's efforts in the past 25 years to reform the power sectors of developing countries, concludes that even though regulation has been widely adopted in most developing countries, practices often fell short of theory and cost recovery goals remained largely elusive. The private sector did finance a substantial portion of new generation capacities, but its contribution to network parts of the industry remained much more limited, with efficiency levels that barely matched those of well-governed public utilities. Restructuring and liberalizing, though beneficial in a few of the larger and comparatively better-off countries, have proved too complex for most of them to implement (The World Bank, 2020).

Pakistan is already reeling from the adverse consequences of its experiment with IPPs in its generation portfolio. It would be better advised to avoid a new (mis)adventure in privatizing its distribution, as it is much more complex as well as risky. Similar efforts undertaken by many countries in the past two decades have mostly failed. Some countries even had to revert them back to the public sector. In a few cases where such efforts had some success, they were only in countries with a long history of private sector involvement in supplying such basic utility services and a legacy of strong state and regulatory institutions.

There are many other ways our government can resolve the issue of bad performance in distribution companies, provided it is willing to take some bold decisions. Even if it's determined to privatize them, it would be wise to follow an evolutionary and phased approach. To conclude (on a somewhat light-hearted note), we must learn from the mistakes of others because we may not live long enough to make all of them ourselves.

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