An Obsession to Sell*

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Early in its tenure the second NDA government has launched on a huge privatisation drive. Having announced in its first budget in July that it intends accelerating the processes of 'disinvestment' and privatisation, it got on to the act quickly and announced cabinet clearance in early September for the first stage of that process. As per that decision the government is to dilute its stake in three major profit-making public sector undertakings—Oil and Natural Gas Corporation (ONGC), Coal India (CIL) and National Hydroelectric Power Corporation (NHPC)—to garner an estimated total of around Rs.45,000 crore based on current market prices. Given the fact that these are blue chip companies in areas where demand is high and rising, the stake sale is likely to sail through.

The intention is to dilute equity to the extent of 10 per cent in Coal India (which is expected to yield Rs.23, 600 crore), 5 per cent in ONGC (Rs.19, 000 crore) and 13.3 per cent in NHPC (Rs. 3, 100 crore). The government's stakes in CIL, ONGC and NHPC are at present 89.65 per cent, 68.94 per cent and 85.96 per cent respectively. That allows the process to be characterised as 'disinvestment' rather than privatisation, since the majority stake in all three firms would still remain with the government even after the sale. On the other hand, the process when completed will in all likelihood yield a sum almost equal to the Rs. 48,425 crore it had provided for in the budget. Allowing for an additional Rs. 15,000 crore from "divestment of government stake in non-government companies", or those in which the government has a minority stake, the budget had projected total receipts from sale of public equity at Rs. 63,425 crore over 2014-15. Considering that the highest annual receipts from disinvestment since liberalisation began was Rs. 25,890 crore in 2012-13, this is an ambitious target. But a combination of a bull run in the stock market and the willingness to sell a part of the government's stake in the best public sector companies suggests that the record would be breached by a large margin.

At the moment, therefore, the issue is not whether the government's strategy is feasible, but whether it is rational. The government's claim is that from a budgetary point of view the sale of equity reduces the need for borrowing that increases the interest burden in future years. But this rationale for preferring disinvestment of stock in profit making companies to borrowing to finance budgetary expenditures that are in excess of revenues (or the fiscal deficit), is not clear from a purely accounting point of view. Private buyers of public sector equity are presumably betting on getting a much better return on that equity than on public debt. This is because government bonds, or the securities sold to mobilise public debt, are backed by a sovereign guarantee and, therefore, carry the least risk among all financial instruments, including equity of public enterprises. This would imply that the return on public equity must be higher than the interest rate earned on safe government bonds. So by substituting equity sale for debt to finance its deficit the government is giving up a stream of incomes that must be larger than the stream of interest payments on debt, if disinvestment is viable at all.

This raises the question as to why successive governments whether of the NDA or the UPA have placed so much emphasis on disinvestment. There appear to be two factors responsible for this tendency. One is the inadequacy of revenues from taxation to finance proposed government expenditures. Surprisingly, this has occurred in a context in which the government has been pruning expenditures, especially social sector spending and capital expenditures, to control the fiscal deficit. What that implies is that despite the fact that GDP growth has been reasonably good or remarkable over the last three decades, the government is starved of resources to an extent that it cannot finance even pruned public expenditures with available revenues. This is because tax revenues relative to GDP are low, and even falling in some periods. That tendency, in turn, is explained by the fiscal ethos underlying liberalisation or "economic reform", which holds that as part of the effort at promoting and facilitating private investment the government should display tax forbearance. Policies such as lower tax rates, exemptions, concessions and tax holidays for select sectors, together with rationalisation of indirect taxes, are used to reduce the burden of taxation in order to incentivise investment. As a result India is characterised by a low tax to GDP ratio by international standards, and despite reduced expenditures, the fiscal deficit remains significant.

This in itself does not necessitate privatisation. The second factor responsible for the disinvestment drive is the belief that even if the public debt to GDP ratio in India is not as high as in many other countries across the world, fiscal prudence and consolidation requires, besides a cap on the fiscal deficit, a ceiling on government borrowing. This implies that non-debt receipts must account for a rising share of the capital receipts mobilised to finance the fiscal deficit that remains. This explains the turn to privatisation as a means of financing the fiscal deficit. Not surprisingly the forces that favour privatisation are also the ones that push for "fiscal consolidation" or reduced borrowing. As is to be expected those forces consist of large private players wanting to acquire at bargain prices public assets they see as being lucrative short or long-term investments.

This too is a recent phenomenon. A substantial chunk of public sector assets consist of investments made in capital intensive areas. These were seen as sectors with positive economy-wide externalities that supported or facilitated growth elsewhere in the system. To maximise their effect, the sectors concerned were subjected to administered or quasi-administered price regimes aimed at keeping the cost of their outputs low for developmental reasons. As a result, in earlier times, private investors were unwilling to enter these areas seen as inadequately profitable and too risky, necessitating public investment. So the recent eagerness, not just willingness, of the private sector to buy into public equity or even acquire control over public assets is intriguing.

One explanation is of course that Indian business has come a long way since the early post-Independence years and sees itself as capable of managing and sustaining much larger investments. So areas that were considered untouchable earlier are strong investment options now. In addition, liberalisation has decontrolled or deregulated pricing, or made government subventions or viability gap funding a must for private projects in areas where prices are capped. Greater flexibility in pricing and transfers to ensure profitability have opened up new possibilities for profit in these areas that the private sector earlier shunned. If some private players are interested in taking over areas that were earlier reserved for the public sector, others would be interested in buying into small chunks of equity in exiting firms in those industries which they can then sell for a profit to interested private buyers. So, in areas that promise profits, disinvestment is bound to be a success.

Given this opportunity, a range of arguments is adopted to push the government to rely on disinvestment receipts rather than borrowing to finance its deficit. One such case for restraints on government borrowing is that it will crowd out private investment by absorbing a larger share of a given volume of saving or by pushing up interest rates and raising the cost of the capital. So if privatisation is the alternative, it should be pursued. Some advocates of privatisation have no time for such niceties. They just declare that public sector managers are either too inefficient or too corrupt to deliver a profit, or that it is just not the business of government to be in business.

Arguments such as these ignore the basic unsustainability of the policy being advocated. So long as the government adheres to the principles of tax forbearance it would have to run a deficit of some magnitude because not all activities that are financed by government expenditures can be or will be taken over by the private sector. And so long as it sticks with the idea that public borrowing must be restrained, sale of public equity seem unavoidable. But that involves a contradiction. Disinvestment receipts unlike tax revenues are once-for-all. An asset sold cannot be recovered by the seller to be sold again. A process wherein the source of revenue diminishes but the expenditures it sustains keeps increasing is obviously unsustainable.

The limits to the process can assert themselves quite quickly for a number of reasons. To start with, disinvestment would be successful only when equity in profitable or potentially profitable public sector enterprises is sold. There are few such enterprises, so that over time chunks of equity from the same enterprises have to be periodically brought to market. This not only questions the distinction between disinvestment and privatisation, but implies that finally the “wealth” that finances current expenditures must run out.

This can occur much faster than expected. If disinvestment is done through the market, the funds that could be mobilised are determined not so much by the “real value” of the underlying assets available but by the market price driven by market sentiment. Today we might be witnessing a bull run in markets, but fundamentals would finally assert themselves and market prices of equity are bound to fall. So this would necessitate selling larger bundles of equity to mobilise a given volume of resources, accelerating the exhaustion of the available stock of profitable equity.

Moreover when markets are weak the government is likely to adopt other means of sale. An example was the decision to resort to strategic sales by which private buyers were enticed into buying a large chunk of equity (26 per cent of total shareholding) by offering them the benefit of full managerial control. Even allowing for the requirement that the acquirer would have to make an open offer to buy the stake of minority shareholders at the same price it pays the government, the amount of equity bought is likely to be much smaller than the actual stake required to wrest control. Moreover, since the number of players willing to make a strategic buy out would be limited, the government has had to underprice the equity to ensure its sale. That too would require a faster pace of retrenchment of equity, if disinvestment and privatisation become means of financing budgetary expenditures.

In sum, while adherence to the neoliberal agenda is accelerating the process of privatisation under the NDA, that process remains fiscally irrational and unsustainable, and amounts to a way of enriching the corporate sector at the expense of the exchequer. On the other hand, it is bound to adversely affect workers employed in the public sector, who will loose the hard won right to a decent livelihood that permanent public sector employment offers.

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