Public sector disinvestments and implications for economy

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Privatisation of public sector undertakings by selling off a part of the equity of the PSUs to the public is known as Disinvestment. It is the key to survive the ever-changing economic environment, and for the economic progress of the nation.

The economic policies across the world can be broadly classified into

The Stabilisation measures – The short term measures taken up the government to keep sufficient foreign exchange reserves and to keep a check on the rising prices.

The Structural reforms measures – The Long term measures aimed at improving the efficiency of the government which can be further classified into Liberalisation, Privatisation and Globalisation.

The reasons behind divestiture could be varied and inter-linked.

Reducing the public debt that is threatening to assume unmanageable proportions and to mobilise private investments and generate new sources of tax revenue.

Releasing the tax payers' money that is locked up in the PSUs and is often exposed to risk and trying to channelize it towards welfare items like basic health, family welfare, primary education etc.

Attempt to release certain tangible and intangible resources like manpower and redeploying them in other high priority sectors.

To incorporate financial discipline and facilitate modernization.

Redistribution of wealth by offering shares to investors.

Anticipate an overall beneficial effect on the economy in the long run as the economic activity would increase with an increase in appropriate private investments.

Due to the current expenditure of the government on items such as interest payments, wages to the employees and other subsidies it is hardly left with any money to spend on social infrastructure. To raise capital to be spent on social welfare programs, Law and order etc it becomes highly imperative for the government to disinvest in PSUs even though they enjoyed monopoly in their respective areas.

Though the concept of disinvestment has been floating around since 1762 (Adam Smith coined it), it was tried widely in the mid 1970s. The then Prime Minister of UK, Margaret Thatcher applied disinvestment to reform the ailing

UK economy. The UK government let go off a large stake in many of it erstwhile PSUs like British Airways, British Power and Regional water boards etc. They used public offers to transfer the state owned assets to private parties. This resulted in an increase in the shareholding population by 21%. With the privatisation of electricity, gas supply and telephones, the cost of services fell and the quality of performance also improved manifold. This also led to greater competition and it was soon agreed upon that some of the natural resources should have remained under the government to prevent duplication of resources.

Germany privatised 13500 companies in a span of two years. Ukraine, Taiwan, Hungary, Poland, West Asia, Vietnam, France and China marched ahead with their disinvestment programs and were successful in improving their foreign direct investments. Apart from Ukraine all the other countries used their disinvestment proceeds to meet their budget deficits.

In India the disinvestment process started in 1991-92 when the Congress government offered up to 20% of the equity in selected PSUs to mutual funds and investment institutions. The Disinvestment commission set up in 1996 came up with a classification of PSUs into Strategic and Non Strategic.

Strategic PSUs

Defence related organisations

Atomic energy related organisations

Railways

All the other organisations would fall under Non-Strategic PSUs where the government stake would be reduced to 26% to release the trapped resources. In the 2000 – 2001 budget, Indian government reassured the work force of the PUS’s that the disinvestment proceeds would be used to provide restructuring assistance to the PSUs and to provide a safety net to the workers.

Indian government realised Rs. 47671. 62 crores as disinvestment proceeds during 1991-2000 and Rs. 36007. 20 crores during 2000-01 from the sale of majority shares of Kochi Refineries Limited (KRL), Chennai Petroleum Corporation Limited (CPCL) and Bongaigaon Refineries and

Petrochemicals Limited (BRPL). Indian government has also decided to constitute a National Investment Fund into which the realized proceeds from the sale of PSUs would be transferred and monitored such that the proceeds are used to achieve the primary objectives laid down in the policy of disinvestment.

Implications:

Corruptions and Malpractice

The scandalous nature of disinvestments cannot be discounted especially in an economy like India which is marred by red tapism. The extent of damage that can be seen on the exterior is only the tip of an ice berg with deep ramifications wrenching out the hard earned tax-payer’s money in yet another form. Instances of favouring preferred buyers, incomplete contracts, under pricing of assets, non compliance of agreement have been widely reported.

The best example of such grave losses can be seen during the tenure of NDA government in 1999 when the government decided to off load major stakes in PSUs to so called “ strategic partners”. The government proceeded to disinvest with undue haste, ignoring warnings of grave losses to the exchequer. Starting in January 2000 the government sold control in nine companies and 19 hotels belonging to ITDC. The government earned Rs. 5, 544 crores from the strategic sale of the nine enterprises. Each of this was dubious to say the least. The major issue was non valuation of surplus land in most cases, which brought a real estate angle to the whole episode. In all, disinvestment scandals could supposedly amount to thousands of crores, and, could very well be a devil in disguise.

While the more obvious economic impact of such malpractices amount to siphoning out the tax payer’s money the story doesn’t end there. Often the disinvestment has been seen to turn in sick in less than a year which results in closing down of the operations. Hence an otherwise successfully running enterprise was forced to an early demise due to the corruption of a few men in power. This not only resulted in loss of production but also to loss of jobs and livelihood of those who were successfully running the enterprise with their blood and sweat.

While there have been other explanations which highlight the zealous nature in which the governments tried to disinvest. This ideology-driven disinvestment in any case is a poor decision by the government.

Fiscal Deficit Implications

Disinvestment of PSUs can be used to reduce the Fiscal Deficit of the government. This is a better way to reduce the deficit than by deficit financing or the printing of new notes. Deficit Financing has known to cause crowding out in private investment and is also a cause of inflation and increased rates of interests which discourage private investments. Hence, if disinvestments are carried out in a fair manner it could be a good tool to reduce Fiscal Deficits.

A reduced Fiscal Deficit increases the credit worthiness of the home country. The safeguard against a Sovereign Debt default cannot be overemphasized more specially in a developing economy. The Sovereign Debt default by Argentina had caused its bonds to lose value in the foreign market. As a result of which the Argentine government was unable to raise further capital from foreign markets. In developing markets like India it is essential that the government maintains a strong global image to garner collaboration from foreign markets. The present Fiscal deficit is at a worrisome 6. 8 percent of GDP in India. Besides adding the state deficits of 3. 5 percent the total deficit would go around 10 percent. This is creating a huge debt burden for the future generations of the country.

Core Competency

View the government as an organization who has two major goals

To uplift the country by providing services in health care, education and other social areas.

To safeguard the financial system.

A primary motive for an organization to disinvest is to concentrate on its core activities, while the second one is obvious fallout from the system by reducing Fiscal Deficit (as was earlier mentioned), the second one is more utopian. Indeed a desired implication and reason for huge disinvestments of PSUs would be that the government focuses more of its energies into developing the economy while reducing the income inequalities. Disinvestments would help the government to get rid of any extra baggage that sick units may have and instead focus on the development of the education system and improve the spite of healthcare in India.

Creating Monopolies

Another implication of disinvestment is the creation of monopolies in capital intensive sectors. Disinvestment in sectors such as power generation, distribution, natural resource extraction like coal, iron ore and petroleum would pave way for monopolies in these sectors. These high capital industries with a high learning curve have high barriers of entry along with regulatory restrictions due to their potentially exploitative nature. Divesting in these areas would risk the transfer of power to the private sector which by default works on the goal of profit maximization. These sectors are the back bone of an economy and the products and services are used by the poorest of the poor. Transferring the onus of such sectors to the private sector could be a risky affair.

Conclusion

The rationale for disinvestment lies in improved efficiency and raising government revenues to reduce fiscal deficit. However this could also be cloaked in increased income inequalities as a result of natural monopolies being created by disinvestments in key sectors. While the government can indeed concentrate on development activities which are its core competency, extreme caution must be taken to monitor and account for the disinvestment procedure in order to eliminate malpractices during the process of disinvestment.