THE POLITICS OF DISINVESTMENT

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18 · 7 · 02

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Contents

Preface

The objective of this research, "the politics of disinvestment" basically is to highlight the performances and efforts at reforms in public sector enterprise and also privatization and disinvestment pursued as one of the most important reforms. The politics involved in the whole process refers to the reasons for pursuing these programmes so enthusiastically, then manner of implementation and their suitability for a developing country like India.

This dissertation is divided into five chapters and a conclusion.

In the first chapter of introduction, two aspects are emphasised that is, the intellectual basis for privatization and the state versus market debate.

In the second chapter, the public sector enterprises have been dealt in detail relating to its performances, its problems and efforts at reforms.

In the third chapter, the process of disinvestment of public sector enterprises are dealt in great detail as to how the disinvestment programme is put into practice.

In the fourth chapter, privatization experience around the world a study with special reference to the UK which has been the pioneer in initiating the privatization and disinvestment policies.

In the fifth chapter, the politics of disinvestment relates to criticisms of the process and the political face of the whole reform strategy. It focuses on the problems in the disinvestment process in a developing country like India.

The fifth chapter is followed by a conclusion.

This research has been based on primary and mostly secondary sources including journals, newspaper articles and books. This has been my modest attempt to research on this topic and any shortcomings in it are my own.

Chapter I

Introduction

The role of the state in a country like ours becomes important in not only activating various economic activities but also in regulating and controlling them for the larger interest of masses. The Directive Principles of Sate Policy enshrined in the Constitution and the Industrial Policy Resolutions of 1948 and 1956 have emphasized upon the responsibility of the state in promoting, assisting and regulating the development of industry in the national interest.[1] Further, with the adoption of the socialist pattern of society as an objective of economic and social policy, the state was entrusted with many difficult tasks. Apart from the anti-capitalist bias of socialism and its disdain for profits – 'surplus value', there was the belief that the public sector alone can stimulate planned economic growth and ensure the predominance of the poor in politics. Hence, the public sector was hailed as the commanding heights of the economy.

The public sector was considered as an instrument of delivering goods and services and also in accelerating the process of building up a strong foundation of industrialization. In this perspective, the public sector was given a special role in the early period of planning to provide 'social good' and to provide a strong industrial base for the economic development of own country. This vision of self-reliance was broadly indicated by Nehru who called the public sector as the "temple of modern India".[2]

One of the most important objectives of the public sector in the early years of planning was the enlargement of social benefit. The pricing policy in general, has been that of "no profit and no loss". In course of time there has been shift in the emphasis of the public sector in favour of mobilisation of surplus resources for the expansion of public sector itself and also for financing a part of government investment programme. In other words, the commercial principle was adhered to measure the success of public sector enterprises (PSEs). It is also to be remembered that many PSEs are loss-making ones and there is no justification for poor management and lack of accountability. However, as a remedy for such enterprises, various reforms were started and one of the most important being the privatization and disinvestment process.

These process of privatization and disinvestments are justified on economic aspects of enhanced efficiency and revenue mobilization. These programmes are pursued in India with great acceleration. Two points are to be made here: first, are these policies suitable for India where positive state intervention is essential rather than reducing the role of state. This brings in the state versus market debate. Second, if at all these policies are pursued, the manner of implementation of these policies need to be examined. Before that, the very concept, objectives and techniques of privatization and disinvestments must be made clear. A political and social consensus also needs to be built if these programmes are to be implemented in order to make it successful.

Thus, focus has to be on the intellectual basis for privatization and secondly on the state versus market debate in order to fully understand the evolution of a policy in favour of private enterprise.

The ideas of private enterprise, unregulated markets, non-interference by the state, encouragement to private initiative etc. all which today paves the way for privatization can be traced to few centuries back. It can be traced to 'liberalism which is the belief in and commitment to a set of policies that have as their common aim greater freedom for individual men.[3] Classical liberalism in eighteenth and nineteenth century contributed to the establishment of a system of natural liberty of every man free to pursue his own interests. Classical liberalism came to be identified as negative liberalism because of laissez-faire or negative role of the state as freedom from government interference in economic or industrial affairs. The liberal perspective drawn primarily from the field of economics can be traced to the writings of Adam Smith (1723-1790), David Ricardo (1772-1823) and Malthus (1786-1834). Smith and the nineteenth century liberals were the economic reformers of the era. Adam Smith spoke of the beneficial effects of the market and advocated limited role of the government. He displayed a strong preference for private economic activity as he believed in the efficiency of the system of natural liberty. The "invisible hand" allowed for the free and open play of all interests. The state according to him had three main tasks.[4] These were:

(i) defending its citizens from the violence and invasion of other independent societies.

(ii) Protecting every member of society from the injustice from oppression of every other member of it.

(iii) Creating and maintaining certain pubic works and pubic institutions. Here state intervention is justified wherever social benefit exceeds individual benefit.

The classical economists like Malthus and Ricardo were well-aware of the superiority of market processes in general to political process. Their pragmatic and conditional advocacy of laissez-faire had continued into the era of neo-classical economy. The neo-classical economists believed in the market system as they considered it as the optimal solution to the problem of scarcity. They emphasized the fact that the functioning of the market will make the economy adjust itself to price signals which reflect changing economic conditions.

Therefore, the liberals believed that the economic role of government should be limited. They argue that many forms of government intervention in the economy restrict the market and thereby prevent potentially rewarding trades from occurring. On the other hand, the liberals also supported the provisions by government of certain "public goods" and services that is not provided by private markets. The government should educate its citizens, build infrastructure and provide and regulate a common currency. The proper role of government is to provide the necessary foundation for the market.[5]

It is important to note that the struggle for liberalism started in seventeenth century Europe in the wake of industrial revolution with its emphasis on negative liberty in the economic sphere. The state was considered as a necessary evil. It was now intended to pave the way for the establishment of capitalism against the prevailing forces of feudalism. By mid-nineteenth century capitalism had resulted in appalling disparities of wealth and power, oppression and exploitation of workers. In this phase the Marxists and the positive liberals demanded a new definition of liberty. It was Mill who introduced the conception of positive liberty and sought to discover an area where state intervention was justified. He distinguished between "self-regarding" and "others regarding" action and the role of the state in the latter. He supported a positive role of the state in securing social welfare even if it implied curbing the liberty of individuals to an extent.

Marxism which was a response to the spread of liberalism in the nineteenth century saw capitalism and the market creating extremes of wealth for capitalists and poverty for workers. Marx rejected the assertion that exchange between individuals necessarily maximizes the welfare of the whole society.[6] With the emphasis of the positive liberals and the Marxists and the pressure put by the working class for a better deal forced the capitalist state to revise its policies in the socio-economic sphere. This involved abandoning the policy of laissez-faire and adopting the principle of welfare state. After the first World War, the welfare state was established in almost every western nation. The British economist Keynes, a strong believer in individual initiative and enterprise, recognized the role of the state in maintaining a level of effective demand, which was necessary to ensure full employment.[7] He emphasized that economic security should be provided by legislation for full employment at high wages and by social reform as an incentive to increase production. He argued that market forces by themselves could not result in full employment. The welfare state thus undertook labour welfare legislation and also nationalization of pubic utilities.

This led to waves of nationalization in the wake of the second World War in western and eastern Europe. The process of nationalization meant expansion of the state activities. "Nationalization is the process by which the state, in the wake of its sovereignty, takes property away from private individuals or firms either by legal or judicial action"[8]. The ethics of natiønalization is based on the validity of the state as opposed to private property rights. This was the time when the importance of public sector grew and it was considered as an instrument of economic growth. The immense role of the public sector was internationally recognized when the IMF and the World Bank put a conditionality in providing loans to the developing countries in 1960's. The conditionality was that the developing countries must take recourse to nationalization of the key industries. The industrialized countries and the developing countries opted for the public sector for their own reason. The former did so to achieve social and political stability while the latter to develop heavy industries, generating, employment opportunities and reducing the scope of exploitation by the private sector.[9]

However, this period of public sector being an instrument of economic growth could not sustain itself due to recurring fiscal crises in 1970's. It was no longer possible to support the welfare state as an appendage of economic growth. There were systematic attempts made in advanced welfare states during 1980's and 1990's to shift responsibilities towards human welfare from the state to society through privatization.[10] The public sector had received a major setback in mid

1970's due to sharp rise in oil price and the inability of many economies to adjust to the crisis-ridden situation. This inability to adjust quickly was attributed to the inefficiency of the public sector in general.

Hence, it was deduced that the state failed to allocate and distribute the resources efficiently owing to the "overload" and "fiscal crisis". It was so because there was an increasing demand for public services by the sovereign consumers which led to the expansion of the public sector. The expansion according to public choice theorists was also due to utility-maximizing policies of the state officials, politicians and bureaucrats. The Marxists believed that the growth of the state was due to the demands made by capital and the workers for various welfare and distributional services.[11] According to the Chicago school, particularly Milton Friedmen and John Stigler, the states became captives of the vested interests of the various organized groups, trade unions and rich businessmen.

Public choice theory concerned with the nature of decision-making within the government reject the Weberian notion of disinterested officials taking action on democratic decision. The public choice theorists argue that the government officials are just as inclined to pursue their own ends as other individual.[12] The theory seeks to explain political behaviour on the basis of the principle of maximization of utility. It assumes that human beings are rational utility maximizers who tend to promote their own self-interest. In the pursuit of their self-interest the public servants tend to promote their own careers and avoid taking risks. The logical consequences of this behaviour are:

- The government machinery gets unnecessarily enlarged.
- As the government does not have to face any competition there is no compulsion to respond to any changes. The public servants tend to perpetuate the status quo in which their position in secure.

- The politicians tend to set the policies which ensure them popular support. This leads to populist policies which may have harmful results in long run.

It has been demonstrated by the proponents of the public choice theory (Buchanan, Tullock, Niskanen) that even the majority decisions in a democratic system do not result in policies that promote the maximize welfare of all. The decisions of the government do not lead to the rational economic policies conducive to the long-term economic development of the society. Public choice is thus not always guided by public interest. The visible hand of the government is not always benevolent.

As against the government, the private sector always operates under the discipline of the market. Any private sector organization which does not provide efficient service to the community and simultaneously does not make profit, is quickly pushed out of the market. Competition provides the acid test which decide whether a private firm stays in the market or moves out. It is true that competition is not always perfect and there are many distortion in the market. The public choice theorists, therefore feel that the choices made by the private sector dictated b y the market are by and large more rational and efficient than the public choices made by the government. On the basis of foregoing analysis, the exponents of public choice approach feel that the role of the government in development should be drastically reduced. More and large function of the government should be handed over to the private sector, wherever possible. According to them privatization is the answer to the present economic crisis of developing countries. The governments must act as umpires while the private sector plays the real game. This will stabilize and liberalize the economy and release the energies of the people.

The property rights theory complements the public choice economics. In this theory the source of inefficiency in state organization lies in the attenuation of property rights. In the archetypal capitalist firm the entrepreneur has a direct interest in the most efficient use of the firm's resources because his/her income is the residual after revenues are deducted from production costs.[13]

Although the public choice and property rights theories have different nuances, they compliment each other in the sense that together they suggest that economic activity undertaken in the public sector will perform less productive (cost) efficiency than the same activity in the private sector.[14]

Thus, the main intellectual force for the case of privatization has come from the public choice and property rights theories. These have been popularised through the publications of free market, pressure groups such as the Institute of Economic Affairs and Cato Institute in USA. There is yet another theory propounded by Hayek who believed in the institution of markets that can provide best knowledge and mechanism through price signals. He believed in the superiority of the market system facilitating voluntary interaction which served as a means of co-ordinating complex human activities.[15] He described the method of central or state direction as "incredibly clumsy, primitive and limited in scope". The contributions of various scholars in support of market system replacing state intervention paved the way for privatization.

State vs Market Debate

Role of the state and market

In any economic system in which the state is an active participant in the development process, it has few key roles to perform like: to provide public goods, to correct market imperfections, to protect the vulnerable and ensure an equitable distribution of income and to provide an institutional environment in which markets can flourish. The state plays an overwhelming important role in ordering the distribution of productive asses, and thereby the pattern of demand, and following therefrom the pattern of investment and of production in an economy.[16] The process of capital accumulation in a capitalist society leads to an increasing inequality in the distribution of income and wealth and hence, from a purely facilitating role, the state has to increasingly play a 'regulatory role' for the functioning of the market. To an extent, there are positive aspects to the regulatory role of the state.

The essence of a market on the other hand is the central role of relative prices in allocative decisions. Although a market is an abstract concept, it is defined as an arena where goods and services are exchange on the basis of relative prices. Its role becomes important as it is where transactions are negotiated and prices are determined. The market is said to increase the efficient allocation of existing resources. Since, market competition forces the producer to innovate and more the economy to higher levels of productive efficiency and technology, the market dynamically promotes technological and other types of innovation, thus increasing the power and capabilities of an economy.[17] The market is also emphasized due to its ability to shape the modern world as it forces a reorganization of society in order to make the market work properly. Marx commented that when a market comes into existence, it becomes a potent force driving social change.[18]

One test for determining the respective roles of the state and market is the application of the concept of "comparative advantage". Given a particular objective, it may be possible to examine the comparative advantage of state instruments versus market instruments in achieving the objective. It is also necessary to examine whether ownership by the government or regulation is the most optimal method for achieving the desired objective.[19] In some activities, the advantage of combining the government and the market in different proportions can be explored. Prof. V.V. Ramandham has used this concept of comparative advantage as the basis for privatization. He argues that whenever a public enterprise loses its comparative advantage, it is better to privatize it. He argues that comparative advantage has to be measured in terms of commercial returns, social returns and desired trade off between the two. He calls this a 'non-ideological approach'.[20] This concept of comparative advantage has been further elaborated by Dr. S. R. Mohnot. According to him the efficiency of public or private enterprise depends on given conditions of factor endowments and stages of development and at one stage a particular enterprise model will have a comparative advantage over others in any given economic activity. The components of comparative advantage are in terms of economic and social benefits, in terms of supply of goods and services, quality and cost of these goods and services, investment productivity, equilibrium of the system and the distribution of the surplus. The basic goal of all socio-economic development is to maximize this comparative advantage. This can be realized if the most appropriate enterprise model is adopted for various activities. And to be able to adopt the optimal enterprise model, it would be necessary to measure the comparative advantage for a specific period. This is to essence of the theory of comparative advantage.[21]

The logic of the market is to locate economic activities where they are most productive and profitable. The logic of the state is to capture and control the process of economic growth and capital accumulation. Two of the World Development Report of 1991 and 1997 focused on the importance of the market and importance of the state respectively. The "World Development Report", 1991 entitled the "the challenge of development", says that competitive markets are the best way of efficiently organizing production and distribution of goods and services. Domestic and external competition provides the incentive that brings out entrepreneurial qualities of the people. This combined with the use of technology can bring fastest development in the developing countries. The decisions of the state are often influenced by the interest groups and may not be conducive to the good of all. The market on the other hand promotes faster growth as the competition dictates efficient decisions. The development process therefore should be market-led and market-friendly. The state on the other hand should keep its activities at the minimum level. It should intervene only when the market is failing and should directly take up only such activities which the private sector will not take up or which it can perform better than the private sector. By and large, the state should provide only public goods like security, law and order, construction and repair of physical infrastructure, protection of environmental etc. The report say that – unnecessary intervention by the state in various countries has led to inflated bureaucracy, widespread corruption, poor quality services etc. Thus, the central actor in the development process should be the market and not the state. The state should roll back and make way for market to the extent possible.[22]

The "World Development Report" 1997 which concentrated on the state's role in a changing world, argues that many developing countries are not performing their core functions properly. They are failing to protect property, to ensure law and order, and to protect the vulnerable all of which causes unrest and leads to a lack of government credibility. The World Bank outlines a two-pronged strategy for governments to increase both their credibility and the effectiveness of the state: first, governments must match the role of the state to its capabilities and not try to do too much and second, they must try to improve capabilities by reinvigorating state institutions.[23]

With regard to the first aspect of the strategy, the state should concentrate on getting the basics right, such as safeguarding property rights and guaranteeing the rule of law rather than trying to do 'too much'. Governments should decide more carefully what to do and how to do it. The basics should be:- law and order, maintaining macroeconomic stability, investing in basic social services and infrastructure, protecting the vulnerable and protecting the environmental. But the states does not have to be the sole provider of all infrastructure and social services. It can contract out and introduce competition into what they provide, coupled with a regulatory framework to protect the consumers and workers. Privatization has gathered pace throughout the world in recent years. Disinvestment of state companies have increased in developing countries.

Functions of the State

	Addressing market failure		Improving equity	
Minimal Functions	Providing pure public goods:- Defence Law and Order Property Rights Macro Economic Management Public Health		Protecting the poor:- Anti Poverty Programmes Disaster Relief	
Intermediate Functions	Addressing externalities Basic Education Environmental Protection	Regulatory monopoly Utility Regulation Anti Trust Policy	Overcoming imperfect information Insurance (Health, Life, Pensions) Finance Regulation Consumer Protection	Providing social insurance Redistributive Pensions Family Allowances Unemployment insurance
Activist Functions	Coordinating Private Activity		Redistribution	
Function	Fostering Markets Cluster Initiatives		Assets Redistribution	

Source: World Bank 1997

As regards the second aspect of the strategy i.e. of improving the capabilities of the state and reinvestigating state institutions – the task is to provide incentives for public officials to perform better and reduce the scope for arbitrary action that could lead to bad decision-making and corruption. The report outlines three essentials ingredients of such a policy:-

i) Effective rules and restraints to check public authority and prevent corruption. And independent judiciary is a must.

ii) Appointment of public officials on the basic of merit.

iii) Decision-making needs to be brought closer to be people so that they have more confidence in the state.

The debate regarding the state vs market has been given a new dimension by Amit Bhaduri and Deepak Nayyar who set out forward two basic propositions -- "First, the state and the market are, by and large, not substitutes, instead, they must complement one another in many spheres. Second, the relationship between the state and the market cannot be specified once and for all in any dogmatic manner; instead, the two institutions must adapt to one another in a co-operative manner over time".[24]

Tracing the economic history of capitalism, one finds that the market became the organizing principle of capitalism only when it was embedded in the regulatory mechanism of the nation-state. The very extension of the scope of free market necessitated the imposition of new regulation by the state to ensure future growth of the market. Hence, Nayyar and Bhaduri argue that any characterization of the state and the market in opposition to one another is a misreading of history. They further say that both market failure and government failure are facts of life and neither are perfect. But the important thing is to introduce correcting devices against both of them. The proper functioning of a market needs the support and guidance of other institutions, especially that of the state. Similarly, the state also cannot do without the market. In many developing countries, withdrawal of the state from economic activity has meant an escape from bureaucratic controls.

However, the various dimensions of market failure cannot be ignored which are:[25]

- in the absence of adequate composition, monopolies emergence and prices are fixed are fixed by them, thus creating an imperfect market.
- And economic activity may impose cost on society which are not reflected in the costs incurred by individual producers undertaking these activities.
- The production of public goods may not be taken up by the private markets due to non-profitability but these are desirable for the society.
- Further, goods and services which are socially desirable but not individually desirable like museums etc. and are not paid for such services may not be produced or provided by the market. Such goods are called merit goods.
- Markets also tend to underproduce information, manipulate access to information and even create misinformation in pursuit of profit.

On the other hand, perceptions about government failures are based on experience and observation. The interface of the citizen with the state leaves the former disillusioned as he/she is harassed or not properly entertained. Also, the apparatus of the government is often used to promote the interests of the ruling elite. People opted for free market ideology as it gave them freedom from bureaucratic controls and enhanced efficiency. But again, a re-emphasis on the fact is essential that state and market complement one another. It is not the degree but the nature of state intervention which is important. The role of intervention by the state in the market can be classified as functional, institutional and strategic.[26]

Functional intervention by the state seeks to correct for market failures in so far as prices give the wrong signals.

Institutional intervention by the state seeks to govern the market by setting the rules of the game for different players in the market. It creates frameworks for regulating the market and also institutions to monitor the functioning of markets.

Strategic intervention by the state seeks to guide the market i.e. to attain broader long-term objectives of development.

Hence, the above discussion highlights the present scenario where policies of liberalization and privatization should be pursued under the guidance of the state.

Meaning and Objectives of Privatization

The term privatization is difficult to define. It may simply mean the rolling back of the state. According to the Webster's New Collegiate Dictionary (1983), the term privatization implies, "withdrawal of the state from the production of goods and services or transfer of ownership from the public sector to the private sector". It may also be defined as a shift from publicly to privately produced goods and services.[27]

Privatization can be seen as part of a more general rehabilitation of market forces as an intellectual disillusionment with the Keynesian approach to economic management and the failure of socialism as serious intellectual force.[28] The 1970's and 1980's witnessed a marked slow down of economic growth combined with stagflation (i.e. inflation combined with recession and unemployment). Owing to the deterioration of economic activity in 1970s and 1980s, orthodox Keynesian theories were thrown into disarray thus providing an opportunity to the revival of free market philosophy. The rise of Reaganomics and Thatcherism succeeded in advocating the virtues of private enterprise, private initiative and private motive.[29]

Privatization may take different form in different countries. In advanced economies it involves an attempt to reinvigorate a badly run sate enterprise through disinvestment. In developing countries, it may involve liquidation or economic policy reforms such as deregulation and liberalization. The economic environment in these two sets of countries is altogether different and the modalities of privatization also vary.

The two related processes i.e. privatization and liberalization need to be distinguished here. According to Paul Starr, liberalization refers to the opening up of any industry to competitive measures. The opening up of public monopolies to private firm is a form of privatization, that is also liberalization. However, it is entirely possible to privatize without liberalizing as Margaret Thatcher's government had demonstrated by selling shares of two monopolies (British Telecom and British Gas) without significantly subjecting either industry to competitive forces. Conversely, it is also possible to liberalize without privatizing i.e. to introduce competition into the public sector without transferring ownership.[30]

As regards objectives of privatization, economists have generally held the view that private ownership of the means of production would be better in terms of economic efficiency than public ownership and public management. Governments are resorting to privatization for multiple reasons:- improving efficiency and competition, reducing public deficits, generating additional cash, eliminating political interference and widening be ownership of economic assets through disinvestment of equity in select public enterprises.[31] The myth prevails that what the public sector can do, the private sector can do better. At the heart of the privatization movement is the assumption that the public sector is always wasteful, inefficient and unproductive.

Specific reasons for privatization vary, though with each nation depending on the nature of the political set up and ideology, level of development, growth of capital market and special features such as privatization may be dictated by fiscal, social or a combination of several factors, depending on local priorities. Following are the objectives of countries which have so far taken up privatization programme are:[32] –

- To promote economic efficiency by fostering well-functioning markets and competition.
- To redefine the role of the state in order to allow it to concentrate on the essential task of governing and to withdraw from activities best suited for private enterprise.
- To reduce the fiscal burden of loss-making public enterprises in order to help regain fiscal control and macro-economic stability.
- To reduce public debt.
- To release limited state resources for financing of other demands.
- To generate new investment, including foreign investment.
- To mobilise domestic resources for development and deepen domestic financial development.
- To spread and democratise share ownership by encouraging it among individuals, making employees share-owners and by raising productivity through incentives for holding stock.

Hence, we have traced the economic history wherein ideas of laissez-faire and private enterprise gained momentum and have finally appeared again in the economic policies of almost all countries in the form of privatization, liberalization and disinvestment. The collapse of Soviet Union and Eastern European economies have suggested that capitalism has triumphed in the course of history with options of privatization and liberalization subject to state guidance and regulatory control.

In a country like India which has a mixed economy, the public sector was always given more importance in the process of economic and social development. In recent times, private sector is having an upper edge due to introduction of privatization and disinvestment policies since 1991. However, a shift from public sector to private sector demands an inquiry into the working of the public sector enterprises, their successes and failures which will be dealt in the next chapter.

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Chapter II

Public Interprises In India: Its Performance Ailments And Efforts At Reform

The intervention of the state in the economic sphere of a community is an accepted idea by the modern governments. It is no longer a political taboo. Instead it is regarded as an essential and an inescapable part of the obligations of modern governments to redress economic imbalances, to safeguard the interests of the community as a whole, to plan for overall progress and prosperity and to undertake and execute schemes and projects vital to the needs of the nation.[1] The above reasons sums the unique role of public sector especially in a developing country like India. There was a wide consensus around the time of independence about the necessity for the state to play a leading role in the development process. It suited the Indian businessmen who saw public investments in infrastructure and basic industries as being necessary to facilitate growth of private sector. It also suited the socialists who laid stress on the importance of public ownership and state control over the private sector to correct the existing in equities.

Role of PSEs after Independence

The pubic sector in India, as an instrument of state policy was conceived by the founding fathers of the National Planning to achieve the breakthrough in Indian economy from its past stagnation and under-developed state caused by the prolonged domination of the country by the world's foremost Imperial power. J.L. Nehru can be said to be the first visionary and determined believer in public sector for achieving the goal of rapid industrialization and also achieving the goal of a robust and healthy socialist economy committed to improving the quality of life of the people. Nehru emphasized that state initiative and leadership was essential in the industrial fields especially in an under-developed country like India. Therefore, right from the commencement of the second five year plan, the investment in public section was stepped up. Nehru felt that public investment should, to start with, be in the areas of basic and strategic industries since they are essential for creating the necessary base for the accelerated economic development. The two industrial policies have defined the scope and growth of pubic sector while the third one of 1991 has in a way limited the scope and growth of public sector. Hence, after the two industrial policies of 1948 and 1956, the total investments in central public sector rose tremendously. When Mrs. Indira Gandhi came to power, she forged a decisive breakthrough course for the public sector and drew broad contours of the public sector activity with a view to gaining control of the commanding heights of the economy and serving as a promoter of social gains alongside working for earning profits and commercial surpluses with which further economic development was to be financed. Thus, the guiding principles that came to be laid down for the pubic sector were the attainment of self-reliance in resources and technology, better distribution of income and reduction in inequalities, expansion of employment opportunities, removal of region imbalances, lessing of concentration of economic power in fewer hands, building up of cadres of professional manager, acceleration of rate of growth of agriculture and industrial production, import substitution etc.[2] But the managerial, organisational and economic conditions during the first two decades of the inception of the Indian public sector posed grave situations. Inspite of various criticisms of public sector a firm base in the fields of heavy, basic and strategic industries was established by the end of third five year plan and the penetration of the public sector into the vital sectors of economic activity in the country was complete by the end of fourth five year plan. The seventh five year plan saw the public sector as a "pace-setter" in high technology industries and an institution to generate sizeable resources for new investments.

Policy Framework for the Growth and Development of PSEs

The first industrial policy of 1948 emphasized on the concept of mixed ecocomy in India. It divided Indian industries in four categories:-

i) industries where state had a monopoly :- arms and ammunitions railways etc. were to be exclusively in the public sector.

ii) mixed sector:- heavy industries like iron and steel etc. were to be in public sector. Such industries which existed in private sector continued and the issue of their nationalization was debated.

iii) field of government control:- industries in the private sector like the machine tools, paper, antibiotics. Units of such industries can also be in public sector and the government would also regulate the private sector.

iv) field of private enterprises:- these industries would be totally in private sector[3].

Thus, the objective of this policy was that the public and private sector go hand in hand. It also emphasized on small scale industries.

The second industrial policy 1956 came about when the ruling party had declared "socialist pattern of society" as the goal of the country. It classified industries in three schedules:-

(1) Schedule A (monopoly of State) – 17 industries were exclusively reversed for the public sector. At present the number is 4 and these are arms and ammunition, atomic energy, minerals specified in Deference of India Act, control and management of railways.

(2) Schedule B (mixed sector) – both pubic and private sector go hand in hand. There are 12 such industries in this category.

(3) Schedule C (private sector) – all the rest industries fell in this category and it is open to the private sector.

Thus, the objectives of this policy was that it promoted both public as well as private sector, prevention of concentration of economic power and interest of labour to be protected and finally to accelerate the rate of growth and speed up industrialization.

The New Industrial Policy of 1991 brought about significant changes and it diluted the role of public sector. Large number of industries were delicensed except for a limited number of industries related to security an strategic concerns, social reasons, hazardous chemicals, environmental reasons and luxury consumption goods.[4] Further, in 34 specified industries, the government permitted automatic approval upto 51% foreign equity. There was also automatic approval for foreign technology agreement upto one crore. The areas reserved for the public sector was brought down from 17 to 8 and now it is just 4 as mentioned above. The policy also ushered in the process of disinvestment. It also took into consideration the sick public sector units which now is referred to the Board of Industrial and Financial Reconstruction (BIFR). Further, public sector boards would be given greater autonomy by the concept of Memorandum of Understanding (MOU). Arjun Sen Gupta Committee first suggested the concept of MoU as a means to give autonomy with accountability to public sector enterprises. Hence, this policy aimed at reforming the ill-public sector units by means of MOU, referring to BIFR of sick units and disinvestment. It brought into focus the aspect of efficiency in public sector.

Role of PSEs

We come to know from all these policy statements that the public sector has an important role to play in our economy. Mrs. Indira Gandhi in 1966 on the role of public sector said: "we advocate a public sector for three reasons: to gain control of the commending heights of the economy; to promote critical development in terms of social gain or strategic value rather than primarily on considerations of profit; and to provide commercial surpluses with which to finance further economic development".

The role of pubic sector has been immense in capital formation, development in infrastructure, in providing strong industrial base, economies of scale, import substitution and export promotion, removal of regional disparities and check over concentration of economic power. The first three roles of public section need further elaboration.

The role of public sector in collecting savings and investing them during the planning era has been very important. During the first and second plans, of the total investment, 54% was in the public sector. The share of public sector rose to 60% in the third plan. It started decreasing from fourth plan onwards. It was 59% in the fourth plan, 57.6% in fifth plan, 53% in the sixth plan, 47.8% in seventh plan and 45.2% in the eighty plan. This reflects the increasing importance that is now being accorded to the private sector.

Further, without an adequate development of transportation and communication facilities i.e. infrastructure the process of industrialization can not be sustained. Only the pubic sector could enforce a large-scale mobilization of capital, the co-ordination of industrial construction and training of technicians. Thus, the public sector by improving road, rail, air, sea transport system enabled the economy to develop a strong infrastructure for the future economic growth.

Lastly, the industrial base of the Indian economy is much stronger than what it was in 50's. The government has strengthened the industrial base considerably by placing due emphasis on setting up of industries in fields of iron and steel, heavy engineering, coal, petroleum etc. Unless these are set up, the consumer goods industries also cannot progress at a rapid pace.[5] Hence, the absence of private entrepreneurs in developing heavy industries with long gestation periods paved the way for the public sector to step in.

Objectives of PSEs

Taking into consideration the immense role of public sector, it is very obvious that its objectives would be in favour of the economic and social benefit of the country. Pranab Mukerjee spells out its objectives as:

"to provide essential infrastructure; to gain control of commanding heights; to set up capital intensive industries where the resources have to be deployed in a big way; to act as market stabilisers, to help rapid economic growth and industrialization; to earn returns on investment and thus generate resources for development; to create employment opportunities; to promote balanced regional development; to assist the development of small scale and ancilliary industries; and to promote import substitution and save and earn foreign exchange for the economy.[6] Similar are the objectives for setting up of public enterprises mentioned in the Public Enterprise Survey 1999-2000.[7]

Classification of Public Enterprises

In a broad sense, the public sector means industrial, commercial, business, service and promotional activities carried out either by the Central or State Governments. In this sense, the size of the public sector is very large.[8] Today the public sector may be organizationally classified as departmental and non-departmental undertakings. Departmental enterprises form part of the government financial systems but have the separate accounts of income and expenditure. Their surplus or deficit is merged in the accounts of the departments of the government e.g. the telecommunication. Non-departmental enterprises refer to activities that are carried out by entities, which are legally separated from the government and are made to maintain a separate account of all their financial transaction and set them out in the form of profit and loss account. These enterprises are set up under the companies act or under special statutory provision. A further distinction could be with regard to their management and form: statutory corporations; joint stock companies; banks and insurance companies and departmentally run undertaking. The focus here is on central government public enterprises falling under the categories of statutory corporations and joint stock companies.

Performance of PSEs

There were only 5 central public sector enterprises at the commencement of the first plan with the investment amounting to only Rs. 29 crores. According to the latest information available, there are 240 public enterprise with total investment amounting to Rs. 2,25,554 crores as on 31.3.2000[9] (Shown in the figure in the end).

The profitability profile of central public enterprises show that the rate of growth of net profit has increased very slowly. The net profit of these enterprises was Rs. 2,356 crore in 1991-92. It increased to Rs. 9,574 crore in 1995-96 and to Rs. 14,555 crore in 1999-00. In the years 1997-2000, the rate of growth of net profit also saw a decline. In the year 1997-98, net profit of these enterprises was Rs. 13,582 crores. It decreased to Rs. 13,203 crores in 1998-99. However, it again recovered in 1999-00 and reached to Rs. 14555 crores.

Further, Net Profit Before Tax (PBT) has increased to Rs. 22,261 crores in 1999-00 from Rs. 19,702 crores in 1998-99 registering an increase of 12.99%. profit before interest, depreciation and tax (PBDIT) has increased to Rs. 62,352 crores in 1999-00 from Rs. 56,495 crores in 1998-99, thereby registering a growth of 10.4%. Moreover, there are 125 profit making PSEs in 1999-00 with profits amounting to Rs. 24,615 crores. Also, there are 106 loss-making PSEs, losses amounting to Rs. 10,060 crores. As on 31.3.2000, 67 industrial PSUs whose network had become negative and had become sick were registered with BIFR. Of these, 35 units were taken from private sector by the government to safeguard the interests of the workers.

Public sector enterprises have also helped the economy in earning substantial amount of foreign exchange and also in saving the foreign exchange and expenditure via their efforts at import substitution. Capital goods, industrial machinery and other such equipment which were earlier imported are now being manufactured by India itself. This has saved valuable foreign exchange. Foreign exchange earnings by the public sector have been through direct export of items produced in the public sector, through services rendered by public enterprises and through its trading and marketing services. The public sector export earnings increased from Rs. 2,143 crores in 1980-81 to Rs. 6,366 crores in 1989-90, Rs. 9,208 crores in 1991-92, Rs. 20,483 crores in 1997-98, Rs. 18,828 crores in 1998-99 and Rs. 19,714 crores in 1999-2000. Other data revealing the plight of public sector enterprises are:

Return on investment: Public sector enterprises as a whole have earned a return on investment of 14%.

Turnover: Turnover or operating income has increased by 25.5%. In absolute terms, the turnover has increased by Rs. 79,131 crores i.e. from Rs. 3,10,179 crores in 1998-99 to Rs. 3,89,310 crores in 1999-2000.

Contribution to Central Exchequer: By way of excise duty, customs duty, corporate tax interest on central government loans, dividend and other duties and taxes has gone up by Rs. 9,500 crores i.e. from Rs. 46,934 crores to Rs. 56,434 crores, an increase of 20% in 1999-00.

Increase in investment: There is an increase in investment in central public sector enterprises by Rs. 13,387 crores i.e. Rs. 2,39,167 crores in 1998-99 to Rs. 2,52,554 crores in 1999-00, an increase of 5.6%.

Generation of gross internal resources by operating enterprises: It has increased to Rs. 35,891 crores in 1999-2000 as compared to Rs. 31,302 crores in 1998-99.

Capacity utilization in public enterprises: There are 133 enterprises which utilize more than 75% of its capacity, 30 enterprises utilize between 50% and 75% and 65 enterprises utilize less than 50%.[10]

The enthusiasm for the public sector is waning because the public sector has not performed well in terms of profitability. It has not yielded the economy benefits expected from it. It has consistently used up more finance than has been provided for in the plans and the contribution it has made directly or through taxes etc. to the exchequer has fallen far short of what was expected from it under the plans. This has attributed substantially to the dismal state of central finance. As a consequence, it has become almost impossible to sustain growth with price stability.

The contribution of the public sector to the economy has been utterly disappointing. Savings have been showing a downward trend while expenditure has been increasing at a disproportionate rate of the general trend. The public sector is absorbing far too large a share of the available domestic savings. It also absorbs a lion's share of the available foreign capital. The inadequacies and failure of public sector have also adversely affected the growth, efficiency and productivity of the private sector.

Although the public sector is eating away huge investments, the rate of return and dividends have been quite low when compared to what is expected of them. Further, various public enterprises are loss-making enterprises. Still others are sick units either recovering or going towards their clinical death after being referred to BIFR.[11]

Most importantly, the objectives of our economic planning has been the achievement of self-reliance. This objective was to be attained through production at home of basic capital goods and essential goods. Further, exports have to be promoted and reduction in dependence on foreign capital and technology was desirable. The public sector which was hailed as the commanding heights of our economy failed to achieve the basic objective.

The protection of the interests of the consumers is specifically mentioned as a responsibility of the public sector in the industrial policy resolution of 1977. But high costs and rising prices of public sector units are imposing a burden on the consumers. The consumers are also facing hardships due to supply of low-quality products, ineffective public delivery system and also the considerable environmental pollution caused by public sector units.

The debate over the efficiency of the public sector boils down to the type of evaluation of the public enterprises' performance. We have seen earlier that the public enterprises are not performing well in terms of profitability. The question that arises here is, is profit, a private enterprise concept, the only criteria by which these should be judged or should there be other socially relevant criteria evolved for this judgement.[12] For examining the other socially relevant criteria, we must look at the social objectives and its accomplishment. The social objectives of the public sector enterprises can be balanced regional development, employment generation, check on concentration of economic power etc.

The public sector has a large and positive role to play in economic development particularly in the preparatory stages of the industrial take-off as in the case of India where the public sector enterprises spearheaded India's economic development just after independence. The diversified activities of the private enterprises require a supporting infrastructure which only the public enterprises could provide. Secondly, there are regional and social disparities in development which the private sector can never aim to prevent. Therefore, it has been the duty of the public sector to look after the backward regions and also try to modernize them. The public sector also has the responsibility towards weaker sections of the population. In a country like India, where sizeable section of the population lives below poverty live and wherein inequality of income and opportunities between the rich and the poor is widening, the role of the public sector in catering to the needs of the poor and the needy becomes important. The public sector helps in providing necessities to these poor and the needy at subsidized rates. The reservation policy for the weaker sections of the society cannot work in private sectors where there is no such policy as in the public sector. It is a way of protecting and giving opportunities to the weaker sections which the private sector never aims for.

Further, a country like India cannot simply aim at efficiency at the cost of employment of labour and many others. The burden of retrenchment of work will be unbearable for the workers where a guaranteed job in the public sector is the key to a successful life. The government has tremendous control over the quality of life of its citizens by being the model employer. The government in this respect should not lose its status as the largest employer considering the stark reality of unemployment in our country. It is also admitted that there is always a conflict between economic efficiency and social justice. Even if it is assumed that private sector operates efficiently while the public sector does not, there is no likelihood that the former will ensure social justice or economic equity.

Efficiency for public enterprise means:-

(i) production and supply of goods and services ought to take place under conditions of the lowest possible costs.

(ii) besides achieving the lowest cost in satisfying a given demand, it is also able to stimulate demand and regulate its pattern to lower the cost per unit.

(iii) The simplest measure of efficiency of an enterprise is the rate of profit it earns, which can be used for self-financing.

(iv) consumer satisfaction is also a measure of efficiency[13].

Keeping in view the immense task performed by the public sector, one cannot judge the performance of the public enterprises in terms of its profitability only. The objectives of public sector enterprises of development of infrastructure, balanced regional development, employment regeneration etc. are to be accomplished. Although performance of these enterprises has not been upto the mark in delivering services, its performance cannot by undermined by looking at its low profits. The need of the hour is to identify the ailments of the public sector enterprise and find solutions to them so that they become more efficient in fulfilling the objectives for which they exist and also try to sustain themselves by self-financing for the reason that public enterprise in India constitute a major national capability in terms of their scale of operations, coverage of the national economy, technological capabilities and stock of human capital.

Ailments of PSEs

The ailments of public sector can be attributed to number of reasons. Ramesh Thakur has described these ailments as:

"India's public sector suffered from management that was parochial and bureaucratic, a unionized workforce that was militant and obstructionist, and a hostile political culture that was anti-growth, anti-technology and anti-investment".

What ails the public sector? Or what are the problems faced by the public sector enterprises? These problems are:

Price policy of public enterprises is said to be one of the problems which has contributed to low profit rates or rather losses. The purposes of setting up and operating public sector enterprises are varied and price policy is determined by the objectives which they are expected to serve. Here lies the difference between the public and private enterprises. Private enterprises operate with the sole aim of maximizing profit whereas the public enterprise operate with the aim of social benefit and not profit maximization. Therefore, they sometimes suffer losses and sometimes try to equate total revenues to total costs by under-pricing. K.S. Krishnaswamy has pointed out that persistent loss or under achievement had serious effects on the morale of both the management and labour in public enterprises. Moreover, a large amount of investment has gone into public sector enterprises and therefore it is essential that they yield sizeable returns, otherwise the process of economic development will suffer a severe jolt.

There has been a change in the pricing policy since New Economic Policy 1991 which relies on command and control type mechanisms and more on market based instruments of regulation. Price controls on a number of consumer goods have been lifted. The administered pricing policy will continue only in public utilities, transport services etc.

Under-utilization of installed capacity is another reason for the low level of profitability in public sector enterprises. A large number of these enterprises have operated at less than 50% of their capacity for a number of years. One reason for under-utilization of capacity can be of lack of foresightedness on part of the government. Vijay Kelkar pointed out that public enterprises became instrument for meeting immediate or ad hoc demands and therefore were under-utilized. Also, a large number of sick units have been taken over by the government which has added the burden. Other factors for under-utilization include stagnation in the industrial sector during the period 1965-1980, inefficient operation and poor management of some enterprises, political interference in day-to-day working, labour disputes etc.

Another problems which is serious enough is the problems related to planning and construction of projects. Problems crop up as there were serious omissions and understatement of several aspects of the project. Problems also come up when actual costs of projects far exceeded the original estimates, projects took a very long time to complete than originally envisaged and problems relating to projects with inappropriate technology.

The public sector enterprises are also often faced with problems of labour, personnel and management. There is undue political interference in the day-to-day functioning of these enterprises which cause delays in decision-making and also has a demoralizing effect on the personnel. Appointments generally at the top are not made on grounds of professional competence or suitability to the job but are determined by various political considerations. Very often the management at the top constitutes the officers from IAS who are not specialized enough to head capital intensive industrial projects. Further, the work ethic of a public enterprise is like that of a government office which is characterized by over occupation with file work, rules-oriented practices which causes delays and increase costs. Political considerations have also led to overstaffing of unskilled labour and payment of higher wages to such labour. However, there are not many incentives for the skilled labour in the form of better wages and better promotion prospects.

Problem relating to the management often revolves around two terms: control and autonomy. Control basically implies accountability to the parliament for their work or actions. Accountability of this kind is justified as public enterprises are run with the help of the tax-payer's money and therefore accountability or answerability to the public is justified. The will of the people is expressed through Parliament and hence the Parliament constituted a separate committee known as Committee on Public Enterprises in 1964. Also, Bureau of Public Enterprises, Public Accounts Committee, the Estimates Committee, etc. all exercise control and evaluate the performance of public sector enterprises from time to time.

Autonomy, on the other hand, refers to the freedom granted to the management of a public enterprises to run it without any interference from outside. Autonomy is essential especially in day-to-day functioning of the enterprise as such interference can also cause losses in various ways. In order to make public enterprises autonomous in their day-to-day working, the concept of MoU has become popular. Memorandum of understanding is an agreement between the two parties in which one gives autonomy and expects results while the latter becomes autonomous and promises result. It is basically a contract between the government and the public enterprise.

The non-profitability and inefficiency of public sector enterprise poses another problem in contributing to India's huge public sector deficit. The public enterprises deficits have added to the country's current large stock of domestic and external public debt which in turn results in massive annual liabilities on account of interest payments – the interest payments of the Government of India alone, which has financed much of the investments in the country's public enterprises, as also the losses that many of them have incurred, through borrowings on its account.[14]

Yet another reason for the inefficiency of public enterprises is indirectly related to the expansion of the horizon of Article 12 of our constitution to treat even industrial manufacturing and commercial public enterprises as "state" and thereby subject them to various obligations that go with it. Article 12 in our constitution defines the "state" as one which "includes the Government and Parliament of India and the Government and the legislature of each of the states and all local or other authorities within the territory of India or under the control of the Government of India". Judicial decisions have given a wide scope to the expression "other authorities" in Article 12. It embraces every public authority exercising statutory powers, every authority created under statute and even a non-statutory authority exercising public functions. A judgement of the Andhra Pradesh High Court says that the essential tests to determine whether a particular institution is "other authority" within the meaning of Article 12 are substantial financial aid, control by the government, performance of public functions and entrustment of governmental activities.[15] Hence, this definition of the state here brings into its ambit public enterprises of every kind along with their obligations, rules, procedures, control, political interference etc. which create problems for public enterprises to function efficiently.

Apart from the above mentioned problems, there can be problems of other kinds like bad planning, wrong and inflated inventories, delay in decision-making, wrong decisions, low rate of production, lack of motivation, absence of efficient marketing policy, no facilities for systematic market research and proper sales forecasting, absence of trained man-power, very high capital outlay on township and welfare activities, recession hitting the industry, large overhead expenditure, over employment, over-capitalisation (surplus-machine capacity), long gestation period and capital intensive character responsible for poor returns.

Issue of Accountability

An important issue to be raised here is the issue of accountability. According to Allen Hubert, accountability has been described as "that those entrusted with the stewardship of local resources should be able and ready to account for their use to those by whom the resources have been entrusted. It also implies that a public sector enterprise is in principle accountable to the public for spending the public money as it is agreed and spending it judiciously and according to the procedures to achieve the desired results. The accountability therefore is towards the taxpayers who create the resource base of any country and who should legitimately know how their money is being utilized and whether they are receiving the 'value for their money'. Lack of accountability may hinder efficient public delivery systems in many ways. The cost and time overruns increasing the profit costs manifold, the delay in services, misutilization of funds, loss of revenue, failure in achieving the objectives, lack of customer-orientation are few symptoms of this problem.

A recent review conducted by the Department of Programme Implementation of the Government of India showed that 118 out of 187 Central Sector Projects, each costing more than Rs. 100 crores were running behind schedule and the time overrun varied from one month to two hundred months. A study of few major projects as in the Planning Commission Report, indicated that the cost overrun for reasons other than charge in duty or exchange rate regimes, ranged from 40% to 75% of the original estimates. The factors responsible for the time and cost overruns were mainly poor project formulation due to inadequate field investigation and data, inadequate analysis of environmental and rehabilitation implications, delays in clearances from various regulating agencies, poor inter-departmental coordination, indecisiveness, delay in releasing funds etc. This wastage of huge amount of funds could be prevented if there had been a sense of accountability among the officials in charge of executing the projects.

In the World Development Report 1997, it is noted that the Indian people who have very low trust in public institutions, particularly the police (28%) and the bureaucracy (37%), have demonstrated strong popular participation and involvement in politics.

Lack of accountability arises due to many factors like:-

(i) individual performer may not identify himself with the organizational structure or its goals.

(ii) the complicated rules which breeds red-tape and non-transparency also creates space for non-accountability.

(iii) security of job and assured time-bound promotions along with lack of objective performance appraisal and the absence of an effective system of rewards and punishments also account for non-accountability.

(iv) the bureaucrats protected by rules, precedence and legal pronouncements make them complacent.

(v) Lastly, the tolerance of the public emboldens the bureaucrats to perpetuate their non-accountable and non-performing approach. Hence, we see that in order to make the bureaucrats and the public sector accountable, the first and foremost initiative has to come from the people themselves who should articulate their grievances through effective channels such as voter-groups, media, NGOs or the wider civil society. Another important effort in this way would be the passing of 'Freedom of Information Act' which intends to ensure transparency in the transaction of the government. This is one way of reforming the public sector enterprises i.e. by inducing a reuse of accountability.

Other Efforts at Reform

Another attempt at reforming public sector enterprises has been through the imperatives of efficiency under the New Economic Policy. The two imperatives at work are:-

(i) the burden on the budget had risen which required reduction of expenditure on account of public sector enterprises and simultaneous improvement of their performance.

(ii) The consequences of industrial deregulation and trade liberalization will be to expose public sector to intense competition and therefore, poor performance on the part of public enterprises would not only be unacceptable but will halt the reform process if allowed to go on. The obvious conclusion was that performance, in a competitive environment of global dimensions was the key to their existence and in the light of a logical and humane policy of exit for them through the BIFR route, their existence under all circumstances could not be taken for granted.

Further, the elements of New Economic Policy were restructuring of policy environment, portfolio of investments, equity or ownership pattern, board of PSEs, quality of interface between the government and the boards, sickness in PSEs, and safety not for workers[16].

For combating a serious problem like industrial sickness, reform in the form of a rehabilitation strategy of BIFR for revivaling such units are underway. The strategy includes:

(i) financial relief in the form of rescheduling of the loan, moratorium or both, principle and interest and conversion of loan into equity.

(ii) financial reconstruction with or without change in management.

(iii) merger of the company with any other health company of the same group.

(iv) sale or lease of the units of any other party which could bring in the required interest free funds to revive the company etc.

But the BIFR in their more than thirteen years of their functioning has used its winding up provisions very rarely and has only engaged in revival of sick units. BIFR over the years has become the refuge for the sick units. Increasingly it is felt that BIFR should be closed down as sickness continues to grow. Revival is along drawn-out process and these units which are chronically sick are not allowed to die their natural death. In 1992, the government proposed a policy called the Exit Policy which ensured an easier way out for a sick unit but the biggest barrier to this policy has been the trade unions.

Effort at reform also emerged with the idea of MoU which is a regulating relationship between the government and the public enterprise. MoU clarifies the objectives of the enterprise, identify responsibilities on either side and provide a basis for evaluation of performance. The concept of MoU was recommended by Arjun Sen Gupta Committee in 1984. MoU makes an attempt to move the management of PSEs from management by controls and procedures to management by results and objective[17].

In this context then, the concept of 'Total Quality Management' (TQM) is becoming popular which basically means that quality of a product has some features and attributes; absence of deficiencies, performance superiority; customer's satisfaction and to have a vision of organization.

The factors which influences TQM are[18]:

(i) learn to meet the customer's need

(ii) making organization autonomous as the government has decided to minimize its control over nine PSUs called 'Navratnas'.

(iii) Differentiating between quality and quantity.

(iv) Redefining the managerial process.

(v) Identifying bottlenecks and taking remedial measures.

(vi) Learning from experience of other countries.

(vii) Commitment at all levels.

(viii) Bringing change in perceptions, attitudes and overtime.

Hence, the public sector has to initiate such steps like TQM to improve its functioning and image to survive in the environment of globalization.

Apart from the above mentioned reforms, efforts must be made in dismantling some structures of protection and privileges. Downsizing or solving the problem of overstaffing must be carried on through Voluntary Retirement Schemes (VRS). Further, reforms are also needed in the civil service as without carrying out reforms here, reforms in public sector would not be successful. Lastly, the reform now carried on in the form of privatization and disinvestment are the order of the day. These will be discussed in the next chapter.

Obstacles in Reforming PSEs

Although number of reforms have been suggested, there have been numerous obstacles or bottlenecks. First of all, hindrances in reforming or restructuring the public sector have come from the very ideological basis for the public sector which lays emphasis on the socialist pattern of society. Secondly, reforms in public sector depend totally on political will of the leaders or rather political uncertainty. A formidable obstacle to the reform of the public sector is the political clout of the organized work-force employed by it. Workers in the public sector are a privileged class organized in militant trade unions and they resist any change that affects their vested interests. Politicians need trade union support and trade union leadership needs concessions for workers to sustain itself. It is a mutual agreement for political power and economic advantage. Further, repeated efforts to reform the civil service has yielded no results as reforms have ended in failure. The last concerted effort at administrative reform was the establishment of the Administrative Reforms Commission in 1969 and also the Fifth Pay Commission in 1996 but there were no reform implementations relating to changes in the structure etc. except the increase in pay packets for the civil servants. Hence, reforms in public sector enterprises have been unsuccessful due to number of hindrance posed by different interest groups for their own interests. The only reform carried on now is the privatization and disinvestment process which seems the only alternative reform for the public sector.

To conclude this chapter, one finds the present disappointing plight of public sector enterprises which were supposed to be the commanding heights of the economy but became a burden on the economy. However, the commercial failure of many public enterprises cannot overshadow the objective of these enterprises which is social benefit. At the same time one must not forget the practical realities which indicate that these enterprises must self-finance themselves and generate their own internal resources for sustaining themselves. Lastly, the alternatives of privatization and disinvestment are attractive and seem profitable and also help in improving efficiency of public enterprises. But how viable they are, will be analyzed in the next chapter.

Table 1:

Particulars	**Total Investment (Numbers)**	**Enterprises**
At the commencement of the 1st Five Year Plan (1.4.1951)	29	5
At the commencement of the 2nd Five Year Plan (1.4.1956)	81	21
At the commencement of the 3rd Five Year Plan (1.4.1961)	948	47
At the end of 3rd Five Year Plan (31.3.1966)	2410	73
At the commencement of the 4th Five Year P[19]lan (1.4.1969)	3897	84
At the commencement of the 5th Five Year Plan (1.4.1974)	6237	122
At the end of 5th Five Year Plan (31.3.1979)	15534	169
At the commencement of the 6th Five Year Plan (1.4.1980)	18150	179
At the commencement of the 7th Five Year Plan (1.4.1985)	42673	215
At the end of 7th Five Year Plan (31.3.1990)	99329	244
At the commencement of the 8th Five Year Plan (1.4.1992)	135445	246
At the end of 8th Five Year Plan (31.3.1997)	213610	242
As on 31.3.1998	231024	240
As on 31.3.1999	239167	240
As on 31.3.2000	252554	240

Trend Analysis

Trend of analysis of the central public sector enterprises since 1991-92 is give in following table:

Table: Trend Analysis

Rs. in crores)

Particulars	**91-92**	**92-93**	**93-94**	**94-95**	**95-96**	**96-97**	**97-98**	**98-99**	**99-00**
No. of Operating Enterprises	237	239	240	241	239	236	236	235	232
Capital Employed	117991	140110	159836	162451	173948	231178	249855	265093	303411
Profit before Dep., Int. & Tax (PBDIT)	22224	25227	27707	33384	40161	44457	53062	56495	62352
Depreciation	8548	9270	9151	10754	12574	13542	15856	16768	19930
Profit before interest & tax (PBIT)	13676	15957	18556	22630	27587	30915	37206	39727	42422
Interest	9673	10881	11901	12862	13966	15537	17990	20025	20160
Profit before Tax (PBT)	4003	5076	6655	9768	13621	15378	19216	19702	22262
Tax provisions	1647	1805	2110	2581	4047	5192	5634	6499	7707
Net Profit	2356	3271	4545	7187	9574	10186	13682	13203	14555
Profit of profit making PSEs	6079	7384	9768	12070	14763	16125	20279	22508	24615
Loss of loss incurring PSEs	3723	4113	5223	4883	5188	5939	6697	9305	10060
Profit making PSEs	133	131	121	130	132	129	134	126	125
Loss incurring PSEs	102	106	116	109	102	104	100	107	106
PSEs making no profit/loss	2	2	3	2	5	3	3	2	1
Dividend	687	792	1028	1436	2205	2836	3609	4932	5456
Dividend tax						261	464	537	790
Retained profit	1669	3517	3517	5751	7369	7089	9509	7734	8309
Financial Ratio (%)									
PBDIT to Capital Employed	18.8	17.3	17.3	20.6	23.1	19.2	21.2	21.3	20.6
PBIT to Capital Employed	11.6	11.6	11.6	13.9	15.9	13.4	14.9	15.0	14.0
Dividend payout	29.2	22.6	22.6	20.0	23.0	27.8	26.6	37.4	37.5

The list of top 10 profit making enterprises is given below:

Table

Top Ten Profit Making Enterprises

(Rs. in crores)

Sl. No.	Name of the Enterprises	Net Profit
1.	Oil & Natural Gas Corpn. Ltd.	3629.47
2.	National Thermal Power Corpn. Ltd.	3424.53
3.	Indian Oil Corpn.Ltd.	2443.40
4.	Mahanagar Telephone Nigam Ltd.	1087.85
5.	Hindustan Petroleum Corpn. Ltd.	1057.41
6.	Gas Authority of India Ltd.	861.27
7.	Hindustan Steel Works Corpn. Ltd.	851.73
8.	Videsh Sanchar Nigam Ltd.	840.27
9.	Bharat Petroleum Corpn. Ltd.	701.64
10.	Northern Coal Fields Ltd.	628.86
	Total	15526.43

The top ten enterprises have earned net profit of Rs. 15526.43 crores which is 63.1% of total net profit of Rs. 24614.66 crores of the profit making enterprises.

The list of top ten loss incurring enterprises is given below:

Table

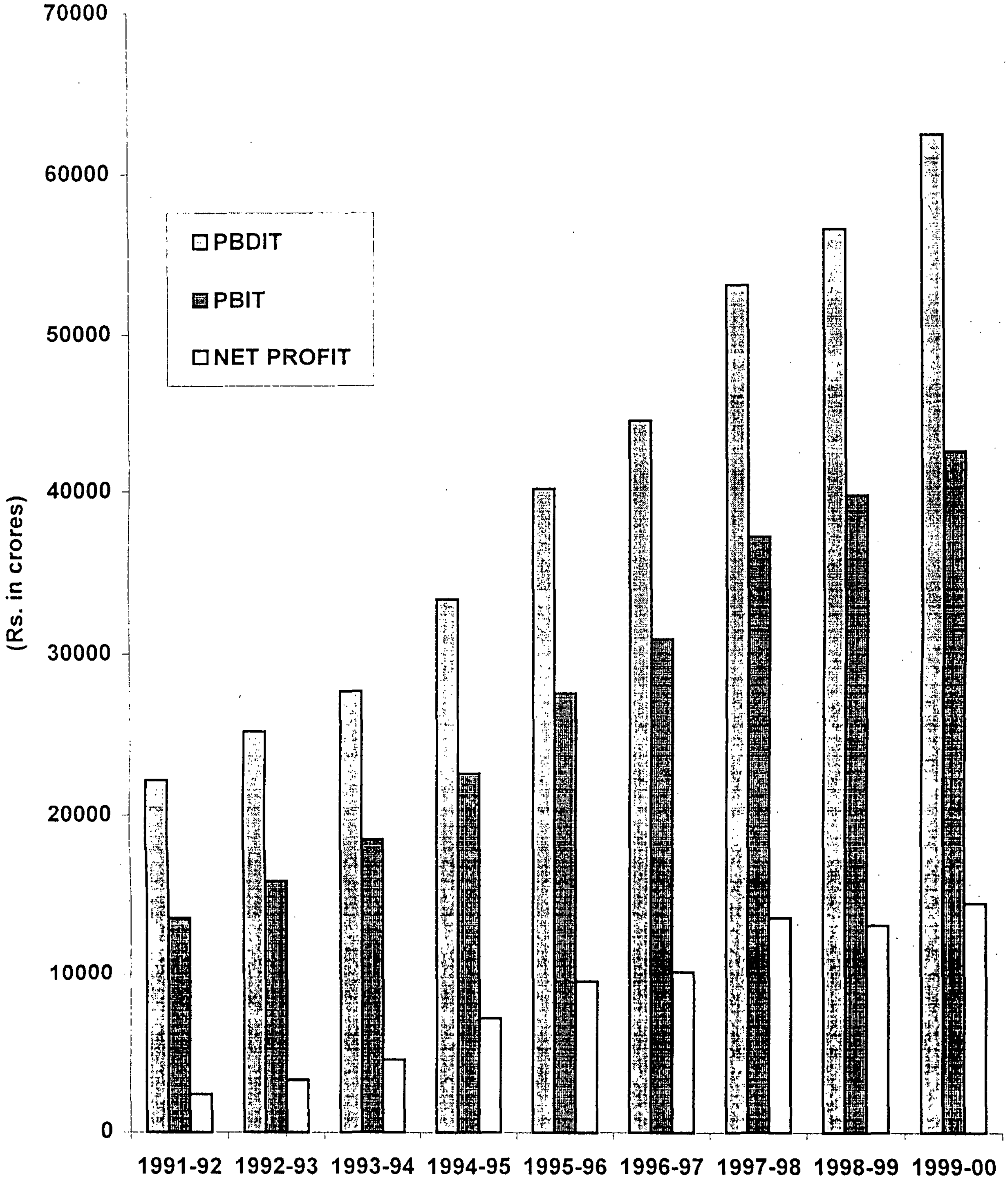
Top Ten Loss Incurring Enterprises

(Rs. in crores)

Sl. No.	Name of the Enterprises	Net Profit
1.	Steel Authority of India Ltd.	1720.02
2.	Fertilizer Corpn. of India Ltd.	854.99
3.	Eastern Coalfield Ltd.	728.23
4.	Bharat Coking Coal Ltd.	692.32
5.	Hindustan Fertilizers Corpn. Ltd.	564.23
6.	Rashtriya Ispat Nigam Ltd.	561.68
7.	Konkan Railway Corpn. Ltd.	384.69
8.	National Jute Manufacturers Corpn. Ltd.	290.51
9.	Hindustan Photo Film Mfg. Co. Ltd.	278.54
10.	Cement Corporation of India Ltd.	216.91
	Total	6292.12

The top ten enterprises have incurred loss of Rs. 6292.12 crores which is 62.54% of the total loss of Rs. 10059.66 crores of the loss incurred enterprises.

Figure - 1
PROFITABILITY IN TERMS OF PBDIT, PBIT AND NET PROFIT



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Chapter III

The Process of Disinvestment

The major plank of the privatization programme initiated in 1991-92 has been the disinvestments of government equity in number of public sector enterprises. According Dr. S.R. Mohnot, "privatization is induction of management control, via transfer of ownership or otherwise, often both, in public-owned or managed enterprises". Disinvestments then becomes the part and parcel of the privatization process. In other words, it can be said that disinvestments or public enterprises constitutes privatization in the strictest sense.[1] It must be pointed out that privatization includes divestiture and non-divestiture options. The latter consists of restructuring, privatization of management entailing management contracts, leases or concession and contracting out. Divestiture on the other hand entails the government's desire to privatize a public enterprise either by selling it or by deregulating entry and allowing the private sector to expand. This would lead to rolling back of the public sector or state to bring about innovative management and for promoting economic efficiency.

The first explicit articulation of the desire to divest government's equity holding is to be found in the budget speech of 1991-92 where it was stated that the central government would divest of its equity holdings in a number of its enterprises in favours of mutual funds and financial or investment institutions in the public sector. This disinvestments would broad-base the equity improve management and enhance the availability of resources for these enterprises.[2] In the New Industrial Policy statement in 1991 it was also made clear that the shares would be sold not only to the public financial institutions but also to the workers in these enterprises and the general public. It also mentioned the extent of divestment which was 20%. Hence, the primary objectives were (i) to raise resources for the budget which are essentially non-inflationary in nature and (ii) broad base the ownership of the enterprises which would eventually allow the enterprises to raise resources from the capital market and thereby lower their dependence on budgetary support.[3]

Objectives of Disinvestment

According to G. Ganesh, the general objectives of the privatization and the disinvestment programme are:- to promote economic efficiency, to redefine the role of the state inorder to allow it to concentrate on the essential task of governing and to withdraw from activities which are best suited to private enterprise, to reduce the fiscal burden of loss-making PSEs to reduce public debt, to release limited state resources for financing of other demands, to generate new investment including foreign investment, to mobilize domestic resources for development, and to spread and democratize share ownership.

However, the main focus of the disinvestment programme has been on raising resources for meeting the costs associated with the PSEs. These enterprises were supposed to have spearheaded India's economic development but they have also been a fiscal burden due to loss-making and technically sick enterprises. Hence, privatization and disinvestment have been pursued as one of the reforms for public sector enterprises which aim to mobilize resources for covering cost like:-

(i) Part of these resources will be used to pay for the costs associated with the closure of enterprises declared as terminally sick by BIFR. These would include expenses relating to Voluntary Retirement Schemes (VRS).

(ii) Another part of the resources would be used for restructuring those enterprises which are on the verge of becoming chronically sick and hence will be given extra infusion of capital after insuring that a management accountability system based on MOU is in place.

(iii) Lastly, a big part of the resources from disinvestment will be used for retraining of the workers displaced or affected as a result of closure and internal restructuring involving downsizing.[4]

It must be pointed out here that the disinvestment policy followed as one of the reforms for PSEs may not actually lead to an improvement in the efficiency of the divested enterprises because in any case they were the best performing and profit-making enterprises. Here then the objective of raising revenue has superseded the objective of improving efficiency.[5]

The Disinvestment Commission has outlined a long term strategy for disinvestment revolving around four long-term objectives:-[6]

(i) to strengthen PSEs where appropriate in order to facilitate disinvestment. It entails strengthening profit-making enterprises to promote greater competitiveness and profitability to enable payment of higher dividends to the government and enhanced share values. It also entails strengthening other marginally profitable PSEs and lastly by financially restructuring and reviving loss-making enterprises to unite private capital for long term.

(ii) To protect the interests of the employees by sustaining long-term employment, by providing adequate and fair compensation through VRS to surplus work force and by providing for employee participation in management.

(iii) To broad-base ownership by retailing PSEs shares to small investors and employees and offering them at discounted prices as compared to the institutional investor.

(iv) To augment the receipts for government by appropriate lends of disinvestment in profit making PSUs and by eliminating the need for budgetary support for loss-making PSUs.

With these objectives in focus, a proper disinvestment programme has to be pursued. This programme should also be based on logical foundations and must have potential advantages for the economy and the public sector. The logical foundations of this programme also voice the advantages implicit in it like:- the disinvestment ushers public enterprises in the domain of acquiring and developing their own corporate identity. The enterprises can be distanced from political and administrative controls although it will still be subject to overall fiscal, monetary and other policy regulations. The public enterprises need to enjoy reasonably high degree of independence. The disinvestment liberates these enterprises from the superfluous controls of their principals. With this change in the 'agent-principal' relationship there is so much for both parties to gain.[7] Further, disinvestment would also help in making the public enterprise, self-reliant or developing its own financial plans and thereby reducing their dependence on the government. The enterprise will also have greater flexibility in all aspects, including resource mobilisation growth and contribution. Also, the internal systems, procedures and practices undergo a total restructuring as the assumption of this concept forces the enterprise to disinvested to come closer to the customer and accept the market signals which may even lead to an attitudinal change on the part of both the management and workers.[8] The management of the enterprise will also be more accountable since it will have to render account to a large group of shareholders. Some or most of the shareholders can be the employees of that enterprise itself and they may experience greater pride and identification with the enterprise in which they hold shares. Disinvestment makes available the scarce capital invested by the government in public enterprises for alternative uses in the projects of greater importance, pruning down budgetary deficits or repaying public debt. In the days of rising prices, the disinvestment could act as a forceful check on containing inflation.[9]

The Process of Disinvestment

The disinvestment process is not a simple and straightforward one, instead it is a tedious process with many preparatory measures to be taken. The process comprises of two major elements:-

(i) Formulation of decision model for selecting the portfolio of public enterprises for disinvestment. There seems to be no guiding principle for this job. The model therefore, could take into account factors like financial success, marketing structure, social obligation etc. Reddy, Rao and Mishra have suggested a 2x2 matrix for disinvestment of these enterprises which takes into account factors like financial success and marketing structure. According to their model, financially successful enterprises operating in competitive market are the most appropriate one for disinvestment. They have also presented another model outlining the approaches for disinvestment in PSEs which is known as 3x3 matrix for disinvestment decision. Public enterprises are considered as high and low on three factors i.e. social purpose, profitability and resource mobilisation.[10]

(ii) Setting up a committee to select appropriate techniques of share valuation for enterprises proposed to be disinvested. The Committee on Disinvestment of shares in PSEs under Prof. Rangarajan came into being which submitted its report in 1993. in its general approach the committee took into consideration factors such as contributions made by the public sector in general to economic development and entrepreneurial skills, institutional, technological and fiscal' compulsions, taking account of unusual circumstances in capital markets, need to enhance the competitive strength, protecting the interests of workers and the requirement of consistency with the ongoing economic reforms.[11] It also laid down the objectives to be achieved through disinvestment as:- resource mobilisation, reducing fiscal deficit, improving economic efficiency, imparting new dynamism in management through diversification of ownership and control. These objectives have already been stated before. Apart from these, the committees also recommends the modus operandi of disinvestment, criteria for valuation of equity shares of PSEs, target clientele for disinvestment etc.

The Department of Economic Affairs for the first time recommended the following procedure thereby highlighting the nature of disinvestment process:-[12]

(i) The PSEs to be divested was to be selected by the Department of Public Enterprises.

(ii) The selected ones would be placed in three categories of very good, good and average.

(iii) Bundles consisting of different combinations of six to nine PSEs were to be made including some from each category of very good, good and average.

(iv) Criteria to be used for classifying an enterprise as very good, good or average was PSEs Net Asset Value (NAV) per share of Rs. 10 face value.

(v) Particular combination of each bundle was to be decided by Department of Public enterprises.

(vi) The bundles were offered for bidding to short-listed financial institutions and mutual funds. These institutions were allowed to unbundled then and sell individually in stock exchange.

(vii) The pricing formula adopted for the referral price was average NAV and Profit Earning Capacity Value methods.

The procedure of bundling shares and restricting the disinvestment in favour of public sector mutual funds and adopted in 1991-92 was the first exercise in disinvestment. For the year 1992-93, the sale of shares was made enterprise-wise and to a wider clientele.

There are two acceptable and transparent processes for disinvestment of Government's share holding.[13]

(i) offering shares of PSEs at a fixed price through a general prospectus. The offer is made to the general public through the medium of recognized market intermediaries.

(ii) sale of equity through auction of shares amongst predetermined clientele whose number could be as large as necessary or practicable.

Another method practiced for disinvestment is to transfer the controlling interest in an enterprise to a specific firm or group of persons based on a negotiated price, the entire process being finalized based on certain pre-determined objective criteria.

Hence, the committee on Disinvestment in its 1993 report described the modus operandi of disinvestment as once a reasonable market price was established in a normal trading atmosphere over a reasonable period of time, the fixed price method was the most appropriate. The Committee also recommended that 10% of the proceeds was to be set apart by the government for lending to the PSEs for expansion or rationalization needs. As regards the criteria for valuation of shares, the discounted cash flow method was preferred. Each enterprise would need to be studied carefully into account factors much as value of assets, its market share, potential profit earning capacity and the prevailing price in the market for share of similar enterprises in the private sector. The Committee recommended some preparatory measures which included conversion into company form, deciding the desirable levels of equity and restructing the financial aspects. Lastly, the percentage of equity to be divested should be under 49% for PSEs and further the Committee recommended for a standing committee on PE disinvestment for monitoring and evaluating this process of disinvestment.

The Report of the Disinvestment Commission in 1997 is yet another report which outlined a long-term strategy for disinvestment. The general recommendations of the commission in its first report are[14]:

(i) Establishment of disinvestment fund which is intended to take care of the possible danger of mere short-term budgetary compulsions dictating the process of disinvestment in profit-making enterprises.

(ii) It also suggested guidelines on selection of intermediaries and strategic partners.

(iii) It recommended retailing PSE shares to small investors and employees.

(iv) Recommended the PSEs disinvested earlier or proposed to be disinvested to join National Securities Depository Ltd. (NSDL) and have their shares registered with it to meet the various concerns of the investor including the speedy transferability of shares.

Further, the report also classified 35 out of 40 PSEs referred to it into core and non-care categories for the purpose of determining the extent of disinvestment in accordance with the stated government policy and given the nature of the market in which it is operating. The Commission also expressed concern for the interest of the workers and other employees with respect to VRS and other schemes

Disinvestment Modalities Recommended in I, II, III Reports of Disinvestment Commission.

Modality of Disinvestment	No.	Name of PSEs
Trade Sale	2	ITDC@, MFNL*
Strategic Sale	5	HTL, ITI, BALCO, BRPL, KOCL, MFL*
Offer of Shares	3	GAIL, CONCOR, MTNL, MOIL*
No Disinvestment	1	Rites
Disinvestment Deferred	2	Oil, ONGC
Total :	15	

@ - Lease cum management contracts of hotels in prime locations like Delhi, Bangalore

* - at a later date.

The Disinvestment Commission had submitted twelve reports to the government concerning 58 PSEs. These reports contain specific recommendations including disinvestment through strategic sale, trade sale, offer of share through GDR and domestic route, no disinvestment for one PSE.[15] The chart below shows the numbers.

Modality of Disinvestment	Number
Trade Sale	8
Strategic Sale	29
Offer of Shares	5
No Disinvestment	1
Disinvestment Deferred	11
Closure	4

The government has taken decision for disinvestment in respect of 45 PSEs out of 58 for which the recommendations of the Disinvestment Commission have been given. The term of the Commission expired in 1999 and a Department of Disinvestment was constituted as a nodal department to streamline and speed up the process of disinvestment.

Hence, we find that the disinvestment process which started with divestment upto 20% of the share capital held by the government in 30 PSEs was done in two phrases in December 1991 and February 1992 ensuring that the government's equity would not fall below 51%. Disinvestment process continued in 1992-93, 1993-94 and 1995-96. The Rangarajan Committee on PSE recommended divestment of 49% of equities in industries reserved for public sector and 74% in other cases. In 1998 budget it was announced by the government that it was prepared to dilute its share in non-strategic PSEs down to 26%, shut unviable units and sell their assets to meet the pending liabilities.[16]

As regards the disinvestment proceeds, in 1991-92, the first year of disinvestment, receipts from disinvestment amounted to Rs. 3,038 crore which works out to 2.3% of total receipts and 7.8% of capital receipts. This was the peak year. There is a steady decline thereafter. In 1992-93, out of the budgeted estimates of Rs. 3,500 crore disinvestment was able to garner Rs.

1,913 crore. In 1993-94, the government planned for disinvestment earnings of Rs. 2,500 crore but the amount actually earned from disinvestment was Rs. 1,865.78 crore. In 1994-95 proceeds from disinvestment amounted to Rs. 4,843 crores. In 1995-96, the government had budgeted for Rs. 7000 crores but this investment yielded only Rs. 362 crore. In 1996-97, the proceeds were Rs. 380 crore, 1997-98, it was Rs. 902 crores. It increased to Rs. 5371 crores in 1998-99 and Rs. 1829 crores in 1999-00.[17]

It is seen that in 1991-92, the actual proceeds have exceeded the targeted amount. But it shown by the CAG that the government could have still obtained much higher proceeds if the shares were priced properly. Due to this improper pricing, the exchequer lost large amount of money. Undervaluation of shares was the cause of this heavy loss and there was a wide gap between the price of shares sold and average market price per share. Underpricing or undervaluation of PSE shares in often dismissed as an inevitable consequence of the complexities involved in its pricing. However, the other complexities involved in the process of disinvestment will be dealt in the last chapter.

Review of Progress of Disinvestment

A review of the progress made by the disinvestment programmes highlights several aspects. The financial performance of some divested enterprises compared to pre-divested times show a very unusual picture. The performance in most of the enterprises has deteriorated consequent to disinvestment.[18]

Further, it should not forgotten that most of the divested PSEs have been profit-making enterprises in pre-divestment times. Hence, efficiency and profitability are not induced post divestment only. Lastly, the disinvestment process must into consideration the interests of the workers and draw out a fair compensation and also arrange for retraining facilities in case of downsizing. In other words, rationalisation of the workforce is an important consequence of privatisation and other enterprise reform measures. Overmanned PSEs cannot sustain themselves for long and therefore the way out is to downsize along with a credible social safety net by which the affected labour could be compensated at least financially. It is in this background that are Central government has introduced the concept of National Renewal Fund (NRF). This fund came into being in February 1992 and it aimed to protect the interests of workers who are affected adversely by modernization, technology upgradation and industrial restructuring. The specific objectives of NRF are to provide (i) assistance to firms to cover the costs of retraining and redeployment of employees arising as a result of modernization and technological upgradation of existing capacities and from industrial restructing. (ii) funds for compensation to employees affected by restructuring or closure of industrial units, both in public and private sector. (iii) funds for employment generation schemes in both organized and unorganized sectors. [19]

Voluntary Retirement Scheme (VRS) in another option open to the employees. This expense is met by the NRF which is not adequately funded. VRS first came into being in 1988-89. In the year 2000 the government has improved upon the existing scheme and introduced a new scheme of VRS on 5.5.2000. According to Public Enterprise survey, 1999-2000, Vol.-I, 2,31,885 employees opted for VRS till 31.3.1999. Further, a good number of employees who have opted for VRS are the younger and qualified ones who now seek employment in private sector.

In the present scenario, apart from providing attractive VRS to the employees, the government is also changing its method of disinvestment to gain more from these transactions. The magic formula now used in 'strategic sale'. It simply means that the government instead of offloading a minority percentage of its equity in markets either at home or abroad chooses to sell blocks of shares, usually more that 26% of its stake, to an investor ideally having a strategic interest in the company.

The is accompanied by the transfer of management control.[20] This method of strategic sale involving the choosing of a strategic partner has worked wonders. Not only have a wide range of companies been disinvested, but they have reaped handsome dividends for the government as well. The government for mopping new funds has adopted another strategy which is that after the strategic sale will follow public offers which will widen the horizon of the capital market.

The Strategic Sale Harvest

PSEs	**Equity Sold (in %)**	**Accruals (in Rs. Cr.)**	**Buyer**
Modern Food	74	105	Hindustan Lever
Modern Food	26	44@	Hindustan Lever
BALCO	51	826.5	Sterlite Industries
CMC	51	152	TATAs
HTL	74	55	Himachal Futuristic
LJMC	74	2.53	-
ITDC (3 hotels)	-	264.66*	Bharat Hotels, Tulip among Buyers
HCI	-	242.51	-
IBP	33.58	1153.68	Indian Oil Corp.
VSNL	25	3689 ∝	TATAs
PPL	74	151.70	Zuari-Maroc
JESSOP	72	18.18#	Ruia Cotex
HZL	26	445	Sterlite
Maruti	-	2424	Suzuki
IPCL	25	1490.84	Reliance Ind.
	Total	11064.60	

@ - to be received
# - to be approved by BIFR
* - includes outright sales plus lease payments
∝ - includes dividend and dividend tax.

Hence, a number of PSEs disinvested through the new method have appropriated gains for the government. But they have also stirred criticism relating to the procedure of being open and transparent. On the other hand, some analysts observe that 'true disinvestment' will slip into a passive mode since government control and management of the enterprises concerned will continue. Further, the observers believe that the budgeted Rs. 12,000 crore realization through the actual sale of government equity in PSEs was not possible. Suggestions also have been put forward relating to gaining better value of shares by bringing in a legislation which enables the disinvestment department to aggregate assets and reserves from the PSEs which have been put on block. A special fund should be created from the liquidation of such assets which can be productively used, especially in the infrastructure sector where long-term funds are needed in a big way. Some point out that disinvestment programme is not acquiring resources rather losing them and the entire process smells of corruption.

We should not forget that the process of disinvestment was initiated in 1991-92 under the compulsion of IMF conditionalities which stipulated a sharp reduction in the fiscal deficit. In course of time, this process has become an important reform in PSEs to bring about efficiency and to mobilize resource, the latter becoming more important and the former emphasized upon by the method of 'strategic sale' for improving management efficiency. We also notice that the Committee on Disinvestment, the Disinvestment Commission etc. have not been able to evolve the appropriate guidelines end principles for carrying on the disinvestment process. However, some considerations should govern the disinvestment processes. There is a need for a clear cut political commitment to any disinvestment. Further, care must taken to see the general atmosphere of the share market, proper timing for setting the shares, carrying on gradual and well-negotiated process.

To conclude this chapter, one must also look at privatisation and disinvestment experiences around the world. This study of the cases of privatisation in different countries could help India evolve a more comprehensive disinvestment programme which can be more transparent and profitable for the government and dispel criticisms of selling the family silver. The study of privatisation experience in other countries will be dealt in the next chapter.

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Chapter IV

Privatisation Experience Around The World: Case Study of the UK

The process of privatisation and disinvestment varies from one country to another. The variation lies in the pace of the programme, the modality of this programme and also the purpose or objective for this programme to be initiated and pursued. The variation in pursuing this programme of privatisation and disinvestment is dependent upon number of factors like the performance of public sector enterprises, condition of the capital market size of the private sector etc. Hence, it becomes essential to learn about other privatisation and disinvestment experiences around the world so that lessons could be learnt from them and this would help in evolving a better policy and approach for our own privatisation and disinvestment programme in our country.

Privatisation in the United Kingdom

The United Kingdom's experience in privatisation is considered to be the first such experience and also a successful one, providing a role model for other countries to follow. The term "privatisation" was originally send to have been coined by Margaret Thatcher and Keith Joseph as an alternative to denationalisation. A Conservative government was elected in May 1979 and called for radical reforms in the U.K. economy. The party slogan of the 1997 campaign, "roll back of the frontiers of the state" was foremost on the agenda.[1] In their manifesto, the conservatives had promised to undertake some divestiture of the state assets to combat serious financial difficulties the government was facing in mid 1970's.

When we study the history of privatisation programme in UK, we cannot fail to notice that the country within a short span has moved from private enterprise to nationalization and then again from nationalization to privatization. The UK excelled in an ambitious programme of nationalization during the postwar era the dominant assumption was that the market could no longer he left free to play its own tune. The state was required to intervene to improve industrial and economic management on one hand and to curb the harmful effects of capitalism in terms of inequities of income and opportunity on the other.[2] After the Second World War, large-scale production and nationalization was seen as the most appropriate and effective ways of achieving economic growth and efficiency. It was argued that the plight of many industries was bad due to their small number, inefficiency and outdated technology. Nationalization was considered the best way to plan the economy and promote social welfare. The state was considered the agent of social responsibility and hence it became the duty of government to provide the basic facilities, services and decent standard of living to all of its citizens on egalitarian grounds.

However, things changed in 1970's when the oil crisis and stagflation led to disillusionment with the Keynesian policies of macroeconomic management in general and the performance of the nationalized industries in particular. The UK at that time had the lowest economic growth in Europe. In 1979, the rate of return net of subsidies and depreciation was 0.86%.[3] The National Enterprise Board set up in 1975 to catalyze new developments in industry, turned out to be ineffective too. Efforts to revive the economy did not work and in 1976 the British Government had to seek the help of the IMF to keep the economy running. It faced severe problems in terms of its public sector deficit and balance of payments. Privatization, as a hallmark of Thatcherism, was a natural response to the failure of nationalization in terms of the public sector performance.

Privatization in UK was seen as having two important components:[4] -

(i) denationalisation or divestiture,

(ii) liberalization or exposing enterprises to more competition.

Over time, the Conservative governments and politicians developed many justification for privatization as expanding freedom of choice for customers, increasing economic efficiency, improving government finances and increased employee welfare.

The objectives of privatization in the UK have been vague and conflicting as the government has not taken out any document stating the objectives and techniques of privatization. The objectives have varied from time to time depending upon the economic conditions, political circumstances and changing public attitudes. John Moore, the then financial secretary to the Treasury stated, "Our policies have been specifically designed to further a number of objectives. They are designed to lead to greater efficiency....They reduce the role of public sector and promote substantial sale receipts. They allow employees to take a direct stake in the companies in which they work and this leads to major changes in the attitudes. And, importantly, they provide a major stimulus to wider share ownership".

In the initial years, the Thatcher government made no substantial changes to the structure of the nationalized industries despite their poor performance in terms of profitability. Later, it tightened the financial constraints imposed upon them and introduced more market-oriented management. The government also reported to medium-term financial strategy whereby steady reductions in the rate of growth of the money supply and the Public Sector Borrowing Requirements (PSBR). Privatization also helped in increasing short-term government revenues. Focus was not on microeconomic goals of promoting competition and increasing efficiency but on increasing governments' revenues. Floatation of shares in UK with the objective of widening the share-ownership gained maximum attention worldwide. The government reaped political benefits by claiming wealth redistribution via underpricing shares and pushing back the frontiers of the state. This programme of the government led to a massive expansion in the number of shareholders, including the member of employees holding shares in their own companies. During 1979-87, the total number of shareholders in Britain increased three fold. During the early 1990's every fifth adult in Britain owned shares in more than one privatized enterprise, utility or service.[5]

On the basis of several government documents, official sources and Conservative Party's manifestoes, various objectives of privatization are:-[6]

(i) reducing the size and scope of government by rolling back the frontiers of the state

(ii) taking the government out of business by promoting the ideology that it is none of the business of the government to remain in business.

(iii) reducing political interference in the management of an enterprise by separately the commercial from the social objectives.

(iv) Saving scarce public resources for activities other than state owned enterprises

(v) Attracting domestic and foreign investment through disinvestment.

(vi) Promoting people's capitalism through wider share-ownership.

(vii) Reducing the fiscal deficit and public sector borrowing requirement.

(viii) Generating new sources of tax revenue through higher returns on the capital invested in privatized business.

(ix) Curbing the powers of public sector trade unions.

The UK privatization programme was launched in October 1979 with the offer of 5% of the government's shares in British Petroleum. During 1973-83, twelve enterprises were completely or partially privatized, raising net proceeds of £ 1625 million. During 1983-87, the government was able to raise the net proceeds to £10983 million through the privatization of twenty-four companies and during 1987-91, the government was able to get net processes of £ 22514 million through the privatization of British steel, Water Supply and sewage, Regional electricity companies etc. In 1991, the net proceeds from privatization totaled to £ 21551 million.

Privatization experience in the UK can be studied in two phases. In the first phase, privatization was of industries typically already found in the private sector, with few special characteristics that would predispose them to state ownership as for example, Amersham International, Britoil and British Petroleum. These sales raised comparatively small sums for the government at a time, when monetary policy was very tight and tax revenue was under pressure due to recession. The income generated was welcome and the transfer of ownership was politically expedient and presented relatively few administrative problems. The sale of 51% of British Telecom in 1984 was the beginning of the second phase of privatization which was marked by the sale of public monopolies including the so-called network industrial sectors such as telephone, gas, water and electricity etc. They are all monopolies characterised by supply networks which would be expensive to duplicate. Since this means lack of competition, regulation is needed to ensure consumers' interests against monopoly power.

The modalities of privatisation in the UK varied from time to time and enterprise to enterprise. There can be a combination of measures which privatization can offer like ownership, organizational and operational measures.[7] These include disinvestment, liquidation, management buy-outs, management buy-ins, joint ventures leasing, contracting and disinvestment of shares etc.

The ownership measures would include the sale of an enterprise with full or partial involvement of the private sector, sale of assets and also the sale of an enterprise to employees through management buy-outs.

The organizational measures include all attempts towards introducing market discipline, restructuring in order to limit control to the apex level, breaking up of big company into smaller units to promote competition as in British Steel, leasing out to achieve economic efficiency and deregulating activities relating to entry and exit.

The operational measures include contracting out, franchising , target-setting, imposing fiscal constraints and reforming the pricing policy. In the UK, contracting out and franchising hence been adopted successfully in areas such as hospital cleansing, catering etc.

Privatization in UK had been preceded by some preparatory measures such as.[8]

(i) Enterprises were brought under the rigorous impact of market discipline.

(ii) Redundancies of labour have been consistency and systematically dealt with.

(iii) Enterprises have been financially restructured to make a loss-making enterprise to a profit-making one in order to create a commercial trade record for the enterprise to be privatized. For example, the British

Airways had a loss of £ 41 million upto 31st March 1982 but this was converted into a profit of £ 181 million by 31st March 1986. The 1982 loss figure included rationalization provision of £ 429 million. Other significant changes were also made at the Board level to bring in these who were in favour of privatization as in British Airways and British Telecom.

(iv) Organizational and operational charges were also made to enable smooth transfer to the private sector.

(v) Major privatization in the UK involving public corporations required legal measures to convert them into the company form with an equity structure.

(vi) Where a special regulatory approach was felt necessary, provision was made for it in the privatizing legislation.

(vii) Price control techniques especially in the privatization of utilities were adopted to cut costs of operation, increase efficiency and prevent exploitation of the consumer.

The government in the UK adopted different techniques in different cases. Many have been public sales and the government adopted various techniques of public sales like:-

(i) Offer for sale at a fixed price as in British Port Holdings (1983), British Telecom (1984) and British Gas (1986).

(ii) Sale by tender with the minimum price fixed as in Associated British Ports Holdings (1984), British Petroleum (1983) and Enterprise oil (1984).

(iii) Offer for sale and sale by tender as in the case British Airport Authority (1987).

Another techniques undertaken was the private sale as in the case of National Bus Company, National Freight Company, British Leyland Trucks, Sealink Ltd., British Rail Hotels, British Airways Helicopters and Royal Ordinance.

There are several aspects of allocation of shares in UK which merit special attention:-

(i) Importance has been given to allotment of shares to "small applicants" in accordance with government policy of encouraging wider ownership. Allotments were characterised by some form of rationing.

(ii) Limits were placed on individual shareholdings for example not more than 15% of the voting shares could be owned by any individual as in Amersham International.

(iii) Special terms of offer were formulated in the case of employees and pensioners of a privatized enterprise. They got some free shares at government's expense.

(iv) The idea of loyalty bonus for individual shareholders was introduced i.e. a free share would be given in case a special numbers of shares, for instance 10 shares were held continuously for roughly three years as in Britoil.

(v) While setting a public enterprise, the government retained a 'special share' or some cases which entitled the government to intervene in cases where public interest is concerned. The government holds special share in Amersham International, BAA, British Aerospace, British Gas, British Petroleum, British Telecom, Britoil, Enterprise Oil, Jagnar etc.

(vi) Management buy-outs were experimented within labour-incentive corporations.

(vii) Privatization of public utilities has been followed up with establishment of arrangements for public regulation besides there being under the jurisdiction of the office of Fair Trading and the Monopolies and Mergers Commission.

There are two important features of British privatization experience. They are:- regulation and competition.[9] It has been found that regulation is needed in cases where there is lack of competition in the individual market place. Regulation was not found necessary in British steel and British Airways both of which functioned in competitive market conditions. Regulation was introduced in others to ensure that the privatized monpolies did not abuse their great power. Consequently price control formula was devised and specialist regulations were appointed to administer these schemes.

In the case of Telecom and Gas, the government had to introduce competition after their privatization in view of their sheer size and power. However, the method of introducing competition through regulation was found to be very difficult. Hence before privatizing water and electricity sectors, they underwent extensive restructuring and separation of production, distribution and marketing arrangements. This resulted in immediate competitions in the production of electricity and benefits flowed to industrial consumers.

Hence, the Thatcher government succeeded in making the privatization programme popular by making an unapologetic case for the virtues of capitalism, individualism and the profit-motive.[10] The government also highlighted the benefits of privatization in terms of its ability to increase industrial efficiency, mobilize resources or revenues, encourage wider ownership among employees and the general public etc.

Four reasons can be stated for the attaching so much importance to the privatization by the government.[11] They are:-

(i) Privatization will enhance economic freedom. According to Sir Geoffery Howe, "The consumer is sovereign in the private sector. In the public sector he is dethroned by subsidy or monopoly". This assertion projects the view that public enterprise threaten economic freedom. Individual freedom is fostered by extending competition and by reducing the public sector so as to allow individuals the keep a higher proportion of the wealth in the form they themselves choose. But there is some fundamental objective to the government's stand. It is based upon a limited definition of economic freedom which takes into account only the absence of government intervention in the market. State on the other hand can make a positive contribution in promoting individual liberty.

(ii) Privatisation will increase efficiency. According to Sir Keith Joseph, "Nationalized industries are immunized from the process of spontaneous change which competitions and fear of bankruptcy impose upon the private sector". This new projects that public-enterprises one less efficient than the private ones because they are insulated from the disciplines of the capital market. Also, their efforts have been hindered by government interventions.

However, the case of privatization in order to increase efficiency seems less important keeping in view the UK privatization experience as there are other factors which focus not on efficiency but on reducing public sector borrowings.

(iii) Privatization will ease the problem of public sector pay. The problem of pay bargaining in the public sector has been prominent. At the same time, there have been voices against higher pays for private sector managers also.

(iv) Denationalisation will reduce public sector borrowing, but this in actuality has not come true fully.

Although privatization, UK was pursued with great enthusiasm, it has its own drawbacks which need attention. In the wake of privatization the sale of national assets deprives the government of resources which could be used for the benefits of its citizens. In a number of cases, including BT and British Airways, large and immediate profits had gone to individuals and institutions fortunate enough to be allocated shares. Proceeds from the sale to the government have been correspondingly lower than they might have been. The extent of underpricing, especially in larger privatization has been much greater than in typical privatization issues. Besides losing money, the government also lost direct control over the activities concerned. It made it difficult for the government to act at all times in the public interest. Privatization in the UK has also led to the creation of special interests and has resulted in inegalatarian use of scarce resources. It can be said that social costs of privatization has been high. Further, the cost of sale, promotion professional and advisory fees and underwriting fees have been very high. On closer inspection we find that there is no hand evidence of any substantial increase in terms of efficiency or competition. Though large amounts of revenues were raised through disposal of assets, the net effect on government's balance sheet was negative because the public sector enterprise were usually sold below then market price. Additionally, large costs were incurred in their disposal.

Hence, privatization programme in the UK has deeper connotations and its consequences are far and wide. Although model of privatization in the UK cannot be imitated by developing countries, there can be lessons which can be learnt from its experience as:- privatization requires lot of preparations to be done alongwith gathering political support from the public, trade union etc. The objectives of privatization and is modalities and techniques should be spelt out clearly. Priority should be given to long-term objectives along with short-term gains. There should be transparency in all privatisation deals. Lastly, the country should be ready to undervalue the social costs of privatization like inegalitarian use of resources, loss of jobs or employment of many, inequalities deepen and the positive role of the state in promoting individual liberty and equality undermined.

Privatization in France

The French Prime Minister Mr. Jaques Chirac once remarked "the state is not meant to be a producer, when it turns to be one, it does expressively and badly". The privatization in France had a chequered history. Between 1986 and 1987 a vast programme of privatization was down up, launched and carried through. Then it was put for a while in cold storage only to re-emerge in the autumn of 1993.

With the election of a socialist government in 1981, the first in the fifth Republic, a massive wave of nationalizations followed embracing banking, insurance and industries. Later till inner contradiction of this policy gave rise to severe financial crisis with the French social welfare system breaking down with rising unemployment. At the same time, the government faced the dilemma of providing arms-length support to nationalized industries which were in financial difficulties. The government found that it did not have the finances to support the pace of its industrial policy and therefore by an Act in 1983, it authorised nationalized concern to call on private sector investment and prepared the way for future privatization. Privatization effectively meant restoring the pre 1981 position. Privatisation meant that budgetary deficits and level of indebtness were reduced and that resources could now be had to capital markets for financing the much needed investment of the industries.[12] This, in turn, meant revitalization of the financial markets.

The Chirac government which had fought its electoral campaign on privatization took office on 20th March 1986.

The first phase of privatisation saw that within one year. There were eleven floatation which privatized eight large groups out of twenty-seven and three medium-sized banks. Privatization was carried out according to a scheme which gave 10% to the employees, 15% to foreigners, about 50% to the public at large and 25% to about 10 larges shareholders comprising a stable nucleus. This policy resulted in increasing the total number of small shareholders in large businesses. Therefore, a quota system had to be applied. It also made possible for large shareholders to acquire the right to majority representation on boards of the divested enterprises. For availing this advantage, their shares cost 5% more than that paid by an ordinary buyer and they had to agree to hold on to the shares for at least two years.

Further, a Privatization Commission was set up which was a seven member body. The commission had to examine the balance sheet of the firm to be privatized. It listened to comments and advice of bankers chosen by the government and the firm and then fixed a minimum price below which a share could not be sold. Later, it was at the discretions of the ministers for finance for fixing the price which was not below this minimum,

The culmination of this privatization programme was the sale of PARIBAS in January 1987. 3.8 million individuals bought shares and the number of shares had to be limited to four. The privatisation programme took place over a short period of nine months and then came the crash of October 19, 1987. There was however, an intermission in the privatization programme with the victory of Francois Mitterand as the President. It was due to his policy or formula of "no more nationalization and no more privatisations" but it was adhered only in theory not in practice. Between December 1991 and January 1993, the socialist government sold altogether French franc 8 billion worth of public shares.

The second phase of privatization saw the victory of the right wing and the defeat of the socialists in March 1993. The "privatization programme" published in the summer of 1993 comprised 21 concerns including two of the largest bank BNP and Credit Lyonnaise) and the largest insurance companies (VAS, AGF and GAN). The combined value of these companies was assessed at French franc 500 billion. Launch of the privatisation programme was meticulously undertaken. The initial privatisation that of BNP in October 1993 was a success. As of now, (after 1996 onwards) increased attention is given to state divestment in the medium term. Apart from privatising AGF and CNP in 1996, the French government announced its plans for consumers electronics manufacturer Thompson SA to be privatized.

Hence, the French experience of privatisation shows the dependence of much a programme on the state of the stock market and the confidence of all investing public. Further, a meaningful dialogue with the labour unions and employees of the enterprise slated for privatisation must be started.

Privatisation in East Germany

When we study the privatization experience of East Germany, the important role played by Treuhandanstalt (THA) is highlighted. THA was a state trustee agency which was responsible for the privatization of state-owned property of the former German Democratic Republic. Privatization experience is this country is unique. The THA provides a unique example of privatization by the state and market. Usually, the state is considered an impediment, but in East Germanay, the THA which was a state agency was responsible for the restructuring of the entire economy of the German Democratic Republic within a short time.[13] Restructuring and privatization was taken on when this country was facing a lot of problems – social, economic and political in the wake of privatisation. THA was a public agency with a supervisory board consisting of representatives from the federal government, state governments, commercial banks, trade unions, major West German firms and two European businessman.

Privatization of the state-owned enterprises in the former German Democratic Repubilc was the most crucial and difficult part of the transformation of the planned economy into a market economy. The decision for a sweeping privatization on a massive scale was in tune with the spirit of the federal republic of Germany which had always assigned an important role to private ownership since the second World War. In contrast to other European countries, there was no wave of nationalization in the post-second world war.

During a short span of four years and half years since German reunification and the culmination of the THA, the THA was able to fully or partially privatise all but 192 companies out of a total portfolio of 13815 holdings. In the process of privatization of the THA companies and parts of companies 2983 management buy-outs or management buy-in agreement were signed of which 2081 were administered by the THA branch offices and 902 by its headquarters.

The THA worked on the maxim, "have as little government as possible and as much government as necessary possible and as much government as necessary". It became involved thus in the process of creative destruction of state-owned holding enterprises into smaller units to make them saleable and economically viable and efficient. THA had three objectives in mind before dismantling[14]:

(i) to make the enterprises competitive

(ii) to create transparency in order to enable appropriate reviews and inspection to be carried out and

(iii) to change management attitudes of the enterprises.

For selling the companies or part of them two method were adopted:

(i) auction method which can lead to rapid privatisation on transparent grounds but does not guarantee sufficient competition among bidders.

(ii) Bargaining method which ensures a greater degree of freedom and flexibility for both negotiating parties but provides little transparency and it often found to be time-consuming.[15]

The auction method is recommended for mass privatization and the bargaining method is useful when there are only a few bidders or suitable buyers.

Further, THA resorted to large-scale management buy-outs and management buy-ins also. These methods lead to decentralization and worker-participation in small and medium-sized businesses.

However, the THA has been criticised for the manner in which it carried on the privatization programme. Some criticise it for hurrying up the programme or making hasty decision. While others criticise it for deindustrialising East Germany. It was also criticised for being bureaucratic and secretive with its only concern to sell the firm as fast as possible. Some instances of financial irregularities and miscalculation were also reported. Many east Germans nourish the feeling of being deprived in their own country as they were able to invest in only 6% of the privatization deals.

Hence, the privatization experience in East Germany has been different with the unique role played by the THA. The agency's work of privatization in a matter of few years is laudable ignoring the hasty decisions and some financial irregularities arguments.

Privatization in other Countries

Privatization and disinvestment programme has been undertake in various countries although the technique and pace of the programme varies. In the post-communist societies, the objective of rapid privatization was to allow the growth of the private sector relative to the public sector, rather than transferring existing firm to the private sector. In these countries, various alternative approaches like restitution, direct sale to domestic citizen, management and worker buy-outs vouchers and sale to foreigners have been undertaken.[16] At the same time it should be remembered that the western-style privatization cannot be imitated due to different economic conditions relating to thin private capital markets in these countries.

The privatization programme has assumed importance in the agenda of African countries in the context of movements aimed at restructuring of the public sector and economic liberalization.[17] Africa's experience of divestiture has been are of long standing starting with Ghana experiment in 1966. It was realized in African countries by 70's that the public sector had failed to deliver, was inefficient and therefore public sector reforms were important. Privatization in the African context included divestiture where the government retained majority control in the enterprises. The main objective of privatization here has been to relieve the state of the fiscal burden by disposing off subsidy consumers rather than to attract private investment. Liquidation and closures dominate the scene rather than sale of assets. Hence, the privatization programme developed here is according to the economic specificity of the country. The Latin American countries like Argentina, Bolivia, Brazil, Chile, Haiti, Mexico, Panama, Peru etc. resorted to privatise their public assets in a phased manner. Of these, Chile had an extensive experience. While the base principle adopted was the sale of shares, Chile experimented in a variety of ways including techniques like transferring public owned assets to the employees, pension funds, small domestic investments etc.[18]

The privatization and disinvestment programme in other countries vary in various senses. In developed countries like UK, this process was started due to prosperity i.e. due to technological innovations and changes in the economic situations led to uncontrollable economy which further led to the weakening of the government authority. The efficiency of the market in adjusting itself according to the changing demand and supply conditions was highlighted, along with the inefficiency of the public sector. In the developing countries however, this programme was initiated for quick political and economic dividends. In these countries the approach towards privatization and disinvestment has been primarily negative. It is generally seen as unloading loss-making public enterprise rather than building viable enterprises.[19] Privatization in the post-communist societies differ from the developing countries as the former's privatization programme involved the transformation of the entire economy whereas in the latter it involved only substantial parts of their economies.

Apart from stating different reasons for initiating privatization programme in different countries, the modalities and technique of such a programme is also different. In the case of UK, it included a combination of ownership, organizational and operational measures which are disinvestment, liquidation, management buy-out and buy-ins, joint ventures, leasing, contracting etc. There were mostly public sales of the shares of the public enterprises. In East Germany, the process included selling off assets through auction or bargaining method. It also resorted management buy-outs and buy-ins and focused more on privatization from below in contrast to African countries. Due to non-performance of public enterprises, the African countries resorted to restructuring and divestiture. However, the governments showed reluctance in selling large state monopolies and retained control in most of the privatised enterprise. In the post-communist countries, the approaches taken up were restitution, direct sale to domestic citizens, management and worker buy-outs, vouchers and sale to foreigners. In the developing countries the techniques varied from partial to full divestiture, contract management, franchising or leasing.

Differences in the privatization experiences also relate to the machinery involved. In France, a separate Privatization Commission is set up while in East Germany the task was entrusted to the THA. In all countries the machinery was either temporary or permanent with its powers varying in different countries. The pace of privatization (as for instance quick in Chile and gradual or slow in Mexico) varies from country to country. However, privatization in haste is not a good sign, learning from Chile's experience. Apart from these differences, there can be end number of differences pertaining to legal, procedural and political ones in various countries.

Lessons from privatization experiences worldwide

The experiences of the different countries worldwide helps us to earn lessons from their privatization experiences. These lessons could be summarized as:

1. The objectives of privatization programme in any country should be made very clear. Focus should however, be more on long-term objectives than the short ones.

2. Before initiating the process, there should be some measures undertaken like garnering support from the public, trade unions and bureaucrats so that these groups are aware of the aims, priorities targets and modalities of privatization.

3. It is better to set up an independent institution for privatization which can provide the necessary force and credibility to the whole exercise as the THA in East Germany.

4. Privatization should not be seen as a panacea for all economic ailments. It can be a means to an end but not an end in itself.

5. Modalities of privatization may vary from enterprise to enterprise and may change also in course of time.

6. There should be transparency and credibility in all the transaction in the process of privatization to avoid criticisms of corruption and other financial irregularities.

7. Privatization may only relieve the government its operational tasks. The conceiving, planning goal-setting and evaluating still remain its responsibility.[20]

8. The 1st lesson to be learnt from the various experiences of privatization in developing countries including the post-communist countries it that each country needs a tailor-made privatization strategy to meet its particular requirements, capabilities and learning skills.[21]

9. Privatization in developing countries should be carried with caution as the state cannot absolve its role as the sole provider of social welfare to large sections of deprived population.

10. The British mode of privatization would prove more suitable for countries having well-developed capital markets and large private sectors.

11. It is easier to indulge in small privatization than big ones especially when the appropriate legal, economic and political structures are either lacking or underdeveloped as in post communist societies.[22]

12. Lastly, before initiating the privatization programme, each country should bear in mind the political and social costs incurred in this process especially in developing and underdeveloped countries.

In conclusion, we can say that the lessons from the privatisation experiences of different countries gives us valuable insight into the various ways and methods according to which this process can be carried on. Also, these lessons caution us about considering privatisation as an end and not as a means for finding solutions for a country's political and economic ills. Privatisation and disinvestment programme should be country-specific taking into consideration the performance of the public enterprises, condition of the capital markets, size of the private sector and most importantly the political consensus for implementing these programmes. The results of these programme is not certain. It can appear as a boon or can even blow up the economy. In a country like India a cautious approach which is gradual should be evolved. Importance should be laid on the dedication of the government in making the privatisation deals fair and transparent so that the citizens do not feel cheated in any way. However, the task ahead of the government in initiating the process is very difficult as there are number of problems and obstacles in pursuing these programmes. These problems are dealt in the next chapter in detail.

Endnotes

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[12] Ganesh, G. (1998), Privatization Experience Around the World, New Delhi, Mittal Publication, pp. 128-129.

[13] Gupta, Asha (2000), Beyond Privatization Great Britain, MacMillan Press Ltd., p. 95.

[14] Ibid., p. 82.

[15] Ibid., p. 86.

[16] Ibid., p. 107.

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[18] Mandal, R., (1994), Privatization in the Third World, New Delhi, Vikas Publications House Pvt. Ltd., p. 12.

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[20] Ibid., p. 97.

[21] Ibid., p. 153.

[22] Ibid., p. 119.

Chapter V

The Politics of Disinvestment

The process of disinvestment of public sector enterprises is being carried on as a measure of economic reform and privatization. The economics of disinvestment highlights the virtues of an enlarging private sector and its efficiency in all respects in sharp contrast to the public sector. It focuses on the economic gains derived from the process of disinvestment in the form of additional revenues to the government through the sale of assets and also improving the management efficiency by introducing a method of 'strategic sale' whereby along with a part of equity, the management of the enterprise also is entrusted to the private sector or to the 'strategic partner'. Hence, two important objectives seem to be fulfilled i.e. of raising revenues and increasing the efficiency of the enterprises. The proceeds from the disinvestment of shares are supposed to restructure and reinvigorate the loss-making enterprises by infusing capital to make them economically viable. The picture painted above seems perfect with all the imperfections of the public sector ironed out by the process of disinvestment.

However, the economies of disinvestment is different from the politics of disinvestment. The politics of disinvestment involves various groups of people who directly or indirectly play an important role. They can be the politicians, the bureaucrats, the workers of an enterprise, the trade union etc. All of them contribute directly or indirectly in the manner in which the policy is carried on and the politics underlying the whole process of disinvestment. It all started when the government embarked on the policy of disinvestment in 1991 on a very cautious note. In course of time, the cautious approach was abandoned and an accelerated and full-fledged programme of disinvestment carried on as of now. The matter of concern has been the gap between the expected result and the result obtained in reality. Further, the fairness of the financial deals between the government and the private sector is questioned. The need of the hour therefore, is to examine the policy of disinvestment and also raise question like:-

(i) Do we have a proper policy of disinvestment?

(ii) What are its objectives (long and short ones)?

(iii) Has the disinvestment of shares in various enterprises led to achievement of economic objectives as expected?

(iv) Has the disinvestment been a step towards public enterprise reform?

To start with the formulation of policy of disinvestment has not been clear and has been left to the Disinvestment Commission, the Department of Disinvestment and finally to the Cabinet. The earlier policy of disinvestment is now converted to strategic disinvestment. The manner in which this programme is carried on varies from enterprise to enterprise. The task is further complicated due to the heterogeneous nature of the public sector itself. Both profit and loss-making units are distributed across a range of industrial sectors. Some are characterised by competitive or contested markets where private entry is acceptable. Others are characterised by a natural tendency towards monopoly or oligopoly because of the large size of units relative to be size of local or national markets which renders private sector presence problematic.[1] Thus, there have been ad hoc statements of the government on the policy of disinvestment but a more coherent and consistent policy is needed.

Not only the policy, the objectives of the policy of disinvestment are also unclear. There are a host of objectives listed is various government statements on this policy which are not similar.

For instance, the Report of the Committee on Disinvestment of Shares in PSEs in 1993, the objectives stated are to mop up resources of non-inflationary character to meet the budgetary needs, gradually reducing the fiscal deficit, overall economic efficiency by bringing about a more competitive atmosphere and also efficiency to be enhanced in individual enterprises etc.[2] On the other hand, the first report of the Disinvestment Commission in 1997, laid down objectives (which were long term in nature) like strengthening public sector enterprises where appropriate in order to facilitate disinvestment, to protect employee interests, to broadbase ownership and to augment receipts for government.[3] There may be thus conflict between various objectives especially between short-term objectives and the long-term objectives. However, the India disinvestment programme appears to have been guided by short-term considerations of meeting the fiscal deficits rather than a comprehension and well-thought out and effectively implemented programme.

The machinery entrusted with the task of carrying on the disinvestment programme is a nodal department for disinvestment which is to handle all matters relating to the sale of the government's equity in the public enterprises, including the timing and modalities of sale and pricing. The final decision on these is taken by the Cabinet. The Disinvestment Commission reconstituted is now under the Department of Disinvestment. What role the government envisages for this commission is unclear. There appears to be a complete lack of clarity on the part of the government in these matters as is evident from creating a specialized group on disinvestment to give its report in three months. Further, the direct involvement of the PMO in the process of disinvestment suggests that not much room is left for an independent commission in decision-making. The PMO should be totally insulated from the actual process of disinvestment since it is amenable to various kinds of pressures.[4] Thus, the state of confusion due to the absence of an independent body can lead to arbitrariness and adhocism in the decision-making process. The cost of wrong decision can prove quite heavy to the nation.[5] Decisions relating to disinvestment process need considerable expertise, not readily available with the generalist civil servants. It is, therefore, necessary that these decisions are carefully examined and scrutinised by an expert body well-versed in the technical details relating to the short-run and long-run consequences, including the financial implications, social costs etc. The expert body should be composed of persons known for their integrity and expertise.[6]

The disinvestment programme invites lot of criticisms due to lack of transparency in the financial deals between the government and the private sector. The marriage between the market and the political process is an uneasy one.[7] There have been various allegations of kickbacks in decisions relating to disinvestment process. In order to make the transactions and the whole process transparent, there should be studies to inform decision-makers and the public about the reasons for divestiture. The revenue that is generated and put to use should be open to the public. This creates credibility and dispels doubts regarding shady deals. Transparency is also enhanced by the absence of any personal interest of the minister or of the civil interest concerned in the contract or the deal in question. It is imperative that the decision-makers should never be in a position as to give rise to doubts about the prevalence of personal advantage. However, the disinvestment and privatization programme is not free of suspicion and distrust. The public feels that some businessmen may benefit in this process of disinvestment by conniving with the political executive or the bureaucrats and treating bribe as a part of their costs.

The technique of sale is also under scrutiny as the technique varies from enterprise to enterprise. There also have been criticisms regarding underpricing of shares which means miscalculations on the part of the government or hasty decision-making which results in loss to the economy. Critics pointed out that the whole exercise of disinvestment has been carried out in a hasty and unplanned manner by the government. Thus it failed to realize not only the best value but also the other objectives of the disinvestment programme. It launched the programme without creating conditions for its take-off. It did not get public enterprises listed on the stock exchange. Adequate efforts were not made to build-up the much needed linkage between the public enterprises on one hand and the capital market on the other.[8] The Department of Public Enterprises and the Finance

Ministry adopted techniques and method which resulted in far lower realizations than justified.[9] There have been such miscalculations in disinvestment of many enterprises like HPCL and the much recent one GAIL. The shares of the GAIL were sold very cheap. Merchant bankers had suggested that the shares of the GAIL, a blue-chip Navaratna company should be sold at much higher rate i.e. in the range of Rs. 300 to Rs. 350 whereas the shares were sold at Rs. 70 in the GDR market when the ruling domestic market price was Rs. 79. By selling the shares in the domestic market instead of the GDR market, the government could have raised more money. The CAG report also criticised the government's move. While some allege that kickbacks were offered to these who took decision to underprice the shares, others point out that this decision of the Vajpayee-led regime was linked to its eagerness to show some "achievements" on the deficit control front.[10] It should however, be recommended that pricing of shares is a crucial issue in disinvestment. The government should avoid offloading its stake in a depressed market because by doing so, the government spoils the pricing of the scrip and thereby impedes future efforts of public enterprises to tap the capital markets".[11]

The disinvestment of profit-making enterprises only has also come under criticism. The government intended to disinvest both the profit making and the loss-making enterprises. On one hand, disinvestment may be warranted more for loss-making units than for others. On the other and, disinvestment may be more feasible in the case of the profit-making enterprises. The government has been just doing that i.e. disinvesting the profit-making enterprises.

However, it stand with reasonable judgement that if the task is to reduce the burden placed on the budget by the public sector, it is the loss-making units which swallow almost 60% of the ever-shrinking budgetary outlays on the public sector enterprises that need to be sold.[12] But it is obvious that these units would not attract buyers in the market. It they were to be sold, they would need fresh infusion of new capital to make them economically viable. Recognizing this reality, the government has ignored these units in its drive. This of course implies that the task of dealing with the burden that loss-making enterprises place on the budget in the long run have been ignored and attention has been focussed on disposing equity in the more profitable public enterprises.[13] The losses of loss-making enterprises will increase if the government does not infuse capital into them to modernize and restructure them to sell them. In the long run then, the burden of these loss-making enterprises will increase. The profit making enterprises on the other hand are either the ones which can be restructured to function more efficiently (MTNL for example) or are the ones which operate in areas where oligopoly is inevitable, the belief that the private ownership can make a positive contribution is either misplaced or an exaggeration.[14]

Disinvestment of profit-making enterprises means a revenue loss for the government. It is so because if the management and functioning of profitable public enterprises can be revamped to enhance their revenue generation capabilities, then there is no reason why that long-run stream of revenues should be sacrificed in order find the resources to do away with a long run stream of losses.[15] Further, using the proceeds from disinvesting profit making enterprises for current consumption needs amounts to frittering away of valuable public assets.[16] The correct policy would have been to allow the public sector units themselves to use the resources they generate via the disinvestment programme. This would have helped them to revitalize and expand their activities.[17] This programme of the government i.e. disinvesting profit-making enterprises has thus deprived the government of future yields from the these enterprises.

Other problems of the disinvestment process relates to the costs incurred in disposing or selling equity of public enterprises. The costs incurred here refer to infusion of capital in loss-making enterprises to make it economically viable for selling it later. The costs incurred in profit-making enterprises refer to the expenses in preparatory measures undertaken before the disinvestment process which may concern legal matters and also measures to make the sale attractive for the private sector.

Even though the process of disinvestment is going on since 1991 there is lack of wide consensus among the people and among various groups in particular. While there is wide-spread dissatisfaction among the public about the poor performance of a large number of public enterprises, there is insufficient recognition that disinvestment could be the corrective action to tackle this problem.[18] Here in India, there has not been any conscious effort towards building up such a consensus among the different sections of the people. However, the Disinvestment Commission mentioned that the disinvestment as a long term strategy does not mean mere sale of some proportion of government shares in blue-chip public enterprises but involves concerted action to introduce elements of commercial orientation and market responsiveness into the management of the enterprises to enhance the enterprise value.[19] The commission has also stressed that its approach to disinvestment is not ideological but driven by the imperative need for better utilisation of public resources. The results of this process in better utilisation of resources is yet to be seen.

There have three very important criticisms of the disinvestment programme. These have been called as misconception by the Disinvestment Commission and it tries to remove these misconceptions through explanations. These are:-

(i) Disinvestment is considered as a short-term budget balancing measure by disposing of valuable public assets carefully built over the years without demonstrating explicitly the use of the proceeds for priority investment for long term benefits to the economy.[20] The Disinvestment Commission emphasizes fact that its recommendations should be implemented by the government as a package and not merely sale of a part of equity in a profit-making enterprise. A procedure that is open and transparent regarding the disinvestment deals would help in dispelling any misgivings of the public. The Commission also recommended for the creation of a Disinvestment Fund to build up the credibility of the programme.

(ii) Disinvestment is seen by organised labour and the trade unions as a threat to job security. This programme is seen as a threat to pensions and other labour rights and an awareness that most of the public enterprises are overmanned. Sale of assets to the private sector would certainly result in reduction of the work force. Worker retrenchment or early retirement is the cause of worry of most workers and trade union. However, the Disinvestment Commission stressed that mere transfer of ownership from government to the private sector does not in any may imply closure or total retrenchment. Right-sizing the work-force may be required to improve the viability of a concern in an increasingly competitive environment and this will be inevitable in the long run whether an undertaking continues to be managed or owned by the government or not.[21] Overmanned public enterprises, particularly the loss-making ones face the eventual prospect of closure and hence retrenchment will be permanent. Right-sizing of such enterprise therefore, turns out to be in the longer term interest of employees as a whole. This will certainly mean that a social safety has to be provided to the retrenched workers. They should get the VRS benefits and also retraining for taking up alternative jobs. The Commission has in its report commended the formulation of an attractive VRS and a scheme for retraining and redeployment of employees affected by closure of units.

(iii) Disinvestment is perceived as a prelude to the withdrawal of state intervention from the critical areas of the economy. According to the Disinvestment Commission, the process of disinvestment will not lead to withdrawal of the state but help in reallocation of public investment from the sectors where public purpose is no longer served to other sectors where there is a greater need for it.[22] Disinvestment, according to the commission does not aim at curtailing state activity for economic growth is an important area but towards channelising it to areas of greater priority for better utilisation of resources, but this argument does not sound convincing enough.

Despite trying to dispel the misconceptions regarding disinvestment by the Disinvestment Commission, the whole process is seen as transformation of social gains or benefits into private profits. The Indian government went ahead quietly with disinvestment which is a part of the privatisation programme.[23] Lack of agreement on the meaning and scope of the word privatisation has led to conflicting interpretations. Generally it meant rolling back of the government's involvement in the economy which can create lots of anxieties in a country like India. Sale of assets is another aspect of privatisation which is the disinvestment process. The process is likely to create new owners only among the relatively rich sections of the society. Thus, the vast majority of the poor are likely to view any transfer of ownership of assets with scepticism.[24] This aspect of the process disinvestment depicts a picture in which the objectives of the public sector has been set aside. The process seems to widen disparities and enhance inequalities rather than checking concentration of wealth in few hands and utilizing resources evenly and equally for everyone.

An important question that arises here is whether disinvestment and privatisation is the only answer to public sector reforms? An alternative to these processes can be by improving the economic efficiency of public enterprises which can be achieved by shedding excess labour and by introducing efficiency criteria into these operations. Through these means it may be possible for many loss-making public enterprises to become profitable. Technological modernization and improvement of management practices are essential for raising productivity in these enterprises. Monitoring and controlling the managements of public enterprises by various government ministries and departments, which dilutes managerial responsibility, need to be carefully streamlined and single-window procedures established.[25]

Privatisation is a term invented by politicians to explain their economic policies which signify the 'shrinking of the welfare state'. It is generally felt the privatisation has been uneven and plagued with unforeseen obstacles. Some of the problems have arisen due to lack of understanding of the concept of privatisation, others have arisen due to the lack of the necessary prerequisities for privatisation to succeed and some others have arisen due to lack of adequate preparatory measures and the efficient management.[26] Privatization, however, can not be a panacea for solving the economic ailments. It should be seen as an impetus to galbanise the ailing economy rather than getting rid of the sick enterprises. The privatization programme adopted by various countries is either due to the failure of the preceding system or because others are privatising. The politicians may simply want to reap immediate benefits out of it or they may be forced to adopt it under pressure from international aid donors.

Like all economic reforms, privatization also has distributional consequences. It may favour certain groups within a polity at the cost of others. Every political compromise involves economic costs in terms of sacrificing long-term goals, slowing down the pace of reforms and increasing the duration of the transition period. As privatization process favours some groups and disfavours others, economic disparities will increase further. It also involves reduction in employment, capital expenditure and social infrastructure by the government. The new economic policies are more elitist in orientation. They are meant to serve the interests of the industrial sector at the cost of the agriculture sector and the rich sections of the population at the cost of millions living below the poverty line.[27] An attempt it can be said, is made to achieve 'economic efficiency' at 'the cost of equity'. It should be remembered that in the context of efficiency-equity debate, it is possible to have an allocation of resources that is efficient but highly inequitable or one that is equitable but lightly inefficient. In countries like India, the notion of efficiency can acquire meaning only with reference to equity and not as a contrast to equity.

Moreover, with privatization, the entire value system is likely to change. It will give rise to western type of consumerism. Self-interest in bound to prevail upon altruism. Privatization can either lead to poor quality of public services or reduction in expenditure on public services by the state. Therefore, the privatization programme can fail when its true social costs become apparent.[28]

Thus, we find that privatisation is not the mantra for all economic problems, deficits, inefficiencies etc. It can not yield quick results in terms of economic efficiency, enhanced competition, de-bureaucratisation and less government. Disinvestment of equity in public enterprises also can not solve problems of resource limitations forever and can not lead to efficiency in reality.

Endnotes

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28 Ibid, p. 146.

Conclusion

The privatization and disinvestment programme initiated in India in 1991, had been in response to the IMF's structural adjustment programmes. It was also in response to bring about reforms in the public sector enterprises. These enterprises as envisaged by Nehru were to be the commanding heights of the economy. They helped a newly independent country like India to cross the hurdles of underdevelopment and to start its industrial take-off. The public sector was important at that time when Nehru desired for a healthy socialist economy dedicated to improving the quality of life of the people. Importance was given to state initiative in the industrial progress and advancement of the country. The role of the public sector was to make the country self-reliant in resources and in technology, better distribution of wealth along with reduction in inequalities, generation of employment opportunities, removing regional imbalances etc. Thus, the public sector was entrusted with massive tasks of development and growth of India.

However, in course of time it was realized that the performance of the public sector in terms of its profitability was poor. Many public sector enterprises were loss-making enterprises which in the long run would not be able to sustain themselves may ultimately opt for closure. These loss-making enterprises increased the budgetary burden of the economy, being overmanned, inefficient and loss-making. To arrest the accumulation of losses of public enterprises, reforms were introduced in the form of MoUs, downsizing carried along with VRS, reforms in civil service etc.

One of the public enterprise reform has been the programme of disinvestment. This entailed the sale of a part of equity of public enterprises to the private sector. Such a sale of equity was thought to increase efficiency of the enterprise and also bring in revenues for the government. However, such a process was marked with various intricacies. The economics of disinvestment and privatization hailed this process as a solution to all the economic ills. On the other hand, the politics in the process brought in various actors which supported or opposed it. The politicians although hesitant in the beginning of the disinvestment programme became audacious enough to carry on a full-fledged disinvestment programme with disinvestment of shares increasing from 20% to 49% and later to 74% in non-core categories of public enterprises.

On the other hand, the workers and the trade unions fearing loss of their jobs and other rights opposed the process. Although the Disinvestment Commission has recommended for an attractive VRS and also facilities of retraining for the retrenched workers, the opposition and uneasiness in these quarters prevail. It seems that while carrying the disinvestment policy, the government is indulging in escapism as it has continued to neglect the loss-making enterprises and focused on disinvesting shares of the profit-making ones. Disinvesting shares of profit-making ones brings revenue for the government in the short term but the picture in the long run would be that the government would be saddled with the loss-making enterprises only. Disinvestment in this sense seems to give immediate gains to the government and the politicians too want to reap benefits during their short tenure.

The purpose for which the disinvestment programme was started remains unfulfilled: there are still loss-making enterprises waiting for fresh infusion of capital to make them viable for disinvestment. In spite of disinvesting the profit-making ones, the proceeds from disinvestment has not been able to cap the fiscal deficit. The short term objective of reducing fiscal deficit remains unfulfilled. At the same time in the long-term, the country will face problems as the government is sacrificing the revenues of the profit making enterprises for the revitalization of the loss-making enterprises. This long-term objective also seems to remain unfulfilled as the proceeds are used in present budgetary outlays rather than using it for reinvigorating the loss-making enterprises.

The question arises as to who is benefitting from the disinvestment policy? It seems that the politicians in nexus with the bureaucrats accelerate the process either to gain accolades for carrying on the economic reforms or are benefiting directly from the process. Allegations of kickbacks rent the air in the not so transparent disinvestment process. The beneficiaries also include the businessmen to hold stake in profitable public enterprises. The loser in this case seems to the common man who will be hurt when the objectives of the disinvested enterprises will be altered by the private sector for private profits. Social gains is hence transformed into private gains. All this led to increase in inequality and concentration of wealth in fewer hands. This also suggests tat the socialist principle of equality and improvement in the standard of living of all will remain just a dream.

Privatization seems to have a limited scope in a country like India where there are wide inequalities, poverty, unemployment and a huge population to support. State intervention becomes essential when majority of the population cannot do without the welfare measures of the state. The disinvestment process in a way seems to mobilize resources rather than to reduce the role of the government in the economy. However, such short-sighted objective may cost the country dearly. It is not to say that these process of privatization and disinvestment do not have any merits but they only provide partial solutions to fiscal problems. However, the calculations by the politicians and bureaucrats must be done taking into account the economic costs of the efficient public enterprises and the social costs of the privatization and disinvestment programme.

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