Impact of disinvestment on indian economy

Public sector undertakings were established in India as a part of mixed economy with the objective of providing necessary infrastructure for the fast growth of economy & to safeguard against monopoly of industrialist community. However, the entire mechanism did not turn out as efficient as it ought to be, all thanks to the prevailing hierarchy and bureaucracy.

To illustrate the trailing scenario, the average return on capital employed (ROCE) by PSUs have been way too low as compared to the cost of borrowing. For instance, between 1940 and 2002, the average ROCE was 3. 4% as against 8. 6% average cost of borrowing. PSE survey by NCAER shows that PAT has never exceeded 5% of sales for or 6% of capital employed. The government pays a higher interest though, by at least 3 percentage points.

As per an NCAER study report the cost structure of PSES is much more than the private sector (the following table shows a comparative scale) :

Lack of autonomy, political interference, nepotism & corruption has further deteriorated the situation. For instance, the head of a PSU is appointed by the Government, who in turn appoints all employees who play major roles in the organization. So directly or indirectly the Government itself controls the appointment of all manpower in these organizations. It is not the business of the Government to do business, i. e. it is best controlled by experts and professional managers.

To quote some figures, on 31. 3. 1997, there were 242 central public sector enterprises with a total investment of Rs. 1, 93, 121 crores. At the end of the fiscal year 2000-01, PSEs had a total investment of Rs. 274, 114 crores. Of these, 104 were loss-making enterprises and about 53 chronically sick enterprises. If we exclude the profit making enterprises, mostly restricted to a few sectors like petroleum and allied sectors, which basically enjoy a position of State monopoly, the total loss of the 104 loss making units was a mind boggling Rs. 58, 620 crores as on 31. 3. 1997. As the losses continue, there is an increasing dependence on direct budgetary support, and such losses are continuing to be a recurring draft on the budget.

Due to the current revenue expenditure on items such as interest payments, wages and salaries of Government employees and subsidies, the Government is left with hardly any surplus for capital expenditure on social and physical infrastructure. Additionally, the continued existence of the PSEs is forcing the Government to commit further resources for the sustenance of many non-viable PSEs. The Government continues to expose the taxpayers' money to risk, which it can readily avoid. To top it all, there is a huge amount of debt overhang, which needs to be serviced and reduced before money is available to invest in infrastructure. All this makes Disinvestment of the Government stake in the PSEs absolutely imperative. Disinvestment of the Maruti Udyog Ltd. will work as a beacon for future.

In an era of globalization, liberalization and dissolution of boundaries between nations, industrial competitiveness has especially assumed an important role, necessitating privatization or disinvestment of PSUs. Though it is claimed by many that ownership isn't all that an important indicator of an organization's functioning as is its management, it has been proven by an ample number of examples that private controls of an organization bring about drastic changes in its effectiveness. This is especially true today when competitiveness is essential not only for leading the industry but for mere survival.

Bureaucracy has been an inherent part of PSUs and attempts to overcome it have been unsuccessful if not inadequate. Private management has proven to be a panacea in most such cases, including VSNL and Delhi Vidyut Board. The success of these organizations after privatization has been evident by turning from red to black within a short span of time. PSUs no longer enjoy the privileges as they did in past times in terms of reputation and awe, on the contrary are stigmatized by the lack of efficiency and social considerations of past times.

Despite huge injection of funds in the past decades the functioning of many public sector units (PSUs) has traditionally been characterized by poor management, slow decision making procedures, lack of accountability, low productivity, unsatisfactory quality of goods, excessive manpower utilization, labor intensive units, lack of technological up gradation, inadequate attention to R&D, inadequate human resource development and low rate of return on capital. However, with increasing privatization, disinvestment or change of control into hands of professional managers, many organizations have seen the tables turn. Some examples are IRCTC and CRIS to facilitate the functioning of Indian Railways etc.

Inefficient PSU’s were largely responsible for the macro-economic crisis faced by India during 1980’s. Although they were set up for the purpose of providing employment and the same time generate revenue surplus. But they could not stand to expectations. Hence steps for disinvestment had to be taken. Experts are of the opinion that disinvestment is unavoidable for the success of second generation reforms. Health of the stock market is essential with the progress of economic reforms.

We have seen every socialist country adopt industrialization, rather efficient industrialization, for appropriate growth, be it China or Russia. We preferred Russia's old model. Now that we have seen even the social countries succeed with privatization and fail without it, it is high time we implement it too in major respects.

Implications of Disinvestment on Indian Economy:

If India wants a continuous increased growth, it has to scale to the next level of performance. This is not an option but a necessity and disinvestment is a tool to get there. Increased population, unemployment, and poverty levels are main reasons why India needs to scale. The cost of not scaling to the next level will see India eclipsed by China and other South East Asian aspirants leaving India to its internal chaos. It needs a 10% rate of growth every year in its GDP to continue to be competitive with China and potential emergent nations in South East Asia.

In the context of macroeconomics, time has shown us how countries like Chile , UK, China , New zealand , Poland successfully used disinvestment to achieve new economic heights. Many countries used disinvestment as a sure means of restoring budgetary balance & to revive growth on a sustainable basis after facing economic crisis in 80s. Analysis of these countries before & after disinvestment shows that market-driven economies are more efficient than the state-planned economies

At the micro level, the change in ownership will increase domestic competition, hence efficiency; and encourage public participation in domestic stock market – all of which will promote ‘ popular ‘ capitalism that rewards risk taking and private initiative, that is expected to yield superior economic outcomes. Disinvestment shows that govt means business which will attract FDI, FII to finance projects in India.

Disinvestment will be extremely positive for the Indian equity markets and the economy. It will draw lot of foreign and domestic money into the markets. It will allow PSU to raise capital to fund their expansion plans and improve resource allocation in the economy. It will allow the government to stimulate the economy while resorting to less debt market borrowing. Private borrowers won’t be crowded out of the markets by the government and will have to pay less to borrow from the open market. Disinvestment will allow government to have much better control over the market economy without upsetting norms of market behavior.

In future disinvestment will assume the role of a major instrument of policy intervention by government as 48 PSUs listed on BSE as of February 8, 2010, account for close to the 30% of the total market cap of the exchange. This is significant as a total of 4, 880 odd companies were listed on the exchange. As of February 8, 2010, the BSE PSU index had a total market cap of Rs 17, 14, 466. 96 crore.

As certain no. of shares are reserved for retail investors & Splitting the stocks of some big PSUs , will attract more retail investors. Market cap of PSUs can go higher in future & can provide extra money in the kitty of govt.

5% Reservation for employees will work as an incentive & will keep momentum going. This will be true democratization of capital. Disinvestment would encourage citizens' participation in management of public enterprises and improve the capitalization of stock markets. Listing of enterprises on the bourse adds certain economic and financial benefits to the economy. This is known as financial deepening, a term used by development economists. Financial deepening improves the efficiency of the financial system as well as contributes to GDP growth.

Latest loan bribery case(in LIC, PNB etc.) has shown the wrongdoing, loopholes & drawbacks in the working of PSUs. If India has to become a economic super power, working way of PSUs have to be changed. PSUs contribute about more than 1/4th in the GDP of India & a large chunk of working population is employed in PSUs . Economic super power dream is not possible without PSUs coming at par with private sector.