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India restarts privatisation drive

David Keohane and James Crabtree in Mumbai

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Doubts remain over whether Delhi can slim the bloated state sector

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Arun Jaitley, India’s finance minister, appeared upbeat after last week’s annual budget, pledging to meet what he called an “ambitious” target to sell Rs565bn ($8.4bn) of stakes in state-backed companies over the next year.

“Probably in March, we’ll have one or two more,” he said of the first of a spate of sales, set to include holdings in major state-backed groups including energy explorer Oil and Natural Gas Corporation and miner Coal India .

Pushing these through would help Mr Jaitley hit a tough government budget target next year. More importantly, the goal embodies wider hopes that India may finally accelerate its previously timid privatisation efforts, and slim its bloated state sector.

Such hopes were greeted with a sense of both scepticism and déjà vu last week, however, given India’s record of repeatedly flunking previous asset sale goals.

Last year’s effort was especially poor, achieving barely one-third of the targeted amount. Worse, much of that was sold to Life Insurance Corporation of India, a state-backed insurer, meaning India’s privatisation programme is often derided as merely a financial transfer between state bodies.

Mr Jaitley blamed last year's failure on inauspicious market conditions, especially for the energy and commodity groups that dominate India's so-called public sector undertakings (PSUs). Partly as a result, this year's goal has been lowered, in theory making it easier to hit.

Yet doubts remain. "The problem is they are scared any sale will be accused of being done at too low a price, losing money for the exchequer, and so they delay," says Ila Patnaik, an economist at the National Institute of Public Finance and Policy, and until recently an adviser in India's finance ministry. "It is hard to make out exactly what their strategy is to hit the target."

Jayant Sinha, minister of state for finance, disputes this, arguing that this year marks a "paradigm shift" — a change indicated by India's decision to mothball its old department of divestments and launch a newly renamed department investment and public asset management in its place.

> "India's privatisation programme is often derided as merely a financial transfer between state bodies"
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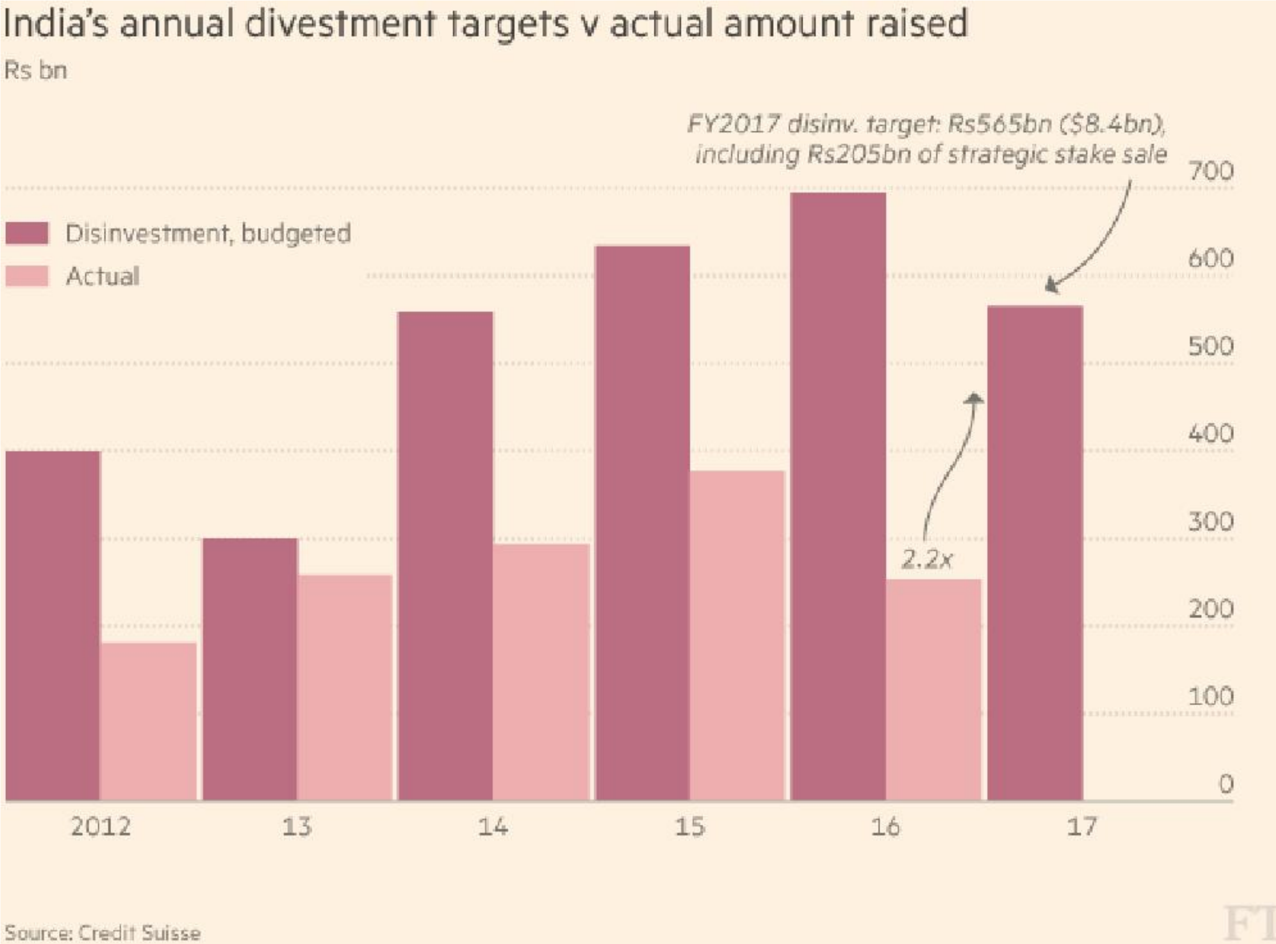
The government has a healthy pipeline of a dozen or more PSUs from which to sell off stakes, ranging from industrial group Bharat Heavy Electricals to energy group NTPC. It also owns parts of valuable private sector companies, including lender Axis Bank and engineering group Larsen & Toubro, worth more than $7bn.

Equally, Mr Sinha puts emphasis on "strategic sales". This could mean full privatisations — which India has found notably hard to deliver over the past decade. Equally, it could mean moves to bring companies into majority private ownership, such as government-backed IDBI Bank, or to float unlisted public bodies.

"This will help to transform the way these assets are run, not just raise revenue by selling parts of them," Mr Sinha says.

Even so, considerable barriers remain, with investors pulling back from emerging markets and commodity prices at rock bottom. "There are very few big things they can sell," says the head of one global bank in Mumbai. "There is almost no chance they can sell ONGC with the oil price where it is, so why even try?"



Many PSUs are also heavily unionised, prompting political battles when a sale is announced. As a result, most sales happen late in the financial year, leaving little time to hit targets.

"Announcing a number at the end of February and then only deciding if you are going to meet it or not nine months later is hardly fiscal responsibility," says Rajeev Malik, a CLSA economist.

India's use of the quasi-government LIC as a backstop is often criticised, but it at least means sales are likely to succeed, since LIC is forced to buy much of the available offer and often even makes a tidy profit, selling holdings off again if markets rise.

Put this together and some observers are confident that India will, finally, hit its goal next year. "As long as there is political will, the divestment target for next year should be no problem," says Sunil Sanghai, managing director of HSBC in India.

More doubtful, however, is whether India's divestment programme can be viewed as akin to China's push to reform its state-owned enterprises, using private investors to improve efficiency and reduce state subsidies.

Other observers have more basic suggestions, beginning with a planned calendar of stake sales to lessen the risks of timing the market, selling small slices of companies every quarter or month in order to diversify price risk — upping the chance the government target can be met.

"If they move to a strategy of having a regular calendar of sales it can be met," says Ms Patnaik. "If not, all the old issues will crop up again."

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