NovaDhruva

Privatization: An Elixir to Achieve Economic Objectives of the BJP Manifesto

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The largest democracy has given a thumping re-mandate to Shri. Narendra Modi led NDA government. Post this, it is important to delve deeper into the charter that the BJP had set out for itself in its very interesting election manifesto. Focusing on the economic aspects of it, there is a proposal of capital investment to the tune of approximately USD 1.5trn over the next 5 years. The funding for the same will be a herculean challenge for the government in the coming years. This challenge will only get compounded with the current economic scenario.

1. Current Economic Slowdown

As the NDA returns to office, key priority for it will be to revive the Indian economy which has started to show early signs of an economic slowdown with December 2018 growth muted at 6.6%. This is primarily because of declining growth in private consumption, slow increase in capital investment and subdued exports. These factors have dampened the corporate investment climate and can further hurt growth prospects.

Depressed Consumption Activity

India’s rural economy has a huge footprint, supporting 70% of its population and accounting for almost 18% of India’s gross domestic product and private consumption. Rural output growth slowed from 8% in January 2018 to 4.4% in January 2019. This has resulted in a crunch on spending by agricultural workers, whose cost of living has been rising and incomes falling. Given the size of the rural economy in India, this adds headwinds to growth and can be witnessed in sectors such as FMCG.

Weakening Industrial Activity and Contracting Exports

Industrial activity is slowing as evident from a muted Index of Industrial Production (IIP) growth of 3.7% in the quarter ended December 2018 being the lowest in the past 5 quarters. January IIP fell further to just 1.8%. Electricity generation, another indicator of industrial activity grew 3.6% in FY19, the lowest in the past 5 years. Similarly, growth in finished steel production is the second lowest in 5 years.

Exports contracted both in y-o-y terms and sequentially, despite the sharp depreciation in the rupee. Due to the overall slowdown, imports also moderated leading to a drag on overall external trade.

So, what is the solution? We believe that the capital investment proposal of USD 1.5trn in the BJP Manifesto will ameliorate the situation. The challenge however would be to find the financial resources keeping the fiscal prudence in check.

Privatization: An Elixir

Basis the systemic economic slowdown discussed above; it is fair to construe that a reset is required. The Indian economy is awaiting a kickstart which can be facilitated by massive funding which only the Central government can undertake. Fiscal prudence is the need of the hour but given there is no further significant headroom for higher tax rates; and with the government already pulling reins of stricter compliance with indirect and direct taxes, there must emerge unconventional means of revenue generation. One differentiated way forward is by monetizing assets through privatization. This was implemented in 1999, when the Vajpayee government expanded the process of economic liberalization and initiated privatization of most state corporations and focused on infrastructure development by launching projects such as the Golden Quadrilateral. The government today needs to turn back to this mode of fund generation by adopting aggressive privatization of public sector undertakings.

2. Privatization: Channel for Fund Augmentation

Privatization can help relieve the fiscal crunch on an ongoing basis by getting rid of perpetual loss-making and inefficiently managed business units. Additionally, this will result in multifold gains to the economy such as attracting fresh capital, buy-in by foreign resources, auto-correcting balance sheet of the government, and lowering of macro indicators such as inflation and interest rates which will make the Indian economy highly competitive and would serve as a compelling opportunity attracting new investments. This can result in a virtuous cycle of a sustainable growth for a long period of time.

Government of India owns a plethora of assets which could be monetized through strategic sale with a significant premium for control. A back of the envelope calculation suggests that this could generate funds to the order of **c. USD 400 to 500bn.** A broad breakup of the same is as follows:

Market capitalization of listed companies (Govt.'s stake value only)	USD 140bn
Control premium (Assuming 50% of current market value)	USD 70bn
Total value generated from listed companies' holdings	**USD 210bn**
Value of unlisted entities including govt. owned real estate	USD 190 to 290bn
Possibility of total fund mobilization	**USD 400 to 500bn**

Below represents a sectoral breakup of the listed companies in which the government has majority ownership and there is a potential opportunity to monetize its stakes through privatization.

Oil & Gas

Focus companies: Indian Oil Corporation, Bharat Petroleum, Oil and Natural Gas Corporation, Gas Authority of India and Oil India. Current market value of government's stake is c.USD 46bn. India's oil & gas industry requires huge investments for exploration, refining, and marketing activities. Privatization would ensure flow of investment to this sector.

Power & Utilities

Focus companies: Power Grid Corp of India, National Thermal Power Corporation, National Hydroelectric Power Corporation, Satluj Jal Vidyut Nigam and Neyveli Lignite Corporation. Current market value of government's stake is c.USD 20bn. The financial health of the power sector companies has deteriorated over a period of time. It's imperative for the Government to eliminate its exposure to this sector.

Financial Services

Focus companies: Government owned banks, Insurance companies and others such as Housing & Urban Development Corp and Industrial Finance Corporation. Current market value of government's stake is c.USD 36bn. As RBI's December Financial Stability Report suggests that NPAs of Indian banks will rise further even though the financial system remains stable and given the fact that the public sector banks are fast losing relevance, privatization is a better solution than merging them with the stronger ones.

Industrials & Materials

Focus companies: Container Corp of India, Bharat Heavy Electricals, Engineers India, Cochin Shipyard, Metals and Minerals Trading Corporation, Bharat Earth Movers, Balmer Lawrie, Hindustan Machine Tools, State Trading Corp of India, National Mineral Development Corporation, Steel Authority of India, Hindustan Organic Chemicals. Current market value of government's stake is c.USD 11bn.

Metals and Mining

Focus companies: Coal India, National Aluminum Co, Hindustan Copper and Manganese Ore India. Current market value of government's stake is c.USD 21bn. Mining sector requires a heavy dose of investment in modernization for efficiency enhancement. It's appropriate that this investment is made through private sector.

Aerospace, Defense & Marine

Focus companies: Bharat Electronics, Hindustan Aeronautics, Shipping Corp of India. Current market value of government's stake is c.USD 5bn.

Unlisted Entities/Assets

There are multiple other assets such as unlisted companies, real estate and many others that the Government can monetize through privatization. It can take a medium-term view while monetizing its ownership in real assets. Currently, the government owns at least 13,505 sq. km land which is about nine times the size of Delhi. The railways being the biggest landowner among Union ministries, owns 31,063 land parcels spread over 2,929 sq. km which can be used to generate additional resources. From a longer-term horizon, the government can also look to privatize/part disinvest Life Insurance Corporation and Indian Railways which if listed, would be one of the most valued companies in the country.

3. Execution of Privatization

As was done earlier, in order to receive proper focus, we would suggest that a separate ministry be formed to implement the privatization road map. This ministry can put together a 5-year plan and a transparent execution process.

4. Deployment of Funds Generated

The funds generated by privatization is in the nature of capital receipt. These should be kept separately and can be invested through a Sovereign Wealth Fund. SWF will have the ability to leverage the Government's contribution and increase the overall resource pool multifold. It would deliver on twin objective of investments and better governance. NIIF could be one such vehicle.

In Conclusion –

We believe that Government's intention to make significant capital investment is a very well thought out strategy for which key would be to augment resources and prudent utilization of such resources in medium to long term. Monetization of government assets could be the right prescription. This will also help achieve Government's objective of **Minimum Government, Maximum Governance.**

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