Business Standard

# Balance sheet reforms

**An effective, transparent mechanism for transferring public assets to the private sector is long overdue**

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When a company sells assets, shareholders are entitled to know how the assets were valued. Some are easy; there is an active market and prices are relatively visible. Others are more complicated. In the absence of market opportunities, the management will need to persuade shareholders that legitimate methods of valuation were used and the transaction price was justifiable. Of course, companies rarely have assets that cannot be valued to shareholders' satisfaction.

Things are not the same with governments. Any government, by its very constitution, controls massive amounts of assets. Strictly speaking, it is not the ultimate owner; rather it plays a custodial role, managing these assets as a representative of the citizens and acquiring or divesting them in the larger public interest. Further, many of these assets have value only in the context of the use that they can be put to, which is something the government also has control over. Consequently, valuation of public assets is tricky and somewhat arbitrary. Values can also change significantly as a result of the government expanding or restricting the uses that the assets can be put to.

India's policy problems over the past few years revolve around this basic problem. The fundamental issue in both the spectrum and the coal allocation situations is the valuation of these previously public assets as they were transferred to private ownership and control. In both cases, decisions that were ostensibly taken with the intention of significantly enhancing capacity and supply through private investment generated controversies that are severely constraining the government from carrying out its functions. The assets - 2G spectrum and coal mining concessions - are generally perceived to have far greater value than the government realised for them. Therefore, the argument goes, side payments must have been involved.

Although the government's argument that value maximisation was never the primary objective in these ownership transfers hasn't cut much ice, it is actually a legitimate defence - in the right circumstances, of course. The price at which the asset is transferred obviously determines the price at which the goods and services that are produced by it are sold. If it is a policy objective to sell these at a low price, then it makes sense to transfer the assets at correspondingly low prices. This leaves open the question: if it isn't the price, what is an objective and transparent basis on which the asset transfers are made? This is actually the crux of the problem.

To get back to my starting point, just as shareholders deserve to know whether their company got a good price for the assets it sold, citizens deserve to know whether they got a good "value" for the assets that were transferred. "Value" needs to be interpreted in a broad sense - it could involve revenue, or it could refer to some other objective that the transfer of assets is expected to accomplish. What is important, though, is that if it involves an objective other than revenue, this needs to be articulated explicitly before the process begins. Also, the anticipated role of the asset transfer in achieving this objective needs to be made clear.

In one way or another, the transfer of assets from public to private ownership and control are going to be a huge part of economic policy in the coming years. Recent experience should prod the system to create a mechanism to do it as non-controversially and non-disruptively as possible. The economic and political costs of getting it

wrong are, as we have discovered, enormous.

What should this mechanism look like and how should it go about its business? First, it needs to be multi-partisan, with all parties being represented. There are both philosophical and practical reasons for this. Ideally, all citizen interests and views need to be accommodated in defining both the objective of a specific transfer decision and the parameters of the transfer. Practically, this arrangement might help to immunise the process from changes in the government. Given that the programme is likely to be in place for quite a few years, it needs to maintain some consistency over time and should be visibly independent from the government.

Second, it needs to articulate a plan, which lays out the objectives and anticipated social benefits of each category of transfer. As indicated earlier, some assets could be transferred on purely revenue motivations - privatisation of some public enterprises might fall into this category. But others, including spectrum and mining rights, may be driven by legitimate non-revenue objectives. These need to be announced ahead of the action and not as an afterthought. The plan should also address the criteria on which transferees are identified, the terms of the transfer and, most importantly, the penalties for not living up to the bargain.

Third, it should take a long-term perspective of the revenues raised from the transfers. It has been repeatedly argued that realisations from asset transfers should not be clubbed with other revenue streams in order to meet current commitments. Accounting niceties apart, the spirit of such transfers is that they work off the balance sheet. As some assets are transferred, others with high potential social returns in the current environment are created.

It is not as though the Indian reform process has not tried to deal with these issues. There was the Disinvestment Commission in the mid-1990s, which was supposed to design and implement a meaningful strategy for the process. In 2004, the National Investment Commission was proposed, with a view to effecting exactly the kind of balance sheet substitutions described above. Both these initiatives amounted to nothing, and perhaps that was the nature of the times. But things are very different now. Governance and policy making have been impacted at a time when the economy can least afford delays in decision making and implementation. If the root cause of this disruption lies in a non-existent mechanism for effective asset transfer, then the solution must lie in putting such a mechanism in place.

The success of the reforms that were initiated in 1991 lay in the fact that they made everyday business transactions much easier and, consequently, much more efficient. I would refer to this as the "profit and loss" phase of reforms. Sooner or later, this phase would logically have to be followed by a "balance sheet" phase. Recent events suggest that this phase is now overdue.

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