ISSUES IN PRIVATISATION AND ITS PRACTICE: A CRITICAL STUDY OF INDIAN PUBLIC SECTOR DISINVESTMENTS

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By

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CERTIFICATE

Certified that the dissertation titled **"ISSUES IN PRIVATISATION AND ITS PRACTICE: A CRITICAL STUDY OF INDIAN PUBLIC SECTOR DISINVESTMENTS"** submitted by NEERAJ KUMAR, in partial fulfillment of the requirement for the award of the **Degree** of **MASTER OF PHILOSOPHY** is entirely his own work and has not been considered for the award of any other degree either at this or any other University.

We recommend that the dissertation may be forwarded to the examiners for evaluation.

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To
My
Beloved Parents

CONTENT

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CHAPTER ONE

INTRODUCTION

The development literature in economics has witnessed changing perceptions on the role of state versus market mechanism over time. As is well known, during the early decades, it was neo-classical theory which dominated the economic discourse. However after the post world war II, there was an unprecedented interest the world over for activist state intervention under the under the influence of Keynesian economics.

Similarly in the developing and newly independent countries, the limitations of neo-classical theory and perceptions led to search for alternative development paradigms like planned development based on import substitution strategies as a guiding force of economic policy. The observation that the effective government itself is a public good was viewed as the raison-d'etre of state economic intervention (Stiglitz, 1936).

The genesis of industrial policy in Independent India can be traced back to the setting up of a National Planning Committee in 1938, under Pandit Nehru against the success stories of planning in Soviet Union and other erstwhile countries. All the key infrastructure and basic industries which were capital-intensive and required large scale investments was to be set-up by the state through setting up of the public enterprises (PEs)

especially after the 2nd FYP. This was even advocated by Bombay Plan (1994). The public enterprises was to play a strategic role and was seen as a harbinger of socio-economic transformation in an economy plagued by severe bottlenecks and imbalances in the post-independence time. Most of the public enterprises was seen as natural monopolies where controlled pricing was followed which itself points out to the claim that public enterprises were not run solely on commercial (profit) motive. The socio-economic goals were also paramount.

The industrial policy resolution of 1956 further envisaged extending the share of government ownership and control in a mixed socio-economic framework. Although Schedule A among three Schedules A,B,C, was to be the exclusive responsibility of state, it was not watertight compartments and private enterprises were allowed to set up unit in areas through industrial licensing.

The analytical reasons for the establishment and operation of PEs partially in LDCs have a long standing in the literature and are well known. These arise partly from market failure' arguments arising due to presence of externalities, etc. and partly from other macroeconomic considerations,especially the nature of private investment in a mixed economy. Kaldor (1980) provides a classic statement on this point – 'When public investment is a part of a national plan, it is possible to take into

account all kinds of criss-cross effects (or indirect effects) into consideration which would not be possible with private investment. Keynes once said that in the face of complete uncertainty, investors generally rely on a convention that the future will be just like the present and for that reason the effects of the existing situation enter in a sense disproportionately, into the formation of long term expectations' Hence capacity is only likely to be created in so far as its use appears to be profitable at the existing state of demand since the demand for commodities depends on the level of incomes which are generated in production, the additional production generated in the future by the sum of the investment decisions of the present will itself increase the demand of commodities in comparison with the present level (or can do so only imperfectly) since they take their decision independently of each other. Investment by public enterprises on the other hand, can take the comprehensive effect of all investments into account in judging the social profitability of any particular investment project. It should be noted however that a state plan is capable of doing this even when the investment is undertaken by private enterprises, as the Japanese example shows. What is required is that there should be a fairly comprehensive state investment plan for industrial development and the state should be capable of giving effect to this plan through the administrative guidance of the privately

owned firms provided, as in Japan, these are native and not foreign owned firms (Kaldor, 1980).

The other consideration for establishment of PEs, are, building up of local technological capability on the premise of self reliance, exploiting dynamic comparative advantage in a country with underdeveloped capital markets which require large scale investments (steel, transport etc.). These theoretical arguments can provide the basis for relative performance evaluation of public and private sector.

The public sector outlay as a proportion of GDP in an indicator of industrialization and it showed constant increase in India upto 1980s. From 36.7% of GDP in 1950s, it reached upto 40% of GDP by end 80s. There was no open criticism until then regarding the performance of public sector. But the 1980s saw many changes. The interventionist fiscal policy which was accorded a crucial role under Keynesianism saw major reversals in many countries like UK and USA in 1980 due to rise of conservative governments in the wake of going skeptism on the part of government and growing inefficiency in public expenditure policies and industrial recession and stagflation. The centralized mode of functioning came to be recognised as inefficient, inflexible and unresponsive to consumers. In the developing countries, several PSEs were making losses resulting in staggering burden of subsidy costs, heavy external borrowings etc. It was visible that

subsidies were paid mainly for political reasons and little thought was given of PE's financial performance. Government guaranteed foreign borrowings of PE's and preferential access to domestic credit on confessional terms added substantially to PSE's debt. According to Gillis, the public sector deficits in developing were estimated at 3% of GDP in late 1970s were as high as 10-12% of GDP in 1980s and one of the major element in the reformation of PEs was commitment to sell then and thus began the debate on privatisation.

The operational efficiency in the case of Indian PE'S also came under attack. A major concern with regard to operation of PE's was the poor returns on capital employed and the net returns (which is a more clear indicator of the health of PSUs) remained more or less stagnant and abysmally low at round 2.5 percent throughout the seventies to early 90's. The Indian fiscal system reached the cross-roads in 1980s and strains an government finances became increasingly burdensome as was apparent from the deteriorating balance of payments and growing public debt. Sustaining the inefficiency of PE's was socially high lost proposition where the government was in acute financial stress. The undue protection arising from the governments regulatory mechanism like MRTP, FERA, not only fragmented the capacity utilisation but also reduced the competition as was reflected in the higher incremental capital-output ratio till the 1980s (Rangaran, 1996). The area which suffered a major set back was the

infrastructure sector. A lost of factors was responsible for the disquieting trends in the operational performance of PEs which will be examined in the course of study.

The above factors led to the revival of debate on free market versus state role. The economics reforms launched in July 1991 was reflective of the new orientation towards free market mechanism and redefinition of state role in economic development. The fiscal retrenchment effected since 1991 to curb down fiscal deficit and public debt was a clear indication of reducing the PE's role and involving more private-sector participation.

The role of state has gone considerable dilution since then and the government was conditioned to give more thrust to market induced privatisation programme. Of necessity, the correctives for restructuring PE's which should have applied in the 1970s and 1980s became imperative in 1990s as otherwise the economy could not have managed its balance of payment. The virtues of competitive markets acquired dominance with the emergence of economic liberalisation and it is in this environment that the role of PEs is being reappraised. The government more towards privatisation of public sector through disinvestment has remained one of the most contentious economic issues in the post-reform period in the policy circles.

It should be noted at this point that the push for privatisation in the developing countries came from the world Bank and IMF (and not the countries concerned) as they were bound by certain conditionalities (Ramamurthi, 1992).

The world Bank came out with a headline 'New Research Priorities: 'The world has changed so has the Bank' in its publication, Research News in 1985. The article observed that the record of development and growing store of empirical research have heightened the recognition of the importance of markets and incentives and limit of government intervention and central planning. It introduced a standard package of structural adjustment policy measures to bring out institutional changes with a view to increasing the competitiveness of the domestic sector, increasing the share of relatively more efficient sectors in the national product and achieve faster growth of the economy by relying on market forces. To achieve these objectives the policy instruments are deregulating the economy by dismantling the licensing requirements, dismantling controls and reliance on market forces, privatising the public sector so as to enable these units to work with profit motive, having an exit policy for labour so that productivity can be increased, deregulating the financial sector so that the capital and money markets may be developed better, encouraging the direct foreign investment and portfolio investment by removing foreign exchange deregulations etc. Thus from 1980s, privatisation of state owned

enterprises (terminology used by World Bank) become a major economic policy in many countries.

Despite an obvious move towards privatisation there is as yet no comprehensible policy towards privatisation Disinvestment of PEs in India has remained a part of fiscal policy and the redivide between public private sector is a combination of fiscal policy, industrial and tariff policy combined with strands of policy on public enterprises reforms. The sum total is a non-policy on privatisation. The lack of comprehensible policy on privatisation stands out in contrast to other policy declarations of NEP and which if neglected can have a significant bearing on public sector management and performance. (Gouri, 1996).

Before describing Disinvestment, it would be better to delineate some cases on which privatization was adopted by Indian state. To some the economic and political ideology of neo-liberalism that state regulation is bad and market forces are good, private is good and public is bad played a role. The main theme which finds a resonance in present Indian state is that market always allocates resources optimally private ownership always insures incentives to maximise efficiency and it promotes greater competition. Private management is intrinsically more efficient and the problems of principal-agent and property rights do not hamper the efficiency of private sector as in public sector. To other economists and

policy analysts, the move towards privatisation was a matter of practical necessity in view of the unsustainability of the public debt profile It was the fiscal incapacity of the government which prompted move towards privatisation (Jalan, 1992).

Despite the shift in views, it would be mistake to regard privatization as a panacea for all ills of the public sector. In many countries where it has been properly planned and where the economy as a whole is functioning efficiently privatisation has improved industrial performance (like in U.K., France etc.). In other countries privatization has not yielded the positive results (former Soviet Union). In some other countries because of implementation problems, the privatization process had to be slowed down (Brazil, Hungary). The only general conclusion that can be derived from varied experience is that the success or otherwise, of the policy of privatisation is likely to depend on country's circumstances, particularly its macro-economic performances.

The other premise which supports privlisation is that public sector crowds out private sector investment but the empirical findings in case of India suggests that there is indeed complementary relationship between the two and data suggest that private investment has moved symbiotically with public investment upto late 1980s.

As regards efficiency of private sector vis-a vis public sector, there is large literature on theoretical and empirical fundings and there are many contradictory and conflicting views on this. There is also no clear visible relationship between the ownership and performance.

To regard private capital as a substitute of public capital would be a mistake because the objectives of two entities have been entirely different. The PEs are constrained by multiple objectives and its performance cannot be judged solely on the tenets of financial performance (profitability). There is need for more efficient execution of projects, efficient marketing and R and D and improvement in their management. The trade off cannot be between private and public enterprises but between the public enterprises geared to the development of strategic industries and a modern infrastructure and unchecked exploitation of Indian Capital by foreign capital (Sundaram, 1996) The success of any public enterprise depends on three distinct though interrelated areas such as Investment decision, pricing decision and performance evaluation. (Trivedi, 1990).

Another dimension of inefficiency relates to growing corruption in both the public and private sector. The real failure is the black economy for both the private and public sector (Kumar, 92). Kumar says that the strength the ruling classes provided the state to face challenges from foreign capital was also a threat to the existence of private capital. Hence

Indian capital took an ambiguous position towards the public sector and took a position of sub-optimality from the point of view of its long term interest. It promoted the black economy to discredit the public sector and to make public policy fail. (Kumar, 1992).

The cautions and hesitant policy of reforming PSEs was given up in March 1991 budget when the government announced disinvestment of PE's shares. There are several conceptual issues regarding disinvestment, which will be taken up in the course of further study. Disinvestment is one of the means of privatlisation. Disinvestment involves sale of only past of the equity holdings held by government to private investors (both domestic and foreign). It widens the ownership base. But there can be a case of disinvestment without privatisation or vice-versa (Datta, The ET, 1992).

The government may transfer a part of equity holdings in PSUs to state owned financial institutions and to their subsidiaries, like mutual funds. The full ownership then remains within the public sector in its wide definition. All that happens is that the budgetary and balance-sheet liabilities of government are transformed into similar liabilities of non-departmental bodies within the government orbit. There is no reason to feel that such a transfer will necessary make the management of the units concerned more efficient. It has been the common experience that the public sector financial institutions owning large block of shares in private

companies have done very little to exercise effective control over management.

There are various modalities of disinvestment. It can be a trade sale, strategic sale or sale in the domestic or global markets through ADR/GDR issues. On the other hand, there can be a competitive bidding of shares either through public tender, public offering on stock exchanges or non-competitive placement of shares through contracts, franchise, management employee buy-outs (MEBOs) etc. It should be noted that there is also a large literature on the theories of privatisation.

The question that arises here, Is the private capital in the Indian stock market have capacity to absorb divested share of public sector enterprises. If not, would the multinationals by whatever methods succeed in acquiring the equity of public sector enterprise? The securities scam and the wholesale involvement of the multinationals banks is a strong pointer in this direction.

Bimal Jalan has pointed out (in India's Economic crisis:The Wayout Ahead,1991)

'Despite the impressive growth of capital markets in India in the 1980s the total capital issues raised in 1989-90 were Rs. 2610 crores, of which equity and preference capital was only Rs. 504 crores. Total capital

raised in a whole year (inclusive of debentures) was thus only 1.1 percent of the assets of PSEs.

Even the secondary capital market does not have adequate depth, and its magnitude in terms of capacity to absorb additional equity issues cannot be measured by the stock market turnover which was Rs. 29, 385 crores in 89-90 and only Rs. 71,777 crores in 91-92. It is obvious that the sale of public sector share inspite of the inadequacy of capital market would do two things (i) It would result in uncompetitive bidding and depressing the prices. (In the Indian case as a result the market – capitalisation has suffered to the extent of 30-40% due to under pricing of shares) (Manmohan Singh, 1994) and (ii) enable foreign investors to pick up valuable assets of the Indian people at a throw away price.

This is evident from the last eight years experience on disinvestment. The government except for two three years did not achieve the disinvestment target as the market and the institutional investors linked the PSUs disinvestment with the fiscal correction exercise. (move aimed at reducing the fiscal deficit) of the government. This puts the government at a disadvantage in terms of getting the best price for its shares and many times had to withdraw from the market after offering its shares in some companies as the price was too low. Recently, the government has decided

to delink the disinvestment exercise from budget and has opted for medium term strategy on disinvestment.

Any rational pricing of shares of PE should take into account the forgone future earnings and losses of public sector enterprises. Overall disinvestment programme in India has been at a modest success and it is open to criticism on several accounts (Even if one were to assume that privatisation can lead to gains in efficiencies which itself is a highly problematic assumption.

There is lack of clarity on the objectives of disinvestment and if the government's motivation is to reduce the fiscal deficit, the government could have easily mopped up the retained profits of PSFs without resorting to divestment (K. Ashok Rao, 1996) (It should be noted that the proceeds collection in the year 1995-96 were just less than 1% of fiscal deficit). Most of the divestiture companies are profitable ones and the loss making sick PSUs are yet to be divested. Restructuring and reviving the potentially viables ones of a loss making units from the Disinestemnt Fund in the short term so as to reduce its long term dependence on the budget was one of the general recommendation of Disinvestment Commission, but this major recommendation is still hanging in balance.

Privatisation is one aspect of overall micro-economic reforms but its implementation has impact on changes in competition policy and the

quality of regulations. Privatisation without concomitant changes in competition policy can convert publicly owned monopolies into privately owned monopolies (Majumdar, 1997). This has happened in Great Britain of British Telcom. Nevertheless, as Ramamurthi (1996) contends, in the short term the privatisation of monopolies is unlikely to be accompanied by a strengthening of competition became it is easier to sell a state firm with market power than without power. The introduction of necessary regulations in sectors which are monopolistic is more likely to be undertaken in short-term as it ought to be, otherwise the absense of regulations can lead to market failure.

Therefore, even if changes in competition policy may not occur in the short-term introduction of regulations in countries such as India which have not had a regulatory framework for factors such as power and telecommunications, can constrain newly privatised monopolies from behaving in manner detrimental to consumer welfare. Hence along with privatisation, changes in competition policy and regulatory policies are equally necessary and are important aspects of the reforms process which can lead to changes taking place in the behaviour and performance of PEs (Majumdar, July 1997). It is in this connection that India has yet to learn more from the privatisation experiences from other counters like Britain, Mexico, France, South Korea etc. Kohli (1987, p.26) has summarised the lessons learned from ADB country studies and Pliatzley (1987; p.65) lists

five golden rules based on British experience. Most of the these have to do with setting clear objectives and performance criteria, monitoring performance and rewarding success. These objectives should include productive efficiency, profitability and efficiency pricing and the PSEs should be subject to competition wherever possible: these should be no entry barriers (facing private competitors) nor-exist barriers (preventing the bankrupty or liquidation of PSEs). Social and distributional objects can been addrerssed by separate instrument–targetted subsidies or programmes – rather than distorting the prices charged by the PSE. (Newbery, 1992). A central question in the management of PEs is the degree of autonomy to be given to enterprise managers and principal agency theory offers several insights to guide the design of management system.

The disinvestment policy cannot ignore the welfare implications arising due to loss of employment in PEs due to restructuring and modernisation and disinvestment should be reconcilled with proper safety nets. The setting up of NRF by (National Renewal Fund) was set in in this direction but it has not met with success. It is alleged that PEs suffer from lower productivity due to excessive trade-unionism and excess-manning. It should also be noted that public sector enterprises provides several goods and services to rural consumers on the basis of cross-subsidization. Such cross-subsidization would not be possible after privatization.

PEs should be supplemented by a proper exits policy to improve the labour productivity. It should be also noted that the disinvestment of public in favour of multinational corporations (MNCs) or other private interest will undermine the long term goals of technological development by weakneing design and engineering capabilities. The employees of each public sector should be involved to make a thorough evaluation to improve the units. (Haskar, 92)

Disinvestment will be accepted by the public when there is transparency about the whole process. The Disinvestment Commission's (set-up in November 1991 and August 1996 to determine the modalities of disinvestment and terms of reference by-Congress and United Front governments respectively) job is further complicated by heterogenous nature of public sector itself which comprises competitive or 'contested' markets, where private entry is acceptable, natural monopolies or oligopolies became of large size of units relative to the size of local or national markets. Finally among the loss making units, large number were originaly private sector units which had to be taken over by the Government on order to protect workers' interests. (Chandrashekhar, 92). Lack of proper accounting practices and information on individual PEs also hinders the performance evolution of PEs.

Most of the recommendations and suggestions of DC has remained on paper and are yet to be implemented. Even the objective of raising resources by privatising the public seector has been only a modest success.

Aim of Study

This study is an attempt of the reappraisal of public sector role in the changing free-market economic regime in favour of privatisation and critical evaluation of policy option of disinvestment for reforming PEs. The debate about privatisation typically compares the efficiency of PSFs with comparable private firms but whether this debate between private and public sector in India is a real issue or just a rhetoric is to be seen. The more interesting question why in other mixed economics both private-public firms are efficient while in others both are inefficient. The rationale and modalities behind the disinvestment will be looked into after studying the other counters experiences on privatisation like UK, France Korea etc. Other alternative policy options will be examined after questioning the feasibility of disinvestment in Indian context in the end.

Chapterization

To proceed with we have divided the work into five chapters including the introduction which is the first chapter.

The second chapter surveys the literature on privatisation and discuss briefly theory, objectives and methods of privatisation. The three main conceptual issues namely ownership, competition and regulation in the privatization debate are broadly analysed, after drawing from various empirical studies of UK, USA etc. who had undergone privatization. The experiences of privatisation from other countries like Britain France, Moscow, etc. is also being examined.

The third chapter deals with relative performance evaluation of PSEs with regards to efficiency and profitability considerations, vis-à-vis their role in national economy. The causes of inefficiencies in PEs are broadly divided into two heads; one relates to strategic and technical consideration and other relates to corruption. The last section deals with the consequences of inefficiencies on fiscal front especially the public debt, fiscal deficit and balance of payments.

The chapter four makes a critical appraisal of the disinvestment programme started in India in 1991-92 and the rationale, modus operandi and different modalities of disinvestment program. Several case studies of individual PSEs is drawn into study and major criticisms regarding the disinvestment program initiated since 1991-92 ie. sale of assets and pricing is covered. The different dimensions and policy implications is studied.

The Rangarajam Committee and Disinvestment Commission's suggestions and recommendations is dealt briefly and subsequent disinvestment of PSUs until recently will be studied. The last section deals with the alternate policy options to reform PEs.

Finally in the last chapter all the main conclusions of this study will is put together. Bibliography will be listed at end.

CHAPTER TWO

LITERATURE REVIEW ON PRIVATIZATION: THEORIES AND PROBLEMS

The public sector expanded quite rapidly in the early decades of the century but the situation changed drastically in the mid-1970s, when the inability of economies to adjust to external price shocks led to a market deterioration in macro economic performance of the public sector (see Hemming and Mansoon, 1988). Subsequent recovery of the public sector was slow, leading to a growing demand for privatization in the policy circles.

The protagonists arguments are based on deep seated convictions about the efficiency of free markets and importance of ownership in guiding enterprise behaviour. The problem of state owned enterprises[1] are not ownership per se, but rather a lack of explicit goals and objectives and an absence of organizational cultures as well as systems that support and encourage fulfillment of those goals. In some circumstances, privatization may aid in fulfillment of an enterprise's goals and objectives because of the culture and systems it fosters, in other cases it does not.

Certainly private sector ownership is no guarantee of good ownership and there are in-fact examples of state owned enterprises in Brazil and South

[1] The word has been coined by the World Bank for the public-sector enterprises and used interchangeably for public sector enterprises.

Korea that perform quite well. Problems concerning public enterprises differ between developed and developing countries, on the one hand and among developing countries themselves, on the other. While there are several policy options for reforming PEs and privatization is one of them, the suitability and appropriateness of any option depend to a great extent, on the specific socio-political and economic environments, prevailing in difficult countries. While experiences of different countries in terms of content or modalities of their reform process might provide some guidance about the outcome of specific policies experiences may not be replicable in all countries and in all situations.

In India, privatization debate has been viewed in the context of serious concern with the perceived low levels of efficiency in public enterprises, the problem of financial resources which the government has to resolve and inadequate competitive elements. Those three elements constitute the immediate and more important provocations for a debate on privatization. However, it is not been established that the efficiency of public enterprises cannot be improved or that private enterprises can be more efficient through a simple process of transfer of ownership.

Indeed the disenchantment with public enterprises is not matched by an enthusiasm for private enterprises in India. Introduction of competition sequences requires decisions far beyond privatization, and privatization will

be only one element in a strategy to remedy the situation arising from the poor performance of public enterprises. Even so, large areas of the existing public enterprises involving huge investments, monopolistic units and public utilities are not amendable to privatization in developing countries, given the size of capital markets and large transaction costs.

Privatization- The Conceptual Issues

Among the various policy options that are advocated, privatization has figured prominently in the attempts to reform PEs. Privatization, in principle, represents transfer of ownership from government or quasi-government organisations like state holding companies and public sector organizations, to private investors. To give a broader definition of privatization, Kay. Mayer and Thompson (1986) delineate the following activities: (1) denationalisation- the sale of public sector assets, (2) deregulation - the opening up state activities to private sector competition, (3) contracting out, (4) the private provision of public services, (5) joint capital project using public and private finance, (6) reduction in subsidies and increase of introduction of user charge (7) disinvestment- dilution of government ownership. More recently, Boycko, Schlifer and Vishny (1996) have defined privatization as combination of two activities. The first is corporatization of PSEs thereby transferring control from politicians to managers and the second, is reduction of cash flow ownership by the treasury (or ministry) and increase of cash-flow ownership

by managers and outside shareholders. In essence privatization is a process whereby it is intended to reduce the influence of politicians and bureaucrats on the functioning of PSEs and to transfer the controlling rights to managers, accountable in the usual way to private owners (subject to the regulatory mechanisms). Even in the narrower sense, divestiture connotes privatization. Privatization involves sale of part of equity holdings held by the government to private investors i.e. exchange of (part of) public financial assets for private financial assets. It therefore leads only to dilution of ownership and not transfer of full ownership. The disinvestment process is also conditioned by multiple objectives as the case with privatization and hence trade off becomes inevitable. There is still one important difference - the government renounces its control over the PEs through privatization while it may retain its control after disinvestment.

The objectives of privatization include (a) improving the performance of public enterprises in terms of both internal efficiency (depending upon the total costs to the firms producing given levels of output) and a allocative efficiency (depends upon the output levels of firms, given cost structures) (b) raising revenue for government activities thereby reduce budgetary deficit through sale of assets of public enterprises and (c) promoting popular capitalism through wider share ownership (through disinvestment or through primary issue). The objective of broadening share ownership is to increase public backing for market oriented economic policies and to make it difficult

for subsequent government to reverse market policies by renationalization (Megginson, Nash, and Randenborgh, 1994).

Theoretical Arguments

The theoretical basis of all these arguments is found in the economic literature particularly in property rights theory, agency theory, theory of economic regulation etc. while several theoretical arguments have either explicitly or implicitly influenced the process of privatization in different countries, such arguments are invariably based on country specific socio-economic and political environment Generalisation of there arguments into a coherent theory may not stand the test of their universal applicability. The three major conceptual issues involved in the privatization debate are namely. Ownership, competition and regulation.

Ownership and Incentives:

A change in the allocation of property rights leads to different structure of incentives for management and hence to changes in both managerial behaviour and company performance. The general agency problem can be characterized as a situation in which principal seeks to establish incentives for an agent, who takes decisions to act in ways to contribute maximally to the principal's own objectives set by the owners of both public and private enterprises. In public enterprises, the citizens or voters in the country are ultimate owners. But the decision making power and responsibility to ensure

the optimum utilisation of resources by public enterprises remain with politician and bureaucrats. This could be viewed as agency problem (see Boycko, Shleifer and Vishny, 1996). As per agency theory, conflicts in the interest of managers (agents) and owners (principals) of the enterprises result in less than most desirable managerial behaviour from the owner's point of view. It is suggested in the property rights theory that attenuation of property rights is at the source of inefficiency of PEs (see Jenson and Meckling, 1976). A clear allocation of private property rights between owners and managers may ensure better monitoring of managerial behaviour.

The pursuit of its own objective by the management shall be constrained by certain capital market participants like the firms' shareholders through shareholder's monitoring other investors or other agents through take over threats, etc. In the case of shareholders' monitoring, the working assumption is that shareholders seek to maximise their respective financial return. But if the monitoring is sub-optional, then the managers can be said to have discretion to pursue their own objectives and it may not be appropriate to base analysis of maximisation assumption. If the management fails to act in consonance with optimal contract, the deviation between P (purchase price of share of the target company) and P* (value of each share after introduction of optimal contract) increases, the management will at some point become vulnerable to a takeover bid. The existence of these perceived threats of takeover in turn act as an incentive mechanism that deters management from

the pursuit of policies that are substantially at variance with the interest of shareholders[2] The second defence is that company law establishes a framework in which monitoring activities can be centralised in a Board of Directors for the firm, where for practical purposes control lies in initial promoters who invariably are a group of minority shareholders. (Berle and Means, 1968). This is true in respect of many companies in the Indian Corporate sector. These companies are being run almost like family enterprises, despite the fact that FIs are major shareholders. In this context, it is pertinent to note that in India, the FIs have sometimes exercised their weight to prevent attempts of takeover by other groups. A recent study on corporate control by Herman in the U.S. concluded that managerial control was present in 40.5 per cent of the cases (Herman, 1991).

In brief, the problems created by the principal-agent paradigm exist more or less in all equal measures in both PEs and the private corporate sector, the only difference being that interest or pressure groups are different in both sectors. Efficiency then is more related to management capabilities and market structures than ownership per se (See Vickers and Yarrow, 1988). Yarrow (1986) in his article, 'Privatization in Theory and Practise' argued

[2] Here the argument does not mean managerial discretion does not exist, some amount is bound to exist if the transaction cost of the acquisition is not low, implying low take over threat because of low capital gains.

that competition and management accountability are more important rather than privatization per se in promoting economic efficiency.

Competition

The main question here is whether liberalising conditions of entry into an industry create entry threats of sufficient power to impel the incumbent firm or firms to behave efficiently and in accordance with consumer preferences. The most important one is the role of potential competition.[3] In their theory of contestable market, Baumol and others, examine free entry in its pure[4] from and argue that contestability exists if free entry in its pure form is assumed. But the economics of strategic entry deterrence and predatory behaviour shows that in many circumstances, incumbent firms may be able to thwart political competitors by anti-competitive factors.

This is central question for privatization policies in the UK and other countries because major enterprises (BT, BGC) entered the private sector with positions of great dominance and it is not clear to what extent measures to liberalise entry with their industries will promote truly effective competition. The key to strategic entry deterrence by an incumbent firm is to make credible

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3 Full (actual) competition is not essential for achieving desired efficiency, only the threat of competition is sufficient.

4 A contestable market is one in which firms are vulnerable to hit and run entry. Entry involves no sink cost, a firm can enter the market without making irrecoverable expenditures, and so there are no barriers to exist. Thus a natural monopoly market in principle can be contestable and vulnerable to hit and run entry. Equilibrium exists in a contestable market if all firms make zero profits i.e. P=AC.

the threat of responding to entry - for example by aggressive pricing, in such a way that rival would regret having entered the market (Vickers, 1985) Another way is to deny the rival, the access to technology that would allow him to compete. (Direct, 1930). The Gilbert and Newberry (1982) examine pre-emptive patenting - the acquisition of a patent by an incumbent firm with the purpose of denying the patent and hence an entry opportunity to a potential rival. The other ways are advertising brand proliferation etc. Therefore, economics of potential competition is highly pertinent to the problems of regulating privatized industries.

Another contribution to the theory of competition is the issue that arises in connection with networks and vertical relationships. For example in the current state of technology in U.K., competition in long-distance telecommunications is possible whereas in local network, there should be natural monopoly prevailing. The question for policy in these circumstances is how to promote and maintain effective competition in activities where it is feasible. The focus here should be on (1) vertical separation (not allowing the firm that operates in long distance telecommunication links) and (2) rulings in interconnection stipulating the terms of relationship between the two vertically separated sections. Telecommunication policy in the US and Britain illustrate (1) and (2) respectively.

Economics of Regulation:

Competitive process provides an incentive system that impels private firms to behave in ways that are broadly consistent with efficient resource allocation. But such circumstances do not always hold. There is then a need for regulatory policy to influence private sector behaviour by establishing an appropriate incentive system to guide or constrain economic decisions. Therefore the problem for regulatory policy is to see how to induce the firms to act in accordance with the public interest without being able to observe the firm's behaviour (asymmetry of information).

Asymmetric information is at the heart of the economics of regulation. If the government and the firms managers had access to same information about industry conditions and the firm's behaviour, then the regulatory problem could be solved by simply directing the managers to implement the socially optimal plan, given the common information available. But in reality the decision makers within the firm are generally far more knowledgeable than regulators, and the regulator can neither observe nor infer all aspects of firm's behaviour. So their behaviour can be monitored only imperfectly. The question is what is the optimal regulatory mechanism given the information available. In doing so it illuminates the trade off between internal and allocative efficiency that results from asymmetric information, and it reveals how the effectiveness of regulation depends critically upon the information

available to the regulators (See Baron and Myerson, 1982 and Laffont and Tirole, 1986).

The economics of regulating multi-products firms is central to an assessment of policy towards companies (e.g. BT, BGC, ESI etc.) irrespective of how they are owned. For example BT supplies a wide range of product (telephone, handsets, mobile phone services, private branch exchange etc.) and its principal - activity supply telephone calls is also a complex business. Therefore, the pricing structure of multi-product firm must reflect these differences between time and space (e.g. local call is different from a long distance call), and their associated costs.

Among the many arguments favouring privatization, Jones, et al present a convincing theoretical framework based on social welfare considerations (Jones, Tandon and Vogelsang, 1990). They argue that the government may not choose to exploit a monopolistic or oligopolistic situation, but the private buyer may do. So the government should care about the operation of the enterprises even after the sale. So, they suggested that a third value should be introduced into the calculation to reflect the social value of the enterprise (after divestiture) and justified the privatization only if it leads to an increase in social welfare. The privatization of PEs is justified if it leads to an increase in social welfare. In other words, the social value of the privatised enterprise plus the net social value of the sale proceeds of the

public enterprise should be greater than the social value of the enterprise under public ownership.[5]

Operationatisation and Privatisation:

Many PEs operate in industries with low profitability for various reasons. As has been pointed out, PEs are often those private firms which have been nationalised due to their badperformance. Moreover, some such (ex-private) PEs operate in declining industries where the profitability is likely to be low without massive restructuring. When the PE put for sale is unprofitable it is doubtful whether there will be many buyers. In other words, government wants to sell the least profitable PEs-which private investors are the least willing to buy (World Bank, 1987, p.68).

The most obvious solution to this problem is to improve the performance of such enterprises before privatization (like the Thatcher government did with privatized PEs like British steel and British Airways). (For details, see Daring, (1989) and Rowthorn, (1998)) in order to make them attractive to potential buyers. However, if the performance of PEs can be improved under public ownership, there is no efficiency reason to sell them, although the government may still want to sell them for other reasons. (for

[5] This has been explained in detail as follows: The sale of a public enterprise can be justified if V_{sp}+ (ag-ap) $Z>V_{sg}$ where V_{sp} is the social value of firm under private ownership, V_{sg} is the social value of firm under public ownership Z is the sale price and ag and ap are shadow prices of the public and private sector income respectively

example ideological reasons like UK under Thatcher or Chile under Pinochet).

Moreover, privatization is not a costless business. First of all, there is the problem of valuation of the PEs put on the sale. Often times, the assets of PE, have been purchased at subsidized prices, whose value when sold to the private sector is hard to estimate.[6] The problem is often aggravated in the LDCs, where there exists no reliable accounting system and there is an acute shortage of qualified accountants. Secondly, there are costs involved in floatation and underwriting for the shares of PEs which are sold and the developing countries, which are attempting privatization mainly out of budgetary reasons, this can constitute an obstacle to actual privatization. More importantly, it should be noted that selling off PEs carries an opportunity costs is the sense that the future income streams from those enterprises are forgone by the government. In the case of those PEs which are mainly serving a revenue raising function (e.g. alcohol and tobacco monopolies), this is obvious. Even when the PEs concerned were making losses, it is not obvious that selling them off will actually improve the budgetary situation. If such enterprise have been used as a means to subsidize consumers (e.g. subsidized public transport) or private producers. (e.g. subsidized electricity or fertilizer) even if they are sold, these subsidies may still have to be provided. This

[6] The obvious solution to this problem is to use a comparable PF as the benchmark for such valuation, but the problem here is that often there exists no such PF due to the simple fact that many PEs are monopolies.

means that taxes have to be raised to finance the subsidies. And there is no guarantee that running the tax/subsidy scheme is going to be less costly than doing it through a PE, because such a scheme could impose costs of information collection, tax collection and monitoring for tax evasion or false reporting from the recipients of subsidies. It should be remembered that one important reason for setting up PEs is to save the often prohibitive costs involved in running tax/subsidy schemes.

Let take the case of other important issue i.e. employment creation pr or preservation through PEs. It is often argued that creation of employment per se is not a suitable objective for the PEs to pursue and that employment is best promoted through other government measures e.g. macroeconomic policy. Stated in this way the argument seems unexceptional. However, in practice the issue is much more complicated. For example, in a period of rapid structural change within the context of an economic crisis, like the 1970s and the 1980s, macroeconomic policies on their own would be insufficient to maintain the employment level, if only because it takes time to train and retrain workers for the new industries. And in this situation overrunning some PEs for a period time may be the most efficient alternative available to the government. The interesting example in this context is the contrast between the orderly phasing out of the Swedish industries

(sometimes through nationalisation) and the fast rundown of the British industries in the late 1970s and the early 1980s.[7]

Most importantly, privatization does not necessarily mean that government can simply pull out of the responsibility. Except the PEs set up for pure revenue reasons eg Tourist hotel or tobacco monopoly, most of the now-privatized PEs will have to put under regulation, since they either possess market power (e.g. monopoly or oligopolies) or generate positive and negative externalities. And when a firm or an industry is put under regulation there arises the possibility of "regulatory capture", where the regulated acquires the ability to manipulate the decision by the regulatory agency to his/her own benefit (Stigler, 1975, Pettzman, 1976: Laffont and Tirole, 1988).[8]

The general aim of regulations, as already stated, is to prevent (for reasons either efficiency or income distribution) the exploitation of market power. In the USA, the cost of service (or the rate of return) regulation is the most widely used form of price control. It is characterized by a process in which prices are set so as of cover the full cost of providing the regulated good or service, including an allowance in costs for recovery of a reasonable

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7 For a fuller discussion of the British and the Swedish employment experiences in the 1980s. See Rowthorn and Gyln (1990)

8 This, of course, does not mean that the government should not regulate and adopt a laissez- faire policy - as newest of the proponents of the theory of regulation capture do - because the costs from regulatory capture, may not be as great as the benefits from such regulation.

rate of return in capital employed. It essentially puts a limit on the return to be earned by the firm on its assets. The major criticism of this approach is that, by creating a cost-plus syndrome, it reduces the incentives for cost reduction and distorts the pattern of investment. Another criticism is that it covers the whole particular services where monopoly power and public concern are greatest.

Although in some context, regulation may be a better solution, it should be borne, in mind that this option will incur costs from 'regulatory capture', which may more than offset whatever benefits which privatisation may bring about. Again it should not be forgotten that the difficulty of an effective regulation has traditionally been one major reason behind the establishment of PEs or the nationalisation of PEs.

Problem of privatization in LDCs

1. Stock Market Floatation

Privatization requires the sales of the shares of a going concern. The most common measure suggested to achieve this is floating the shares of the public enterprises in the stock market. However in LDCs, sales of shares through capital market is often impossible due to the underdeveloped nature of the stock market (World Bank, 1987, P.86). Even in sub-Saharan African countries and poor Asian countries, where stock market exists, they are often so small that they cannot raise enough funds to purchase any substantial numbers of PEs, which tend to be the largest firm in many LDCs.

In this context, it should also be remembered that the underdevelopment of capital market will mean that, even when it can be sold, a large ex-PE may not become fully subject to the discipline of the capital market because the threat of takeover bids will be minimal, given the difficulty of raising large funds (For details on this issue, see Singh, 1989).

Moreover, even when it is achievable diffused sales of shares may create more problems than it solves, because of the problem of "shareholder collective action". That is, the large number of shareholders created by the diffused sales militants against the effective monitoring of the managerial behaviour by the shareholders because the individual costs of a higher monitoring (the costs involved in collecting information, etc.) may outweigh the individual benefits from it (increased share price and dividends due to improved performance). This apparently makes selling the public enterprises to a small number of individual or even to a single individual, a better option.

2. Sales to small number of Individuals

If a developing country attempts to sell many PEs to a small number of individuals, it is not often a feasible option became there may not be enough number of rich individuals, who are able to buy them all.

Moreover this method may raise serious political opposition in the LDCs because the sales of PEs (which often are biggest enterprises in these countries) to a small number of individuals can easily be seem as aggravating

the already serious inequality in the distribution of income and wealth. Also, there is the danger that privatization, by sales to small number of individuals, may be used as a means to promote "crony capitalism "through the sales of PEs at undervalved prices to those individuals who are politically well-connected (Commander and Killick, 1988).

3. Sales to Foreign Interests

The underdevelopment of capital marked and the lack of individuals who are able to buy the often-large PEs have led to the suggestion that the PEs be sold to foreign interests. But thus option is not without problems. First, of all, sales of a PEs to a foreign firm will simply substitute one level of delegation (ministers – manager) with another one (headquarter local manager) and does not solve the acute principal-agent problem, thus leaving the number of the levels of delegation concerns now - foreign owned ex-PE unchanged (Singh, 1999).

Moreover in developing countries, where economic and political situation are often volatile, foreign capitals may just leave the country or in Hirschman's terminologies exercise the exit option in the face of a short-term adversity in economic and political conditions with detrimental long-term consequences. Actually, the fear of foot- loose multinational capital was one of the most important reasons for nationalism is many developing countries. In other words, sales of major enterprises to foreign interests will carry a big

cost by making it difficult for the state to control them in a way that fits the national economic developmental needs.

In view of the many problems associated with privatization it can be concluded that operationalisation is necessary complex. Decisions have to be taken regarding the restructuring of PSEs, the method of privatisation the regulation of the privatised public utilities etc. Implementation of these decisions involves, legislation valuation of PSEs, sales of PSEs to private sector and creation of appropriate regulatory confronts. When a whole industry with a monopolistic or oligopolistic structure is to be privatised, it may be desirable to restructure them to separate major functions of PSEs which can be performed by different entities. This paves the way for potential competitors which may be efficient provider of public services.

In the UK, the electric services industry was completely restructured before privatisation with generation transmission and distribution allocated to different entities. The restructuring of firms (financial and operational) prior to privatisation is generally undertaken to make PSEs attractive from investor's point of view with provisions designed to improve competitiveness phased in over a longer term period. This is because it is generally feared that operational restructuring during or after privatisation may result in loss of jobs. However the evidence of privatisation or employment is mixed. (See

Meggison, Nash and Randenborgh, 1994), Parker and Martin (1996), Bhaskar and Khan, 1996).

Methods of Privatisation

The Methods of privatisation[9] can be divided into two categories - (1) conventional methods (2) Non-conventional methods. The commonly used conventional methods are public offering of shares (stock market floatation i.e. distribution of shares in public limited company to the general public), private sale of shares (sale of all or part of government share holding to a single entity or group), sale of government or enterprise assets (no shares), fragmentation (restructuring or reorganisation and then each entity is privatised separately), new private investment in public enterprises through joint ventures (primary share issue leading to dilution of government's equity stake instead of its disposal), management employee buy-out, leases and management contracts (no ownership transfer. Under lease, fee is payable to owner; lessee assumes full commercial risk; under management contract, owner pays for management skills, while manager has full management and operational control.

Sale of either part or all of a PE's shares or assets by public tender is the most common privatisation-instrument worldwide. Most small firms in the

[9] For extensive details on the methods, see "Method of Privatisation' by Andrew Berg and Elliot Berg, Journal of International Affairs, Winter, 1997, 50, n.2.

transition economics were privatised by auction, as were many firms in the developing countries. It avoids the major deficiency of public floatations; uncertain impact on corporate governance and therefore an improved firm-level efficiency. Most of these transactions entail sales of going concerns, they are of the type commonly called "trade sales". The objective of raising revenue may also be achieved by competitive bidding. However the proceeds will depend on whether restructuring losts and debt obligations have to be assume by the central government. Proceeds depends also on how wide the net is cast in seeking buyers.

Choice of method for privatisation depends on factors like objective of sale, cost of sale, and feasibility of alternative methods. Many of these conventional methods have been used in the UK and elsewhere in the Western Europe, Asia and Latin America and more recently in Hungary. Prominent among them, used in U.K. (example BT, BGC, BAA, British Steel etc.) are stock-market floatation, management/employee buy outs. (MBO/EBOs) (e.g. NFC) and sale to existing private sector companies (eg Royal ordnance, etc.). Although the number of privatization through is about 158 against 48 public offers, the market capitalisation of firms privatised through public offers is near $45 bn against the total value of less than $ 2 bn for MBO/EBO (Wright and Thompson, 1994). The above suggests that the average size of firms which used MBO/EBOs as a privatisation is much smaller than those which used public floatation.

The non-conventional methods are the mass privatisation methods used in ex-communist countries with embryonic capital markets. Here, the allocation of assets (in the form of shares) to the population is virtually free. No privatisation glove fits all hands. A public offering may be right where the priority objectives are development of the stock market and wider spread of share ownership, and where government has adequate time and resources. Where overall economic growth is slow and public sector assets are poorly used sale to an outside investor may be the most promising route.

Much of the frustration that can surround privatisation derives from the inability of any method to fully satisfy the multiple objective that characterize privatization programs. Public floatations generate revenues for the state, invigorate capital market and broaden share ownership, but hasty implementation and poor - price setting may seriously dilute positive impacts for corporate governance.

Global Experience and Lessons

India being a late starter in initiating the disinvestment process in PSUs has to learn much from the way other developed and developing countries have gone about disinvesting their stake is state enterprises.

Countries like the UK, Australia and Korea have more than two decades of experience in privatisation. U.K. followed the PPP (Public Private participation) form of privatisation in year 1979 in the utilities sector (gas and

electricity) and infrastructure sectors like airports, telecom services and ports. As per this module the agreement disinvests 50 per cent of its holding to a private party such that both have equal stake in the company.

Management control very often rests with private entity even as the rights and duties of both the parties are well defined in the shareholders agreement. The private parties fund their stake through loans from government-controlled institutions. Again the private parties opt for short-term goals because they have to service the huge debts increased to finance the acquisition while government sets long term goals so that it can sell its remaining stake at a decent price. Such diverse interests are best suited for viability of the PSUs. (However the UK government failed in its disinvestment efforts of ports. The private parties sold their stakes in these ports within three years at six times the purchase price. This affected long term goal of government.)

In certain cases, to safeguard the interests of the nation and employees, the UK government opted for a special share called "golden share". This share has the veto power to stop or alter any resolution against the country. These type of shares have a time limit after which if the government is satisfied with the performance of company, they will be transferred to the private party.

Other OECD and development countries have emulated the British model of case-by-case privatisation, including Argentina, Canada, Chile,

France, Italy, Germany, New Zealand and Spain. Case-by-case privatisation must be tailored to the circumstances of the country and the enterprise. Although there are a number of best practices and generally accepted privatisation methods, only careful packaging, timing and sequencing can guarantee success. For successful privatisation, transparency, fairness and a level playing field are essential. Preprivatisation restructuring should be brief and defensive and related structural reforms should keep pace with privatisation.

In the USSR, privatisation of state enterprises is belong pursued vigorously. A law on individual economic activity was passed in 1986. Private initiative is encouraged in manufacturing, services and agricultural sectors. The proposals based on 'Glasnost' and Perestroika included massive decentralisation of economic management and decision making, higher wages based on productivity, pricing private enterprises in selected areas. Cases of privatisation in China included.

(1) Leasing out to the private parties about 30 state owned enterprises in Shanghai;

(2) transferring about 200 units from government ownership to collective ownership;

(3) proposals for setting of high street shops and small industries. The share of private ownership including form tie-ups has moved from nil

in 1978 to 0.8 in 1982 and 1.9 in 1985 (Journal of Economics, 1987). Many Central and Eastern European countries are starting to move beyond their initial privatization programs which focussed on small-scale privatisation and mass (Voucher) privatisation. (World Bank, 1985).

The global experience reveals that (1) Most of the programmes have been predominantly of the nature of contracting out of services (2) Generally severe budgetary constraints and a strong political commitment in favour of private sector have constituted significantly to the progress of privatisation, (3) Strong private sectors and well developed capital markets are necessary requisites for successful privatisation (4) the services became cost effective after privatisation (5) Privatisation of monopolistic enterprises has been followed by the creation of specialized industry - specific institutions to regulate their operations but it does not promote competition (See Peter, 1991).

Conditions for Success:

Two main factors affect the outcomes-in terms of economic productivity and consumer welfare - of privatisation (see figure 1). One is the nature of the market into which enterprise will be divested that is whether it is competitive or non-competitive.

Figure 1 Privatisation: A Framework for Discussing

Country Conditions	Enterprise Conditions	
	Competitive	Non-competitive
High capacity to regulate; market friendly	Decision • Sell	Decision • Ensure or install appropriate regulatory environment. • Then consider sale.
Low capacity to regulate; market-unfriendly	Decision • Sell with attention to competitive conditions	Decision • Conder privatisation for management arrangements • Install market friendly policy framework. • Install appropriate regulatory environment. • Then counder sale

Source: Privatisation: The Lessons of Experience, by Sunita Kikeri, John Nellis, Mary Shirley (W.B., Washington D.C. 1994).

Privatisation of enterprises in competitive and in particular tradable sectors such as industry, airlines, agriculture and retail operations is likely to yield solid and rapid economic benefits as long as three are not economy wide distortions that hinder competition. Even with such distortions privatisation can have the benefit of reducing the fiscal burden of PEs subsidies and exposing fully the costs of the distortions.

The second factor is country conditions: the overall macro economic policy framework and capacity to regulate. Privatisation of both competitive

and non-competitive enterprises will yield more immediate and greater benefits the more market-friendly the policy environment. For this reason, World Bank Group often supports privatisation as one part of an overall government program of exchange rate fiscal, trade and price reforms, when privatisation involves enterprises is non-competitive markets- usually large SOEs operating as natural monopolies in such areas as power, water supply and telecommunications, a legal and regulatory system must be in place to protect consumers. Good policies and regulatory capacity are correlated with income, thus middle-income countries tend to be in a better position to privatise rapidly enterprise in non-competitive sectors.

The privatisation process itself is also easier if the enterprise is in a competitive sector and the environment is market-friendly. The sale of an enterprise in a competitive sector in a favourable country setting, requires little more than adequate attention to transparency in the transaction and lifting of any inappropriate regulations or price controls. In unfavourable country settings, where the existing private sector is small, capital markets are thin and the interests of external investors is limited, the sale of enterprises even in competitive sectors may be more difficult. But the benefits is economic gains are potentially large especially in comparison with the continued operation of a loss-making SOE. (For a fuller discussion, See S. Kikeri, J. Nellis and M. Shirley (1991) article in Privatisation: The Lessons of Experience (WB, Washington D.C. 1994). The governments intent on privatising PEs faces a challenge: the benefits of efficiency and innovation materializes only if privatisation is done rightfully.

CHAPTER THREE

RELATIVE PROFITABILITY OF PUBLIC SECTOR ENTERPRISES AND ECONOMIC EFFICIENCY

Since the 1980s many countries have engaged in several privatization programmes. India too started privatizing PSUs in 1991 by disinvestment. The common perception is that there programmes have been successful. Inefficiency of the public sector and their inability to stand as viable units have been justified for recent macro-economic policies which includes withdrawal of budgetary support, closure of sick PSEs, endorsement of capacity, delicensing, broadbanding rationalsing, MRTP act etc.

The relative performance of publicly and privately owned firms in term of allocative and internal efficiency will depend upon a range of factors that include the effectiveness of the respective monitoring systems, the degree of competition in the market, regulatory policy and the technological capacity of the industry, etc. Lack of competition, internally and externally, deliberately fostered by M-Substituting industrial strategy has been identified by many [1]I. J. Ahluwalia (1985). Industrial Growth in India, Stagnation since the mid 60s OUP, New Delhi. as the prime cause of inefficiency.

The task of evaluating the performance of PSEs in India is itself not easy as the public enterprises in India possesses dual characteristics of commercial and social objectives. Moreover, the enterprises are a heterogenous entities-some are characterized by monopoly or oligopoly markets and some are competitive or

1. See J. Bhagwati and P. Desai (1975): 'Planning for Industrialization and Trade Policies since 1951', OUP, New Delhi.

contestable (Chandrasekhar, 97). They have a complex hierarchial structure, owned by central, state governments and local government. Efficiency then becomes a relative or value laded concept in relation to the objectives envisaged and the role of enterprises in an economy. Unless the objectives of public sector are clearly defined and parameters of efficiency sharply demarcated, economic liberalization measures can lend themselves to contradictory situations. (Gouri, 1989) Empirical research on the subject has employed various criteria such as financial profitability, cost efficiency, technical efficiency, labour productivity etc This chapter is a modest attempt to look into the some of these approaches.

While envisaging the scope of PSUs it was very clearly stated that among the main objectives,[2] they are to generate more surplus for investment and increase exports so as to reduce the strain on the balance of payments, self reliance was to be promoted to ensure reduction in imports or substitution for imports for strengthening the foundation of the country. A wide ownership of economic power to prevent its ownership in a few hands also formed the basis of setting up of PSEs. The government and the policy makers failed to insist on the efficient management of the PSUs. (Nanjundappa, 98).

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2 The objectives envisaged in PSE survey,Govt. of India, are help in the rapid economic growth and industrialization of the country and create the necessary infrastructure for economic development; to earn return an investment and thus generate resources for development to promote redistribution of income and wealth, to create employment opportunities to promote balanced regional development to assist the development of small scale ancillary industries and to promote import substitution, save and earn foreign exchange for the economy.

In the beginning the public sector [3]under the Ministry of Defence form the departmental enterprises. Non-departmental enterprises cover all the establishments set up by the government eighth as statutory corporations or as companies producing and selling goods and services. was restricted to heavy and basic industries like iron and steel, heavy engineering, heavy electrical plant etc. which was justified in the sense these investments were capital intensive, had long gestation periods, low or no profits, a large foreign exchange component, complex technology and equally complex problems in co-ordination (Hazari and Oza) but later the public sector was extended to non-critical areas such as consumer oriented industries, service sector etc. Derelict private establishments were taken by government, spread all over the country.

PSEs, a symbol of self-reliance and planned development, triggered growth in other sectors in terms of providing inputs to the private sector (e.g. Iron and Steel to automobile industry). This facilitated development in hinterland areas. For example all the four major steel plants in the public sector were set up in backward states. The share of public sector in the total Gross Domestic Product in the economy increased from 8 percent in 1960-61 to 24 percent by 1990-91 (National Account Statistics 1993, Dept. of Statistics, Ministry of Planning, GOI). At the time of First Plan (1951) there were 5 enterprises with an

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3. The pubic sector in the Indian economy includes public administration, defence central and state government undertakings such as railways, Post and Telegraph, communications, transport, power and several other manufacturing trade and service activities. The Railways, Post, Telecommunications and production establishments under the Ministry of Defence form the departmental enterprises. Non-departmental enterprises cover all the establishments set up by the government either as statutory corporations or as companies producing and selling goods and services.

investment of Rs.29 crores, but by the year 1993, there were 245 enterprises with a total investment of Rs.146971 crores. Most of the investment were in goods manufacturing enterprises. About 85% of the investment of goods manufacturing enterprises were in 5 sectors namely, steel, minerals and metals, coal and lignite, power and petroleum. Public sector has increasingly contributed to the industrialization and development of indigenous technology. Bulk of the real investments in R and D have been in the public sector with the private corporate sector playing a minor role.

The public sector has played a dominant role in providing employment in the organised sectors of the economy. In fact during the eighties, while employment in the public sector declined marginally, it rose by a few lakhs per annum in the public sector.

The most important criticism levied against the public sector has been that, in relation to the capital employed, the level of profits has been too low (see Table 1). Even the government has critised the PSEs on this count. In the year 1980-81 the loss of 74 los making units (Rs.760 cr.) was greater than the profit of 94 profit making units, giving rise to a net loss of Rs.103 cr. (Raghavan 1994, PE survey 1982-83). The 8th five year plan noted that the public sector has been unable to generate adequate resources for sustaining growth process (see VIII five year plan, vol II) and was a drag on government's budget (Jalan 1992).

Table 1
Profitability of Central Public Sector Enterprises

(Rs. billion)

	1970-71	1980-81	1990-91	1993-94	1996-97
Number of Units	87	168	236	240	236
Paid-up capital	18.2	87.3	432.4	559.7	602.6
Net Worth	22.0	115.5	757.3	1088.1	1091.0
Capital Employed	36.5	182.3	1020.8	1598.4	2020.2
Gross profit	1.5	14.2	111.0	185.6	305.7
Pre tax profit	0.2	0.4	35.0	66.6	154.7
Profit after tax (PAT)	0.0	-1.8	22.7	45.5	102.6
% Gross Margin to capital Employed	9.5	13.2	17.9	17.3	22.0
% Gross profit to capital employed	4.0	7.8	10.9	11.6	15.1
% Pre tax profit to capital employed	0.6	0.2	3.4	4.1	7.7
% PAT to net worth	-0.1	-1.6	3.0	4.2	9.4

Source : Public Enterprise Survey, BPE, GOI, 1980-81, 1990-91, 1996-97

The factors responsible for low profits are - huge costs and time over-runs in project implementation, inappropriate locational and investment decisions including those on technological choice and product-mix, balancing of capacity not ensured down the whole chain of production and poor marketing arrangements, uneconomic pricing/tariff rate-signifying large cross subsidies, inadequate allocation of resources, delays in filling up top level posts, tight regulations and procedures for investment and restrictions on financial autonomy. (see Economic Survey, 1993).

Parameters of Efficiency

Profitability

The most conventional measure of the performance of an enterprise, both private and public sector is its profitability, not least, because it can be derived from the most readily available data, that is, their balance sheets and profit and loss accounts.

It would be disregard to judge the performance solely on the basis of profitability. PEs were established for reasons other than making profits and serve multiple objectives. For instance, the decision on the choice of technology and location was very often based on development and strategic considerations. At times, location of public sector units was based on the need for opening up backward areas. This meant heavy infrastructure costs. Also since the interest of public sector was not paramount with the policy makers, delays in project monitoring and implementation did not bother them. The problems were compounded by the inadequate budgetary support to the plans, which led to delays and cost over runs which then led to further delays. With capital intensive plants this added to the over capitalization of the pants, high initial costs and heavy burden of debt which had to be serviced (Nigam, 86).

Despite its widespread use in studying enterprise performance, profitability is not a fully satisfactory performance indicator even for private enterprises for two reasons.

First of all, profitability is not only affected by enterprise performance but also by accounting procedure. The difficulty of profitability accounting especially in an inflationary period is well-known (see for example, Likerman, 1984 pp.163). And more generally, calculations of profits over a short period may be substantially influenced by arbitrariness in accounting conventions, changes in convention or action taken to reconstruct company balance sheets (Bishop and Kay, 1988, p.5).

Secondly, short-term profitability may not be a good indicator of long term performance of an enterprise. Therefore it is necessary to use long term accounting rates of return, averaged over a number of years, to properly judge enterprise performance. Such consideration is especially important for enterprises in capital-intensive infant industries (a likely condition for a PE in a developing country) where it may be performing poorly in terms of current profitability, but they may be expected to improve its performance in the near future, if it manages to reduce its operating costs through "learning by doing". Such learning effect will especially be important for PEs in developing countries [4] (Singh 1975).

Therefore, if PEs have objectives other than making profit, it is not justiciable to use profitability alone to judge the performance. Indeed ideally, the process of performance evaluation ought to follow a sequential procedure of identifying the objectives, constructucting indicators to measure the degree of attainment and then measuring performance although in practice, objectives are

4. These is a large theoretical and empirical literature on these issues. For recent surveys, see Hughes and Singh (1987), Hughes (1989). See also Grossman & Hart (1982) and Stiglitz (1985).

seldom specified in a clear and unambiguous way. Objectives may be mutually inconsistent there are problems in devising satisfactory single and multiple good performance measures, and the necessary data are often not available "(Cook and Kirkpatrick, 1988 p.11).[5] And the fact, these PSEs have low profitabilities or even make losses does not necessarily mean that they are performing badly, because their profitabilities do not adequately reflect their social contribution or "social profitabilities" in the words of welfare Economics.[6]

It has also been alleged that lack of profitability in the public sector in India is due to over manning and labour aristrocracy (Kumar, 1991). The labour gets little work and gets fat salaries. But if we see the empirical evidences, wage share in the total value of output is indeed low and has declined over the decades. Indian wage rates are negligible compared to international norms. The rise in the real wages is mainly the result of changing composition of employment, skill levels and seniority in the public sector. (Bhattacharya, 1991).

Accountants use a number of ratios to indicate the level of profitability. Profit after interest and taxes related to net worth or net assets, or sometimes equity, is used by the private sectors. The public sector literature deals mostly with the return on capital employed i.e. return/gross profit before interest and tax on capital employed as the index. It has generally been agreed to relate the profit

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5. There are however, a handful of studies which do use multiple criteria (e.g. Killick, 1983 and Green 1985). But even these studies do not address the important issue, whether the objectives which the PEs are asked to pursue are the most appropriate ones.

6. See Kaldor, N (1980) Public or Private Enterprise: The Issues to be considered in W. Baumol (ed.) Public and Private Enterprises in a Mixed Economy, London & Basingstock, Macmillan.

before interest and tax (PBIT) to total net assets, to assess the total impact on the economy, and PBIT to effective capital employed, to asses the effectiveness of management and profit after tax to net worth from shareholders point of view. (Shankar, Tilak and Sai, 1989).

It is interesting to note that, in terms of return or gross profit on capital employed which is an index of productivity of capital the public sctor profitability is only about 12.3% while that of private enterprises is 13.6%. The difference in only 1.3% (Table 2). The table also indicates the need for enquiring into low profitability. Starting with almost similar levels of economic profitability, the private enterprises end up with a projection of successful profit making organisations while the public enterprises achieve almost the opposite effect. The existence of unused capital is high in the public enterprises when compared to private enterprises. This can be seen between the two ratios (PBIT to capital employed and PBIT to total net assets). It can also be noted that petroleum sector is a major contributor to the overall profitability of public enterprises and most non-petroleum units includes even those loss makings units and sick enterprises in private sector which had to be taken over by public enterprises to protect workers interests.

Table 2

Relative Profitability Ratios: Table 2a

(Rs. crores)

	Public Enterprises			Private Enterprises		
	1983-84	1985-86	1989-90	1983-84	1985-86	1989-90
Gross Margin (Profit before dep. Int., tax etc)	5790	7460	8392	3343	4014	4792
Pre depreciation operating profit	3704	4931	5273	2073	2556	3111
Operating profit	1499	2173	2289	1017	1288	1630
Pre tax profit	1479	2099	2200	1154	1441	1732
Profit after tax	240	909	1200	667	870	11075
Return profit before tax plus interest	3567	4628	5319	2419	2899	3413
Net sales	43870	50844	57771	25705	29838	34095
Total Net assets	65461	77210	89017	25513	29382	35558
Net worth	15849	18943	22850	7727	9216	11828
Capital employed	29851	36382	43096	17406	20299	25003
PBIT to capital employed	11.94	12.72	12.34	13.90	14.28	13.65
PBIT to sales	8.13	9.10	9.20	9.41	9.72	10.01
PBIT to Total net assets	5.45	5.99	5.98	5.48	9.87	9.60
PBIT to Net worth	1.51	4.80	5.25	8.63	9.44	9.36

Source. Public Enterprise Survey, Economic Survey for data on Public Enterprise and CMIE reports for private sector data.

Notes: For last four rows, the figures are in percentage.

Table 2b

S.N	Year	No. of Companies		value of production/capital employed		PBDT/CA		Operating Profit/Gross Sales (%)	
		Public	Private	Public	Private	Public	Private	Public	Private
		2	3	4	5	6	7	8	9
1.	1991	268	1978	1622	1927	15.7	29.3	3.1	8.4
2.	1992	276	2156	1677	1921	17.2	29.7	3.3	8.3
3.	1993	269	2541	1855	1716	17.6	25.7	3.5	7.6
4.	1994	283	3376	1913	1533	48.1	24.0	4.3	8.8
5.	1995	324	4716	2159	1448	21.3	23.6	4.8	9.6
6.	1996	343	5958	2336	1399	23.0	23.0	4.9	9.7
7.	1997	295	5958	2380	1286	22.0	20.6	4.1	8.8

Source :Centre for Monitoring Indian Economy, corporate sector April 1998.

Further more, administered prices make profit a misleading guide in judging efficiency. The artificially low prices of certain products and service (eg. electricity, urban transport) encourage their uneconomic or inefficient use. This sometimes results in one group of customers/users subsidizing another group which in turn, constricts growth (Chakraborty, 1987).

Comparisons between the public and private sector shows that in terms of profit after tax (PAT) to sales, both public and private sectors have performed more or less at the same level. But it is in PAT to net worth (NW), that the private sector which has performed better (Gouri 1996). This could be due to the increase in the contributions from incomes other than from the main stream investment because the other income was showing an increasing trend. In the year 1993-94 it was found that the ratio of net profit to capital employed for all public sector enterprises (non-departmental) came down to 1.81% from 2.43% in

1992-93. The manufacturing sector alone registered a decline of 178.46% (Gouri, 1996). But here, the major contributors of these losses were the 103 loss making units mainly from the textile sector, many of them acquired by the government when it was running in losses in the private hands. Another possible reason for the drop with net profit to capital employed ratio may be due to increase in interest costs.

A comparative study of the financial performance of some profitable PSEs with their equivalent private sector enterprises for five years (upto 1995) shows that the performance of PSEs have been uniformly better. In the case of steel though initially TISCO did better, later from 1993 the trend was seversed. This many be due to change product-mix and deregulation of prices (Gouri 1996).

Differences in the product-mix is one of the reasons cited by Patnaik to substantiate that profitability comparisons of same sectors, say steel, is no index of relative efficiency. (Patnaik 1997). According to him, it is the engineering notion of efficiency i.e examining the use of some key inputs per unit of comparable output, for example, consumption of power per unit of pig iron production, which should be considered. On such a comparison, the public sector does not come out badly (Bagchi 1995, Patnaik 1997).

The CMIE undertook an exercise of comparison between the central public enterprises and some selected private sector companies for the sixth and seventh five year plan period and observed that the performance of BPE survey

Enterprises in term of rate of return on total net assets (i.e. capital employed) isn't impressive when compared with the same in the private corporate sector. ROI for the CMIE selected private sector companies for the sixth plan period was 10.5 percent and it declined to 9.3 per cent for seventh plan period. As against it, ROI for the central public enterprises improved from 6.1 percent during the sixth plan period to 6.5 percent during the seventh plan period.[7] On the contrary, the record of private sector revealed by RBI survey of finances of public limited companies (RBI Bulletin, 1990) reveals a rather dismal picture for private sector and concludes that private sector are only a shade better than public sector enterprises.

These is no clear or compelling evidences that in terms of profitability, public enterprises are more efficient than private companies (S.K.Mazumdar 1992). Prahlad Basu (1990) says that no analysis of performance evaluation can be complete without evaluating the physical performance with financial performance. The deterioration in financial profitability during 1989-90 was accompanied and indeed preceded by deterioration in physical performance of the manufacturing sector which was reflected in lower capacity utilization .

Out of 239 units surveyed in 1989-90 117 central PSEs (44%) had capacity utilization less than 75% and remaining 122 had a capacity utilizations more than 75% (PSE survey, 1989-90). The capacity utilization in ingot steel showed a decline from 71 percent in 1982-83 to 63 percent in 1989-90. The production of non- ferrous industry, on the either hand, showed an impressive

7. Collected from CMIE, Public Sector in India, May 1991.

increase during the same period the higher losses increased by public enterprises in the steel sector, coal sector, chemical and fertilizer sector was also a reflection of lower capacity utilization. BHEL's contribution to power generation capacity was 89% in the sixth plan and 80% in the seventh plan. In cement, capacity utilization in the public sector was barely 54% while it was of 76% in private sector. Coal India Limited had also a low capacity utilization of production potential. On the side there were enterprises which were showing better results. The Indian Oil Corporation increased capacity utilization from 95% in 1985-86 to 100% is 1987-88. HMT and ECIL also showed a good record in production and capacity utilization. Hindustan Teleprinters Ltd. has slumped down in capacity utilization from 60% in 1988-89 to barely 25% in 1989-90, (PSE survey, 1989-90).

One study carried out by Baldev Raj Nayyar (1990) evaluated the performance of public sector through two cases studies of steel and aluminum industries in which the PEs were paired with private sector enterprises for purposes of comparison. (Hindustan Steel, now part of steel Authority of India, has been compared with Tata Iran and Steel company, while Bharat Aluminum has been compared with Hindustan Aluminium Company). A significant finding of this study was that the poor financial performance of PEs in both steel and aluminum industries has been caused by poor production performance (capacity utilization) and over capitalization. While the private sector enterprises in these two industries quickly adapted their product-mix to changing market demand through timely modernization, the PEs did not take quick decisions on such

matters (Nayyar, 1990).

For example, in India we are still struggling with long wall mining technology in the coal sector and continuous casting technology in the steel sector even through technological gradation should have come about in seventies. Similarly restructuring of engineering enterprises can not brook a day's delay.

The unsatisfactory performance on physical as well financial front had a debilitating impact in savings and Gross - domestic capital formation. The contribution of public sector savings to total savings showed a declining trend right since 1980s from 3.4% in 1980-81 (total 21.2%) to 10% in 1990-91 (total 24.3%) to 0.0% in 1998-99.[8] (22.3%) (Economic Survey 1999-2000).

Even as peripheral issues relating to public enterprises continue to occupy policy makers the strategic issues are largely overlooked. The strategic issues include a turn around on physical and financial performance, devising effective strategic for modernization, diversification, restructuring and technology development and the need to overcome failures in government policy which have inhibited managerial performance over the last few decades. (Prahlad Basu, 1990).

8. Quick estimates of 1998-99 (Economic survey, 1999-2000) Figures in brackets denotes the total savings figures

Other Measures of Enterprise Efficiency

In view of the problems discussed with the use of profitability as a performance indicator, economists have tried to employ other measures of efficiency.

The most preferred indicator used in empirical studies of PSEs is technical. The idea here is that by estimating how much inputs are required to produce a unit of output (production function) for different firms (public as well private)- of course, after controlling the factors other than ownership, which may affect enterprise performances one can compare enterprise performances. This technical method is equivalent to production function method if the production function is homogeneous, or on a more practical level if it is of CRS although these assumptions is difficult to justify in practice (Millard, 1988).

The study carried by M. Gupta for the period 1969/70 to 1976/77. (although outdated) pointed out that ownership or management cannot by itself explain the relative performance of public and private sector enterprises measured in productivity or profitability terms. The performance of an enterprise is also influenced by many other factors, such as size of plant, its location, age technology status and sources of raw materials (Gupta, 1982). The study found that total factor productivity (TFP) as well as productivity of labour tended to decline in both public and private sectors when the performance of all the units was considered. However, TFP and productivity of labour in the public sector showed an increase when the performance of very old and obsolet units

as well as of new units facing teething troubles was excluded from the analyses. On the other hand private sector showed a decrease even after making the same adjustments as were made in the case of public sector (Gupta, 1982).

The above method drawback is that there is no unambiguous way to construct quantity data both for inputs and outputs in the case of multi-factor firms which practically means all moderns firm of reasonable size.

Constructing quantity indices is necessary to do justice to the method, because the idea behind the method is to isolate production efficiency (or technical efficiency) from pricing efficiency (or allocative efficiency). When various market imperfections exist, value indices can be misleading. (Parris et al, 1987 pp 148-9, Milward, 1982, p.63).

To overcome the problems, cost efficiency measure have been suggested. It is generally believed that there is a close relationship between ownership structure of enterprises and their cost - efficiency, which was emphasized by Leibenstein. (Leibenstein, 1966). It is argued that private enterprises constantly strive to minimize costs in order to maximize profits while PSEs are not cost conscious. The wastage of materials along with the under utilization of plant capacity and manpower result in high costs and low profitability.

Efficient production in any enterprise is influenced basically by three factors viz., status of technology, economics of scale and professional management. The PSEs in India have been handicapped on all these three counts and such a situation has adversely affected their efficiency. The

capital cost of public sector project increases due to both time and cost overruns. The reasons are first, the decision making process and procedural formalities are so time consuming that the project costs escalate even before these are approved. Secondly, gestation periods get lengthened because initial allocation of funds is inadequate and resources are spread thinly over a large number of projects and over time. (Chakrabarty, 1987). As a result, capital costs get highly inflated bearing no relation either with the size of plant or with technology. Over capitalization pushes up the overall cost of production.

But cost - efficiency index of comparison have also certain drawbacks. First input prices are not the same for all the firms. Public and private firms may face different factors prices. For example, subsidized capital and inputs for PSEs or lower wage rates for PFs. (See short, 1984, pp 142-3; Cook and Kirkpatrick, 1988. p.16). Firms may face different costs for the capital equipments with identical physical characteristics because they have respectively purchased them at different points of time (with different interest rates and in different terms, say instalments). Firms operating in different regions may face different wage rates if labour mobility is not perfect.

As already argued (when discussing the validity of using profitability as the performance indicator) PSEs may generate externalities in the forms of move jobs, high aggregate demand, lower inflation rate, higher demands for infant industries, lower input costs for PFs, and so on. If this is the case even when the unit cost of a public enterprise is higher than that of a comparable private firm, or when various productivities of a PE is lower than those of comparable PF,

it is not clear whether the PE is using its production resources in a less efficient way from the social point of view. (Dholakia, 1978, Pryke, 1980).

Geeta Gouri.[9] has identified two approaches to efficiency. They are economists approach and managerial approach. Economists approach are divided into neo-classical approach and non-neoclassical approach. The nco classical economics proceeds with faith in market. The nco-classical paradigm judge efficiency in term of pareto optimality where free trade plays the role of selector. Any deviation from international specialization such as protectionist policies of import substituting industrial strategy leads to sub-optimal utilization of resources and hence inefficiency. The tools used for measuring inefficiency in industry are Effective Rate of Protection (ERP), Domestic Resource Cost (DRC) and Total Factor Productivity (TFP). ERP and DRC utilize international prices for quantifying inefficiencies. This approach to efficiency has been criticized on accounts of stringent assumptions upon which theory are based, estimation problems of ERP, TFP and market arbitration upon which principles of trade welfare is based.

Unlike the neoclassicists, the non-neclassicists approach is holistic where industrial development is not viewed as an end but as a means to an end. Efficiency is not measured in market yardsticles but involves such factors as (1) technological upgrodation; (2) self reliance (3) changes in class-structure (4) backward and forward linkages (5) concerns of equity and income distribution.

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9. See Article, "Economic Liberalisation in India and Efficiency in Public Enterprises - Some Issues" in book Privatization: Diversification of ownership of public Enterprises (ed) by T.L.Sankar Y. Venugopal Reddy (1989).

An active role of state (through setting up of Public Enterprises) is perceived in contrast to the nco classical assumption of a neutral state.

The managerial approach to efficiency centres around the rate of return, namely profits and profitability. Technological upgradation and quality of product are only complementary factors which may enable the realization of larger surplus.

The economic liberalisation measures initiated since 1991 are a blend of nco classical and managerial approach to efficiency. (Gouri,1989). In the case of pubic enterprises, the paradox is evident. The public enterprises being non-market institutions conceived with the specific purpose of fostering rapid economic growth with social justice in import substituting industrial regime are subjected to solutions and means which are neoclassical with their emphasis on market competition. It is but natural that concept of efficiency tends to get blurred. The issue that arises here is : can market tools be used for assessing non-market institutions?

Two measures of efficiency of public enterprises are analyzed. They are the managerial efficiency criteria of return on capital employed and neo classical measure of efficiency as given by DRC. The capital goods sector has achieved greatest attention in term of protection by tariff barriers from international competition. protection paid rich dividends in terms of (i) developing a diversified industrial base and (ii) in achieving a break through on the

export front with exports of equipment and technology and to compete successfully for turnkey projects abroad. Despite these achievements, the capital goods industry did witness a slow down in its growth rate. Low capacity utilization with high capital output ratios are an outcome of inefficiencies in the capital goods industry.

Efficiency had been evaluated by comparing price differentials between domestic prices and international prices of capital goods. (Table 3). DRC and ERP despite their limitations [10] have been used by economists as a measure of efficiency. The Bureau of Industrial costs and Prices (BICP) tabulated in selected items of capital goods sectors which was later converted into value - added terms for estimating DRCs by the chairman in a separate article. [11]

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10. Vijay L.Kelkar "Evaluation of India's Trade Policies' Economic and Political Weekly., Vol XII, No. 25 June 18,1987, p 993-998.

11. Vijay L. Kelkar. Note on strategies for cost Reduction some Lesson from BICP (mimeographed copy), 1988 Bureau of Industrial costs and Prices. Domestic and International Prices of selected capital goods. New Delhi. The data presented in the Table are mainly from three major public sector units. They are Hindustan Machine Tools (HMT) for machine tools, Bharat Heavy Electrical Limited for electrical machinery, and Heavy Engineering corporation (HEC) for mining equipment.

Table 3

	Domestic Price (Rs lakhs)	C.I.F. (Rs. Lakhs)	DRC	Diff in Prices (International-domestic)
Machine Tools				
Radial Drill	2.408	1.293	1.48	73.4
Surface Grinder	4.658	2.462	1.51	79.0
Gear Hobber	10.765	5.505	1.52	91.6
CNC Lathe	15.638	6.591	1.82	113.8
Central Lathe	22.370	6.480	6.87	44.7
Electrical Machinery				
210 MW Boiler	4419.00	2828.00	1.00	63.7
Thermo Generator	3535.00	2248.00	1.00	65.7
Hydro Turbine	1043.00	640.00	1.14	81.5
Auto Transformer	192.65	96.78	1.32	98.9
Mining Machinery				
Shorel 1650	98.56	61.80	1.62	78.00
Crusher 1750	52.95	22.95	4.80	74.8
Crusher 1350	235.20	126.35	1.70	65.2
Drage line	2067.88	1064.85	2.40	62.00
OB Drill Slash	85.12	46.11	1.80	86.3

Source PSE Bureau of Industrial cost and Prices, New Delhi. 1988-89

Note: Date presented in Table are mainly from three major public sector units Hindustan Machine Tools (HMT) for machine tools, BHEL for electrical machine and BHEL for mining machinery

From the DRC figures it is not possible to generalize that lack of competition has been the main reason for inefficiency in public enterprise Many capital goods sector like electrical machinery sector are comparable in international terms. The table reflects a mixed picture of efficiency which gives lie to the blanket belief that Indian industry in inefficient. It may be noted that picture of efficiency is common to both the pubic and private sector. Studies by individual scholar and the World Bank have come to similar conclusions.[12]

12. Y.K. Alagh, "Industrial Policy in India: Theory measerment and practice", paper presented at the seminar on Indian Industrialization, CDS, Trivandrum, 1987. C.P. Chandrasekhar, 'Investment behaviour, Economic of Scale and Efficiency in an import substituting Regime'. Economic and Political Weekly (1987) vol XXII, Nos 19,20 and 21 pp 61-72. World Bank Industry Department India: Non-Electrical Machinery Manufacturing, A sub-sector study.

Taking the financial criteria of EBIT (Earrings before Interest and Taxation) to capital employed a mixed trend everges with regard to public enterprises in the heavy engineering industry (Table 4) the heavy engineering sector emerges only next to petroleum sector as most profitable. The cause for low profitability of pubic enterprise have to sought elsewhere such as wrong decisions with regard to technology and location and external factors such as administered pricing (Gouri, 1989). The basic question that still remains unanswered is whether market criteria should be used for answering the efficiency of pubic enterprise. Market tools ignore an important component of public enterprises, namely, its role to fulfill non commercial objectives. When multiple goals are to be fulfilled defining profitability and inefficiency becomes difficult and lack of clarity on efficiency and the means to achieve it can nullify the aims of liberalisation.(privatization).

Table 4

EBIT to capital Employed in selected Public Enterprises .

Groups	(Per cent)	figures				
	1976-77	1978-79	1980-81	1983-84	1985-86	1988-89
Heavy Engineering	15.14	6.03	3.39	11.54	16.16	15.67
Chemicals and Fertilizers	0.39	-1.43	0.19	3.31	2.34	1.52
Petroleum	20.41	19.69	12.13	30.42	-	25.69
Steel	4.12	3.94	2.07	-1.26	4.93	2.42
Mineral and metal industries	4.53	3.60	2.61	0.43	0.30	1.89

Source: PSE survey, Bureau of Public Enterprises, GOI various issues
Average ROR for the period 1980-81 to 1985-86

Heavy Engineering 0.58%
Medium and High Engineering 3.33%

Indian policies with regard to either industry or to public enterprises have always been plagued by ambiguities. The changes brought under NEP in general and specifically with regard to pubic sector is based not on a macro framework but a micro theoretic understanding of the economy (Kumar,92).

A fairer judgement should be based on multiple criteria and not just on one or two performance indicators like rate of return or DRC (which only partially reflects profitability). A holistic approach which incorporates the social dimensions of public enterprises requires a case by case pragmatic examination. The choice of criteria to be employed should be decided upon after considering the specific condition faced by industry and by the country concerned. This is because the objective of individual PSEs are not all identical and because similar PSEs in different countries may serve different purposes. For example, overmanning public enterprises established to raise surplus, for example tobacco and alcohol monopolies, may not be justified, but overmanning firms, which were specifically established to create employment in an economically depressed region may be permissible.

Especially when we look at the PSEs of the LDCs , where property rights and other institutions are less well established. it becomes important to incorporate externalities considerations into the study. For example, since the LDCs are often under severe foreign exchange constraints the (positive or negative) balance of payments contributions of PSEs should be taken into account (See Killick, 1983), For another example in an LDC, which is attempting to develop domestic technological capabilities somewhat

higher production cost of a PE due to its deliberate attempt to buy from domestic infant firms with higher costs (given the quality) may be acceptable, or even necessary.

Some Theoretical Considerations of Efficiency

There is a fundamental distinction between the public and private sector. This has to do with nature of decision making. The private sector is an atomistic decision maker and the principal agent problems unli__ the case of public sector does not arise. in private sector. To put it in terms of current concerns of theory of firm, there is a principal agent problem which result from the inability of the principals (the public in this case) to contain the consequences of self seeking beaviour by the agents (the PE managers in this case) due to imperfect, and especially asymmetric information (see paper by Jenson and Meckling for a discussion or Principal Agent problem, Stiglitz, 1987), Therefore it is argued that privatization by eliminating the two tier delegation structure (the public-ministers-PE managers) and constructing a direct link between the principal and the agent (share holders- PF managers), would reduce the harmful inefficiency consequences of public ownership. (Yarrow, 1989). Further, Baumol (1982) raises the point that as far ar private firms are not run by owner-manager, the above problem exist also for private firms.

Even if there is no principal agent problem it could be argue that PSEs are very likely to be inefficient because these is no effective way to punish their bad performance. In the case of private firms, dissatisfied customers exit from a badly

performing firm (that is, stop buying from the firm) which results in the falling profitability of the firm. (for the concept of exit as a disciplinary mechanism, Sec Hirschman, 1970, p.4). Falling profitability in turn leads to the exit of the shareholders, which exposes the firm to possibilities of takeover (sec singh 1971, 1975).

PSEs are often monopolies and therefore dissatisfied customers do not have the exit option Moreover they are usually immune from threat of bankruptcy. PE managers are not likely to be motivated to improve the efficiency of the firm (Yarrow, 1989). In other words, due to their exclusion from capital market, or to the absence of the market for corporate control, for PSEs (Yarrow 1986, p.330), the PSEs do not have the same pressure to remain efficient as PFs, hence their inefficiencies. At this point, it should be noted that this disciplinary mechanism has been criticized on many counts. For example the notorious soft budget constraints exists not only for PSEs but also for large private firm which has turned sick and government is obliged to take over sick units to bale them out and preserve employment (Ahluwalia, 1987).

The private sector maximizes profits on the basic of its judgement about the future. Each decision maker acts indepently on the basis of partial information about the economy. Hence, decisions go wrong and this is the risk the entrepreneur has to take to make profits. This causes imtability in the investment decision and since investment determines the rate of growth of the capitalist economy, this translates into the latter as well.

Public sector decision on investment are not based on conderations of immediate profitability. Further since its decision can be co ordinated, a climate of growth can be created and risk reduced. Thus while the private sector can't (most of the time) go against the trend and reverse it, the public sector can. This was an insight that resulted from the works of Keynes and Kalecki, However Kalecki pointed out that the direction of government investment and expenditure limits the role of the private sector and is not liked by the private sector. This is the dilemmma of the capitalist state an essential feature of which is not liked by its constituents. Kumar (1992) says that the private sector in India has invariably worked for the failure of the pubic sector. A successful public sector is a threat to the very existence of private capital. The private sector based largely on borrowed funds, and therefore, having a large component of public, realizes that an unsuccessful public sector is the best adverlisment for its own survival.

Turning from the narrow issue of firm profitability and stock market discipline to the broader concept of overall economic efficiency which must inevitably involve questions of investment and economic growth, Keynes strictures [13]direct new investment into the most profitable channels in terms of future Yield, cannot be claimed as one of the outstanding triumphs of laissez faire

13. In Chapter 12 of the General Theory, Keynes had observed "Speculators may do harm as bubbles on a steady stream of enterprises. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes a by product of the activities of a casino the job is likely to be ill done. The measure of success attained by wall street, regarded as an institution of which social purpose is to direct new investment into the most profitable channels in terms of future yield, cannot be claimed as one of the outstanding triumphs of laissez faire capitalism..." (Keynes, 1936).

capitalism....." (Keynes, 1936). on the role stock market continue to be pertinent and needs to be seriously addressed.

The other Dimension: Corruption

The New Economic Policies (NEP) introduced in 1991 marked a major shift in policy paradigm and according to proponents, this was necessitated by the failure of policies prevailing till then. However, neither the analysis of the failure of earlier polices nor the NEP look into account the existence of substantial black economy. In other words the shift in policies was based on inadequate analysis.

Kumar (1999) says that the cause of growing inefficiency and corruption in both the public and private sector is the unchecked black economy. The black economy leads to fiscal crisis and erosion of the public sector profitability due to diversion of profits to private hands.

While there was legitimate areas of political and bureaucratic guidance of the public sector, so that national goals could be achieved, it was also misused by those in power to build personal fiefdoms and is at the root of political and bureaucratic interference. A nexus was formed between managers, politicians and the senior bureaucrats which resulted into the demoralization of total work ethics and lack of commitment to the idea of role of public sector. There were not only the narrow ends to be met but sheer corruption.

The policy analysts have ignored the impact of the black economy on the macro economy either because they have not developed the required analytical

framework and/or because they argue that data are not available (reliable). But ignoring such component would lead to erroneous results, as it is evident from official estimates that black economy constitutes a significant proportion of national income.

The rising budgetary deficit bears the brunt of black economy because the expenditures are over invoiced or inflated or misappropriated and revenues are underestimated. For example when contract are awarded margins must cover pay off (to politicians and bureaucrats) and super profits. Fictitious expenditures are claimed. Large amount of subsides are also siphoned off by propertied through misappropriation. Subsidized public services cornered by those in power are also transferred to propertied class. The rapid rise in the interest burden on the budget is a result of the growing black economy and this amount to vicious circle trap because the interest rates is unsustainably rising leading to higher budgetary crisis and higher borrowings. This leads to losses is the public sector which turn up ultimately in sick units.

It has been argued in Kumar (1988) that the high incidence of indirect taxes and high interest rates on the public sector themselves directly relate to the black economy. Lack of profitability of the public sector from cost side is the result of growing black economy in India. (See Table 5).

Table 5

The burden of Indirect Taxation in the Public and Private Sectors

Year	Indirect tazees pard by public sector (ITP)	Total indirect taxes collection by the government	Indirect tax paid by private sector (ITPV)	ITP/NVAP	ITPV/NVAPV
1980-81	2269	7395	5126	0.634	0.338
1981-82	3010	8809	5799	0.528	0.361
1982-83	3653	10052	6399	0.485	.386
1983-84	4487	12152	7665	0.382	0.463
1984-85	3670	14132	10462	0.602	0.394
1985-86	6581	16868	10287	0.799	0.842
1986-87	7220	19689	12469	0.504	0.370
1987-88	9484	23135	13651	0.585	0.450

Source : National Accounts Statistics and Report on Currency and Finance. (various issues).

An International Study (Ingo Walter: Secret Money the shadow World of Tax evasion and Capital flight by Fraud) estimates that during 1975 to 1983 over $120 billion (Rs.1,55,000 crores) was transferred by residents of developing countries into clandestine assets abroad. In this race, Mr. S. Gurumurthy writes, "India is no exception. The buccaneers of the private sector would no doubt lead in number and in volume. That the public sector is not different is not a secret either. Dr. Raja Chelliah and colleagues have confirmed with the help of retired government officials and public sector executives that foreign suppliers usually provide a cushion of 3 to 7 per cent of imports of public sector. Where does this cushion go? Its destination is predictably clandestine Indian assets abroad. These deals are related not only to development projects but also defence contracts. The World Bank has suspected a capital flight of the order of Rs.50-100 crore in each deal.

What the public enterprises need today is the philosophy of change a philosophy of turnaround with a perceptible as well stable improvement in performance. While depotitisation of public enterprises would require strengthening managerial cadres and suitable arrangements for insulating them from the spoil system, debureaucratisation of PEs would require liberating then from the dysfunctional control of the government, unless, the bureaucrats can be trained to become managers accountable for results. Which is most developing countries has remained an unfulfilled hope. (Basu, 1990).

In India, the performance improvement has suffered due to inadequate performance evaluation criteria and inadequate institutional arrangements for improvements (Basu, 1990).

The criteria of public enterprises performance evaluation is a mosaic of many coloured glass with several dimensions. They include one physical dimension of production and productivity and capacity utilization, two, financial dimension of returns on investment in the context f investment cum pricing policy; three, human dimensions of building up a managerial cadre, a supervisory cadre and a cadre of workers; four technological dimensions in assimilating improving technological basic, and five , dimensions of organisation and control. The pragmatic aspects of socio-political ideological considerations cannot also be ignored. The conflict between market and public interest, between commercial or private project and national or social profit can be reconciled by recognizing all these dimensions.

A single system should embrace both the internal and external appraisal. Backward linkage from external appraisal to internal appraisal may be established by institutionalizing the performance criteria of public enterprises through the instrumentalities of performance contacts, or MOUs. The strategic issue is a search for overcoming as well as removing the areas of failure in government policy which inhibited managerial performance of public enterprises. These reforms should precede and not follow the reforms needed in overcoming the areas of management failures (Basu, 1990).

Assessments

Although there is no rigorous empirical evidence showing the general inferiority of public enterprises vis-a-vis private sector this does not mean everything is fine with PSEs or that there is no room for improvements. The picture is far more complex than one of "efficient private enterprises versus inefficient public enterprise". Among the public enterprises in various countries we can find anything from world-class manufacturers (eg. POSCO in Korea), the very respectable enterprises (e.g. TANESCO in Tanzania), to the usual distressing examples of inefficiency- laden politically corrupt PSEs.

In India, the investment in operating PEs increased over the years. In 1981, total capital employed in CPEs were Rs 21935 crores which increase to Rs.118492 cr. in 1991-92 and Rs 2230.47 cr. in 1997-98 but the corresponding net profit to capital employed remained at a dismal figure of 4.47 percent in 1990 and declined to 2.09 in 1991-92. The loss of loss making enterprises

increased from Rs. 848 cr. in 1981-82 (83 PSEs) to Rs.3674 crs. in 1991-92 (102 enterprise) and further to Rs.6117 cr. in 1996-97 (104 enterprises). (Public Enterprises survey, various issues) Bimal Jalan says that to a large extent the fiscal crisis of early 1990s was a reflection of the financial crises of the public sector. As the result of government borrowings increased over the years and reached an all high of 52.9% of GDP in 1990-91 (Economic survey 1999-2000), out of which one third was constituted by public sector. The public sector which was supposed to generate resources of the growth of the rest of the economy gradually became a net drain on the society as a whole. To finance the high fiscal deficit, the government resorted to market borrouings and as a result it could not prevent itself from falling into debt-trap position. While envisaging the scope of PSE, it was clearly stated that among the main objectives, they are to generate more surplus for investment and increase exports so as to reduce the strain on the balance of payments. Self reliance was to be promoted ensure reduction in imports or substitution for imports for strengthening foundation of the economy. The government and policy makers failed to insist on the efficient management of the PSEs. An important reason for the state of fiscal incapacity is without doubt, the failure of PSEs to generate adequate return on past investments (Jalan, 1992).

The important question remains is how can PE, performance can be improved. The most popular and solution has been privatization. However as is suggested by may authors [14]for developing countries. See Aylen (1987),

14. For more extensive analysis on the issue of privatization, see Aharoni (1986), Vickers and Yarrow (1988), Vernon Wortzel and Wortzel (1989), Rothorn (1990)

Commander and Killick (1988), Bienen and Waterbury (1989). Barum (1990). For socialist countries see Singh (1990), Newberry (1990), Rawthorn (1990b). and as will discussed in next chapter that privatization may not be the only, let alone the best, or even an acceptable solution to the problems of bad PE performance. Privatization has remained till now one of the most contentious economic issues of the post - reform period.

CHAPTER FOUR

APPRAISAL OF PUBLIC SECTOR DISINVESTMENTS IN INDIA

Since early 1990s, the government - both Central and State, are contemplating the sale of equity in public sector enterprises. So the procedures followed and issues involved in the privatization of public sector enterprises can provide an useful insight – and valuable lessons for future course of action. This chapter is an attempt to the appraisal of Indian disinvestments in the public sector and examine its pros and cons in the context of stated objectives.

As has been noted earlier, the PSEs, a symbol of self reliance and planned development, triggered growth and balanced regional development through economics of scale and forward and backward linkages upto the 1970s but the decades of 1980s saw a turnaround in the performance of PSEs w.r.t. objectives envisaged and there were host of factors responsible for this (see chapter 3).

The most important criticism levied against the public sector has been that in relation to capital employed, the level of profits has been too low. Even the government has criticized the PSEs on this count. In the year 1980-81 the loss of 74 loss making units (Rs. 760 cr) exceeded the profit of 94 profit making units giving rise to a net loss of Rs. 103 cr (Raghawan, 1994, PE survey 1982-83). The 8^{th} five year plan noted that the public sector has been unable to generate adequate

resources for sustaining growth process (See VIII five year plan, vol.II) and was a drag on government's budget (Jalan 1992).

Performance of Central PEs

There were 5 Central public sector enterprises at the commencement of First Five Year Plan with investment amounting to Rs. 29 crore only. Their number rose to 163 in 1980-81 and 236 in 1997-98. Capital employed in them correspondingly rose to Rs. 18,207 crore in 1980-81 and to a struggling Rs 2,23,047 cr in 1997-98. Gross sales of central public sector enterprises rose from Rs. 28,635 crore in 1980-81 to Rs. 2,85,251 crore in 1997-98 (Table 1). Of the total investment in central public sector enterprises in 1997-98, 65.5 per cent was in enterprises producing and selling goods while 31.7 per cent was in service enterprises. As far as the former is concerned, the four most important sectors were power (counting for 16.9 per cent of total investment, steel (12.3 per cent), petroleum (11.5 per cent) and coal and lignite (7.7 per cent of total investment). In the case of service enterprises, the most important were financial services with a share of 15.1 per cent in total investment in1997-98.[1]

As has been pointed earlier (chapter 3) profits cannot be the sole indicator for examining the performance of public sector enterprises. But their financial performance is of wide interest and concern as they are set up at a huge cost to the

[1] Tata Services Ltd., Statistical Outline of India, 1999-2000 (Mumbai, December, 1999) Table 130, p.123.

national exchequer. As is clear from table 1. Over the period 1980-81 to 1900-91, the ratio of gross profit to turnover rose from 5.0 percent to 12.7 per cent, while the ratio of net profit to capital employed which was 1.1 per cent in 1980-81 rose marginally to 2.2 per cent.

Table 1

Expansion and Performance of Central PSEs

Year	1980-81	1990-91	1996-97	1997-98
Running Enterprises	163	236	236	236
		Rs. Crores		
Capital employed	18.207	1.02.084	2.01.496	2.23.047
Turnover	28.635	1.18.676	2.54.910	2.85.251
Gross Profit	1.115	11.102	30.309	36.093
Net Profit	-203	2.272	9.992	13.725
Gross Profit to Capital Employed (%)	7.8	10.9	15.2	16.2
Gross Profit to turnover (%)	5.0	9.4	12.0	12.7
Net Profit to Capital Employed (%)	-1.1	2.2	5.0	6.1

Source:Tata Services Ltd., Statistical Outline of India 1999-2000 (Mumbai, December 1999), Table 130, p.123.

What is more, the reliance of public sector enterprises on budgetary resources declined while their net internal resources increased substantially. In 1990-91, the budgetary resources contributed 24.4 per cent of gross resources available to public sector enterprises, but plummeted to 11.8 per cent in 1995-96. On the other hand, the share of net internal resources recorded quantum jump from 33.9 per cent (i.e. one-third) in 1990-91 to 50.2 per cent (i.e. one-third) in 1990-91

to 50.2 per cent (i.e. half in 1995-96). The contribution of public sector enterprises to exchequer rose from Rs. 19,520 cr in 1990-91 to Rs. 38,665 cr. In 1997-92.[2] Despite all this, and despite the fact that the ratio of net profit to capital employed touched 6.1 per cent in 1997-98 the fact of the matter is that this ratio continues to be highly inadequate booking at the colossal investments that have been made in the public sector (in a number of years in recent past, this ratio has been in the range of 2.0 to 2.5 per cent). Bimal Jalan alleges that it is this low return of on investment in the public sector enterprises that is, to a large extent, responsible for the fiscal crisis of the central government.[3]

The Public Enterprise Survey for 1998-99, released on March 10,2000 says the public sector companies showed a marginal rise of 6.5 per cent in profit before tax during 1998-99 while the turnover rose by 12.3 per cent in 1998-99 from 1997-98. There was an appreciable increase in net worth turnover, profits before depreciation, interest and tax and profit before interest and tax. (Table 2).

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2 RBI, Report on Currency and Finance, 1997-98.Vol.I, p.4-15. Also, Government of India, India 2000 – A Reference Annual (Delhi, 2000), p.527.

3 Bimal Jalan, India's Economic Policy. (New Delhi, 1996), p.21.

Table 2

Performance of Central PEs

(in Rs. Crores)

Sl.No.	Particulars	Manufacturing Sector		Services Sector		Total	
		1998-99	1997-98	1998-99	1997-98	1998-99	1997-98
1.	No. of operating Enterprises	160	161	75	75		
2.	Capital Employed	18307.04	170139.30	90622.75	83521.84	273696.79	253661.14
3.	Net Worth	113856	105682.94	34162.73	29380.54	148019.41	135063.48
4.	Turnover/Operating Income	241450.22	212809.77	68643.57	631.86.38	309993.79	275996.46
5.	Cost of productio/services	217789.08	187946.68	63835.82	62052.71	281624.90	24997.39
6.	Cost of Goods Sold	214499.55	186245.51	64081.10	59594.40	278580.65	2458.91
7.	Profit before dep., Int and tax (PBDIT)	39200.48	38620.17	17331.81	14447.45	56532 09	53067.72
8.	Depreciation	13197.9	12748.85	3568.81	3106.93	16766.17	15855.78
9.	Profit before In. and tax. (PBIT)	26003.12	25871.32	13762.80	11340352	3976.92	37211.84
10.	Interest	12666.72	1188.1	7365.63	6049.46	20032.35	17857.77
11.	Profit before tax (PBT)	13336.40	14063.04	6397.17	5291.06	19733.57	19354.07
12/	Tax prvisions	458465	4118.38	1917.35	1515.73	6499.0	5634.11
13.	Net Profit	8754.75	9944.63	4479.82	3775.33	13234.57	13719.96
A.	Sales to Capital Employed	131.89	125.08	75.64	75.65	113.26	108.81
B.	PBDIT to Capital Employed	-	-	-	-	-	-

Source:Dept. of Public Enterprises (Government of India, New Delhi) Public Enterprises Survey, 1998-99, vol.I, pp.10-11.

Due to the excessive interest burden imposed by faulty leverage policy, profits before tax registered a decline. This trend continued during 1990-2000 in which the profitability was further affected by the government imbalanced competition policy.

PBIT to capital employued, PBT to net worth, and PBIT to turnover ratios were saisfactory. However these was a need to adopt suitable debt –equity ratio

and initiate appropriate changes in the macro-tax regime and tax- planning measures. On the PE front, there existed tremendous scope for increasing turnover, reducing net fixed assets balances and greater effectiveness with regard to materials management.[4]

The dependence of PEs declined significantly with regard to budgetary support which turned out to be less than 10 percent of total plan outlay in 1998-99. The internal resources assumed primacy over exra-budgetary resources. This hinted at the internalisation of financing in PEs. Table 3 underscores this transition;

Table 3

Resource Mobilisation and Plan Investment in Central PEs (in Rs. Crores).

Year	Net Internal Resources	Extra Budgetary Resources	Budgetary Support	Plan outlay
1996-97	13157-81	16901.23	3644.97	33703.41
1997-98	15111.81	14912.25	3840.56	33864.62
1998-99	19294.95	12280.46	4250.32	35825.72

Source:Department of Public Enterprises (Govt. of India, New Delhi) Public Enterprises 'Survey, 1998-99, vol.I, p.23.

The PSE survey 1998-99 disclosed that investment in Central public enterprises has risen by Rs. 8153 crores (i.e. from Rs. 2,21,987 cr in 1997-98 to Rs. 2,30,140 crores in 1998-99, an increase of 3.7 per cent. Besides out of 235 operating enterprises, 127 earned profit 106 incurred losses and two neither earned

[4] R.K. Mishra, Public Enterprises', Alternative Economic Suvey 1998-2000:Two years of Market Fundamentalism, pp.50.

profit nor incurred losses during 1998-99. The PSEs as whole earned a net profit (profit after tax of Rs. 13,235 crore after setting off loss of loss-incurring enterprises.

The top ten PSUs of 1998-99 in the chronological order were namely Oil and Natural Gas Commission (ONGC), National Thermal Power Corp. (NTPC), Indian Oil Corp. (IOC), Mahanagar Telephone Nigam Ltd. (MTNL), Videsh Sanchar Nigam Ltd. (VSNL), Gas Authority of India Ltd. (GAIL), Bharat Heavy Electricals Ltd. (BHEL), Hindustan Petroleum (HPCL), Northern Coalfields Ltd. (NCL), Bharat Petroluem BPCL) which earned a net profit of Rs. 15,422 crore in fiscal 1998 (76.1% out of a total prifit of Rs. 20,266 crore made by all PSUs). From this, five were from the petroleum sector, two each from telecommunication and coal and one from the power sector. Interestingly all the above PSUs are fully or partially in a business controlled by the government.

The bottom ten PSUs incurred losses more than Rs. 3,416 crores out of total Rs. 6,541 core losses made by the PSUs. Steel Authority of India Ltd. (SAIL) topped the list of loss-making units, with net loss of Rs. 1,573 crores in 1998-99. The other loss-making units in order were fertilizer corporation of India (FCIL) Hindustan Fertilizer Corporation Ltd. (HFCL), Eastern Coal Fields Ltd. (ECL), Indian Iron and Steel Company (IISCO), Hindustan Steelworks Construction Corporation (HSCC), Air India (AI), Rastriya Ispat Nigam Ltd. (RINL), Hindustan

Photo Film Manufacturing Co. (HPFMG), Hindustan Cables Ltd. (HCL) and Hindustan Copper Ltd. (HCL).

The Denationalisation of PSEs

As a part of New Economic Policy (NEP) initiated in July 1991, the Government of India initiated disinvestments (one of the variants of privatisation) in public enterprises in October 1992. Though the new Industrial Policy, 1991 Statement was silent on the extent of equity to be sold, it was made clear in the union Budget 1991-9 that about 20% of the equity of certain select PSEs will be offered to the Mutual Fund (MFs), Financial Institutions (FIs), General public and workers. The memorandum to the IMF in August 1991 also contained points on public sector reforms. One point was, to provide market discipline for public enterprises and to encourage healthy competition. (Mishra, 1997).

The 1991 industrial policy also brought the public sector units at par with the private sector units and the Board for Industrial and Financial Reconstruction (BIFR) now decides whether a sick public sector unit can be effectively restructured or whether it is to be close down. The NRF (National Renewal Fund) was created for retaining and redeployment of retrenched labour and to provide compensation to public sector employees seeking voluntary retirement. The concept of MoU (Memorandum of Understanding) system was started in 1988 (consequent to Arjun Sengupta Committee recommendations on PSE restructuring

which submitted in report in 1984), by which managements were to be granted greater autonomy but held accountable for specific results.[5] Privatization is viewed as necessary because sick enterprises impose an unbearable burden on the budget; because larger revenues are needed for crucial expenditure on infrastructure and the social sectors and sometimes because the discipline imposed by the market would increase accountability and efficiency in public sector. The widely held perception that disinvestment, by broadbasing share ownership would raise internal efficiency of PSUs in commercial activities; case short-term budgetary strain by generating non-inflationary form of finance for budget, impart greater professionalism in publics sector activities, etc. prompted India to denationalize PSUs.

The Disinvestment Programme Since 1991-92

Of the 236 running central PEs at the end of March 1991 only 124 enterprises were profit making and the government decided to offload equities of the profit making enterprises. The strategy of the government seemed to indicate that did not want to fail in its maiden effort of divestiture. The final choice came down to 31 and they categorised them as 'very good', 'good' and'average' based or their net Assets vlaue (NAV).[6]

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5 Government of India, Economic Suvey, 1992-9, pp.143-145.

6 'Very good' if the NAV was above Rs. 50; good if it' was between Rs. 20 and Rs. 49 and 'average' for those enterprises whose NAV was between Rs. 10 and Rs. 19.

The modality of disinvestment (sale) was not on individual company basis but on package or basket or bundle basis consisting of different combinations of 6 to 9 PSEs, using (some from each of the 'very good', good and average) a wholesale or tender method through which the government divests its holding of PSUs shares to the FIs and MFs which in turn offload these shares to the public by unbundling them and selling individually after they are listed on the stock exchange. The reserve price for the bid was to be the average of the two highest values of the three[7] calculated by each public enterprise. But the bids were when opened, it was found that they were far below the value of the bundles computed with reference to the above formula and so they had to reduce the minimum reserve price. So, according to the new formula; the bids was priced at or above the average of the NAV and PECV, computed using an average cpitalisation rate of 10% minus 10% of the average f the NAV and PECV computed at 10% discount rate (2nd term is used if necessary) for its acceptance. But the price of the I tranche was not made public. The reserve price per bundle for the II tranche was Rs. 10.08 crores fixed in consultation with ICICI Ltd. which was higher or equal to revised reserve price of I round for disinvestment.

Table 4

[7] For fixing the reserve price for bids of the bundles (various public enterprises are combined to give a bundle) for the first round of disinvestment in 1991-92 the Dept. of Public Enterprises (DPE) wrote to the 31 PEs to value their shares by three different methods, namely (1) NAV method (2) Profit Earning Capacity Value (PECV) method and (3) Discounted cash flow (DCF) method, based on the future cash flow streams for a period of about five years; discounted at appropriate average capitalisation rate and take the average of two highest values.

Extent of disinvestment till the end of fiscal 1995-96

	No. of PSE	No. of shares sold (Rs. Crores) (Face value Rs.10)	Targetted disinvestment proceeds (Rs. Crs)	Actal realisation (Rs. Crs)	Average per share (Rs)	Range of equity disinvestment (in percent)
1991-92 lst tranche (Dec'91)		51.62		1427	27.65	
2nd tranche (Feb '92)		35.59		1611	42.25	
	30	87.21	2500	3038 (+22)	34.84	0.12 to 20
1992-93 1st tranche Oct'92		12.97		6.82	53.00	
2nd tranche Dec'92		31.06		11.84	38.10	
3rd tranche Mar'93		1.01		47	46.27	
	16	44.94	3500	1913(-45)	42.57	0.11 to 10
1993-94 6th round	5	11.4	3500	2291 (-35)	200.96	0.01to 18.57
1994-95 7th round	16	2.7	4000	2618 (-35)	969.63	0.01 to 18.7
1995-96 8th round	2	NA	7000	357 (-95)	NA	NA

Source: 1. GOI 1991-92 and 1992-93
2. Sunil Mani, 1997.
3. Mohan, 1996.

Note: 1. 1991-92 and 1992-93 covers the first five rounds to disinvestment

2. Figures in bracket indicate the extent of short-fall in percent of actual realisation compared with their respective target!.

The minimum reserve price for 1992-93 diinvestment was fixed on the recommendation of three merchant bankers, namely ICICI, IDBI, SBI capital Markets Ltd. For the I tranche of 1992-93 (October 1992), the minimum bid offer was reduced to Rs. 2.5 cr. but this high price automatically eliminated the small investors (since 1992-93 the shares was offered to the public). In the subsequent tranche, in December 1992, through the tender method continued, the minimum bid offer was reduced to Rs. 10 lakhs. The sale of the bundles in 1991-92 realized a sum of Rs. 3038 crores but in 1992-93, the government could only realize Rs. 1913 crores from the sale of equity, against its target of Rs. 3500 crores. It may be

noted that in its last round of the 1992-93 disinvestment, it could sell only 2% of the total 55.3cr shares put up for sale and its collection was just Rs. 47 cr. (see the first five round of disinvestment in table 4).

A Major Controversy

One of the major costs due to the exercise was the alleged mispricing of the shares and consequent loss in revenue to the exchequer. The Comptroller and Auditor General (CAG) is one of its report (Report no.14, GOI 1992) has worked out the extent of loss to government on this account (see table no.5).

The extent of loss to the government in percentage terms has thus varied from 127% (in the case of HPCL) to 616% (in the case of NLC), and on an average the loss is about 256%. If we were to apply this percentage to the divestiture proceeds of 1991-92 and 1992-93, we find that the potential process would have been Rs. 4904 cr. x 2.56 =Rs. 12554 cr as against the actual realisation of only Rs. 4904 crore (collection of March 1992 also included (Sunil Mani, 1995). Another major problem was little or no trading in most of the listed shares (e.g. FACT, HZL etc.) Many of the Mutual Funds (MFs) and Financial Institutions (FIs) which have acquired PSE shares have not been able to sell them in the market.

Table 5

Extent of loss of Government on Account of PSE disinvestment

Name of PSE	Average Price at which share value of Rs. 10 was sold (Rs)	Market Price as per Economic Times closing Price 30.10.92 (Rs.)	52nd week			Loss to the Government
			High (Rs)	Low (Rs)	Av. (Rs)	
BPCL	244	750	1275	650	963	506 (208)
BHEL	38	140	200	130	165	102 (268)
HCL	25	65	65	60	63	37 (148)
HOCL	57	144	220	135	178	87 (553)
HPCL	243	550	1200	550	875	307 (1270
HZL	22	59	65	48	56	35 (160)
HMT	18	80	85	68	76	58 (321)
SAIL	13	42	80	41	48	29 (217)
RCPL	10	44	55	41	48	34 (343)
NLC	11	82	NA	NAQ	NA	71 (616)

Notes: 1. The loss has been arrived at by deducting the closing price on Oct. 31, 1992 from the average price at which shares have actually been sold.

2. Figures in brackets indicate the loss to government in % terms (AG (1993).

Soruce: CAG (1993)

The Rangarajan Committee Report in Brief

To devise a better criteria for selection of PSEs for disinvestment the government appointed a Committee in February 1992 with Shri V. Krishnamurthy, member, Planning Commission (PC) as its chairman. Later the government reconstituted the Committee in November 1992 with Dr. C. Rangarajan, member, Planning Commission as chairman. The report covered various aspects of divestiture such as the preparatory steps for divestiture, choice of method of valuation of shares, the modus operandi of disinvestment, the limit of equity to be divested, the target clientele and other issues.

The preparatory steps to be undertaken included converting PSEs into company form, restructuring of finance with debt-equity gearing and evaluating whether an independent regulatory mechanism for the concerned sector is necessary. For the valuation of shares, it preferred the Discount Cash Flow (DCF) method and recommended that the method of valuation should take into account factors such as value of assets, its market share, potential earning capacity and the prevailing price in the market for share of similar enterprises in the private sector. Regarding the modus operandi of disinvestment, the committee's suggestion was that the best method is public offer of shares at a fixed price through a general prospectus but recommended the auction method of selling shares (whose reserve price will be determined by the merchant bankers), can be adopted for the PSE shares which have not been traded so far in the stock exchange (SE) and added that the best solution should be adopted once a normal trading atmosphere is established. Its recommendation on the limit of equity to be disinvested is 49% for the units reserved for the public sector (excludes the six strategic industries[8] which are exclusively reserved for public sector) and 74% for other and also recommended that out of the proceeds collected through disinvestment, 10% should be set for concessional lending to the PSEs for meeting their restructuring needs.

[8] Arms and ammunitions and the allied items of defence equipment defense aircraft's and warships (defence production) (2) atomic energy (3) Coal and lignite (4) mineral oils (5) minerals specified in the schedule to Atomic Energy (Control of Production and Use) Order 1953 (ratio active materials) and (6) railway transport

According to the Committee, the target clientele should be the general public, MFs, NRIs and foreign investors (no reservation recommended for NRIs and foreign investors), employees (200 shares per employee at a discount of 15% on the market price subject to a lock –in-period that is normally prescribed for reserved allocation of shares) and technical collaborators. Other recommendations are the right timing of the issues and choosing intermediaries (say, for e.g., underwriters) at a fair' price to ensure reasonable costs, reconstituting the PE's board with appropriate representation for non-government director as disinvestment would give rise to dispersed ownership and adopting image – building policies like media coverage to ensure continuous entry into capital markets for raising resources. The report was submitted in April 1993 and its major recommendations are yet to be adopted by the successive governments. Finally, in the budget speech of 1996-97 the U.F. government approved the proposal to establish a Disinvestment Commission (DC) which will be responsible to take decisions with respect to divestiture in a transparent manner.

The Disinvestment Commission

The United Front Goernment in 1996, constituted the Public Sector Disinvestment Commission (DC), an advisoory body, in pursuance of the Common Minimum Progamme, initially for a period of three years under the chairmanship of Shri G.V. Ramakrishna. A comprehensive overall programme within 5 to 10 years for the PSUs referred to it by the core Group, the preferred

mode of disinvestment and the extent of disinvestment in each PSU, the instrument, its pricing and timing decision and advice to the government on capital restructuring process are some of the broad terms of reference of the Commission. The government's final decision rested upon their suggestions and advice about each PSU referred to the Commission.

The Disinvestment commission (DC) initiated with a set of general recommendations. They were restructuring non-viable units (which includes for e.g. hiving off business which are no longer attractive, cut in the surplus labour force, change in the capital structure, exchange of technology between PSUs or technology upgradation, mergers and de-mergers of PSUs etc), corporate governance sand autonomy[9] specific recommendations, formation of standard empowered group, establishment of Disinvestment Fund (with the proceeds of disinvested profitable PSU, especially to revive potential viable loss-making units and to operationalise the Voluntary Retirement Scheme (VRS) after taking into account the sale of unviable loss-making PSUs), retailing of PSUs shares to small investors and employees at a price upto 10% below the issue price to institutional investors with a ceiling of 200 shares and an additional preferential

[9] the Corporate Governance recommendation are appointing non-government professionals, suggested by Public Enterprises Selection Board (PESB) and elected directors as non-executive directors and director respectively on the Board of Directors (BODs) of PSUs, selecting the top management on the basis of the recommendations of a well-expertised PESB only, increasing the salaries of top managers (CEOs and other functional directors), empowering the PSUs to determine the prices of its products, making them accountable by measuring and assessing the performance with reference to certain board for evaluating all questionable decisions at the BODs. level. There are applicable to all PSUs. Apart from these the Commission recommends additional delegation of autonomies like power to dispose assets and freedom of investment within certain limits to moderate performers for selected PSUs..

allotment upto 500 shares for employees only for a lock-in period of three years (if the shares are highly priced, then the employees may be allowed to pay in installments upto a maximum of two and small investors may be allowed to buy shares much less than the normal tradable lots), guidelines on offer for Sale - Book building for domestic and GDR issues etc.).Out of 245 PSUs, only 50 PSUs[10] had been referred to the Commission and it had given case to case recommendations for 45 PSUs (based on the information from 12 reports when 12th report was released in August 1998).

DC recommended a trade sale for MFIL (disinvest 100%) , ITDC (100% after demerging the hotels located in locations other than prime places like Delhi and Bangalore, in prime locations, a lease cum-management contract had been suggested) and PHL (100% to OGCC or 78.5 to any other investor and also

[10] Air India (AI), Bharat Aluminum Co. Ltd. (BALCO), Bharat, Earth Movers Ltd., (BEML), Bharat Electronics Ltd. (BEL), Bongalgaon Refineries and Petrochemicals Limited (BRPL), Container Cooperation of India Ltd. (CONCOR), Engineers India Ltd. (EIL),Gas Authority of India Ltd. (GAIL) Fertilizers and Chemicals (Tranvancore) Ltd., (FACT), Garden Reach Shipbuilders and Engineers Ltd. (GRSEL), Hindustan Aeronautics Ltd. (HAL), Hndustan copper Ltd. (HCL, Hindustan Latex Ltd. (HLL), Hindustan Zine Limited (HZL), Hotel Corporation of India Ltd, (HCIL), HTL Ltd., IBP Co. Ltd (IBP), India Tourism Development Corporation (ITDC,), Indian Petrochemical (IBP), Indian Petrochemical Corporation Ltd. (IPCL), ITI Ltd. (ITI), Kudremukh Iron Ore Co. Ltd. (KIOCL), Madras Fertilizers Ltd. (ML), Mahanagar Telephone Nigam Ltd.(MTNL), Manganese Ore India Ltd. (MOIL), Modern Food Industries (India) ltd. (MFIL) National Aluminum Co. Ltd. (NALCO), National Fertilizers Ltd., (NFL), National Hydro Power Corporation (NHPC), National Thermal Power Corporation Ltd. (NTPC), Neyveli Lignite Corporation Limited (NLC), Northern Coal Fields Limited (NCL), Oil India Ltd.(OIL), Oil and Natural Gas Corporation (ONGC), Pawan Hans Helicopters Limited (PHL), Power Grid Corporation of India Ltd. (PGCIL), Rail India Technical and Economic Services Limited (RITES)Shipping Corporation f India Ltd. (SCI), South Eastern Coalfields Limited (SECL),Steel Authority of India Ltd. (SAIL), Western Coal fields Limited (WCF), Hinsustan Vegetable Oil Corporation Ltd. (HVOCL), Nepa Limited (NEPA), Electronic Technology and Trade Development Corpn. Limited (ET and TDC), Hindustan Prefab Limited (HPL) . Ranchi Ashok Hotel Corporation Ltd, Pyrites, Phosphates and Chemicals Ltd. (PPCL), Central Electronics Ltd. (CEL), Engineering Projects (India) Ltd. (EPIL), Utkal Ashok Hotel Corpn. Limited, Rehabilitation Industries Corporation Ltd. (RICL).

recommends the writing off of wasteland loans together with interest). All of the above are categorized as non-core PSUs.[11] On the modality of disinvestment, offer for sale was recommended for GAIL (disinvest 25% between international and domestic investors), MOIL (No immediate disinvestment, later disinvest upto 49% in one or more tranches with preferential allotments to small investors and employees), CONCOR (upto 49% initiate with a book-building process followed by a retail offering of shares to small- investors at a discount of 10% to the institutional price and the MTNL (a GDR isue of 10% of the total equity price) and the balance, 4.73% of the eqity be offered to institutional investors and to small investors at a discount over the institutional price. These and the already disinvested figure gives a total of 49%). The above four are categorised as the core PSUs.

For almost all the other PSUs, strategic sale was recommended. They are HPL and EPIL -disinvest upto 74% to a strategic partner; BRPL, ITI, HTL; MFL and HCL[12] -disinvest 50% to a strategic partner with an agreement to make a public offer in the domestic market (institutions, small investors and employee) to

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11 In some of the capital or technology intensive industries PSUs have a considerable market presence other than the private sector and should continue being present till the market becomes fully competitive. Such industries are classified as "core" whose disinvestment be limited to maximum of 49%. Disinvesting beyond 49% can be thought to when private investments make the market fully competitive. Non-core group of industries are the ones where these are large number of players, and forces of competition in these industries shave made these markets fully contestable. Here, the existing public sector may not have special responsibilities and hence disinvest upto 74% or more. In addition to these, there is the strategic group which are exclusively received for the government sector. This is the definition given in the terms of reference of DC.

12 HCL – disinvest 51% to a strategic partner after the completion of Khetri Smelter Expansion Project and closing down unviable mines through VRS.

bring down its holding to 26%: BALCO and KIOCL-disinvest 40% of the equity to a strategic partner (either domestic or foreign) through a transparent global bidding process with an agreement that government within two years would make a public offer in the domestic market to bring its holding down to 26%, IBP – offer 33.9% out of the government holding of 59% to a strategic partner thus bringing the holding down to 26%; EIL-disinvest 30% of the equity to a strategic partner, 10% of the equity to Employee Stock Option Plan (ESOP), 10% to public sector oil companies; SAIL , GAIL and NTPC and increase the equity with the public from 60% to 74% and HZL-disinvest further 25% of remaining to a strategic partner or disinvest 25% in one or more tranches in domestic market.

In the case of SCI, cross holding of shares by other oil refineries, upto 40% recommended (20% already disinvested). Other PSUs are Ranchi Ashok, Utkal-Ashok and HVOCL-100% disinvestment in favour of private entrepreneurs through competitive bidding process; RICL-discontinue its operations but complete unavoidable existing contracts, PGCIL disinvest after restructuring but can implement BOOT techniques in select projects now; ONGC and OIL-defer disinvestments until APM is dismantled and for RITES, NHPC and NTPC doesn't recommend any disinvestment.

Subsequent Disinvestments

The NDA government on December 10, 1999 created a separate Department of Disinvestment (DOD)[13] and appointed Mr. Arun Jaithey as minister of state of department, after extended term of members of Disinvestment Commission (DC) expired on Nov. 30, 1999. Consequently the PSEs identified for disinvestment would come under the new department. Most of the recommendation of DC are yet to be implemented and progress of government's implementation of the DC proposals are very sluggish.

The government followed book-building process in GAIL's GDR issues and disinvested 24.82% (recommendation was 25%) of the total equity through GDRs. In addition to above it granted autonomy to GAIL and MTNL under Navratna status. The disinvestment fund was set up prior to the recommendation. These are the notable ones where implementation has taken place. Some other recommendations like retailing PSU shares to small investors and employees, recommendations on joining Natural Securities and Depositories Ltd. (NSDL), revamping the MOU system, freedom of investment for strong performers, and specific recommendations for BALCO, MOIL, BHEL, OIL, OGNC, RITES have been accepted and are yet to be implemented by the government.

[13] The man function of department would be to assess the recommendations of the Disinvestment Commission (DC) on the sale of Public sector equity, work out the modalities including restructuring and undertake the actual exercise of disinvestment.

The Government's strategy towards the public sector, continues to encompass a judicious mix of strengthening strategic units 'privatizing' non-strategic ones through gradual disinvestment or strategic sale and devising or viable rehabilitation strategies for weak units. The Government intends to encourage marginally profit making PSEs to promote VRS (voluntary Retirement Scheme) by raising money from banks against government guarantees and interest subsidy. PSEs would also be encouraged to issue bonds to workers opting for VRS with the Government guaranteeing the repayment of such bonds and fully reimbursing interest payments. (Economic survey, GOI, 1999-2000).

For the first time during the 1990s the government used the term priviatistion in Budget 1999-2000 presented to parliament. For expediting the process, the Government has decided to study deferred cases afresh.[14] The government moblised Rs. 18,288 crores (41.28%) against the cumulative target of Rs. 44,3000 crore through disinvestments in 39 public sectors enterprises since 1991-92. In nine years of disinvestment process, only in three years, 1991-92, 1994-95 and 1998-99 the actual proceeds exceeded the disinvestment target (table 6). The Union Budget (2000-2001) also propose to raise Rs. 10,000 through disinvestments, this fiscal.

[14] The Economic Times, New Delhi, 15 February, 2000.

Table 6
Disinvestment in Central PSUs

Year	1991-1992	1992-1993	1993-1994	1994-1995	1995-1996	1996-1997	1997-1998	1998-1999	1999-2000
Target (Rs. Crore)	2500	2500	3500	4000	7000	5000	4800	5000	10,000
Actual proceeds (Rs. Crore)	3038	1913	Nil	4843	362	280	902	5371	1479*

* till 31.12. 1999

Source: Economic Survey, GOI, 1999-2000

The government has divested a part of its equity in 39 PSUs as an March 31, 1998. The range of equity divested varies from 0.2% (IRCON) to 48.9% (HPCL) (See table 7). In the case of HPCL, a core company (according to the definition of DC) the figure has already reached 49% (suggested by Rangarajan 1993; DC 1997). In the case of Madras Refineries Ltd. And Cochin Refineries Ltd., the GOI holding has been reduced to 51.8% and 55.04% respectively with just divestiture of 32.82% and 6.12% because the GOI holding before divestiture was 84.62% for MRL and 61.16% for CRL. In 20 PSEs, the divestiture works out to be less than 10%, only in four enterprise (HPCL, HOCL, IPCL, MTNL), the disinvestment exceeded 40%. In the Union Budget 1998-99, disinvestment in VSNL, CONCOR and IOC was announced. The CONCOR issue raised Rs. 221.65 crores through 49% divestiture of PSU equity. The CCD as also approved the appointed of global adviser/merchant banker (through competitive bidding) to work out the modalities of proposed disinvestment in Indian Airlines (IA) and Air

India (AI). The Commission's recommendations, with regard to divestiture of shares of IPCL, BALCO, EIL, EPIL, BRPL MFIL, HCIL, HTL, R-Ashok, U-Ashok is being implemented. The GAIL GDR issues was successfully completed and it raised proceeds worth Rs. 945 crores on November 4, 1999. (Economic survey , 1999-2000).[15] In the case of IA, a foreign or domestic investor can buy – upto 26 percent, leaving 25 percent to institutional investors and employees. In AI, foreign airlines have been permitted to a take a stable upto 26 per cent. A domestic private partner can take another 14 per cent. At least 20 per cent is set aside for domestic financial institutions and Employees Stock Option Plan (ESOP). The government will retain 40 per cent holding. For profit making BALCO, the Government is to undertake capital restructuring[16] prior to divesting 51% equity so as to increase the realizations (from disinvestment by Rs. 244 crore) by improving earnings per share, increased dividend pay-out and market capitalisation of company.

Table 7

The PE-wise extent of disinvestment made till March 31, 1998

S.No.	Name of PSE	Divestiture Amount (Percent)	GOI holding after Divestiture (percent)
1.	HPCL	*48.94	51.06
2.	VSNL	*33.04	66.96
3.	MTNL	43.80	56.20
4.	HOCL	41.39	58.61
5.	IPCL	40.05	59.95

[15] The Economic Times, June 20, 2000, New Delhi.

[16] 12.The Economic Times, March 2, 2000. New Delhi.

Critical Appraisal

Disinvestment policy and its implementation during the nineties shows how in its quintessential form it is arguably the most telling example of market fundamentalism. (Kabra, 2000). "Disinvestment", say the Disinvestment Commission of GOI, "has been viewed as a tool for bringing down the budgetary deficits of the Government". (Disinvstment: Strategy and Issue p.33, Dec. 1996). During the period 1992-97, equity of 39 public sector enterprises (PSEs) was disinvested in proportion ranging from 0.27 percent to 48.94 per cent (with average of 22.20 per cent of the shares disinvested, and in the case of 20 PSEs off-loaded shareholding was below 10 per cent of the total). An over whelming proportion of these 39 PSEs are profit making ones.

That the entire exercise of disinvestment is economically irrational, that the government is losing resources rather than acquiring them in this process, that in-fact entire game plan smells of large scale corruption would be clear from analysis of the Working Group on PSU) Disinvestment Issues (WGDI). The Working Group based all its findings on data contained in different issues of Public Enterprises survey (published by Bureau of Public enterprises) data contained in reports of erstwhile Disinvestment Commission and other official sources.

Two points sources by noted here. Firstly, sales of PSU equity have been limited to only the most profitable PSUs. Thus in selling off these PSUs, the government is obviously losing part of the profits made by the PSUs (either in form of dividends declared or as the pro rata share of retained profits of these enterprises). That is a clear objective loss to the government. Secondly, the government also saves by way of interest, the amount of deficit that would otherwise have had to be covered by additional government borrowing to the same extent (as raised from the sale of PSU equity). According to the Working Group on Disinvestment issues. (WGDI), the interest saved as a result of transfer of disinvestment proceeds as capital receipts to GOI from 1992-97 was Rs. 946.43 crore as against the return foregone (computed on the net profit after tax as given in GOI's Public Enterprise Survey, 1996-97) as Rs. 1783.91 crore because of sale of equity on market.

Table 8

Returns Foregone through Disinvestment Versus Interest Expenditure saved (Rs. crores)

	1992	1993	1994	1995	1996	1997
Averge Interest rate (%)	9.67	9.18	9.3	9.36	9.96	9.9
Interest Amount Saved	263.4	436.97	436.97	892.12	908.90	946.43
Return forgone	266.78	394.88	470.17	976.27	1415.18	1783.91

Source: Public Enterprise Survey, 1996-97.

Instead using disinvestment as a tool for reducing fiscal deficit, the actual experience is one of loosing Rs. 837.48 crores as a result of parting with a part of the equity of the PSEs. Thus, disinvstment has increased fiscal deficit; without disinvestment fiscal deficit would 'have been lower by Rs. 837.48 crores. Moreover there is a further loss to the public exchequer by realising lower price for the equity of the PSEs, estimated[17] to be Rs. 3,529 crore upto 1993-94.

To justify its disinvestment, the government notes that in the period 1991-97, it has invested more than it has gained as dividends. The facts speaks otherwise. While the budgetary support provided from 1990-91 to 1996-97 was Rs. 27,546 crores dividend earnings and internal resources ploughed back into the PSUs were Rs. 87,876 crores. (Obviously the capital plonghed back into the PSUs enhanced their asset value and has to be taken into account. Even the total figures of Rs. 2,00,000 crores invested in PSUs over the years is fallacious as it lumps equity put in by the government with loans. The actual equity put in till 1996-97 was of order of Rs. 65,000 crores of which (the loans have been largely paidback). As against this, the asset value of just the top ten PSUs stands more than Rs. 5,00,000 crores even by most conservative estimates (Mainstream, May 20, 2000.

Thus in financial terms and on the criterion of its objective of reducing fiscal deficit disinvestment has been total failure and against national interest. It

[17] R.K. Vaidiga in Mid Year Review of the Economy 194-95, quoted by N. Dhameja and K.S. Shastry Privatisation, New Delhi, 1998.

has provided enormous windfall capital gains to the operators in the financial markts who have acaquired valuable assets at throwaway prices. Apparently, no cost-benefit analysis and rational decision making would support such a set of decisions. It is purely an ideological decision which favours private sector and markets per se irrespective of social cost and adverse consequences. (K.N. Kabra, Alternative Economic Survey, 1999-2000, p.55).

That the Indian capital market is too narrow and illiquid to absorb the massive equity of PSEs is borne out by the fact that during 1998-99 and 1999-2000 the sum raised by disinvestment were Rs. 5,874 crore and Rs. 2,600 crore respectively (well- below the budgeted figure). It is obvious that inadequacy of domestic capital market would result in (I) uncompetitive bidding thereby depressing the prices) and (iv) enable foreign investors and multilateral financial institutions to pick up valuable assets of Indian people at throw away price. This has what happened in sales of Gas Authority of India Ltd. (GAIL), MTNL and Modern Foods, (MFIL sale shows to Hindustan lever). In all these cases distress sale at a fraction of their market prices took place. The GAIL's GDR issue was 135 million shares with a greenshoe option of 20 million shares. Each GDR comprising six GAIL shares was priced at $9.67. The price per share worked out to be Rs. 70, which was below the then prevailing market price of Rs. 79.80. Earlier the UF Government declined to disinvest GAIL shares when the book-building exercise yielded shares would fetch Rs. 150 to Rs. 170. The Modern

Foods (MFIL) was sold to Hindustan Lever which already had a huge presence in the food sector for Rs. 150 crores while just the value of land under the control of Modern Food was estimated to be of the value of about Rs. 500 crores. The disinvestment is being done in favour of money bages and manipulators under the misnomer entrepreneurs (Kabra, 2000).

In the seventh round of disinvestment carried out in 1994-95, small fraction of ownership (generally less than 10%) in high profile companies like ONGC< SAIL, IOC and SCI was offered to the private investors. The government set a target of Rs. 4000 crores from this disinvestment, however given the then profitability of these high profile companies and future prospects, the shares offered would have easily be worth Rs. 8000 cr (S.P. Kothari, 1994). The replacement value of PE's assets at current prices would easily be over a 100 times the initial investment. For example, the replacement cost of a company like BHEL could be anywhere between Rs. 25000 and Rs. 30,000 cr but the owners of sold equities had to invest not more than Rs. 300 cr to get BHEL (which has 4 plant and installed capacity is 7155 mw) whose paid up capital is Rs. 244 cr and whose reserve are worth around Rs. 300 cr. (Abhijeet Sen, 1993). (See Table 9). In the case of BPCL, new owners had to invest around Rs. 300 cr only to get the enterprise with reserves of Rs. 616 crore.

Table 9

Financial details of some of disinvested PSEs

Name of PSE	Paidup Capital	Net profits (1990-91	Reserve and Surplus
Hind. Petroleum	63.84	120.04	729.69
Bharat Petroleum	50	127.81	616.16
Bharat Earth Movers	30	43.14	320.05
Videsh Sanchar	60	8.58	285.19
BHEL	244.76	164.52	292.49
Shipping Corporation	216.23	95.25	308.01
IPCL	186	57.25	510.62
SAIL	3985.89	244.69	1127.51
MTNL	600	95.8	51.66
Bharat Electronics	80	34.25	182.84

Source: P.E. Survey 1991-92.

As per the calculations made by WGDI, the proportions of average gross profit to capital employed over 1994-95 to 1996-97, was 22.2 percent for disinvested PSUs and 14.93 for all central PSUs. Comparing 22.2 with an average public borrowing rate of say between 10 and 11 percent, the GOI has given this largesse to financial (capital both domestic and foreign). The case of IPCL disinestment brings out the other fallacies in the scheme of disinvestment. The DC classified the IPCL as a non-core unit and recommended that the GOI should sell 25 per cent equity to a strategic partner (SP) and hand over to SP the management control. It is not quite clear as to why the SP was to have management control with 25 percent equity, even though after the required disinvestment, GOI would still retain 34.9 percent equity of IPCL. The recommendation came after IPCL was declared Navratna. It is also alleged that GOI has invited bids stipulating a

minimum price of Rs. 180 per share for 25 per cent of IPCL equity , although its replacement cost would have been higher to be atleast Rs. 265 (Arun Ghosh, Mainstream May 20). In this way the strategic partner will pay Rs. 1100 crores to acquire 25 percent share and get control over assets worth Rs. 10,000 crores and cash reserves of Rs. 2780 crores. As reports indicate that Reliance India, another frontier technology unit in Petrochemicals unit, is being considered as Strategic Partner. It this is case, it will create a virtual monopoly in a number of petrochemical products which defies the objectives of setting up of PEs..

Also the option of workers –cooperatives was excluded in IPCL, who offered to run and rehabilitate the PSE and pay a competitive price but were denied the opportunity. The worker and other staff of the IPCL made a concrete offer to buy up the required 25 per cent of the equity of the IPCL

through a 'Holding company' in which workers. Would hold 40 percent (with fund lying-in their provident fund) and their proposal envisages appointment of competent technical expertise to run the company. The advantage with such scheme is that worker management relations and workers' performances can be expected to be exemplary. The non-transparent manner in which the bidders for IPCL were shortlisted has given rise to suspicion of some large -scales can in privatizing PSUs. No prior value-addition to the PSEs to be sold is being done in order to realize a better value and there has been no tripartite agreements - among owners, managers and workers regarding the sale of public enterprise.

The government adopted unethical tactics to raise resources through buy-back of shares' and cross-holdings in the case of PEs in the oil sector which implied acquisition of government shareholdings by cash rich companies. This worked in favour of government but turned out to be huge of dream on the diverted enterprises affecting the temp of their investment in R and D, expansion and maintenance. The IOC-ONGC had to settle for a price following, which the market capitalization fell by at least 15 to 20 percent. Since long, the government was trapped in a controversy over the technique of disinvestment and could not decide between formation of a trust or a special purpose vehicle (SPV). It also did not realise that time element is vital element for downloading equity. As a result Container Corporation of India Ltd. (CONCOR) which had earlier pitched the price of its hares at Rs. 450 per share climbed down to a price of Rs.225 to Rs. 235 per share. This affected the disinvestment programme of the Oil and Natural Gas company Ltd. and Indian Petro-Chemicals Ltd. (IPCL) (R.K. Mishra, 1999).

Some specific recommendation of Disinvestment Commission illustrate the contradictions and logic leading to it Recommendation: MOIL Disinvestments upto 49%. Logic: No public purpose will be served by converting an almost public monopoly into a private monopoly and control of MOIL by private investors has the potential of destabilizing the ferro alloy industry. Taking into account the limited reserves, continued government control may be desirable. Similar recommendation and logic can be noticed in the case of most of running PSU, like

HZL, NMDC etc. Recommendation: CONCOR Disinvestments upto 40%. Logic A core group PSU. Its links with the Railways are critical for its operational efficiency. It also has a large volume of assets on lease from Railways. Its access to the railway personnel which enables close coordination with the railways and contributes to improves its efficiency.

Recommendation BHEL: Domestic FIs may be offered equity slakes of 10% and foreign private equity funds /FIs including multilateral institutions be offered a further 10% in the company with appropriate role in management to both Indian and foreign parties.

Logic: Looking at the global trend towards consolidation in the Power Plant Equipment (PPE) industry, it would be desirable, that BHEL remain an Indian Company with a majority Indian equity stake.

The Government's decision to disinvest shareholdings in the Indian Airlines (IA) and Air India (AI) has also come under cloud. It is alleged that the CCD had chosen to be selective about Kelkar Committee Report, and ignored its recommendations with regard Rs.922 crore compensation to IA for equity infusion and ground of Airbus A-320. The Comptroller and Auditor General recently[18] observed, "IA signed productivity linked Incentive (PLI) agreements with trade Unions on 'Irrational productivity parameters and in contravention of the directives

[18] The Economic Times, New Delhi Edn, 6th July 2000.

of Department of public Enterprises. results in huge financial out go. the downturn for both IA and AI began when they abandoned professional management and began to compete with each other. the same mistake should not be repeated while disinvesting'.

With regard to share valuation, neither the Rangarajan Committee nor Disinvestment Commission has recommended whether asset valuation to the considered at the book value or the market value and was vague regarding valuation procedures.[19] Their recommendations have remained advisory and have not been implemented seriously limit to the holding of PSE shares by NRIs and foreign investors. Moreover, there is no lock - in period to their holding of shares. Most divestiture companies, as stated earlier are profitable ones and sick and loss values, sick PSUs are yet to be divested. Restructuring and reviving the potentially viable ones of all loss making units, using part of disinvesment proceeds units, using part of disinvesment proceeds from Disinvestment Fund so as to reduce it long term dependence on budget was one of the recommendation of DC (DC Report I) but this major recommendation to still hanging in balance. The turnaround management is not strong enough to restore sick enterprises to a good health.

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[19] the first step in restructuring sick PSEs was to bring the sick PSE under SICA (Amended) Act, 1991. As on March 31, 1999, 67 enterprises had eroded their net worth and were registered with BIFR which approved revival packages respect of 22 central PEs.

With the highly volatile insider - trading ridden and FIIs dominated stock exchange, it is doubtful we can go in for a really meaningful offloading of the PSEs in older to raise finances on the one hand and subject the disinvested PSEs to the discipline of capital market on the other. Out of 39 PSEs only in four highly profitable PSEs, the disinvestment amounted to 40 to 49 per cent of the equity and for 20 PSEs it was less than 10 per cent. With these levels is futile to expect the PSEs to improve' under the impact of the discipline of capital market, which itself works more like a casino and is buffeted around by the full and bear brand of speculators. (Kabra, 1999). It is in this above context that one has to interpret the latest government policy to divert itself of atleast 74 per cent equity of all non-strategic enterprises.

If the only motivation of the government in disinvestment is to reduce fiscal deficit, the government could have easily mopped upto the retained profits of PSEs without resorting to disinvestment. (K. Ashok Rao, 1999)(It should be noted that proceeds collected in disinvestment in 1997-98, 1998-99 and 1999-200 were just 1.2 per cent, 6.0 per cent and 1.8 per cent respectively). (Economic Survey 1999-2000). To state briefly the centre's gross tax revenue to GDP ratio has declined from 10.0 per cent to 8.5 per cent between 1991-92 and 1998-99. As per Economic Survey 1999-2000, India's GDP in 1998-99 (at current prices) was Rs. 16, 12383 crores; and if tax to GDP ratio had been 10 per cent (as in 1991-92), the increased tax collections would have amounted to Rs. 24,186 crores. Not only

would there have been no need to budget for Rs. 10,000 crores through sale of PSU equity (a figure repeated for 2000-01), a substantial additional amount - as much as Rs. 14,186 crores would have been available for incurring genuinely development expenditure. The series of tax concessions and allowed over the years since 1991-92 and proliferation of parallel economy is the main reason for large fiscal deficits despite heavy cuts (in real terms) in development expenditure generally and in plan outlay, in particulars. (Ghosh, Mainstream, May 20, p.4.)

Kabra[20] says the scope for discretionary decisions -making under disinvestment infinite which would surely intensify cryonism and rent collection, inherent in the process of disinvestment as an ideological fixation. It is on such grounds that one is justified in treating disinvestment as a prelude to privatization and crypto privatization. It is an attempt to do away with the PSEs (embodying the sacrifices of common man in terms of savings, parting with land and forests without adequate and timely compensation and hardwork of workers) in installments and make room for the private corporates to occupy the commanding heights of the economy. It is a blatant extension of liberalization. It may be noted that in addition to fostering cryonism and collection of rent of authority, the process and procedure of decision-making as the pace and methods of disinvesment has bee highly secretive (disregarding the advice of the Disinvestment Commission and ultimately its winding up), ad hoc and

[20] Alternative Economic Survey -1999-2000, p.55.

bureaucratic. Thus the stated objective of liberalization to debureaucrtise has not been in evidence in the course of disinvestment. Probably to centralise such bureaucratic discretionary methods of disinvestment and also to indicate that the process of disinvestent is likely to be persisted with for long, a separate Department of Disinvestment has been create by the Union government. It would hardly be in a position to improve what the standing conference on public Enterprises (SCOPE) has described as 'largely indiscriminate process of disinvestment' so far.

We are not going into the question of the appropriateness of mode of utilisation of the proceeds of disinvestments and the likely role that he new shareholders would play after privatization. This is because in our view the very principle of selling of public sector enterprises in order to meet current profligacy is inappropriate.

In short, India's privatisation programme is open to criticism on several account even if one were to assume that privatisation can lead to gain in efficiency, which itself is a highly problematic assumption and it as easy to find that the quest for raising resources has been the primary consideration of government, which too has met with very little success. The entire exercise of disinvestment lacks coordination and India has to learn much from the way other developed and developing countries have gone about reformers the public enterprises.

CHAPTER FIVE

CONCLUSION

In public enterprises, though citizens are the ultimate owners, the decision making power rests with politicians and the bureaucrats, as the public corporations role is statutorily defined and therefore, subject to direct political control. In other words, it is argued, it is the attenuation of property rights at the source of inefficiency of public enterprises (Jensen, 1976) and he claimed that a change in the allocation of property rights should eliminate politicians direct day-to-day intervention in management decision making which lead to a different structure of incentives for management and hence a change in both managerial behaviour and company performance.

If the holdings of public enterprise is dispersed, then monitoring may be poor but is it argued that profit maximisation shall still hold and maintain dominant position in the above type of an analysis of company behaviour due to takeover threats (act as an incentive mechanism that deters management from pursuit of policies of their interests), Company Law, which establishes a framework in which monitoring activities can be centralised via Board of Directors for the company, etc. Though the property rights problem in public enterprise is cited by many economists as one of the reason for the inefficiency and failure of PE, it should be noted

that there are many efficiently run PEs. So it could be concluded that efficiency is not related to change in ownership per se.

In the theory of contestable markets (a theory of competition). Baumol argues that given free entry and exit conditions, the role of potential competition will ensure firms to behave efficiently and in accordance with consumer preferences but the economics of strategic entry deterrence and predatory behaviour shows that in many circumstances, incumbent firms may be able to thwart potential competitors. (Swann 1988, Mitchell 1990) and so it is not clear to what extent measures of entry liberalisation will promote an effective competition as there is little evidence of effects of ownership in a truly competitive environment (Stevens, 1992).

The welfare based argument on privatization argues that privatization could be justified only if (expected) social value under public ownership is less than the (expected) social value of the privatised public enterprises (a key value introduced by Jones, Tandon and others) plus the sale premium (net social value of the sale proceeds of the PEs). They also suggests that government should care about the operation of PSEs even after the sale so that an increase in the social welfare could be maintained and assume welfare to be an aggregation of the levels of welfare of different sections - consumers, workers, producers etc. in the economy. But

unfortunately, calculating the optimal (selling) price and the charge is welfare are no easy exercise and precise answers are exceedingly unlikely.

Regarding the operationalisation operational restructuring is generally preferred before privatisation, as it is feared that it may result in loss of jobs, if taken up during or after privatization and as the ultimate motive behind the exercise is a complete and total shift from one kind of market structure, monopolistic or (restrictive) oligopolistic, to another kind, competitive market structure, this might pave the way for potential competitors who may be efficient providers of particular services (Baumol 1982, Yarrow 1986). However, the evidence from different countries prove that the path to privatisation is full of hurdles, and features and discrepancies were found at different stages. The evidence on the effect of privatisation on the employment level forms is also mixed (Megginson 1994, Parker, 1996, Bhasker 1995).

Other decisions include the method of privatisation (prominently used are stock market floatation, management/employee buy out and sale to existing private sector companies), the regulation of the privatised public utilities etc. and the implementation of all these decisions involves legislations, valuation of PSEs shares, creation of regulatory mechanism etc.

The debate about privatisation typically compares the efficiency of PSEs, with comparable private firms and inefficiency of the public sector is used as an argument to justify the recent macro-policies which include withdrawal of budgetary support, closure of PSUs etc. The criterion of profit is used a proxy variable for measuring efficiency was profit making the real objective with what the public sector enterprises was launched? The answer would be in negative and hence profitability cannot be the indicator of public sector enterprise efficiency.

Comparisons between the public and private sectors shows that in terms of profit after case (PAT) to sales, both public and private sectors have performed more or less at the same level. But, if it is in terms of PAT to net worth (NW), then it is the private sector which has performed better (Gouri, 1996). This could be due to increase in contributions from other income than from the mainstream investment, because other income was showing an increasing trend. In the year 1993-94 it was found that the ratio of net profit to capital employed for all PSEs (non-departmental) came down to 1.81% from 2.43% in 1992-93 the manufacturing sector alone registered a decline of 178% (Gouri, 1996). But here, the major contributors of these losses were the 103 loss making units, mainly from the textile sector, many of them acquired by the government when it was running in losses in the private hands. Another possible reason for the drop

with net profit to capital employed ratio (as compared to gross profit to capital employed ratio) may be due to increase in the interest costs.

A comparative study of financial performance of the profitable PSEs with their equivalent private sector enterprises for five years (upto 1995) shows that the performance of PSEs have been uniformly better. In case of steel, though initially TISCO did better, later from 1993, the trend was reversed. This may be due to changed product-mix and deregulation of prices (Gouri, 1996). Differences in the product-mix is one of the reason cited by Patnaik to substantiate that profitability comparison of same sectors, say steel, is no index of relative efficiency (Patnaik, 1997). According to him, it is the engineering notion of efficiency, i.e. examining the use of some key input per unit of comparable output, example consumption of power per unit of pig iron production, which should be considered. On such a comparison, the public sector does not come out badly (Bagchi, 1995, Patnaik, 1997).

Empirical[1] studies on the relative efficiency of public and privatised enterprises, give rise to a set of mixed results. They lends only limited support to the hypothesis that state owned enterprises are less efficient than

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[1] There is an extensive literature on empirical evidences on the relative efficiency of public and private enterprises. For details, see Borcherding, W. Pommerclive, and F. Scheinder (182); W.M. Crain and A Zardkoohi (1978) P. Tandon (1997); J. Vickers and G. Yarrow (1988) D.W. Caves and L. R. Christemsem (1980); G. Hutchinson (1991) M. Bishop and J. Kay 1988).

private firms. On balance, results are consistent with hypothesis that, controlling for market structure, there is no systematic difference in the performance of public and private firms.

On the basis of several empirical studies, one may conclude that 'the degree' of market competition and 'the effectiveness' of regulatory policy should have larger effects on performance than ownership per se. In other words, if the PSEs had abandoned their commitments to social responsibility, the former public corporations could have recorded profit by the above means at any time but whether this could have benefited the wider economy is open to question.

The privatization experience in Britain also do not gives a rosy picture. Britain had gone for privatization in the late seventies with the initial objectives like reducing the public sector borrowing requirements and the government's intervention in the enterprise decision making etc. during the conservative rule because none of the suggested remedies, say for example, external financial limit on short term borrowing., helped to revive the crippling public economy (which had accumulated huge losses) so as to improve their efficiency mainly. The privatised companies included British Aerospace (1981) and high tech company, Amersham International (1982) (which were running successfully in public sector),

both of which were oversubscribed 3.5 and 24 times respectively as prices were set low and speculators made high profits.

After Thatcher's re-election in June 1983, the privatization programme accelerated and major companies like British Telecom, British Gas and other utilities in gas, electricity etc. were sold under PPP (Public - Private Participation) module under which, after divestiture the government and private parties had equal stake in the company. Management control, very often rests with private entities and rights and duties were well-defined in Shareholders' Agreement. Employee participation were encouraged by long term employee share ownership schemes in utilities, promoting management and employee buy outs in smaller enterprises and by developing incentives to encourage employee participation. BT and other utilities continued to enjoy a large degree of market power and were subjected to a framework of regulation. In certain cases to safeguard the interests of nation and employees, UK government opted for "golden-shares" to veto or alter any unfavourable resolution. However in case of ports, UK government failed as private parties sold their stake in these ports within three years, at six times the purchase price.

In Mexico the government embarked on a programme officially referred to as 'disincorporation' mainly to improve the fiscal accounts of the public sector as it was precarious even before the crisis of 1982. They

performance and hence assist rather than hinder economic development and to increase the credibility of the government's commitment to increased economic efficiency. Kohli (1987, p.26) has summarised the lessons learned from the ADB country studies and Pliatzky (1987, p.65) lists five golden rules based on British experience. Most of these have to do with setting clear objective and performance criteria, monitoring performance and rewarding success. These objectives should include productive efficiency, profitability and efficiency pricing, and the PSEs should be subject to competition wherever possible, there should be no entry barriers (facing private competitors) nor exit barriers (preventing the bankruptcy or liquidation of the PSE). Social and distributional objectives are best addressed by separate instruments - targeted subsidies or programmes rather than distorting the prices charged by the PSEs.

A central question in the management of public enterprise is the degree of autonomy to be give to the enterprise managers, and the form of regulatory oversight. Principal-agency theory offers several insights to guide the design of a management system. Autonomy is desirable if the principle (the ministry or agency responsible for overseeing the enterprise) has access to good quality information in which to assess the enterprise's performance. On the recommendations of Arjun Sengupta committee in 1984, the Indian government adopted the practice of signing memorandum of understanding (MOU) with public enterprises in an effort to improve

their functioning by imparting greater autonomy. But K.R.S. Murthy (1990) says that MOU system as implemented in India so far, unfortunately provides for just that, more memorandum than understanding, what is required is just opposite. The only way out is that the responsibility of the government for the formation and supervision of goals and long term policy for various sectors must be separated from the administration of enterprises. For this closely related group of enterprises should be brought under the umbrella organisation, say it a Holding Company or a Sectoral Corporation (K.R.S. Murthy, 1990).

India, a late comer did not learn much from the experiences of nations which had undergone privatisation, is revealed by its program of disinvestment. The whole disinvestment programme has been carried out by the government in a irrational, unplanned and hesitant way. The widely held perception that changes in ownership will lead to gains in efficiency and hence improvement in performance of public enterprises is itself highly contentious issue. A number of problems continue to afflict the smooth functioning of PEs. These includes, erosion of functional autonomy of public enterprises, ineffective turnaround management for sick PSEs indifferent wage policies, lip sympathy to Navratras and Mini Ratnas and scant respect to professionalism of Boards.

In financial terms and on the criterion of its objective of reducing fiscal deficit the disinvestment (which was part of WB-IMF stabilisation package) has been a failure . Most of the disinvested companies are profitable and successful companies and there have been fever attempt to restructure sick companies and make them potential economically viable units. Apparently no cost benefit analysis and rational decision making would support such a decision.

That the government is loosing resources rather than gaining them is further substantiated by the study of Working Group on PSU Disinvestment (chapter 4). In most of the tranches, the collection proceeds fell short of targeted amount because (i) there was no proper valuation of shares and shares were heavily under priced in most of the PSU sales (ii) market was not in a favourable situation many a times for a successful public offer of shares through a tender method, due to some exogenous and uncontrollable factors. The alternative to disinvestment programme was not given a serious considerations. The proceeds collected during the entire period 1991-99 accounts for less than 2% of the fiscal deficit. According to Mani (1997), these should have been a 'claw-back' provision atleast, which would have granted the government with an opportunity for sharing in any profit which successful bidders may receive consequent to their onward sale of shares.

The entire manner in which the proceeds have been used is objectionable. The capital receipts from government's equity in profitable public sector enterprises has been used to offset the short falls in revenue receipts and hence fiscal deficit, which amounts to selling family silver to support a profligate life style. Instead consequent to creation of Disinvestment Fund, the proceeds should have been utilised partly for retiring part of public debt, part for restructuring and for rehabilitating unviable PSUs (includes contribution to NRF) and remaining on social sector expenditures. Privatisation in India has helped to finance soft and profligate Budgets in the short run, while ignoring the problem of a rising budgetary burden in the long run (Chandrasekhar, 1997).

The Commission's recommendations was nothing but an elaboration of Committee's Recommendations with a proper definition of different sectors of industries like strategic, core and non-core. It is, in fact, in part a justification of liberal industrial policy framework of the 1990s (Chandrashekhar 1997). Olassa says that a study of the recommendations should reveal that the Commission has taken into account the prominent fallacies of British and Mexican experiences, which had given rise to concentration of wealth among few rich shareholders. (Olassa, 98).

The commission's task was further complicated by the heterogeneous nature of public sector itself and the two-fold variety of

objectives of disinvestment and firm characteristics had contradictory implications. On the one hand disinvestment may be warranted more for those units whose losses were being financed through the Budgets but on the other hand, disinvestmet will be more feasible in the case of profit-making enterprises than in the case of loss-making ones. (Chandrashekhar 1997). Moreover, the Commission had no statutory powers and its advice and recommendation are yet to be implemented Recommendation is not mandatory upon the government.

It should be noted that in a developing country like India where market functions poorly and enterprises are still vulnerable to arbitrary government edicts, the privatisation may dislocate the vulnerable sections of the society without proper safeguards and strong infrastructure (because a hike in price of basic inputs will reflect in all others). Additionally, without a fundamental re-negotiation of the terms of trade and aid with the developed world, the developments in the developing world are unlikely to achieve moderate success. So any government will have to consider such views before embarking on such a programme.

In short, India's privatisation programme is open to criticism on several accounts and it is not a panacea for the ills of the public sector. It is inappropriate in India to replicate the policies of West to reform public enterprises under the pressure of WB-IMF. Hence, Privatisation requires

satisfying certain preconditions like strong capital market, proper assets valuation proper and adequate safeguards for employed workers, etc. which unfortunately are not met in India. The effort should be to make public sector units work efficiently by imparting a change in work-culture and professionalising PE Boards. One solution lies in transforming these enterprises into board-led entities and liberating them from superfluous government control (Mishra, 2000). Disinvesting PEs is a cure worse than the disease and would intensify the crisis of India's public sector and thus of the economy as a whole.

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