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REFORMING ASIA'S PUBLIC ENTERPRISES

When reforming Asia's public enterprises, change of control and ownership is not essential, argues Mukul Asher.

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The proposition that nationalisation (transfer of enterprise ownership and control from the private sector to the public sector), and privatisation (technically defined as involving transfer of ownership and control of an enterprise from the public to the private sector), both represent policies in search of a theory, is strongly supported by economic theory and empirical evidence.

Thus, theoretical literature on organisational decision making and on drivers of its efficiency does not distinguish between a private and a public ownership. There is only a single theory of the firm or a business organisation. While under some efficiency, there are many examples of globally competitive and technologically dynamic public enterprises (such as Airbus Group, European aerospace and defense corporation; Indian Space and Research organization, ISRO and; Huawei, a China state enterprise global conglomerate). At the same time, there are also many private sector firms which are globally competitive, such as Toyota Motor Corporation of Japan; Samsung of South Korea; and IBM of US A. Inefficient and uncompetitive firms may also be found in both the public and private sector. Admittedly, incentives to exit are much weaker in the case of public sector firms.

The traditional distinction between public and private sector organisations has become too restrictive, as more complex organisations, not fully fitting in the either category, have emerged. Thus, Life Corporation of India (LIC) is a public sector organisation which is not listed on the stock exchange. But it has engaged in partnerships, such as in LIC Nomura Mutual Fund with a Japanese company. This has added to the complexity of reforming public enterprises.

The above suggests that drivers of organizational efficiency do not primarily lie with ownership, but with other factors discussed below. If receipts accrue due to a partial or full equity sale of a public enterprise (or any public asset), an appropriate fiscal balance sheet treatment is to regard it not as an ordinary receipt but as an extraordinary item financing budget deficit. The practice of putting such receipts aside in a separate investment fund, discarded in recent years, could be revived.

The first factor is the extent to which public enterprises operates in a competitive or a contestable environment, where performance is

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subject to market and/or regulatory discipline

The primary reason to be against a monopolistic structure is that it prevents information from emerging about what the alternative organizations can deliver. The power of ideas, the main source of progress in better utilisation of society's resources, and in a heterogeneous society, the necessity of experimentation to suit the local context, can only be obtained in a competitive/contestable environment.

As an example, providing choice to members of Employees' Provident Fund Organization (EPFO), the largest non-bank financial institution in the country, to join the National Pension Scheme (NPS) would have the potential to improve incentives of both the organizations to become more service oriented. Similar choice can be provided to members of mandatory membership of the Employees' State insurance corporation (ESIC).

Such examples can be multiplied in many sectors vitally affecting quality of living of average households, be in education, health, waste management, water, electricity, transport services, agricultural inputs, mining, defense sector, food procurement, storage and distribution, tourism and project management. The primary socio-economic role of public enterprises and organizations is to operate in a way that checks the monopoly power of the alternative providers, not to stop entry of alternatives.

Second, organisational incentive structure, involving Board composition and its skill-sets, human resource policies, outcome or result orientation demanded from the enterprises etc. In the Indian context, separating the role of the Chairperson of the

Corporate or organisation's Board of Trustees on the one hand and Managing Director or Commissioner on the other merits serious consideration. The unhealthy practice of a Minister automatically becoming Chairperson of statutory organizations such as EPFO and ESIC also merits revisiting.

The potential of a public enterprise or an organisation coming under the purview of the Companies Act, and being listed on the stock exchanges could be explored as this could lead to indirect regulation, and provide uniformity between public and private sector organisations. LIC and Air India are among the public sector organisations which may merit such transformation, but with careful planning.

Modern accounting practices, such as accrual rather than cash based accounting, needs to be introduced in public sector enterprises and organisations, including Indian Railways, India Post, EPFO, and ESIC. The key deficiency of cash based accounting method is that a balance sheet cannot be produced. Both income statement measuring flows, and balance sheet measuring stock are essential to assess the performance of an organisation.

Third, individual incentive structure, which aligns performance of the individuals with their contribution to the organisation's objectives, and balances job security with the public enterprise mandate to utilise society's resources effectively, and deliver basic services and amenities related to quality of living in a competent and sustainable manner. The feasibility and desirability of organisation level rather than broad public sector level compensation structures also merits exploration.

Fourth, technological up gradation of public enterprises. This could involve not just the manufacturing technology, or modernisation of service equipment, but also accounting and management information system and data collection and mining capabilities, and abilities and willingness to benchmark their performance. An inappropriate choice of technology or unwillingness to bring in technologies better suited to prevailing and probable future factor and input prices has often led to poor public enterprise performance globally. This particularly applies to those areas where technological change has been rapid and minimum scale needed for competitive operations, such as in steel, automotive, and mining sectors, has increased significantly.

A technology policy and assessment office at the highest national level could significantly assist in up gradation of technology of public enterprises and organisations.

For assessing the macro-economic performance of the public enterprise sector as a whole, the following two indictors are helpful.

The first indicator, utilising stock concept, is the share of total capital stock of a country that is accounted for by public enterprise sector, and comparison of it with the contribution of the sector to GDP of a country. Thus, if the public enterprise sector accounts for half of the total capital stock, but contributes one-fifth of the GDP, efficiency with which the sector uses capital requires a searching examination. For India, estimates of this indicator are not available, but given substantial investment in public sector organisations over several decades, and a general lack of attention to the drivers of organisational efficiency and effectiveness discussed above, there is likely to be effectiveness discussed above, there is likely to be significant scope for improving the performance of this indicator. It is suggested that data bases be developed to better track this indicator in the future.

The second macro-level indicator, utilising flow concept, concerns comparing investment by public enterprise sector as a percentage of GDP to the saving of the sector. If investment exceeds savings, this implies that savings of other sectors, households and businesses, need to be utilised, or foreign savings in the form of direct or portfolio investment must be obtained. This has fiscal, macroeconomic management, and financial and capital market implications. An inefficient public enterprise sector could crowd-out more productive use of savings by other sectors, potentially lowering economic growth on which the economic and social security of both the young and the old depends.

The official data indicate that net public sector savings and investments averaged minus 1.51 percent and positive 5.94 percent of GDP annually during the 2008-09 to 2011-12 period, suggesting that net public sector investment is more than wholly reliant on savings generated by the household and business sector. The public investment in the Union budget has also declined significantly from around 4 percent of GDP in 2003-4 to around 1 percent in 2013-14.

If the impaired assets of public sector financial institutions; and fiscal risks and contingent liabilities of public organisations due to poor management and governance are taken into account, the case for public enterprise reforms in India becomes even more overwhelming.

There is considerable merit in giving priority to passage of modern procurement bill, with maximum possible usage of E-procurement, and IT driven processes. Total procurement of goods and services at all levels of Government combined is around 15 percent of GDP in India. A saving of 5 to 10 percent on procurement can open up substantial fiscal space, besides improving public enterprise and organisational performance.

The above analysis suggests that public enterprise reform should be viewed as a medium term process of around five to eight years, and requires diagnostic rather than a-priori or an ideological perspective. Each public enterprise or an organisation may require different combination and sequencing of the above drivers of organisational performance. As in other reform areas, sustained focus, competence and integrity of those driving the reform matters, and so does a reasonable level of economic literacy among the stakeholders.

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