

Public Sector Wastage – Issues and Challenges

*Presentation by
Sunil S. Bhandare*

*(Public lecture organized by Nani Palkhivala Memorial Trust in association with
Economic Research Centre and Forum of Free Enterprise at Mangalore)*

TATA STRATEGIC MANAGEMENT GROUP



January 20, 2014

Let us begin our Presentation with a following quote of Late Mr. N. A. Palkhivala

From the Preface to the Eighth Edition of his magnum opus The Income-Tax Act, 1961 [Feb 1990]

“The tragedy of India is the tragedy of waste – waste of national time, energy and manpower. Tens of millions of man-hours, crammed with intelligence and knowledge – of tax-gathers, tax payers and tax advisers – are squandered every year in grappling with the torrential spate of mindless amendments. The feverish activity achieves no more than a fever”.

- What was said in the context of the Income-Tax legislation and administration, is equally valid or even more valid in practically all areas of economic and fiscal management in the country.
- Billions of rupees worth of national output, national resources, national time, energy and manpower are lost to the economy every year.
- All in the name of democracy and so-called social justice, equity and inclusive development

Indian Economy at the Critical Cross-Roads

India's dream run of high economic growth is currently besieged with many challenges

(% Annual Growth)	2003-04 to 2007-08	2008-09 to 2012-13	2011-12	2012-13	2013-14
Real GDP	8.7	7.2	6.2	5.0	< 5.0
Agriculture	4.9	2.9	3.7	1.9	4.5
Industry	8.8	5.4	3.5	2.4	1.8
<u>Of which</u> Manufacturing	10.0	6.7	2.7	1.0	1.6
Services	9.8	8.8	8.2	6.9	6.5

Sources: (1) RBI Bulletin November 2013 - Article based on speech delivered by Dr. K. C. Chakrabarty; (2) Handbook of Statistics on the Indian Economy, 2012-13, RBI; (3) Our Estimates for 2013-14

Causes of India's Growth Deceleration

Growth deceleration attributable largely to domestic factors – impact of ***“policy paralysis”***

▪ Economic fundamentals impacted adversely by

- Persistent high inflation
- High fiscal deficit
- Imbalances in the external sector – huge CAD deficit & rupee depreciation
- Depletion of domestic savings and investment rates
- High interest rate regime
- Failure of infrastructure development
- Uncertain global trade and capital flows
- “Crisis of confidence” of consumers and investors

What is missing – and perhaps implicit in this assessment – is the persistence of Public Sector Wastage!

Various Manifestations of Public Sector Wastage

Under macro fiscal framework – susceptibility of all forms of public expenditure to wastage!

- Persistent large revenue deficit
- Cost and time overruns of public sector projects
- Subsidies for various social welfare programs
- Loan waivers/ loan write offs regularly given to sick PSUs
- Granting of regular budgetary support to loss-making PSUs
- Ripping off profit-making, cash rich PSUs of their surpluses for general budgetary support
- Loss of track on genuine outlay-outcome or performance evaluation

Good governance mitigates, if not eliminates, cancer of public sector wastage!

Consequences : too much government, too little governance

- First, Govt. has limited fiscal space for productive infrastructure development due to
 - Excessive thrust on social sector (MNREGA, National Food Security, etc.)
 - Failure to control non-plan revenue expenditure growth (subsidies, administrative, etc)
 - Loss of tax buoyancy due to economic slow down
- Second, hampers public investment in infrastructure & other developmental projects
- Third, precludes tax reforms and rationalisation of tax structure - GST/ DTC, etc
- Fourth, impedes equitable Centre-States, Inter-States & Inter-Ministerial coordination
- Fifth, prevents leveraging and promotion of PPP models in infra-structure projects

Rationale of Public Spending/ Government Expenditure Growth

The philosophy and strategy for growth of public sector spending is driven by social and developmental objectives - growth with equity and social justice!

- First, the provision of basic public goods and services
 - Food security; primary education & health; family welfare, etc. [Entitlement]
 - Employment guarantee schemes [Empowerment]
 - Affordable housing, parks, gardens, etc. [Enhancement of quality of life]
- Second, building of physical infrastructure [roads & bridges, ports, airports, public transport, water supply, urban infrastructure, etc.]
- Third, maintenance of internal and external safety and security [police, law & order, defence, etc.]
- Fourth, redistribution of income through subsidies, cash transfers, etc.

Provision of most such public goods & services can not attract private funding and investment

Across Most Countries of the World, Public Expenditure Remains High

In the post-liberalization, privatization & globalization era, the governments are seen to be on retreat, but public expenditure still remains high!

- *Global financial and economic crisis of 2008 and its aftermath have caused sharp scaling up of public spending as a counter cyclical economic policy.*

Govt Expenditure [2011/ 2012]	(as % GDP)	Govt Expenditure [2011/ 2012]	(as % GDP)
EU 27 countries	49.1	Brazil	41.0
USA	38.9	Russia	34.1
Japan	37.0	India	27.2
Germany	43.7	China	20.8
France	56.0	South Africa	27.8
U K	47.3	South Korea	21.6

India comparatively has much lower Government Expenditure to GDP ratio. ***By no means, it conveys that quality and effectiveness of public expenditure in India is better. We need to look beyond such macro fiscal indicators.***

India's Lower Ratio of Govt. Expenditure in International Comparison!

India's public spending is relatively lower as ratio to its GDP. Why?

- Magnitude of public spending determined by resource-raising potential/ capacity
 - Tax to GDP ratio is low
 - Large part of the economy outside the purview of taxation
 - Faultlines in tax structure and tax administration
 - Widespread tax avoidance, tax evasion and corruption
 - Erosion of fiscal resources
 - Mounting subsidies
 - Loss-making & low profitability of public sector undertakings
 - Tax revenues foregone through indiscriminate incentives/ concessions

Not just the quantity of public sector expenditure is important, but far more crucial are its qualitative dimensions!

Divergent Classification of Government Expenditure

India perhaps is very unique in the world - **three-fold classification** of governmental expenditure!

- Revenue and Capital Expenditure
- Plan and Non-Plan Expenditure
- Developmental and Non-Developmental Expenditure

Dr. Rangarajan Committee Report revealed many fault-lines of such a system

- Loss of clarity in what is plan and non-plan expenditure
- Lack of satisfactory understanding of developmental and non-developmental dimensions
- Difficulties in ascertaining cost of delivering a service and also in linking outlays to outcomes

It has, therefore, recommended some far reaching reforms in classification of government expenditure, but most of those yet to be implemented

Composition of Government Expenditure (Center & States)

The share of developmental expenditure declined in the first decade after reforms, but has recovered since then

(Rs. Billion)	Total Expenditure	Developmental	Non-Developmental	Share of Developmental	Share of Non-Developmental
1991-92	1859	1094	765	58.8	41.2
2001-02	6530	3322	3208	50.9	49.1
2012-13	28359	16469	11890	58.1	41.9
% CAGR (1991-2012)	13.9	13.8	14.0	-	-

- Governments in India are spending ~58% of their total budgetary resources on “developmental” function/ activities & balance ~42% on non-developmental functions/ activities
- But such broad classification can not explain the qualitative performance of/ or wastages in public spending

Key Components of Non-Developmental Expenditure (Center & States)

Interest payments and administrative services together account for over two-thirds of non-developmental expenditure.

(% share of Non-Developmental Expenditure)	1990-91	2000-01	2012-13
Non-Developmental Expenditure (Rs. Crores)	69,195	298,848	1326,458
1. Defence Services	22.3	16.6	14.6
2. Interest Payments	36.1	41.1	35.4
3. Food Subsidy	3.6	4.2	6.0
4. Administrative Services	25.5	28.2	31.0
5. Social Security and Welfare	3.5	2.8	2.6
6. All Others	9.0	7.1	10.4

▪ **Three key conclusions emerge from this data [to combat public sector wastage]:**

- India has to reduce its public borrowings/ public debt to contain interest payments
- India has to undertake administrative reforms so as to reduce the burden of administrative expenditure (including pension provisions)
- India has to calibrate and target the rising burden of food subsidy

Major Components of Developmental Expenditure (Center & States)

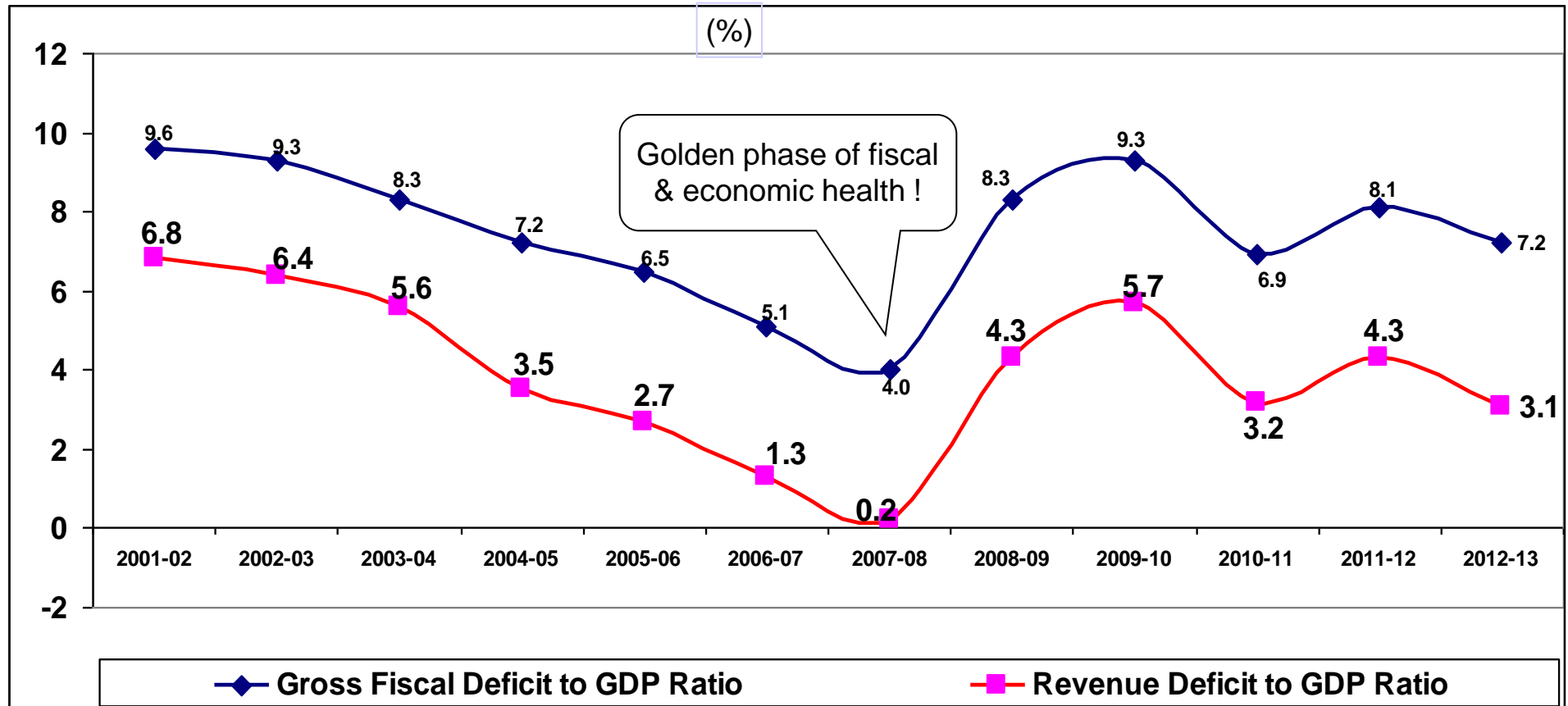
Social and community services accounts for a hefty share of developmental expenditure – almost half of the total.

(% share of Developmental Expenditure)	1990-91	2000-01	2012-13
Developmental Expenditure (Rs. Crores)	74,000	236,096	1456,064
1. Agriculture and Allied	15.8	13.1	13.0
2. Industry and Minerals	5.2	2.9	5.5
3. Power and Irrigation	13.7	14.3	10.2
4. Transport and Communications	6.2	10.4	10.2
5. Railways	2.2	1.4	1.6
6. Social & Community Services	41.9	48.3	48.0
7. Fertilizer Subsidy	5.9	5.8	4.2

- Limited fiscal space is increasingly being pre-empted by allocations to social sector spending
- Intensity of public sector wastage is believed to be generally more in social sector expenditure

Recent Trends in Revenue & Fiscal Deficits – Center & States Combined

After a remarkable improvement in governments' fiscal performance under the impetus of FRBM Act, 2003, the scenario is now wavering and under stresses and strains since 2008-09



Reflections on Wastage in Public Sector Enterprises

Way back in 1971, Dr. B. R. Shenoy in his very perceptive article unveiled the “picture of waste” of government undertakings, which are perfectly valid even to-day

What were then the manifestations of public sector wastage? To quote some of the meaningful descriptions from his observations then:

- Idle production capacities
- Unconscionable wastage of materials and accessories
- Incredible over-staffing
- Lack of cost consciousness
- Gross neglect of maintenance of plant and equipment
- High cost and low quality
- Pressures by politicians and interference by the Ministries

Eternal relevance of these features in the context of PSEs' management in India

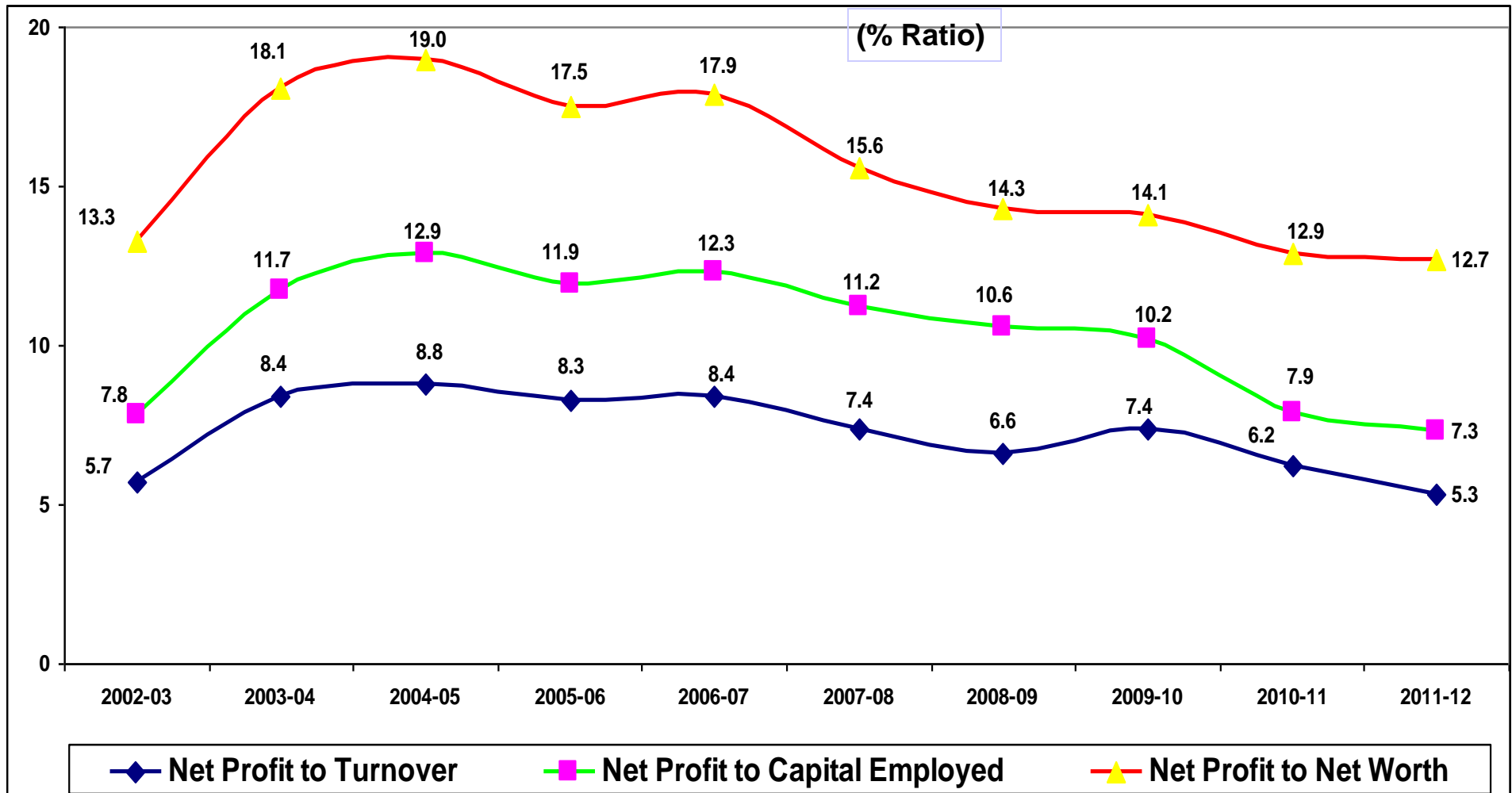
Profile of Central Public Sector Enterprises in India

Key features of CPSEs (2012-13) – opportunities for unlocking their true potential!

▪ No of CPSE	225
<u>Of which</u> (a) Profit-Making	161
(b) Loss-Making	63
▪ Profits of Profit – Making (Rs. Crs)	125,116
▪ Loss of Loss-Making (Rs. Crs)	27,602
▪ Capital Employed (Rs. Crs)	1328,027
▪ Gross Turnover (Rs. Crs)	1841,927
▪ Market Cap of 44 Listed Companies (31/03/2012) (Rs. Crs)	1253,245
▪ Under recoveries of Oil Companies (Rs. Crs)	55,041

- The aggregate performance of CPSEs conceals many problem areas
 - Losses of loss-making enterprises
 - Under recoveries of oil producing/marketing companies
 - Budgetary support to loss-making companies
 - Private Corporate Sector, on an average, shows better profitability performance
 - Every one percentage point improvement in return on capital employed of CPSEs, can generate additional profits of Rs. 13,280 crores
 - Every one percentage point gain in profit margin ratio, can yield Rs.18,420 crores.

Profitability Performance of Central Public Sector Enterprises



Micro / Anecdotal Instances of Public Sector Wastage

Numerous micro level cases & reports [of CAG and/or non-official agencies] at various levels of government bring out overwhelmingly the magnitude of public sector wastage

Illustratively,

- As on March 31, 2012, 555 projects (worth Rs.150 crores and above) were on-going, out of which 179 projects reported cost overruns of around Rs.123,000 crores [based on Minister's reply in Rajya Sabha]
- The CPSUs are engaged in executing over 560 major projects costing above Rs 150 crores in 14 different infrastructure sectors as of Sept 2013. The total original cost of these projects is more than Rs. 790,000 crore and 48% of these suffer substantial delays and cost over runs
- In Maharashtra over Rs.42,000 crores were spent on 426 irrigation projects and most them still remain incomplete as of March 2012.
 - In case of 242 projects, initial cost of Rs.7215 crores has risen to Rs.33,832 crores
- In case of 29 km long Udhampur-Srinagar-Baramulla railway line the original cost of Rs.3077 crores in 1999-2000 has escalated to Rs.19,565 crores

Fiscal Imbalances Symbolize Public Sector Wastage

It is extremely difficult to estimate the overall dimensions of public sector wastage from government finances. But certain fiscal parameters can be indicative.

- Revenue (tax and non-tax) generation at present finances, on an average, about 80 to 85% of revenue expenditure. Balance has to be generated through capital receipts or borrowings.
- Revenue deficits, on an average, represent 50% of fiscal deficits.
- Use of capital receipts to cover revenue deficits amounts to diversion of valuable capital resources. Hence, it signifies wastage caused by public sector profligacy.
- Such diversion of funds causes erosion of capital – depriving the economy of investible resources for future growth and expansion.
- “Crowding out” effect builds pressures on monetary policy – leading to high interest rates regime
- In essence, public sector wastage creates a vicious cycle in the growth-fiscal-monetary policy matrix.

A Way Forward

Key Message from our presentation so far is that “the business of government is governance and not business”

- Centrality of governance in general & fiscal governance in particular
- Reinventing and strengthening the institutions of governance
 - Constitutional institutions [Legislative, Executive, Judiciary, CAG, etc]
 - Regulatory institutions [Financial – RBI, SEBI, IRDA, etc & Non-Financial - CERC, TRAI, CCI, APMC, etc]
 - Others promoting Centre-States relations – NDC/ Inter-States Council, Finance Commissions, etc]

A Way Forward

Strengthening public financial management system that improves efficiency of government spending within the framework of accountability

- Reviving & Strengthening Fiscal Responsibility and Budget Management Act
 - Commitments to fiscal targets – budget deficits, public borrowings & public debt
 - Outlay-Outcome Budget – including targeting subsidies and welfare schemes
 - Performance Monitoring and Evaluation System
 - Reforms in the classification of budgetary expenditure
 - Creation of autonomous Fiscal Council – for review and monitoring implementation of FRBM and for sustained dialogue on fiscal policy
- Administrative reforms
- Vigorous disinvestment and privatisation

Concluding Observations

Indian economy is at historical cross roads – among various challenges, combating public sector wastage through good governance must assume centrality of our focus

Let me conclude with following quote from the talk of Vinod Rai, former CAG, at Harvard Kennedy School in the USA.

“Good governance, according to the United Nations, is when its authority and institutions are accountable, effective and efficient, transparent, responsive, equitable and inclusive and follow the rule of law. In the present age, governance has assumed such critical proportions that it appears too important to be left only to the government. The stakeholders in governance have expanded beyond the executive, legislature and judiciary to civil society, social organisations, media and the public. Apart from the base expanding, each new stakeholder has become very vociferous and demanding.”

Let us all be more vociferous and demanding to restore sense and sensibility in our system of public spending and combat the menace of public sector wastage!

Thanks !

sunil.bhandare@tsmg.com