Privatization: Any method in this madness?*

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In early January, the NDA-government's Ministry of Finance sent out two contradictory signals. The first was a statement from Finance Minister Arun Jaitley that increased government spending on public investment would be used as an instrument to revive a sagging economy. "We made an increased allocation towards public investment last year. Public investment will continue to remain stepped up. When you are fighting global slowdown, public spending has to lead the way," he is reported to have declared at an event to mark the 10th anniversary of the establishment of the India Infrastructure Finance Co. Ltd (IIFCL), a government enterprise mandated to provide long-term finance to infrastructure projects.

On the day this statement was reported, news also broke that the Finance Ministry had sent a letter to the Railways saying that central funding for the transportation behemoth would be cut by Rs. 12,000 crore relative to the original budgetary allocation. That would bring it down to Rs. 28,000crore from the Rs. 40,000 crore provided for in Budget 2015-16. According to reports, the letter stated, "the ceiling of Rs 28,000 crore for Plan Expenditure in Revised Estimate 2015-16 is fixed after careful review of pace of expenditure and the resource position of the government." Thus, the blame for the cut had been apportioned between the railway ministry's sluggish investment record and the resource crunch afflicting the central government.

Specious argument

However, the specious 'lack of funds' argument appears to be the dominant explanation for the cut. The Finance Ministry missive also said that it would not be able to respond favourably to the Railways' request for additional funds to meet the costs of implementing the Seventh Pay Commission's recommendations. In its view, "Since the liability of the General Revenues towards implementation of the recommendations of the 7th Pay Commission is much larger in comparison to Railways, it is not feasible to finance Railways on this account." Moreover, it argued that: "As a departmentally run commercial organisation, Railways is expected to meet its revenue expenditure from its revenue receipts." The message was clear. The Railways was to be left to its own devices both in terms of covering its enhanced revenue expenditure needs and meeting the additional capital expenditure it requires to make. The government cannot raise additional resources from taxation, so if the railways must spend more it must raise tariffs and cut costs to generate more surpluses.

This position is of significance because the Economic Survey 2014-15 had identified the railways as the principal vehicle for a public investment-led boost to government spending that would drive growth. In the words of the Survey, while "private investment must remain the main engine of long term growth," in the short to medium term, "public investment, especially by the railways, will have to play a catalytic role" in triggering growth. In fact, the argument in Chapter 6 of the Survey is that through additional allocations from the budget "the Indian Railways could be the next locomotive of growth." But, judging by the recent letter from Finance to the Railways, it is now being goaded into raising tariffs to finance large additional expenditures or of finding ways to incentivise the private sector to undertake a part of the investments. "The railways has now come on to directionally the right track. We

are inviting the private sector including foreign investment into infrastructure... very shortly, the railways is going to come up with its proposed bids for development of 400 railway stations in the country," Arun Jaitely recently said. This amounts to stating that the public sector can no more play its hitherto-designated role, and the private sector must occupy the spaces it has for long avoided because of the large investments, high risks and low profits involved.

This call to the private sector to play a role it abjured in the past stems from many presumptions associated with a neoliberal policy regime. The first is that the government has more or less reached the limits to additional resource mobilisation through taxation. Second, that the fiscal deficit and the level of public debt are at unsustainable levels, even though India's public debt to GDP ratio is low by global standards. Third, that the private sector would be willing to enter infrastructural areas, if they are allowed to. And, finally, that the private sector would do a better job in terms of operation, delivery and profit performance.

Selling out

What is ignored here is that the government is "cash-strapped" because it has failed to raise the resources needed to sustain its spending, on both physical and social infrastructure, without recording a significantly larger fiscal deficit. This is not because tax revenues have fallen short of budgetary projections. Rather, it is because budgeted tax revenues have been far short of requirements from the beginning, and because the government's expectations of large non-debt capital receipts from disinvestment of public sector equity and privatization through strategic sale of public enterprises has not been realized. Budget 2015-16 had projected disinvestments receipts at Rs. 69,500 crore, of which Rs. 41,000 crore was to come from sale of government equity and Rs. 28,500 crore from strategic sale of public enterprises. But by the middle of the financial year that target had been scaled down to Rs. 30,000 crore on the grounds that market conditions were not conducive. Actual receipts may fall short of even that figure. While the magnitude of the sell-out is large, receipts are still not as high as the government would like them to be. That becomes an excuse for neglecting the public sector.

Underlying this paradoxical position where the inability to hawk public sector assets is seen as holding back investment in public infrastructure needed to stimulate sagging growth reflects the transformed and contradictory attitude to the public sector under the neoliberal dispensation. The government's attitude to the public sector is based on three premises. First, that a large part of the public sector is unprofitable because of errors in decision making, managerial incompetence and overmanning with workers who are pampered relative to their private sector counterparts. Second, that this outcome is the inevitable fall-out of public ownership under which nobody is ultimately affected by poor performance and therefore responsible, and because under such ownership extraneous factors varying from nepotism to corruption influence decision making. And, third, 'soft' budget constraints resulting from financing by the Treasury, allow these problems to fester, and make the public sector a drain on the centre's resources.

The profitability issue

While some or all of these premises may be partly valid in a few instances, they are neither the full nor the dominant explanation for public sector profitability. Nothing illustrates this more than evidence that provision of a certain degree of autonomy in pricing and investment decision-making during the early liberalization years led to an improvement in performance and profitability in the public enterprises involved.

According to the official Public Enterprises Survey 2013-14, which provides data for between 213 and 234 of the 290 central public sector enterprises (CPSEs) over the years 2004-05 to 2013-14, the number of profit making enterprises rose from 143 in 2004-05 to 163 in 2013-14. The aggregate profits of the profit making enterprises rose from Rs. 74,432 crore to Rs. 1,49,164 crore. The losses of loss-making CPSEs stood at Rs. 20,055 crore in 2013-14 which was well below aggregate profits, and CPSEs as a group paid dividends of Rs. 65,115 crore and dividend taxes of Rs. 8,700 crore. That much for the argument that the public sector is a net drain on government resources.

Moreover, there are reasons other than managerial incompetence under public ownership that can explain low profitability or even losses in the public sector. To understand these it is useful to go back to the original reasons why the public sector was established, emphasised and expanded in the first four decades after the launch of planned development in 1951. The principal reason was that there were a number of areas in industry and infrastructure into which private investors were unwilling to venture because of the lumpy investments, long gestation lags, higher risks and inadequate returns associated with them. On the other hand, some of these industries were such that their emergence and growth was crucial for the industrialisation process, and their absence would constitute a drag on industrial growth. Thus the state was required to invest in these areas to ensure their presence and, thereby, facilitate industrialisation.

The government's own realization of the supportive role to be played by the public sector was reflected in the Third Plan which stated that "a number of basic industries which require large investments and extensive collaboration with foreign firms or governments and which could be undertaken only on the assurance of future prospects, with no immediate gain in sight, would not normally be started if reliance was to be placed entirely on private enterprise." If the government is forced to invest in some areas because low profitability and high risk discourages private presence, the corollary is that public sector units in such areas can hardly be highly profitable.

Second, there were strategic areas, varying from petroleum and nuclear energy to the railways and telecommunications, where private control was either not advisable or public presence was crucial. In some of these areas such a nuclear energy, profit considerations alone did not warrant investment. In others like railways, the government’s role in providing cheap urban and cross-country transportation kept profits low or negative. It should be no surprise that in 2013-14, the two CPSEs making the largest losses were Bharat Sanchar Nigam Ltd and Air India, which together accounted for more than two-fifths of the losses of all loss-making units. The former, in its earlier identity as a departmental enterprise, bore the responsibility of building the infrastructure needed to provide landline connectivity across a large country, including areas with low telephone and call densities. The latter was called

upon to connect locations that implied uneconomic routes, which no private provider would touch.

Finally, there were some ‘sunset industries’ with lower relative profitability, epitomised by textiles, where the exit of private capital through the extraction and transfer of surpluses and the neglect of replacement and modernisation of equipment, resulted in “sickness”. Since private capital chose to close down units in these areas, and put at risk the jobs of thousands of workers, the state had to intervene to take over the sick units and nationalise them. While the National Textile Corporation was a typical example of the outcome of this tendency, the problem affected other industries as well. Even after much restructuring, textiles accounted for losses of Rs. 273.69 crore in 2013-14.

Thus, given the objectives with which they were created many public sector units were never intended to function like typical private corporations would. This was reflected in the pricing principles adopted for the public sector. Firms in the private corporate sector aim to add on a margin above operating costs to cover overheads and deliver a profit. So long as the “market can bear” the price and sales would not collapse, the margin above costs would be raised to maximise profits. As compared to this, pre-liberalisation governments in India (and elsewhere) have implicitly treated public sector prices as akin to an indirect tax. In some areas this ‘tax” is kept low so that the price at which public sector products are sold imply a subsidy to buyers of those products. This could prevail in sectors where the product is an “essential” good or service (transportation and energy, for example) or where the government wants to keep prices of crucial inputs produced by the public sector low, to facilitate the growth of a particular downstream industry or support the small-scale sector (steel and aluminium, perhaps). In these areas, to cover losses if any and/or support investment in the units concerned, the government would compensate them with revenues garnered from direct and indirect taxation or dividends accruing from public sector units in other industries. Thus, pricing in the public sector was treated as one of the instruments in the government’s overall tax-cum-subsidy regime.

The combination of the areas into which the public sector entered and the pricing policy it followed meant that it would be segmented into various kinds of units. Those that were bound to suffer losses such as many units under the National Textile Corporation, others that would suffer losses or earn low profits because of the pricing principles adopted (steel and fertilisers) and yet others, which because of being natural monopolies or deriving administered pricing benefits (petroleum), made significant profits. However, on average, through multiple means—taxes contributed, dividends paid out and disinvestment receipts—the public sector as a whole has provided more to the government than it has received in return.

Justifying privatisation

But it was not these features of the public sector that drew attention when the turn to liberalisation occurred. Rather the claim was that the public sector was “inefficient” in the sense that most units were earning low profits or incurring losses resulting in them constituting a source of drain from an already stretched exchequer. This led up to the assertion that the very idea of having a public sector engaged in industrial production was largely mistaken, and that it was not the business of government to be in business.

Such arguments were used as the justification to pursue a completely different agenda: that of divesting equity in profit making public sector firms in order to garner resources to cover the deficit on the central government's budget resulting from a combination of poor resource mobilisation through taxation and unwarranted transfers, especially to the corporate sector. Rather than the public sector being a drain on the central budget, it was being converted into a cash cow to meet deficit targets within an irrational and regressive fiscal regime. Every year the government sets itself a target for garnering "non-debt creating capital receipts" by the sale of public equity. Though the disinvestment strategy has proved difficult to implement to the extent the government wanted, funds garnered through this route have been substantial. There have been only two years since 1991-92, when the disinvestment and privatization drive began when actual receipts exceeded targets set in the budget. But receipts from privatization have risen significantly from Rs. 4,843 crore (1994-95) and Rs. 5,371 crore (1998-99) in those two years, when targets were realised, to a huge Rs. 24,349 crore in 2014-15. This'partial' success of the privatization drive is attributable to the emphasis on the sale of equity in some of the most profitable public sector units, on undertaking such sale at prices that considerably undervalue the real assets and surpluses of these enterprises, and in resorting to "strategic sales" that involved the handing over of complete managerial and financial control to a private investor who commits to acquiring a bloc of 26 per cent of equity held by the state. Through the provision of such concessions the government's equity stake in profitable public sector units has been substantially diluted over time, resulting not just in the erosion of the revenues of the state but also of its ability to use the public sector and its surpluses as a countercyclical instrument in times when growth slows. Since it is not loss making units, which are a "drain", that are being disposed of, the whole exercise is irrational in a financial sense.

In sum, the concern of the government is not the performance or profitability of the public sector. If that were the case the emphasis would be on institutional adjustments that gave autonomy to public sector units required to deliver on targets mutually agreed between management, employees and government, as was recommended by an official committee headed by Arjun Sengupta, for example. The real thrust today is to wind down the public sector to garner budgetary resources, or sell assets to finance even current or consumption expenditures of the government. This suits the private sector and international capital. It allows acquisition of valuable assets at relatively low prices. And where profits are difficult to come by it allows the private sector to demand concessions such as flexible pricing or even funding support in the form, for example, of viability gap funding in so-called public-private partnerships (PPPs). Increasingly PPPs are seen as projects in which the government carries all the risks and the private partner gets all the profits. The perception is that if the government does not provide such concessions, "revenues" from privatization would be much lower than what has thus far been obtained. Not surprisingly, the representatives of big capital, domestic and foreign, including sections of the media, take for granted that privatization is a major step forward in policy-making with respect to the public sector. But the developmental costs of this predatory exercise are large. So are the losses to workers in the public sector, threatened with declining real wages and deteriorating working conditions, and to workers outside it, who could present the wages and conditions of work in the public sector as the standard they legitimately aspire to. This madness must end, but there is a method to it.

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