The PSU disconnect

Political calculations may have slowed privatisation, but economic policies to improve the public sector's performance brook no delay

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If you need any proof of how the Narendra Modi government's policy on the public sector has undergone a subtle but significant change, last week's introduction of a new amendment Bill in the Lok Sabha should be sufficient. Of course, the government remains committed, in principle, to its earlier decision to facilitate the exit of public sector undertakings (PSUs) from non-strategic areas and limit their presence in strategic areas to a bare minimum. But the rollout of this policy appears to have been at least deferred, if not junked.

In February 2021, the Modi government announced its proposal to privatise two public-sector banks in addition to IDBI Bank. Three years have gone by, and now there is only some hope that IDBI Bank may be sold off to a private party by the end of the current financial year. Early this month, the Union Cabinet met and approved a proposal to amend the Banking Regulation Act, the State Bank of India Act, and the Banking Companies (Acquisition and Transfer of Undertakings) Act, raising hopes of privatisation initiatives making some headway.

But as last week's developments showed, these amendments were primarily aimed at allowing up to four nominees for holders of bank accounts and lockers, extending the tenure of directors of cooperative banks, and at helping the transfer of unclaimed dividends, shares and interest or redemption of bonds to the Investor Education and Protection Fund. If the government were serious about the privatisation of two public-sector banks, it could have also approved the relevant provisions in the Banking Companies (Acquisition and Transfer of Undertakings) Act. That, however, did not happen, indicating a longer wait for the Modi government's second privatisation — the sale of Air India in January 2022 being its first and the only such decision so far.

Even the pace of disinvestment of government equity in PSUs has considerably slowed. Barring a high of two years, when disinvestment revenues were close to ₹1 trillion each in 2017-18 and 2018-19, the government's performance on this front has been on a steady decline, particularly after the pandemic. Even during the heydays of disinvestment, the receipts were between 0.5 and 0.6 per cent of gross domestic product (GDP), and subsequent years have seen a further fall from 0.25 per cent in 2019-20 to 0.11 per cent of GDP last year. The official commentary on the gradual decline in disinvestment receipts notes that the government is focusing more on value creation, implying that a decision to sell PSU equity will be taken only when needed and at the right moment.

Have PSU dividends gone up to give the government the confidence that there are early signs of value creation and, therefore, their improved performance would at least improve non-tax revenues and bolster its finances? Not really. Dividends from non-financial PSUs have grown at a slow pace, doubling only in the last 10 years to ₹50,000 crore in 2023-24. By another yardstick, dividends as a percentage of GDP fell to only 0.17 per cent last year, compared to 0.23 per cent in 2013-14. So, dividends are not rising rapidly, and disinvestment receipts are falling. Is the government's approach to the public sector then more focused with respect to its investment strategy?

A cursory look reveals a mixed picture. The story of the public sector's capital outlay in the five years before Covid is starkly different from what unfolded in the five years after the pandemic. From a capital outlay of ₹3.32 trillion in 2013-14 (the last year of the Manmohan Singh regime), PSUs saw their total investment jump to ₹8.52 trillion in 2019-20. In terms of its share in GDP, PSUs' capital outlay rose from 2.9 per cent to 4.2 per cent in the same period. This rise was driven as much by trebling the government's equity infusion as by the PSUs' ability to generate more internal resources and raise more borrowing. What this also showed was that despite the rhetoric of strategic sale and disinvestment of shares in PSUs, the Modi government was busy providing more resources to the public sector and even enhancing their ability to raise more resources.

In the five years following the pandemic, the PSU story has changed significantly. Indeed, by the end of 2021-22, capital outlay by PSUs fell almost by a fifth. The decline could be largely attributed to the PSUs' inability to raise internal resources or even mobilise higher borrowing. The fall would have been sharper but for the government propping up the public sector with increased equity infusion, a trend that has continued since then. The capital outlay situation in the last two years has got better. At ₹8.4 trillion in 2023-24, the declining trend has been reversed, but as a percentage of GDP (2.84 per cent) this is still lower than what prevailed 10 years ago (2.9 per cent in 2013-14).

The worrying trend is that the public sector's investment story in the last few years has been kept intact mainly by the government pumping in more by way equity infusion. The public sector's ability to generate more internal resources or raise loans has been severely undermined in the post-Covid world. If the government believes in value creation as a strategy for the public sector, it needs to urgently do something more than just infusing additional equity, which in any case is largely restricted to a handful of entities like Bharat Sanchar Nigam Limited, National Highways Authority of India, and Indian Railways, accounting for about 87-90 per cent of the total equity outlay announced in the last couple of years.

The government's ability to endlessly infuse more equity into more PSUs is obviously constrained, and it must introduce other performance metrics to ensure that they deliver better financial results to relieve the pressure on its finances. Politically, the government may like to go slow on its privatisation plan and continue to pump in more resources into the PSUs. But there has to be a credible and effective economic policy response to overcome the current financial performance challenge posed by the public sector. The continuing disconnect between politics and economics is not desirable.