

# WEIGHING IN ON THE PUBLIC SECTOR PRIVATISATION DEBATE

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Public Finance, Taxation & Black Money incl. Government Budgeting

There seem to be broadly three positions with respect to the privatisation of public sector undertakings (PSUs). The left position is “PSU is family silver and should not be sold irrespective of its performance”. The divergent stand is that “business is not the business of government”, which found resonance in the United Kingdom, and, of late, in India. There is also the third position: Why privatise profit-making PSUs? Why do you sell the family silver? Bharat Petroleum Corporation Limited (BPCL) which is making handsome profits, comes under this category.

Loss-making PSUs certainly merit privatisation — but no one would buy them with their huge debt and employee liabilities. The government may even have to pay the buyer, as it happened in the case of the Delhi Discom privatisation. Even then it may be worth it, since privatisation will stop fiscal flows to these PSUs. Alternatively, there is the exit route through the new Insolvency and Bankruptcy Code.

Some of the major loss-making PSUs, Bharat Sanchar Nigam Limited, Mahanagar Telephone Nigam Limited and Air India should go under the block as their losses are greater than their revenue. *The Economist* has a term for such entities — value subtracting enterprises. Restructuring them and even ensuring an additional infusion of funds and other resources have not produced results. Their chairmen cum managing directors are bureaucrats who may not have domain knowledge or technical service people bereft of business acumen. Justifying their existence — in the case of BSNL/MTNL which ran telecom at one time as a government monopoly, with a teledensity of 0.01% — by citing national security is strange. At one time the argument was that BSNL alone maintains the military telecom network. It was for the same reason that the private sector was not allowed to operate in the defence sector; we have paid a heavy price for only entrusting it to the public sector in this area. The present government has by and large done well in opening up defence to the private sector.

Privatisation is not a default option; rather, it is resorted to only out of extreme necessity. As World Bank consultants said on the Delhi Discom privatisation: “Privatization is resorted not just when the firm makes losses, but only when the physical performance is so bad that the PSU becomes a political embarrassment to the Government.” This may explain the hesitation to privatise some of the largest loss-making PSUs — Air India, the BSNL and MTNL — as the embarrassment threshold may not have been reached as yet.

But why privatise a profit-making PSU. What comes into play here is not the lofty “business is not the business of government” argument, but a more mundane fiscal imperative. The Finance Minister’s disinvestment target of a little over a lakh of crores for the current fiscal has to be met. It is this fiscal requirement that now drives privatisation. Let us revisit the question: Should profit-making PSUs be privatised? It is good to remember what former Prime Minister Manmohan Singh once said on the issue. He made the assurance that the government would not “privatise profit making PSUs working in competitive environments”. That is, if the output price is a competitive price and you still make a profit, then you are efficient and the need to privatise does not arise.

But if the output price is set in a monopoly background — the case now being the monopoly

cartel of the oil majors, BPCL, Indian Oil Corporation Limited and Hindustan Petroleum Corporation Limited — with the autonomy given being used for monopoly pricing, then your profit is no longer an index of your efficiency. In that case, privatisation will still bring in benefits of the efficient operation of private sector through reduced costs. Examples of PSUs that made monopoly profits and still inefficient were Coal India and Indian Airlines (IA). For IA, there was poor punctuality, high staff-to-plane ratio, high operating costs and overall customer indifference.

The BPCL is not inefficient but its privatisation still offers scope for improvement. When a company such as this has never faced any serious competition, it is impossible to even discuss the issue of efficiency or inefficiency. There is no comparable firm in the private sector to benchmark it with.

However if one looks at just about any public sector company in India, it is impossible to argue that the BPCL can be an exception. Over the years, the financial performance of oil marketing companies has undergone a bureaucratic process called “administrative price mechanism”. All one can say is that the oil PSUs have been allowed to make profit; if one can use *The Economist’s* phrase again, they can be called “allotted millionaires”. On the non-financial performance side, it would be difficult for the BPCL to show what innovations it has implemented over the years either in marketing or refinery operations.

There is no point in converting a public monopoly to a private monopoly; it will only result in inefficiency being replaced by private profits. Privatisation must be accompanied by competition in the post-privatised scenario.

However, the government will face a dilemma. If you want a high price, you must allow a monopoly situation post-privatisation, and if you want competition and low price for consumers, you must be content with a modest sale price, as the post-privatisation valuation of the firm critically depends on the market structure post-privatisation. If that is to be competitive, other PSU national oil companies such as the IOC and HPCL should also be privatised. There is also no issue of national security for downstream oil firms. Oil marketing companies, even if they are not in the public sector, can be made to own strategic petroleum reserves as in most of Europe and by the government itself as in the U.S. Thus privatising the BPCL does not compromise India’s national security.

Similarly, LPG and kerosene subsidies can be handled by direct benefit transfer, which is already in vogue in the case of LPG.

Finally, there is an argument advanced in the case of the BPCL: that the government paid about 622 crore in today’s money to acquire it, while it now has a market value of around 85,000-1,15,000 crore. How did 622 crore balloon into this amount even after the time value of money adjustment? Is it a bargain one cannot refuse? Not quite. After all, in the interim period of many years, the firm would have invested, out of retained profits, and also generated further monopoly profits for dividends which explains its increased value. This is not by its virtue of being a PSU. The BPCL is not a golden goose. It may be an ATM.

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