The public and the private

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ISSUE number six of *Seminar*, dated February 1960, dealt with the public sector and the private sector: the appropriate sphere for each, and the interaction between them. The articulation of 'the problem' written for that issue remains relevant. In the intervening half-century, few of the issues have either become dated or resolved, and the sectors at issue then (manufacturing and mining; finance; trade; agriculture) remain relevant for discussion today. Interesting for its omission in the earlier discussion is the

* The views expressed are personal.

infrastructure sector, perhaps because the public sector's role there was seen to be legitimate and non-controversial. Today, in 2008, this sector has become the poster child for what are now called 'public-private partnerships' (PPPs).

A re-reading is also useful because it allows us to peer into a pre-Indira India. I say this because analysts of Indian economic history tend to divide themselves into two camps, each with its own narrative of post-independence Indian economic policy. One camp takes the view that Indian economic policy under Pandit Nehru was relatively centrist, and that the 'lurch to the left' essentially formed part of Indira Gandhi's seizure of the Congress Party in 1969 and her dependence for survival on the Communists (domestically) and the Soviet Union (externally) in the years following. The alternative narrative argues that the die of Fabian socialism was cast clearly and fully in the era of Panditji.

The *Seminar* article, dating as it does to the period following the Second Plan, a full decade before Indira Gandhi's reign, suggests that the latter interpretation is closer to the mark. It also reminds us that the controversies of the time extended to institutions that today have become unchallenged icons of the state: the State Bank of India (SBI) and the Life Insurance Corporation of India (LIC). One could perhaps include Air India, not mentioned by *Seminar*, but also nationalised in the same era.

The third revealing feature of this early-1960s perspective is its insistence on political economy and ideology, as much as pragmatism, as drivers of Indian economic choices. As the article puts it, 'No answers to these questions are possible without a sober study of the powerful forces, economic and political, which made it necessary to create a public sector and expand its role over the years' (*Seminar* 6, February 1960, p. 13).

Finally, and rightly, the article identifies the key issues for a democratic mixed economy as lying not only in the effective management of the public sector itself, important though this is, but even more for the interplay and interaction between the two sectors.

In the remainder of this article, I will update the debate on the issues raised by *Seminar* almost fifty years ago. To do so, I start by providing some broad indicators of the present role of the public sector in the direct provision of goods and services to the economy. I follow this with an account of the ways in which the debate on public ownership and provision has evolved in recent decades in other regions: the Anglo-Saxon countries (both Atlantic and Oceania); the economies in transition (eastern Europe and China); and other, more 'conventional' emerging markets (South Asia and Latin America). Against this background I then assess the contours and peculiarities of the debate in India today. I conclude with some speculations as to what might be reasonable to expect from any government that takes power in 2009.

In preparing to write this article, I was surprised to discover how extensive, and how relatively underexploited, the data on the public sector in the economy are. While there are several sources, it is convenient to start with the National Accounts Statistics 2007 (NAS) published by the Central Statistics Organization (CSO). The 'public sector' as defined by the nation's statisticians is the sum of four sub-components: administrative departments (including defence services); departmental enterprises (such as the railways); non-departmental enterprises (what we usually have in mind when we talk of 'the public sector') and finally, quasi-government bodies. An advantage of using the national accounts source is that this comprehends both the Centre and the states.

While this essay concerns itself primarily with the group of 'non-departmental enterprises', it is also worth looking at the totality of the public sector for the moment, to get a measure both of current scale, and of recent trends.

The total public sector, as defined above, accounted for 23 per cent of the nation's gross domestic product in 2005-06 (Statement 24 of NAS), down from 25.6% seven years earlier, not an insubstantial change. Virtually all of this adjustment has occurred under the present United Progressive Alliance (UPA) government, despite the fact that it was, until recently, supported by the parties of the left. By contrast, there was absolutely no reduction in the share of GDP of the public sector under the earlier, centre-right, National Democratic Alliance (NDA) government.

As one might expect, of the four categories distinguished in the national accounts, the two that matter most are the administrative departments and the non-departmental enterprises. Of these, the non-departmental enterprises, at 10.8% of GDP, are collectively slightly larger than the administrative departments, at 8.9%. The total of these two categories, 19.7% of GDP in 2005-06 accounts for the lion's share of the total public sector presence in the economy, the remainder being largely accounted for by the departmental enterprises.

The adjustment in the public sector that has taken place in the last four years has been across the board. By stealth rather than by announcement, and aided by the fact that since overall economic growth has been so rapid, the relative share of the public sector in economic activity has slowly been coming down, even as there has been a rapid increase in the share of government revenues in GDP. Since gross domestic product is a measure of 'value added' in the economy, not a measure of gross turnover, the same is true in measuring the public sector share. In particular, 'value-added' by the public sector, as measured net of taxes and subsidies (i.e. at factor cost) represents the sum of two sub-components, namely 'compensation to employees' and 'operating surplus'.

Within this broad aggregate of the public sector, Statement 27 of the NAS provides a sectoral breakdown by type of economic activity. Ignoring for this purpose the sector which includes public administration and defence (classified in the national accounts under 'community, social and personal services'), a review across other economic sectors reveals some surprises. Contributing the largest value-added is the transport and communications sector which, apart from the railways, includes the public telecom companies, the post office and the airlines. This economic sector is followed closely by the sector 'financing, insurance, real estate and business services' which is dominated by the public sector financial institutions (commercial banks, life insurance etc.). Both these sectors have been growing rapidly. Further behind, by a considerable margin, are two other economic sectors, 'electricity, gas and water supply' and 'mining and quarrying'. Real value added in manufacturing (assumed to be dominated by the public sector steel and heavy equipment industries) has been relatively stagnant over this decade. This same is true of the electricity and allied sector.

This *tour d'horizon* gives us a useful framework within which to re-frame the debate on 'the two sectors' for the 21st century. First, the public sector as a whole has not been growing as a share of the economy. Second, other than public administration, four sectors are predominant in the revenue-earning public sector of today: transport, finance, mining, and public utilities. Together, they account for 77% of non-administrative value added. In each of these areas, the public sector competes with the private sector. In each of these, performance is vital to the overall performance of the economy. As we contemplate policy for the sector going ahead, it is these four sectors that we must consider.

Third, the public sector is present in a number of other sectors (manufacturing, tourism, agriculture) largely for legacy reasons. Here, the main issues are not primarily those of impact on the aggregate performance of the economy, but rather those of overcoming inertia, realizing value (or preventing loss of value) and pruning to allow the state to focus on its core goals. Anecdotal accounts suggest that certain states (notably Gujarat) have shown considerably more purpose than the Centre in tackling the issues raised by this 'rump' (though still significant) sector.

As most readers would be aware, the intellectual case for public ownership of productive assets rests on multiple arguments, as does the conservative rejection of these arguments. With respect to the former, one can distinguish at least three separate strands. The first of these goes back to Marx and the radical socialists who followed him, who argued that with private ownership of the means of production, labour was deprived of its rightful share of surplus value. The appropriate response was for the state, acting for labour, to appropriate the means of production. This critique was, however, tempered by the realization that bourgeois capitalism was a necessary and fruitful stage in human social relations, because of its restless dynamism.

A second strand was associated with the quest for faster growth, through planned, coordinated state investment, rather than what was thought to be haphazard, uncoordinated private activity. This perspective was given considerable mathematical sophistication in connection with planned development in Russia in the interwar years. The abolition of private property and the control of all resources in a putatively rational state were expected to resolve many, if not all, of the problems of information and coordination present in a market economy. Indeed, much of the theoretical proof of the optimality of a market-based system of resource allocation was developed to respond to this intellectual challenge from the left.

The third strand deals specifically with the case for public ownership in a mixed economy, and comes in both developed country and developing country variants. The developed country variant is associated with the postwar nationalizations in both Britain and continental Europe, which were in part a response to the capitalist crisis of the Great Depression, and in part an attempt to demonstrate solidarity with the labour movement which had played an important part in the war. The underlying economic logic was twofold: first, to accelerate the investment in key infrastructure sectors (steel, railways, coal, power) by permitting the sovereign to underwrite a measure of the risk; and in return, for the state to appropriate the 'rent' associated with these quasi-monopolies.

The developing country variant was exemplified, if not pioneered, by India's Second Five-Year Plan, where state ownership of the strategic sectors was designed both to solve coordination problems in investment and, through appropriation of profit, to raise the domestic saving rate. In this context one might also mention the Gandhian element in Indian thinking, with its pastoral but also Tolstoyan socialist origins.

The conservative counter-attack against these ideas arose primarily in the United States, although in many cases associated with thinkers of Central or East European origin (such as Friedrich Hayek). The critique was both political and economic. The political critique is perhaps best embodied in Milton Friedman's book *Capitalism and Freedom*, where he argued that a capitalist society provided the only sound basis for political freedom. The economic critique perhaps originated with Joseph Schumpeter, who argued that innovation and creative destruction were the essence of capitalist growth, implying that these dynamic elements of capitalism were not easily reproduced under central planning.

The 'high noon' of the public sector in most OECD economies outside the U.S. was the period from the 1950s till the late 1970s. Deteriorating economic performance and trade union militancy prompted Margaret Thatcher to invent privatization in the U.K. of the late 1970s and early 1980s. As public ownership had never been a prominent part of the American landscape, the echo of the Thatcher revolution in the U.S. was in the area of deregulation and tax reform. (In fact, airline deregulation in the U.S. was initiated under President Carter, even before Reagan.) Again, as a response to sustained disappointing economic performance, both New Zealand and Australia undertook radical reviews of their public sectors in the 1980s. Yet, despite all these initiatives, OECD data do not show any significant roll-back of state intervention in most OECD countries, measured as shares of GDP, largely because of the unchecked rise of transfer payments.

Turning next to the developing world, there has been extensive privatization in the so-called countries in transition (Russia, China, Eastern Europe), with varying degrees of transparency and success. Taking the countries of the former Soviet Union first, the collapse of communism created a political basis for the recreation of a competitive market economy. Yet the collapse of the old administrative order raised many challenges for the implementation of privatization, with many variants emerging. A prime concern throughout was to prevent old public monopolies from being turned into private monopolies or being overwhelmed by foreign capital, and to find a way in which these strategic entities could continue to raise resources for investment after the shift to private ownership.

Arguably the messiest transition was made by Russia, with significant transfer of wealth to the small group of politically connected businessmen known as the oligarchs. Other countries in Eastern Europe seem to have done better, while there remain pockets of the FSU (Belarus, the Central Asian Republics) where the political basis for the transition to a market economy has not yet been established.

The case of China is idiosyncratic, since it represents an apparently successful attempt to establish a competitive market economy without political competition, what is now increasingly being termed 'authoritarian capitalism'. Official attitudes toward the right to private property remain ambiguous, which is one reason why the Chinese state has been so welcoming of foreign domestic investment. As a result the Chinese state has not yet had to deal with the collision between private wealth and state power that has been so evident in Putin's Russia, exemplified by the destruction of the oil company Yukos and the incarceration of its promoter, Boris Khodorkovsky.

Chinese pragmatism has allowed a range of hybrid institutional forms to emerge, ranging from the earlier township and village enterprises, to large shareholder-supported but state-backed multinationals. Meanwhile, as documented by various OECD reports on China, there has continued to be large-scale privatization and closure of a vast range of formerly public enterprises. Ironically, the largest and most successful remaining communist state has had less ideological compunction about privatization than has India.

Finally, it is worth examining attitudes toward the public sector in the non-communist developing world, both in Latin America and elsewhere in South Asia. In South America, the three largest economies, Brazil, Argentina and Mexico have, like India, a tradition of public enterprises in many of the same sectors as us. A fourth, smaller but highly influential economy is that of Chile, which pioneered Thatcher-style radical privatization under the military regime of Pinochet in the 1980s, but which has slowed down since. In most of these countries, even Chile, the natural resources sector has proved too sensitive to privatize. The one exception has been Argentina which undertook a successful sale of its national oil company, YPF to the Spanish company, Repsol.

However in most sectors other than resources (such as steel, electricity generation, telecoms, commercial banking) there has been willingness to privatize relatively freely, with relatively little sensitivity to the nationality of the purchaser. In an ironic twist, some of the acquisitions have been by European firms that are majority-owned by the public sector in their home country: the case of the Spanish company Telefoníca comes to mind. Closer to home, Pakistan has apparently found it easier than us to privatize large parts of its financial system, although admittedly again under an autocratic regime.

This finally brings us to the current Indian situation, and possible scenarios for the future. As the above review of international experience suggests, the boundaries of the politically feasible vary from country to country. It also seems to be the case that radical breaks in public ownership occur either under authoritarian regimes, or at moments of significant economic stress. Since neither of these currently apply in the case of India, it is difficult to be optimistic of any significant or early change in the status quo.

This assessment is lent further weight by public attitudes toward the public sector and the private sector. Despite glaring examples of public sector mismanagement and inefficiency, the public sector appears to be more trusted than the private sector, at least by India's middle classes. Equally, for whatever reason, foreign entry into India's regulated sectors has been painfully slow (in contrast, say to Brazil). The struggles surrounding the recent entry of Vodafone into the Indian market are a case in point, as are the arcane and economically meaningless discussions on the permitted foreign share in so-called sensitive sectors. By contrast, where political leadership has been forthcoming (the cases of Maruti and Balco come to mind), the outcome has been an all-round success – for the firm, for shareholders, and even for labour.

Given the limited number of domestic groups in a position to purchase government assets, a government bent on privatizing through sale of strategic stakes thus faces the charge that it is aiding in the creation of private monopolies, while allegations of corruption are freely hurled at all attempts at objective valuation.

Given the fiscal and managerial constraints facing government, and the need to equip the economy with the means to sustain 9% growth, both the previous government and the present one have resorted to three strategies. The first has been to liberalize private entry, so that incremental growth is in the private sector, even if existing assets remain in public hands. The second is to sell minority stakes in major public sector enterprises while retaining government control. The third, particularly in infrastructure, has been to develop elaborate schemes of public-private partnership with an attempt to ensure uniformity and transparency in the award of concessions. Experience in this area is still evolving, and the risks of privatization of gains and the socialization of losses remains an ever-present danger.

The coexistence of an established, legacy public sector with an aggressive, well-capitalized private sector also raises multiple problems. Notwithstanding the lip-service paid to board autonomy, the plain fact is that in sectors as diverse as hydrocarbons and banking, ministerial diktat has routinely over-ruled commercial considerations. Meanwhile the steady erosion of market share (airlines are a good example) are likely to imply either a steady erosion of market value, or a tilting of the regulatory regime in favour of the public sector incumbent to the detriment of the growth of the sector. Competition for talent is another area of unequal combat, at least in the short to medium run, as is the complicated and largely illusory guarantee of probity in procurement entailed in following the procurement guidelines of the Central Vigilance Commission (CVC).

It is against this background that one needs to assess the position taken by the UPA government (as part of the National Common Minimum Programme) that there is no need to privatize profitable enterprises. This stance is an evasion of the core issue, which is that in a dynamic market economy corporate structures need constantly to evolve. The whole machinery of exit and consolidation that is possible under private ownership is made much more complicated if not impossible when government is in charge.

To conclude, notwithstanding my own preferences, I see little signs of a radical breakthrough; it will be more in the nature of trench warfare. What is badly needed is a political leader who has both the stature and the courage to articulate the case for shifting the boundaries between the two sectors for the 21st century, in the way that Pandit Nehru did fifty years ago. Neither of two previous coalition governments has chosen to grasp this nettle. Till they do, we will muddle along, depriving the *aam aurat* of some of the growth that is her due, in order to placate the rich, the powerful and the ideologue.