Chapter - 4

Privatization in Indian Economic

4.1 Public Sector in the Indian Economy[14]

The present Indian economic structure is often characterised as 'mixed economy. There are two fields of production in the structure — the private sector and the : sector. The present chapter is devoted to a discussion of issues pertaining to the public sector. In particular, we discuss:

- Division of the economy-into public and private sectors
- Role and performance of the public sector
- Problems of public sector enterprises
- Policy towards public sector since 1991.

4.1.1 Division of the Economy into Public and Private Sectors

At the time of Independence, activities of the public or were restricted to a limited field like irrigation, power, railways, ports, communications and some departmental undertakings. After Independence, the area of activities of the public sector expanded at a very rapid speed**.** To assure the private sector that its activities will not unduly curbed, two industrial policy resolutions were issued in 1948 and 1956 respectively. These policy resolutions divided the industries into different categories. Some fields were left, entirely for. the public sector, some fields were divided between the public and the private sector and some others were left totally to the private sector. A cursory glance at the division of fields of industrial activity into the public and private sectors clearly brings out, that while heavy and basic industries were kept for the public sector, the entire field of consumer goods industries (having high and early returns) was left to the private sector. Outside the industrial field, while most of the banks, financial corporations, railways, air transport, etc., are in the public sector, the entire agricultural sector (which is the largest sector of the economy) has been left for the private sector.

[14] Mishra & Puri, Indian Economy, 2010, Himalaya Publication. Pg.391

The important point that arises at this juncture, is — why were the heavy and basic industries like iron and steel, heavy engineering, heavy electrical plant, etc., selected for development in the public sector while quick-yielding consumer goods industries were left for the private sector?

The answer to this question has been attempted by R. K. Hazari according to whom the industrial programmes of government that emerged after 1955 were built around two hypotheses:

(i)private investment in relatively simple goods would be promoted by shutting out imports as well as through excess capacity at home, with a consequent boost to profits; and

(ii) public investment, being autonomous of profits, would take place in basic areas which had long gestation periods, low or no profits, a large foreign exchange component, complex technology and equally complex problems of co-ordination.

The logic of the first hypothesis was that private investment was in the nature of 'induced investment' and could be promoted by adopting a policy of protection against imported substitutes. The logic of the second hypothesis was that investments in low profit yielding and heavy investment requiring industries were in the nature of 'autonomous investment' and could, accordingly, be undertaken only by the State.

4.1.2 Role of Public Sector in the Indian Economy

Public sector in India has been criticized vehemently by a number of supporters of the private sector who have chosen to shut their eyes towards the achievements of the public sector. Following description should be sufficient to convince one that public sector has played a definite positive role in the economy.

1. Public sector and capital formation. 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 per

cent was in the public sector and the remaining in the private sector. The share of public sector and the remaining in the private sector. The share of public sector rose to 60 percent in the third plan but fell thereafter. However, even then it was as high as 45.7 per cent in the seventh plan. With increasing trends of liberalization in 1990s, the share of public sector in total investment fell drastically to 34.3 per cent in the eighth plan (i.e., only one-third) and further to 29.5 per cent in the Ninth Plan. This reflects the increasing importance that is now being accorded to the private sector. The nationalized banks, State Bank of India, Industrial Development Bank of India, Industrial Finance Corporation of India, State Financial Corporations, LIC, UTI etc., have played an important role in collecting savings and mobilisation of resources.

However, savings in the public sector itself are not much. In fact, there has been a precipitous fall in the share of public sector in gross domestic savings. During the period of Sixth Plan as a whole, public saving was 23.7 per cent of total domestic saving and this fell to 14.8 per cent during the period of the Seventh Plan and just 9.2 per cent in the Eighth Plan (at 1999-2000 prices). During the first year of the Ninth Plan, 1997-98, share of public sector in total savings was just 7.5 per cent. Savings in the public sector were negative in all other years of the Ninth Plan. The first year of the Tenth Plan, i.e., 2002-03 also recorded negative savings in the public sector. However, things have distinctly improved since. In 2003-04, savings in the public sector were Rs. 29,521 crore which rose significantly to Rs. 1,37,926 crore in 2006-07 and Rs. 2,12,543 crore in 2007-08. The share of public sector in total savings was 3.6 per cent in 2003-04 which rose significantly to 9.3 per cent in 2006-07 and further to 11.9 per cent in 2007-08. The share of public sector in gross domestic capital formation (GDCF) which was 44.6 per cent during Sixth Plan fell to 31.7 per cent during Eighth Plan. It is estimated to have declined further to 27.3 per cent in the Ninth Plan and 22.2 per cent during the Tenth Plan.

2. Development of infrastructure. The primary condition of economic development in any underdeveloped country is that the infrastructure should

develop at a rapid pace. Without a sufficient expansion of irrigation facilities and power and energy, one cannot even conceive of agricultural development. In the same way without an adequate development of transportation and communication facilities, fuel and energy, and basic and heavy industries, the process of industrialization cannot be sustained. India had inherited an undeveloped basic infrastructure from the colonial period. After Independence, the private sector neither showed any inclination to develop it nor did it have any resources to make this possible. It was comparatively weak both financially and technically, and was incapable of establishing a heavy industry immediately. These factors made the State's participation in industrialization essential since only the 'government could enforce' a large-scale mobilization of capital, the co-ordination of industrial construction, and training of technicians. The government has not only improved the road, rail, air and sea transport system, it has also expanded them manifold. Thus the public sector has enabled the economy to develop a strong infrastructure for the future economic growth. The private sector also has benefited immensely from these investments undertaken by the public sector.

3. Strong industrial base. The share of the industrial sector (comprising manufacturing, construction, electricity, gas and water supply) in Gross Domestic Product at factor cost has increased slowly but steadily during the period of planning. The share of the industrial sector in GDP at factor cost rose from 15.1 per cent in 1950-51 to 24.0 per cent in 1980-81 and further to 25.8 per cent in 2008-09 (at 1999-2000 prices). This shows the increasing importance of the industrial sector in the Indian economy. Not only this, the industrial base of the Indian economy is now much stronger than what it was in 1950-51. There has been significant growth in the defense industries and industries of strategic importance. The government has strengthened the industrial base considerably by placing due emphasis on the setting up of industries in the following fields — iron and steel, heavy engineering, coal, heavy electrical machinery, petroleum and natural gas, chemicals and drugs, fertilizers, etc. Because of their low profitability potential in the short run, these industries do not find favour with the private sector. However, unless these

industries are set up, the consumer goods industries cannot progress at a sufficiently rapid pace. Therefore, the production of consumer goods industries in the private sector is also likely to suffer if the State does not invest in heavy and basic industries. As noted by A.H. Hanson, "Even the view that ; it is the function of the State to provide only basic 'services' leaves room for a great deal of public enterprise in manufacturing industry, as well as in power, transport, communications, etc. For consumer-goods industries, which; are usually capable of attracting; some private capital, depend on the 'services' of the producer-goods industries in which private capital is — at least initially — less interested. Hence one can argue, without any 'socialistic' overtones, that as — for instance — textile or food-processing industries; need the support of native metallurgical and engineering industries (the necessary equipment not being available; from abroad owing to foreign exchange difficulties, delivery; delays, etc.) and as no private entrepreneurs show any;: inclination to pioneer the latter, the State must step in arid;; do the pioneering itself.

4. Economies of scale. In the case of those industries where for technological reasons, the plants have to be large! requiring huge investments, setting up of these industries in the public sector can prevent the concentration of economic; and industrial power in private hands. It is a known fact that; in the presence of significant economies of scale, the free market does not produce the best results. Accordingly, considerations of economic efficiency require some form of government regulation or public ownership. Even in the U.S.A. firms in electric power, natural gas, telephone and some other industries are being regulated by Federal and State regulatory commissions. Countries like France and le United Kingdom have explicitly preferred public ownership in these fields.

5. **Removal of regional disparities.** The government in India has sought to use its power of setting up of industries as a means of removing regional disparities in industrial development; In the pre-Independence period, lost of the industrial progress of the country was limited in and around the port towns of Mumbai, Kolkata and Chennai. Other parts of the country lagged far

behind. After the, initiation of the planning process in the country in 1951, the government paid particular attention to the problem and set up industries in a number of areas neglected by the private sector. Thus, a major proportion of public sector investment was directed towards backward States. All the four major steel plants in the public sector—Bhilai Steel plant, Rourkela Steel Plant, Durgapur Steel Plant and Bokaro steel Plant were set up in the backward States. It was believed that the setting up of large-scale public sector projects. in the backward areas would unleash a propulsive mechanism in them and cause economic development of tie hinterland. These considerations also guided the location if machinery and machine tools factories, aircraft, transport equipment, fertiliser plants etc.

6. Import substitution and export promotion. the foreign exchange problem often emerges as a serious constraint on the programmes of industrialization in a developing economy. This constraint appeared in a rather strong way in India during the Second Plan and the subsequent plans. Because of these considerations, all such industries hat help in import substitution are of crucial importance for the economy. Bharat Heavy Electricals Limited, Bharat electronics Ltd:, Hindustan Antibiotics Ltd., Indian Oil Corporation, Oil and Natural Gas Commission, etc., in the public sector are of special importance from this point of view.

Several public sector enterprises have also played an important role in expanding the exports of the country. Specific reference of Hindustan Steel Limited, Hindustan Machine Tools Limited, Bharat Electronics Ltd., State Trading Corporation and Metals and Minerals Trading Corporation can be made in this context.

~~7.~~ **Check over concentration of economic power.** In a capitalist economy where the public sector is practically non-existent or is of a very small size, economic power gets increasingly concentrated in a few hands and inequalities of income and wealth increase. During the four and a half decades of planning in this country, it has been said time and again that the

expansion of public sector will help in putting a brake on the tendency towards concentration of wealth and economic power in the private sector.

Public sector can help in reducing inequalities in the economy in a number of ways. For instance **(i)** profits of the public sector can be used directly by the government on the welfare programmes of the poorer sections of community; (ii) public sector can adopt a discriminatory policy by supplying materials to small industrialists at low prices and big industrialists at high prices; **(ii)** public sector can give better wages to the lower staff as compared to the private sector and can also implement programmes of labour welfare, construction of colonies and townships for labourers, slum clearance, etc:; and (iv) public sector can orient production machinery towards the production of mass consumption goods.

Performance of the Public Sector

It is usual to judge the performance of private sector units by the yardstick of net profit or loss since in their case, maximization of profit is the sole aim. This yardstick fails miserably in the case of public sector undertakings. Such units are frequently started in those sectors where profitability is low and gestation period long. For instance, investment in infrastructure and basic industries is not likely to yield early returns and, accordingly, profits in the beginning are likely to bevery4ow and in some instances, may even be negative. Yet these investments serve important ends since they create the basis for expansion of industrial activities in the future. Investments made by the public sector in the steel industry, fertilizers, power projects, mining, etc., come under this category. Then, in some cases, public sector provides inputs to the private sector (for example, iron and steel to machine building, tools, automobile industry, etc.) It is very easy for it to earn huge profits by merely hiking the prices of its output. However, this is likely to have an adverse impact on the industrial activity in the private sector on the one hand, and push up prices on the other. Accordingly, prices are intentionally kept low even though this cuts into the profits of the public sector seriously. Also, as noted by Hazari and Oza, private sector has invested mostly in consumer and lighter goods which have been granted far greater

protection against external competition as compared to capital goods which were mostly produced by the public sector and which faced stiff competition from imports financed by aid and foreign private investment. Another point that needs specific mention is that the public sector is not merely capital-intensive and characterised by longer gestation periods; in steel, which accounts for the bulk of investment, it is also material intensive, and to that extent its value added component is smaller than in items like, say, chemicals.

Because of considerations such as these, it is often maintained that the performance of the public sector units should not be judged by what they earn in the form of profits but by the total additions they make to the flow of goods and services in the economy. Thus, instead of profits, the yardstick should be the total value of the sales of an enterprise. For instance, if an iron and steel plant produces steel worth Rs. 5,000 crore in a certain specified period but makes no profit because its aim is to provide steel at low prices to the industries using steel as an input, it would be wrong to say that its performance is disappointing on this count alone. What is important from the point of view of the industrial development of the country is the fact that this plant has added steel worth Rs. 5,000 crore to the social pool of goods and services obtaining in the country.

Expansion of the Public Sector and its Share in National Production

There has been massive expansion in the public sector after Independence. At the commencement of the First Five Year Plan in 1951, there were only 5 central public sector enterprises with investment amounting to Rs. 29 crore. As on March 31, 2009, there were 246 public sector enterprises with an investment of Rs. 5,28,951 crore. The turnover was Rs. 3,89,199 crore in 1999-2000 which rose to Rs. 10,81,925 crore in 2007-08. According to Economic Survey**,** 2009-10, the turnover rose further to Rs. 12,63,405 crore in 2008-09. Of the total Rs. 5,28,951 crore investment in the public sector as on March 31, 2009, as much as 46.1 per cent belonged to the. service sector, 26.2 per cent to electricity, 18.1 per cent to manufacturing and 8.8. per cent to mining.

As far as the share in national production is concerned, Central PSEs play a pivotal role in the production of coal and lignite, petroleum and in non-ferrous metals such as primary lead and zinc. The PSEs have also been making substantial contribution to augment the resources of the Central government through payment of dividend, interest, corporate taxes, exise duties, etc. During 2008-09, contribution to the Central Exchequer by the Central PSEs amounted to Rs. 1,51,728 crore.

The Question of Profitability

Though we have pointed out earlier that profits are not the criterion for examining the performance of public sector enterprises their financial performance is of wide interest and concern as they are set up at a huge cost to the national exchequer. As is clear from Table 30.1, profit before interest and tax increased from Rs. 42,720 crore in 1999-2000 to Rs. 1,55,000 crore in 2007-08 while net profit after tax increased from Rs. .14,331 crore to Rs. 79,736 crore over the same period. The ratio of profit after tax to turnover rose from 3.7 per cent in 1999-2000 to 7.4 per cent in 2007-08 while the ratio of profit after tax to capital employed rose from 4.7 per cent to 10.4 per cent over the same period.

What is more, the reliance of public sector enterprises on budgetary resources declined while their gross internal resource generation increased. Gross internal resource generation in 1999-2000 was Rs. 35,933 crore which rose to Rs. 96,551 crore in 2006-07. Despite all this, the fact of the matter is that the ratio of net profit to capital employed remained highly inadequate for many years looking at the colossal investments that have been made in the public sector (in a number of years this ratio has been in the range 2.0 to 2.5 per cent). Bimal Jalan has alleged that it is this 'low return on investment' in the public sector enterprises that is, to a large extent, responsible for the fiscal crisis of the Central government.

Employment and Labour Welfare

As far as this criterion of the performance is concerned, the public sector seems to have done exceedingly well. It his contributed to a significant extent in improving the overall employment situation in the country and has acted as a model employer by providing the workers with better wages and other facilities as compared to the private sector, the number of, persons employed in the Central public sector enterprises as on March 31, 2009 was 15.35 lakh (excluding casual workers and contract labour). The average per capita emoluments in central public sector enterprises stood at about Rs. 5,45,500 per annum. The industrial sectors which, have a sizable number of employees in the public sector include coal, steel, textiles, heavy engineering, and medium and light engineering.

The public sector enterprises have also spent a considerable; amount on the development. of townships around them. These townships were provided with facilities like schools, hospitals, shopping complexes, etc. A substantial sum of money is spent annually on the maintenance and administration of these townships and social overheads. For instance, gross expenditure worth Rs. 3,581 crore was incurred by public sector units as on March 1, 2007 on township maintenance, administration and social overheads. The employees of the public sector enterprises also enjoy medical amenities, subsidized canteen facilities, transport and, educational facilities, etc.

Public Sector and Foreign Exchange Earnings

Enterprises in the public sector have 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 equipment which were totally imported about four decades back are, now being mostly manufactured in the country itself. This has saved valuable foreign exchange. The ONGC and Indian Oil Corporation have helped the country in reducing the dependence on foreign imports. The Hindustan Antibiotics Ltd. and the Indian Drugs and Pharmaceuticals Ltd. have entered-the field of manufacture of drugs and

pharmaceuticals in a big way. While this has helped in saving foreign exchange on the one hand, it has also enabled the country to break the stranglehold of foreign companies in this field. As far as foreign exchange earnings are concerned, the public sector has contributed in three ways: (i) through direct export of items produced in the public sector, (ii) through services rendered by the public-sector undertakings, and (iii) through trading and marketing services of the undertakings through which exports are canalized. The public sector accounted for 11.5 per cent of export earnings in 2006-07 (Rs. 65,620 crore out of Rs. 5,71,779 crore).

The Question of Efficiency

Though there is no dispute regarding the role of the public sector undertakings in country's economic development, yet the feeling widely prevalent is that the rate of profit in these undertakings is either too low or is negative. Accordingly, they are inefficient.

However, it is not so easy to decide about the efficiency of the public sector undertakings. As noted by us earlier, the rate of profit might be a good criterion to judge the efficiency of a private sector enterprise but cannot be deemed so for a public sector enterprise. To judge the efficiency of a public sector undertaking, A.E. Khan and Hollis B. Chenery have recommended the criterion of social marginal productivity. According to Chenery, the utility of investment in any project should be judged by its impact on the national income, balance of payments and distribution of income. According to Walter Galensen and Harvey Libenstein, the evaluation of investment in the public sector should be done on the basis of "marginal per capita reinvestment quotient". According to this criterion, we must examine whether investment of capital in any project will lead to maximization of national income at any point in the future or riot. Without entering into the controversy regarding determination of investment in the public sector at this juncture, we would like to emphasize that evaluation of any State enterprise should be done on the basis of social benefit and social cost and not on the basis of rate of profit.

According to G.K. Shirokov, efficiency of a public enterprise should not be judged on the basis of profitability alone. ‘’The economic efficiency of a public sector industry manifests itself alone in the transformation of the industrial structure, modernisation, higher labour productivity on a country-wide scale etc.’’ The fact is that a higher proportion of the value produced by the public sector industries is realised outside this sector, and it is, therefore, very difficult to estimate the efficiency of public sector enterprises in terms of cost and profitability**.** Most of the critics of the public sector enterprises fail to take social costs and benefits into account and consider only net profits or losses. They are thus guilty of ignoring the right criteria for judging the performance of public sector enterprises.

Not only this. Even the losses incurred by public-sector enterprises are, to a considerable extent, due to the take over of sick units from the private sector to protect the interests of the working class. For instance, of the 102 loss making enterprises in 1991-92, about 40 per cent constituted sick units taken over by the government from the private sector. Thus, the losses of the private sector 'spilled over' to the public sector.

Before we conclude this section, the following comments from Arif Sharif are in order: **“**Now that decrying public sector performance has become fashionable, many seem to have forgotten the crucial role it has played in India's development since the Second Plan, which cannot be measured against the value of its output. The private sector never had to bear such responsibilities. Instead, it relied on the public sector to meet much of its technology and skilled manpower requirements.”

4.1.3 Problem of Public Sector Enterprise

The most important criticism levied against the public sector has been that, in relation to the capital employed, the level of profits has been too low. Even the government has criticised the public sector enterprises on this count. For instance, the Eighth Five Year Plan notes that the public sector has been unable to generate adequate resources for sustaining the growth process. Of

the various factors responsible for low profits in the public sector, the following are particularly important:

Price Policy of Public Enterprises

Private sector enterprises are operated with the sole aim of maximising profits. Accordingly, prices are determined at a level that would cover total cost (including taxes) and provide a sufficient net return over and above this. As against this, 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. Even under conditions of monopoly, the objective of the pricing policy of a particular public sector enterprise may not be profit maximisation. Indian Railways, Indian Airlines Corporation, State Electricity Boards are examples of public monopolies. Public enterprises like Steel Authority of India and the Fertilizer Corporation of India also operate in seller's market. It is very easy for these enterprises to earn huge profits simply by increasing their prices. But since their object was not profit maximisation but fulfilment of some social objective, they opted for losses in some cases while in some instances they just tried to equate total revenues to total costs.

As an illustration of this statement one may consider the pricing policy for fertilizers and pesticides being produced by the public sector in India. The main aim in this case was to provide fertilizers and pesticides at cheap prices so that even average farmers can easily purchase them. This.: was rendered essential because of the contribution that fertilizers and pesticides make towards increasing agricultural production and productivity. On account of this reason, Fertilizer Corporation of India and Hindustan Insecticides intentionally kept their selling prices low. Even in regard to the pricing of steel, the government's policy was not to earn high profits. Till May 1967, prices of steel were kept so low that they either yielded losses or very low profits.

As regards the pricing policy of public sector enterprises, we can find two different approaches- (i) the public utility approach and (ii) the rate of return approach. The former implies a pricing policy that yields a no-profit-no-loss situation. This pricing policy was followed for a long period by many public

sector enterprises. It obtained support from the fact that many public sector units were in the area of basic industries and unduly high prices of their products could cause cost increases over a large segment of the economy. Thus, the pressure to adopt in some sense a minimal price policy was strong and persistent. On account of these reasons, administered prices were intentionally kept very low. For example, the price of steel (as already mentioned earlier) was kept deliberately low. Similar practices were followed by Hindustan Machine Tools,' Hindustan Shipyard and many other public sector enterprises in the initial stages of their operations.

Because of considerations such as these, it is a folly to regard the observed rates of return, without detailed investigation, as evidence of wasteful investment. In fact, as noted by Bhagwati and Desai, “In a situation where domestic prices are distorted by a variety of endogenous and policy-imposed factors, the observed rates of return cannot be taken to give a proper ranking of the social profitability of alternative investments.” However, such a policy of deliberate under-pricing has. had two adverse effects: “Firstly, a policy of under-pricing may result in distortion of choice of technique by the user industries. Thus, for example, under-priced steel can result in excessive, and sub-optimal, use of it as against other materials wherever choice is available (e.g., with office furniture). Secondly, even where no such choice is available, the fact that, in many cases, there is no de jure (or de facto) regulation of the prices of the end-products of the user industries (e.g.; the prices of textile machinery) implies that the profits foregone by the public sector enterprises wind up with the users, who eventually tend to be in the private sector. The effect of under-pricing by public sector enterprises is thus substantially to redistribute revenue in favour of the private sector: which, in turn, compromises the effort of the government at raising real savings in so far as this leads to additional consumption in the private sector.” Moreover, as pointed out by Krishnaswamy, persistent loss or under achievement had serious effects on the morale of both the management and labour in the public enterprises. Particular examples of this tendency are Coal India Ltd., Mining and Allied Machinery Corporation and Heavy Engineering Corporation. As

against this, positive returns had morale boosting effects in enterprises like Hindustan Machine Tools, Bharat Heavy Electricals and Maruti Udyog Ltd.

Since a large amount of investment has gone into public sector enterprises, it is essential that they yield sizable returns. If this does not happen, the process of economic development will suffer a severe jolt as scarcity of investment resources would appear. Therefore, while some public sector enterprises might adopt a 'public utility approach' in their pricing decisions, others have to yield returns on investment. This brings us to the 'rate of return approach' which has been accepted by the government as the right principle for determining the pricing policy of a number of industries. However, as noted by Krishnaswamy, there has been no consistency in the application of this principle. For instance, in the case of petroleum products, the Oil Prices Committee (1974-76) calculated a retention price for each refinery on the basis of a gross return of 15 per cent on the total capital employed. In the case of fertilisers, the Marathe Committee provided for a post-tax return of 12 per cent of net worth.

In an article published in 2006, R. Nagaraj argued that the real culprit of poor public sector saving is not Central public sector enterprises (that have been the subject of much of reforms) but inadequate pricing of the utilities and infrastructure services, and lack of recovery of user charges for the services rendered. In this context, he has provided data to show that the revenue-cost ratio for SEBs (State Electricity Boards), railways and road transport corporations (RTCs) has deteriorated over time (from 82.2 per cent in 1992-93 to 68.6 per cent a decade later in the case of SEBs, from 91.4 per cent in 1992-93 to 88.7 per cent in 2000-01 in the case of RTCs and from greater than one upto 1990-91 to less than one thereafter in the case of railways). Perhaps a telling evidence of the problem, in the aggregate, is the movement of the public sector price deflator, relative to the GDP deflator since 1960-61. Over the last 40 years public sector prices never exceeded the overall price level, and in 2003-04 the relative price stood just 83 per cent of what it was in 1960-61. This shows that public sector prices have risen at a slower rate than the overall prices in the economy over the long run, adversely affecting its

financial position. In other words**,** the crux of the poor financial returns lies in incorrect pricing of these services and poor collection of user charges.

In an attempt to tackle the above problem, the government has announced changes in the pricing policy of public sector enterprises in recent years. The new policy relies less 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. Cement and steel prices have been decontrolled. In fertilisers, only nitrogenous fertilisers are now subject to price control. The new policy favours a more transparent policy for fixing prices and the government has already recommended the adoption of Long Run Marginal Cost (LRMC) based prices for public enterprises. However, adequate steps to levy user charges in public utility and infrastructure services like power, railways, and RTCs have not been undertaken as their pricing is a politically sensitive issue.

Under-utilization of Capacity

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 per cent of their capacity for a number of years, We must ponder seriously why investments worth thousands of crores of rupees in the public sector were not utilized properly and resulted in substantial under-utilization of capacity. Some people have attributed this to the lack of foresightedness on the part of the government. However, the facts are somewhat different. As pointed out by Vijay Kelkar, after the Third Plan, public investments which till then were decided mostly on the basis of plan priorities, were influenced by various other pressures. The public sector enterprises “became increasingly instruments for meeting immediate or ad hoc demands such as producing mass consumption goods, stimulating growth in economically backward areas or using locally available raw materials which were in some cases, like Khetri copper ore, of poor quality. Furthermore, a large number of industries which became sick under private sector management were taken over by the government with a view to maintaining production and protecting employment.” Other factors that

accounted for under-utilization of capacity in public sector enterprises include inefficient operation and poor management of some enterprises, political interference in day-to-day working, labour disputes etc.

Problems Related to Planning and Construction of Projects

As far as the phase of planning and construction of projects is concerned, following problems had to be faced:

(i) selection of site was not based on detailed soil investigation; (ii) there were serious omissions and understatements of several elements of the projects; (iii) the actual costs of projects far exceeded the original estimates; (iv) the projects took much longer time to complete than originally envisaged; and (v) the projects often embodied inappropriate technology or product mix. For instance, Bhagwati and Desai have argued that the site for Heavy Electricals Limited was selected without any explicit calculation of, the cost of alternative locations and later was changed, when found unsuitable. Similarly, a decision was made to locate a fertilizer plant within each State. This led to corresponding decisions to initiate construction at places which were unsuitable from the viewpoint of either demand or raw materials. In addition, as noted by Bhagwati and Desai: “A careful scrutiny of the methods adopted to plan for the projects, as revealed by the reports of several governmental committees appointed for the purpose as also to evaluate the reasons for subsequent increasing costs, underlines the extremely poor quality in general of the work, both from a technical viewpoint, and even more so from the point of view of economic cost and benefit analysis. These reports have not followed any uniform format varying in their coverage and inquiry underlining that no systematic thought was given to questions of project appraisal and that rough, sketchy, and haphazardly incomplete records were often considered adequate for embarking upon quite expensive investments.”

As far as completion of projects is concerned, several of them were completed 18 months to 2 years behind schedule. Cost escalation has often been of the order of 10-15 to 80-90 per cent of the original estimate. According to Chaudhury, cost escalation was due to the following two major

causes: (i) last minute changes in project design sometimes due to a belated recognition that the product mix that was chosen originally was inappropriate to Indian market conditions. This required expensive modifications to plant. Sometimes changes were induced by the need to add vital parts of the plant which had not been included in the original contract; and (ii) lag in starting or finishing a project, which landed the projects with higher costs due to inflation in supplier countries. Very often aid contracts took much longer to complete than originally envisaged. In some cases, the donor countries took advantage of the practices of tied-aid to increase prices charged for plant and equipment. As noted by A.K. Bagchi, foreign aid was normally tied to purchases of equipment and materials from the countries giving loans and grants. The government made only halting and ineffective attempts to insulate the choices of technology and product-mix against pressures exerted by foreign firms and their agents. As a result, foreign suppliers often got away with misspecifying the capacity of the plants set up and their operating characteristics. In fact, alleges Bagchi, a considerable amount of the excess costs and dynamic inefficiencies of the public sector projects was due to the failure of the government to break out of dependence on foreign sources of funds which were tied to sales of particular types of technology for setting up the installations. This shows that while some problems regarding escalation of costs rose from the Indian side, blame for some others has to be placed entirely at the door of the aid relationship India entered into with other countries.

Also, because of the decision to locate large-sized industrial projects in hitherto backward areas the cost and execution of the project depended heavily on the creation of adequate infrastructure facilities. Delays in completion also occurred due to the interlinking of projects steel plants with heavy engineering plants or with coal mines or with railway facilities; electricity generation with the manufacture of electricity machinery, cables, transmission towers and so on by other public sector units; port development with the production of cranes and other berthing equipment by public sector enterprises: Though there was nothing inherently wrong in this practice, it enhanced the transmission of delays and high cost in one unit to the other.

Moreover^ huge townships were constructed around many public sector enterprises to house the employees. Naturally, the costs increased.

Problems of Labour, Personnel and Management

Public sector enterprises are often plagued with undue political interference in their day-to-day working and this has demoralising effect on the management and other personnel of these enterprises. Many appointments at the top are not made on grounds of professional competence or suitability but are determined by various political considerations. Often the management at the top is constituted of the traditional administrative services of I.C.S. and I.A.S. These non-specialised, non-technical people are often unequal to the task of providing the requisite managerial competence in the complex, capital-intensive industrial projects in the public sector. Also, as noted by Bhagwati and Desai,; with their civil service background, these officials inevitably tended to act with bureaucratic caution and unimaginativeness rather than in bold and inventive ways. The actual management was also hammed in by traditional audit procedures and scrutiny of whether the expenditures incurred were within the framework of the authorizations. “Since this scrutiny is intensive and departure from its exacting standards can lead to censure and disgrace, the scope for imaginative and quick action in the interest of better economic performance is inevitably jeopardized.” The work ethic of a public enterprise is very much like that of a government office over occupation with file work, rules-oriented practices, and keeping within the framework of prescribed rules and norms. The costs of this lengthy procedure or delays in decision often do not matter. More emphasis is laid on precedence and interpretation of rules than on results. It has not been duly recognised that the work ethic of a public sector enterprise has to be different from the work ethic of a government office and practices and procedures that make the latter efficient may not be suitable for the former.

Political considerations have also contributed to overstaffing of unskilled labour and payment of higher wages to such labour than in the private sector. As far as skilled personnel are concerned, the public sector enterprises required an imaginative management policy. It was necessary to

provide incentive to skilled personnel in the form of better wages and better, promotion prospects than in the private sector. However, in actual practice it was exactly the opposite. The private sector bosses weaned away the skilled personnel from the public sector through various incentives.

It is frequent to discuss the problem of ‘control vs. autonomy’ in the context of managerial problems. ’Control’ of government undertakings refers to their ‘accountability’ to Parliament for their work. This accountability is justified on the plea that the public sector enterprises are run with the help of tax-payers money and the latter have: every right to know whether these enterprises are being run efficiently or not. Since the will of the people is expressed through Parliament, it is the latter that exercises control over the public sector undertakings. For this purpose, Parliament constituted a separate committee known as the Committee on Public Enterprises in 1964. In addition to this Committee, Bureau of Public Enterprises, Public Accounts Committee, the Estimates Committee, etc. also evaluate the performance of public sector enterprises from time to time.

‘Autonomy’ refers to the freedom granted to the management of a public enterprise to run it without interference of outside agencies. Autonomy is especially important in the context of day-to-day operations of a public enterprise where many on-the-spot decisions have to be taken on a variety of issues that crop up before the management. Interference in such daily work is neither feasible nor necessary. In fact, it can only create impediments on the one hand and demoralise the management on the other.

The line between ‘control’ and ‘autonomy’ is very thin and has not been properly spelt out. Managements of many public enterprises feel that controls on their operations are too much and too frequent inhibiting the possibilities of independent action unduly. Even in routine matters, interference persists. This leads to a sense of insecurity and indecision in top management circles and a lot of time that could be utilised more productively is wasted on drawing up explanations to convince ‘persons who matter’.

To solve these problems, it is necessary to define clearly and explicitly the limits of control, i.e., the spheres where control is to be exercised and the activities that are to be left entirely to the management. Once the limits of control are specifically laid down and the spheres for freedom of action for the management are explicitly recognised; scope for conflict and suspicion will be considerably narrowed down. It would also be a wise policy to involve the management of State enterprises in die process of policy-formulation, target-setting, delineation of functional limits, organising efficient working, etc.

4.1.4 Policy Towards Public Sector Since 1991

The new industrial policy announced by the government in July 1991 emphasised the following four major measures to 'reform' the public sector enteprises: (i) reduction in the number of industries reserved for the public sector from 17 to 8 (reduced still further to 3 later on) and the introduction of selective competition in the reserved area; (ii) the disinvestment of shares of a select set of public sector enterprises in order to raise resources and to encourage wider participation of general public and workers in the ownership of public sector enteprises; (iii) the policy towards sick public sector enterprises to be the same as that for the private sector; and (iv) an improvement of performance through an MOU (memorandum of understanding) system by which managements are to be granted greater autonomy but held accountable for specified results. In addition, there was a drastic reduction in the budgetary support to sick or potentially sick public sector enterprises.

Dereservations

As stated in the Chapter on 'Industrial Policy', the 1956 Resolution had reserved 17 industries for the public sector. The 1991 industrial policy reduced this number to 8: (1) arms and ammunition, (2) atomic energy, (3) coal and lignite, (4) mineral oils, (5) mining of iron ore, manganese ore, chrome ore, gypsum, sulphur, gold and diamond, (6) mining of copper, lead, zinc, tin, molybdenum and wolfram, (7) minerals specified in the schedule to the atomic energy (control of production and use order), 1953, and (8) rail

transport. In. 1993, items 5 and 6 were deleted from the reserved list. In-1998-99, items 3 and 4 were also taken out from the reserved list. On May 9, 2001, the government opened up arms and ammunition sector also to the private sector Thus, now only 3 industries are reserved exclusively for the public sector. These are atomic energy, minerals specified in the schedule to the atomic energy (control of production and use order) 1953, and rail transport.

Policy Regarding Sick Units

The 1991 industrial policy brought the public sector units at par with the private sector units. As a result, the public sector units were also brought within the jurisdiction of the Board for Industrial and Financial Reconstruction (BIFR). Thus, BIFR was given the responsibility to decide whether a sick public sector unit can be effectively restructured or whether it has to be closed down. As on March 31, 2008, 66 PSEs were registered with BIFR, out of which revival schemes were sanctioned in respect of 9 enterprises, 3 cases were dismissed as non-maintainable, 5 companies were declared as no longer sick, and 5 other cases were dropped on account of net worth becoming positive.

In the process of restructuring of the sick and loss making enterprises, the government has liberalised the Voluntary Retirement Scheme (VRS) to enable the Central public sector enterprises to shed their excess manpower. Cumulatively around 5.90 lakh employees have opted for VRS from Central public sector enterprises since October 1998 till March 2007.[19]

Memorandum of Understanding

One of the major initiatives towards the public sector as outlined in the new industrial policy of July 1991 was to bring all public sector enterprises under the system of Memorandum of Understanding (MOU). The system of MOU envisages an arm's length relationship between the PSU and the administrative ministries. It gives clear targets to PSUs and ensures operational autonomy to them for achieving those targets. The MOU system was started in 1987-88 with four PSUs signing MOUs. This number went upto

144 CPSEs in 2008-09. The government has now decided that all CPSEs including risk and loss-making and CPSEs under construction will be covered under the MOU system.

Policy for 'Navratnas'

The government has identified 18 public sector enterprises as Navratnas and decided to give enhanced powers to the Board of Directors of these enterprises to facilitate their becoming global players. The Boards of these Navratna enterprises have been professionalised by induction of non-official part-time professional Directors. These PSUs have been delegated substantial enhanced autonomy and operational freedom which include (i) incurring capital expenditure, (ii) entering into joint ventures, (iii) effecting organisational restructuring, (iv) creation and winding up of posts below Board level, (v) to raise capital from the domestic and international markets, and (vi) to establish financial joint ventures subject to equity investments with special limits.

The government has also granted financial and operational autonomy to some of the other profit making PSUs subject to fulfilling certain conditions. These enterprises are categorised as Miniratnas**.** The enterprises which have made profits continuously for the last three years and have earned a net profit of Rs. 30 crore or more in one of the three years, with positive networth are categorised as Miniratnas I. Category II Miniratnas should have made profits for the last three years continuously and should have a positive networth. Both these categories of public sector enterprises are granted certain autonomy like incurring capital expenditure without government approval upto Rs. 300 crore or equal to their networth whichever is lower (for category I Miniratna companies) and upto Rs. 150 crore or upto 50 per cent of their networth whichever is lower (for category II Miniratna companies). These enterprises can also enter into joint ventures subject to certain conditions, set up subsidiary companies and overseas offices, enter into technology joint ventures, etc. The total number of Miniratna Central Public sector enterprises is presently 62.

Disinvestment of Shares

The Government of India has decided to withdraw from the industrial sector and, in accordance with this decision, it is privatising the public sector enterprises in a phased manner. The main approach of the government in this regard is to bring down its equity in all non-strategic public sector undertakings to 26 per cent (or lower) and close down those public sector undertakings which cannot be revived. For purposes of privatisation, the government has adopted the route of disinvestment which involves the sale of the public sector equity to the private sector and the public at large. All through the period of economic reforms, successive governments at the Centre have advocated the sale of public sector equity as a means of public sector 'reform.' Equity sale, as the industrial policy statement of July 1991 argued, was a means of ensuring financial discipline and improving performance. However, as correctly pointed out by CP. Chandrasekhar and Jayati Ghosh, the experience suggests that fiscal convenience was the prime mover of such disinvestments. The proceeds from disinvestments were used to finance budget deficits and thus to 'window-dress' budgets, "This meant that while there has been much talk of managerial reform, voluntary retrenchment, and greater public sector autonomy for meeting the new market environment, the thrust of public sector reform was almost entirely concentrated: on the sale of equity." The disinvestment programme is discussed in detail in the next chapter on "Privatisation of Public Sector Enterprises: The Disinvestment Programme in India."

Setting up of BRPSE

The government in December 2004 set up a Board for Reconstruction of Public Sector Enterprises (BRPSE) to recommend measures for restructuring/reviving Central PSUs referred to them. The BRPSE also recommends cases where disinvestment or closure or sale are justified. BRPSE made recommendations in respect of 58 cases until December 31, 2009. The government has approved proposals for the revival of 37 public sector enterprise and closure of two.

NOTES

1. For details, please refer to the Chapter on 'Industrial Policy'.

2. R. K. Hazari and A. N. Oza, "the Public Sector in India", in E.A.G. Robinson and Michael Kidron (eds.), Economic Development in South Asia (London, 1970), p..91.

3. Computed from Government of India. Economic Survey, 2004-05 (Delhi, 2005). Statement 1.4. p. S-6, and Economic Survey, 2008-09 (Delhi, 2009), Appendix Table 1.5.

4. A.H. Hanson, Public Enterprises and Economic Development (London, 1965). p. 188.

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

6. G.K. Shirokov, Industrialization of India (Moscow, 1973), p. 139.

7. Arif Sharif, “Planning a Dishonourable Exit,” The Economic Times, April 4, 1993, p. 7.

8. Eighth Five Year Plan, op.cit., Vol. II, p. 108.

9. K.S. Krishnaswamy, ‘Public Sector Undertakings,’ The Economic Times, 8,9 & 10 January, 1981.

10.Jagdish N. Bhagwati and Padma Desai, India Planning for Industrialisation, (London, 1970), p. 155.

11.Ibid, pp. 156-7.

12.R. Nagaraj, "Public Sector Performance Since 1950: A Fresh Look", Economic and Political Weekly, June 24, 2006. p. 2554.

13.Vijay Kelkar, "Public Sector: Measures to Impart Efficiency." The Economic Times, January 3, 1991, p. 11.

14.Bhagwati and Desai, op.cit, p. 158.

15.Pramit Chaudhury, The Indian Economy (Delhi, 1979). pp. 157-8.

16.Amiya Kumar Bagchi,"Public Sector Industry and the Political Economy'of Indian Development," in Terence J. Byres (ed.j. The State, Development Planning and Liberalisation in India (New Delhi. 1997), p. 308 and p. 310.

17.Bhagwati and Desai, op.cit., p. 165.

18.Government of India, Economic Survey, 1992-93. pp. 143-5.

19.Government of India, India 2010 - A Reference Annual (Delhi, 2010), p. 657.

20.CP. Chandrashekhar and Jayati Ghosh, The Market that Failed: A Decade of Neoliberal Economic Reforms in India (New Delhi, 2002), p. 88.

4.2 Private Sector in the Indian Economy[15]

As stated in the chapters on 'Industrial Policy' and 'Public Sector in the Indian Economy', the Government of India opted for a mixed economy in which both public and private sectors were allowed to operate. For example, the 1948 Industrial Policy Resolution divided industries into four categories: (i) three industries in which State was given a monopoly; (ii) six industries where State was to have the exclusive right to set up new units but existing private sector units were allowed to operate; (iii) eighteen industries where regulation and direction was necessary; and (iv) all other industries (not included in the above three categories) where private sector was allowed the freedom to operate. The 1956 Industrial Policy Resolution divided industries into three categories: (i) seventeen industries (listed in Schedule A) whose future development was to be the exclusive responsibility of the State; (ii) twelve industries where the State would increasingly establish new units and increase its participation but would not deny the private sector opportunities to set up units or expand existing units; and (iii) all other industries (not listed in Schedules A and B) where the private sector was given freedom to operate. However, the private sector had to operate within the provisions of the Industries (Development and Regulation) Act. 1951 and other relevant legislations. In this context, the Industrial Policy Resolution 1956 stated, "Industrial undertakings in the private sector have necessarily to fit into the framework of the social and economic policy of the State and will be subject to control and regulation in terms of the Industries (Development and

[15] Mishra & Puri, Indian Economy, 2010, Himalaya Publication, Pg.412

Regulation) Act and other relevant legislation. The Government of India, however, recognizes that it would, in general, be desirable to allow such undertakings to develop with as much freedom as possible, consistent with the targets and objectives of the national plan. When there exist in the same industry both privately and publicly owned units, it would continue to be the policy of the State to give fair and nondiscriminatory treatment to both of them." The Resolution also emphasized the mutual dependence of public and private sectors. While State could start any industry not included in Schedule A and Schedule B, the private sector could be allowed to produce an item falling within schedule A. In fact, the 1956 Resolution emphasized not only the mutual co-existence of private and public sectors but also provided for their mutual co-operation and help.

The private sector took full advantage of the loopholes and exceptions in the legislation and the 'elbow room' allowed by the 1956 Resolution to set up industries even in areas exclusively reserved for the State sector. In fact, with the passage of time, more and more concessions were granted to the private sector to expand its business activities. The working of the Industries (Development and Regulation) Act, 1951, was also full of flaws as the licensing committee worked in a very haphazard and ad hoc manner and there were no definite criteria adopted for acceptance or rejection of applications. Because of widespread criticism of the working of the Act, the government considerably liberalised the industrial licensing policy as well. The New Industrial Policy, 1991, ushered in a new era of liberalisation as industrial licensing was abolished, role of public sector diluted, doors to foreign investment considerably opened, and numerous incentives and initiatives granted to the private sector to expand its business activities. The 1991 policy was therefore welcomed with unbridled enthusiasm by the private sector initially. It welcomed the thought of lower taxes, less red tape, less paperwork, more 'space' to work and less government interference. However, the 1991 policy had also opened the doors to multinationals and increased competition from abroad as tariffs were reduced substantially. Consequently, many domestic producers suddenly discovered their market shares shrinking drastically as their goods failed to meet foreign competition both on grounds

of quality and price. The corporate world also saw significant changes with many old businessmen being knocked out from their top positions and a number of new entrants making their mark.

Role of the private sector in Indian economy

- Private sector in the post-liberalisation phase
- Problems of the private sector
- MRTP Act, 1969 which was designed to control monopolistic and restrictive trade practices of the private sector entrepreneurs and the Competition Act, 2002 (alongwith its amendment in September 2007) which has now replaced the MRTP Act, 1969.

4.2.1 Role of the Private Sector

1. The dominant sector. Despite the rapid progress of the public sector in the period of planning, private sector is the dominant sector in the Indian economy as would be clear from a glance at Table 32.1. Since government data on the industrial sector are available with some time-lag, the latest data are for the year 2005-06.

• As is clear from Table 32.1, the number of private sector companies in 2005-06 was 1,21,113 out of 1,40,161 total companies. Thus as many as 86.4 per cent of the total companies were in the private sector, the share of public sector being only 9.4 per cent. However, in terms of fixed capital, gross output and value added, private sector's share was much lower. For instance, its share in fixed capital was only 28.1 per cent in 2005-06. Its share in gross output and value added was only 38.9 per cent and 33.8 per cent respectively in that year. In terms of employment, private sector's share was greater in 2005-06. It employed 61.5 per cent of workers as against 34.1 per cent employed by the public sector.

2. Importance for development. In western countries, private entrepreneurs have played an important role in economic development so

much so that Schumpeter has characterised them as the initiator and moving force behind the industrialisation process. The private entrepreneur is guided by the profit motive. He is responsible for the introduction of new commodities, new techniques of production, assembling the necessary plant and equipment, labour force and management and organising them into a going concern. The private entrepreneur acts as an innovator who revolutionises the entire method of production. Such activities help the process of industrialisation and economic development. It was because of this reason that the industrial policy resolutions of 1948 and 1956 of the government gave immense opportunities to the private sector to expand its activities. In the new liberalised scenario that has emerged after the announcement of the new industrial policy in 1991, private sector has been assigned the dominant role in industrial development.

3. Extensive modern industrial Sector. A number of modern industries have been set up in the private sector. Important consumer goods industries were set up in the pre-Independence period itself. Particular mention in this regard can be made of the cotton textile industry, sugar industry, paper industry and edible oil industry. These industries were set up in response to the opportunities offered by the market forces. They were highly suitable for private sector since they ensured early returns and required less capital for establishment. Though the engineering industries did not make an appearance in the pre-Independence period yet a start was made by Tata in the field of iron and steel industry at Jamshedpur. After Independence, a number of consumer goods industries were set up in the private sector. Today India is practically self reliant in its requirements for consumer goods. According to the 1956 resolution, "industries producing intermediate goods and machines can be set up in the private sector." As a consequence, chemical industries like paints, varnishes, plastics etc. and industries manufacturing machine tools, machinery and plants, ferrous and non-ferrous metals, rubber, paper, etc. have been set up in the private sector.

4. Potentialities due to personal incentive in the small sector. Small and cottage industries have an important role to play in the industrial

field. These industries employ labour intensive techniques and are, accordingly, important from the point of view of providing employment opportunities. In India, all small and cottage industries are in the private sector. Personal initiative plays a decisive role in small-scale industries. With the help of a small capital, the small entrepreneur uses his resources efficiently to earn maximum profit. Such management is not available to public sector enterprises. The government has reserved a large number of items for production in the small-scale sector. This sector is granted loans at concessional rates of interest and marketing outlets are also provided. In addition, industrial estates have been established at various places where all facilities are provided under one roof to the small scale industries.

4.2.2 Private Sector in the Post in the Post Liberalisation Phase

As stated earlier, the new industrial policy enunciated in 1991 abolished industrial licensing and opened up the economy considerably. As a result, the private sector registered a fast growth in the post liberalization phase. 'Opening up' the economy to foreign competition has also forced considerable restructuring of the private corporate sector via consolidation, mergers and acquisitions as many business houses are concentrating on their core competencies and exiting from unrelated and diversified fields.

Performance of the Corporate Sector

Table 1 provides information on the performance of the corporate sector in the post-liberalisation period. As is clear from this Table, the average rate of growth of sales was 14.0 per cent per annum during 1990s (1990-91 to 1999-2000) and 14.2 per cent per annum during the period 2000-01 to 2006-07. Gross profits increased at an average

Table 1

Financial performance of the corporate sector.

	1990-91 to 1999-2000	2000-01 to 2006-07	2003-04	2004-05	2005-06	2006-07	2007-08
1	2	3	4	5	6	7	**8**
Growth Rates	(Average)	(Average)					
Sales	14.0	14,2	16.0	24.1	16.3	26.2	18.3
Expenditure	14.1	13.6	14.9	23.6	16.7	23.4	18.4
Depreciation provision	17.3	8.9	6.0	1 1.2	8.1	**15.4**	14.8
Gross profits	12.5	20.4	25.0	32.5	24.6	41.9	22.8
Interest payments	15.8	-1**.4**	-11.9	-5.8	-2.0	1.7.4	28.8
Profits after tax	**11**.8	36,5	59.8	51.2	32.8	45.2	26.2
Select Ratios	(Min-Max.)	(Min-Max.)					
Gross Profits to Sales	**(10**.5-14.2)	(10**.1**-15.5)	**11.1**	11.9	12.2	15.5	16.3
Profits After Tax to Sales	(3.3-7.8)	(2.6-10.7)	5.9	7.2 .	8.2	10,7	11.8 .
Debt to Equity	(58.7-99.5)	(43.0-70.5)*	58.6	'52.7	43.0	n.a.	n.a.
Internal Sources of Funds to Total Sources of Funds	(26.1-40.3)	(43.6-65.3)*	53.5	55.5	43.6	n.a...	n.a.
Memo:					(Amount in Rupees Crores)		
Number of Companies			2,214	2,214	2,730	2,388	2,359
Sales			4,42,743	5,49,449	7,35,216	10,41,894	11,41,711
Expenditure			3,86,559	4,77.609	6,43,824	8,78,645	9,56,930
Depreciation Provision			20,406	22,697	28,961	37,095	40,664
Gross Profits			49,278	65,301	90,179	1,61,006	1,86,665
Interest Payments			15,143	14,268	16,302	21,500	25,677
Profits after tax			26,182	39,599	60,236	1,11,107	1,34,291

rate of 12.5 per cent per annum during 1990s and at 20.4 per cent per annum during 2000-01 to 2006-07. What is most significant is the fact that the rate of growth of profits after tax which was 11.8 per cent per annum during 1990s increased to 36.5, per cent per annum during the period 2000-01 to 2006-07. Performance during the year 2006-07 has been particularly good. Growth in sales in this year was 26.2 per cent as against an average of 19.0 per cent during the preceding three-year period (2003-04 to 2005-06). Growth in gross profits at 41,9 per cent during 2006-07 was also higher than the average of 27.3 per cent during 2003-04 to 2005-06, and outpaced the growth in sales by

a large margin. Profits after tax increased by 45.2 per cent during 2006-07 on top of 48 per cent average growth during the three year period 2003-04 to 2005-06. Concomitantly, profit-margin the ratio of profits after tax to sales that fluctuated between 3:3 per cent and 7.8 per cent in the 1990s, improved from 5.9 per cent in 2003-04 to 10.7 per cent in 2006-07; Reflecting the sustained high profitability, internal sources now constitute a major source of funds. This has partly led to a reduced reliance on debt, and a decline in the debt-equity ratio to around 43 per cent by 2005-06 from more than 59 per cent during the 1990s.

However, as is clear from Table 32.2, the performance of the corporate sector in 2007-08 showed some deterioration vis-a-vis 2006-07. For instance, growth in sales and net profits during this year decelerated to 18.3 per cent and 26.2 per cent from 26.2 per cent and45.2 per cent respectively in 2006-07. Growth in gross profits of the corporate sector also decelerated from 41.9 per cent in 2006-07 to 22.8 per cent in 2007-08;

Private Sector Corporate Giants — Ranking in Terms of Net Sales

Table 2 presents data on top 10 private sector companies in India in 2009 (ranked according to net sales). As is clear from this table, the largest private sector company in terms of net sales in 2009 was Reliance Industries with its net sales touching Rs. 1,51,336 crore. In terms of assets also, the company ranks first with its assets placed at Rs. 2,34,800 crore in 2009. Reliance Industries also ranks first in terms of operating profits and net profits. Its operating profits stood at Rs. 25,336 crore in 2009 and net profits at Rs. 14,969 crore. The second ranked company in terms of net sales is Tata Steel. Its net sales in 2009 amounted to Rs. 1,47,365 crore. The third ranked company in terms of net sales in 2009 was Tata Motors with its net sales placed at Rs. 70,429 crore. Operating profits of this company were Rs. 2,548 crore and net profits were negative at - Rs. 2,505 crore. With net sales at Rs. 65,415 crore in 2009, Hindalco occupied the fourth position in 2009. The fifth position in terms of net sales in 2009 was occupied by Larsen & Toubro with its net sales placed at Rs. 40,371 crore. In terms of assets, Tata Steel was the

second largest company in 2009 after Reliance Industries with its assets at Rs. 1,24,239 crore.

In terms of Table 2, the three top companies in terms of assets in 2009 were Reliance Industries, Tata Steel and Tata Motors. In terms of net profits, the top three companies in 2009 were Reliance Industries, Bharti Airtel and Tata Consultancy Services.

Table 2

Top ten private sector companies (Ranked According to net sales), 2009

Company	Net Sales		Operating Profit		Net Profit		Assets	
	2009	Percentage change over previous year	2009	Percentage change over previous year	2009	Percentage change over previous year	2009	Percentage change over previous year
1.Reliance Industries	151336	10.1	25336	-12.90	14969	-23.3	234800	37.7
2.Tata Steel	147365	12.1	14799	-40.90	4951	-59.9	124239	-2.9
3.Tata Motors	70429	98.8	2548	-46.7	-2.505	**	74165	109.6
4.Hindalco	65415	9.6	3665	-49.7	485	-47.9	66906	-9.2
5.Larsen & Tourbo	40371	37.7	6844	53.8	3790	62.0	55722	42.5
6.Essar Oil	38106	5745.2	1317		-483	***	23151	6.0
7.Bharti Airtel	37352	38.3	15570	36.7	7859	22.9	62502	33.3
8.Tata Consultancy Service	27813	23.0	6743	4.7	5256	4.6	22430	29.1
9.Adani Enterprises	26189	33.7	1224	36.1	505	36.5	19657	63.0
10.Suzlon Energy	26082	90.7	2344	13.4	236	-77.0	35568	38.9

Since 2008-09 was the year of economic slowdown in the country as a result of global recession, operating profits and net profits of many companies fell. Even the top private sector companies could not buck the trend and registered a fall in profits. As is clear from Table 32.3, the net profit of Tata Steel declined by as much as 59.9 per cent and that of Hindalco by 77.9 per cent in 2008-09 vis-a-vis 2007-08.

Private Sector Corporate Giants — Ranking in Terms of Market Capitalisation

In recent years, the attention of many corporate sector observers has been shifting from sales recorded by a corporate enterprise to its market capitalisation. Market capitalisation is simply the value assigned by the stock market to a firm. On any particular day, market capitalisation is obtained by multiplying the number of outstanding shares of a company to the stock price on that particular day. However, since stock prices fluctuate from day-to-day and are manipulated by speculators, it is generally average market capitalisation for a period that is taken into account. .For instance, a six-monthly average could be considered or an annual average could be considered. Information on top 10 private sector companies on the basis of market capitalisation is provided in Table-3.

As is clear from this Table, the largest private sector company in terms of market capitalisation is Reliance Industries. The average market capitalisation of this company stood at Rs. 2,68,448 crore in 2008-09. Bharti Airtel occupies the second position in terms of market capitalisation with its market capitalisation in 2008-09 at Rs. 1,39,238 crore. Infosys Technologies occupies the third position followed by ITC and TCS. What is significant is the fact that the three top IT companies of the country — Infosys, TCS and Wipro are among the top ten companies in terms of market capitalisation.

Conditions of slowdown in the economy during the year 2008-09 affected the investor psychology adversely and, as a result, market capitalisation of most of the companies fell in this year vis-a-vis the previous year. Of the top ten private sector companies in 2008-09 listed in terms of market capitalisation, the most adverse effect can be seen in the case of ICICI Bank whose market capitalisation fell by as much as 42.7 per cent in 2008-09 over 2007-08.

4.2.3 Problems of the Private Sector

1. Profit generation is the main motive. Industrialists in the private sector operate with the sole motive of maximizing profits. Consequently, they are interested in investing only in those industrial sectors where quick profit generation is possible. Therefore, they tend to invest in consumer goods industries and ignore investments that are crucial for building up a proper industrial infrastructure. Since lack of infrastructure and capital goods industries plagued the Indian economy after Independence, while private sector was reluctant to invest in these areas, the public sector had to step in. Thus, for a considerable period of planning, while the public sector bore the responsibility of developing the capital goods and basic industries and industrial infrastructure (electricity and power, transportation, communications etc.), the private sector concentrated on consumer goods industries; where investments were low and profits high. Thus, a-number of economists allege that in the initial phase of

Table 3

Top ten private sector companies – ranked on the basis of market capitalization

Rank	Company	Average Market Cap. 2008-09	Average Market Cap. 2007-08	Average Market Cap. 2006-07
1.	Reliance Industries	2,68,448	3,14,124	1,60,393
2.	Bharti Airtel	1,39,238	1,66,593	97,891
3.	Infosys Technologies	84,595	1,02,417	1,04,532
4.	ITC	69,928	67,223	66,904
5.	TCS	67,808	1,03,535	1,03,974
6.	ICICI Bank	62,775	1,09,586	63,486
7.	Larsen & Toubro	61,349	84,890	36,884
8.	Housing Development Finance Corp. 55,380		62,672	35,065
9.	Wipro	50,400	70,712	77,669
1 0.	HDFC Bank	45,171	46,296	28,658

industrial development lasting for about three decades, the | private sector was not willing to shoulder the responsibility : of a prime mover of economic development processes.

2. Focus on consumer durables sector. Even in the consumer goods sector, the focus of the private sector is on the elite consumer groups since it is these groups that have ample purchasing power. Thus, the production pattern is skewed in favour of the relatively small richer sections of the society. As a result, while production of elite consumer . durable goods like consumer electronics and automobiles is encouraged, the production of mass consumption goods is I neglected. Some economists allege that this implies the wastage of the economic surplus of the country on unnecessary industrial activities while the ‘core’ economic activities suffer. This leads to, what they call, ‘distortions in production structure.’ However, if the increasing trends of liberalisation in the Indian economy during the last two decades are any indication, the Government of India now regards such investments as 'prime movers of growth' rather than distortions.

3. Monopoly and concentration. It is the general pattern of capitalist development that, as the economy progresses, the monopoly organisations is strengthened and concentration of wealth and economic power in a few hands increases. This has happened in India also. In the pre-Independent India, this was encouraged by the managing agency system. After Independence, with the initiation of economic planning in the country, it was expected that this tendency would be effectively controlled. However, this was not to be. The Mahalariobis Committee pointed out in 1964 that the operation of the system had actually resulted in increase in the concentration of wealth and economic power. Similar conclusions were arrived at by the Monopolies Enquiry Commission in 1965. These tendencies have been further strengthened by the substantial liberalisation of industrial policy in the last two decades which has enabled the large business houses to amass considerable wealth with the result that concentration of economic power has further increased.

4. **Declining share of net value added in total output.** Net value added is defined as the amount generated over and above the cost of raw materials which go to the production system after allowing for the depreciation charges. It, thus, indicates the efficiency of the production process. Many industries in the private sector have reported a fall in the share of net value added in output in a number of years. This fall means that the same amount of raw materials has generated less output. It, thus, implies a decline in efficiency.

5. **Infrastructure bottlenecks.** Severe capacity shortfalls, poor quality and high "cost of infrastructure continues to constrain Indian businesses. The most important infrastructural constraint is power. Industry surveys have found that acute power shortfalls, unscheduled power cuts, erratic power quality (low voltage coupled with fluctuation), delays and informal payments required to obtain new connections, and very high industrial energy costs, hurt industry performance and competitiveness. Frequent and substantial power cuts (mostly unscheduled) have forced many units to operate their own (captive) generators, further increasing the cost of power for industry and reducing firm competitiveness. A World Bank - CII survey conducted in 2002 found that 69 per cent of the manufacturing firms surveyed across India had their own power generator, far more than the" 30 per cent in China. For garments and electronics, energy costs in Indian firms were found to be twice those in Indonesia, the Philippines, and Thailand. In fact, industrial tariffs for larger firms in India are 8-9 cents/ kWh, among the highest in the world (typical rates in Western Europe are in the range 6-7 cents/kWh while in China they are in the range 3-4 cents/kWh). Moreover, the 'quality' of power is also poor. Some 40 per cent of the industries surveyed in Andhra Pradesh reported damage to equipment due to the poor quality of power with damage much more costly for industries with sensitive equipment, and process and quality heavily dependent on motor speed.

The second most important infrastructural constraint is transport. While India has one of the most extensive transport systems in the world, there are severe capacity and quality constraints. It has currently no inter-State

expressways linking the major economic centres, and only 3,000 kilometers of four-lane highways (China has built 25,000 kilometers of four-to-six-lane, access controlled expressways in the last 10 years). Poor riding quality and congestion result in truck and bus speeds on Indian highways that average 30-40 kilometers an hour, about half the expected average. India's high-density rail corridors also face severe capacity constraints, compounded by poor maintenance.

6. **Contribution to trade deficit.** A large number of private sector companies have been resorting to massive imports in the post-liberalisation phase to upgrade then-technology in a bid to brace up to global competition. As a result, their import expenditures have increased at a much faster rate than their export earnings. This has pushed up the country's trade deficit.

7. **Industrial disputes.** As compared to public sector enterprises, the private sector enterprises suffer from more industrial disputes. Differences and conflicts between the owners and employees regarding wages, bonus, retrenchment and other issues frequently emerge. Although there is a provision for Works Committees, Arbitration Boards, etc. for settlement of industrial disputes, the employers have better bargaining strength. Taking advantage of this, they often refuse to accede even the genuine demands of workers and the conflicts assume the shape of long drawn out struggles. Industrial disputes often result in strikes, lockouts, gherao, etc. Valuable man-days are lost and productive activity suffers.

8. **Industrial sickness.** This is a serious problem confronting the small, medium and large units in the private sector. Substantial amount of loanable funds of the financial institutions is locked up in sick industrial units causing not only wastage of resources but also affecting the healthy growth of the industrial economy adversely. As at the end of March 2007, the total number of sick/weak units in the portfolio of scheduled commercial banks stood at 1.18 lakh involving a bank credit of Rs. 30,333 crore. Causes of industrial sickness are many and are generally divided into two categories: (i) external and (ii) internal. The former include factors which originate outside the unit

and are, therefore, not under the control of the unit such as power cuts, demand (or market) recession, erratic availability of inputs, government policies etc. The latter include factors which originate within the unit and can, therefore, be said to be under the control of the unit such as production, management, finance etc.

9. Problems relating to finance and credit. Since the rate of capital formation in the economy is low and the capital market is in an underdeveloped state, the private sector enterprises have to encounter serious difficulties in arranging finances. Because of high inflationary tendencies in the economy, people are attracted towards purchasing land, gold and jewellery and are not willing to invest in industries. Inflationary conditions have also given birth to black marketing and a large parallel economy which weans away funds from productive activities. The industrial finance institutions have filled up this gap to some extent but the problem continues to be enormous.

10.Threat from foreign competition. The process of liberalisation unleashed in 1991 has opened up the gates to foreign investors and the government has progressively introduced measures to ‘open up’ the economy to foreign competition. This process of globalization and 'integration' of the Indian economy with the world economy has led to an unequal competition a competition between ‘giant MNCs (multinational corporations)’ and ‘dwarf Indian enterprises’. In the early euphoria of liberalisation, the private sector welcomed the measures of the government, but it soon came to realise that opening up the Indian economy to foreign competition meant not .only more and cheaper imports and more foreign investment but also opportunities to the MNCs to raid and takeover their enterprises. Even the large Indian enterprises are just pygmies compared to the. Multinational corporations and while some of them have already been gobbled up by the latter, some others are awaiting their turn with bated breath. As once noted by an MP from West Bengal, the globalization of the Indian economy is like integrating a mouse into a herd of elephants.

4.3 Privatisation of Public Sector Enterprises : The Disinvestment Programme in India[16]

- Meaning and rationale of privatisation
- Methods of privatisation
- Evolution of privatisation policy in India
- The disinvestment programme in India as it is in this form that privatisation has been carried out in India
- A critical evaluation of the privatisation and disinvestment programme adopted in India.

4.3.1 Meaning and Rationale of Privatisation

Privatisation is a process by which the government transfers the productive activity from the public sector to the private sector. Many countries of the world—industrial market economies, the former socialist economies (belonging to Central and Eastern Europe and Soviet Union), and a large number of developing countries belonging to Asia, Africa and Latin America — have launched massive programmes of privatisation during the period of last two-three decades or so. While many industrial market economies (particularly OECD member countries) have carried out the programme of privatisation on their own accord, former communist countries and many developing countries were forced by the IMF and World Bank to carry out privatisation as a condition for assistance under the economic stabilisation and structural adjustment programmes.

According to the supporters of privatisation, the rationale for privatisation and disinvestment is as follows:

1. The private sector introduces the 'profit-oriented' decision making process in the working of the enterprise leading to improved efficiency

[16] Misra & Puri, Indian Economy, 2011, Himalaya Publication, Pg.402.

and performance. Moreover, private ownership establishes a market for managers, which improves the quality of manage.ent.

2. While personnel in the public enterprises cannot be held responsible (or accountable) for any lapse, the areas of responsibility in the private sector are clearly defined. This makes it possible to take people to task in the private sector units for any blunders committed by them whereas in public sector units, it is easy to pass the buck. Even when responsibility is defined in the public enterprises, there, are too many pressures and forces operating to reduce its effective implementation.

3. Private sector firms are subject to capital market disciplines and scrutiny by financial experts. In fact, the ability to raise funds in the capital market is crucially dependent on performance. Not so in the case of public enterprises. On account of government ownership of these enterprises, they have easy access to credit and budgetary support irrespective of their performance. Thus there is no compulsion for these enterprises to perform well.

4. According to Bimal Jalan, political interference is unavoidable in public corporations and is a major cause of decline in operational efficiency. "Such political decision-making reflects itself in the less than optional choice of technology or location, overstaffing, inefficient use of input, and purchase or price preferences for certain suppliers."[1] Most governments also impose non-economic objectives on public enterprises.

5. Many public sector enterprises remain 'headless' for long periods of time. This causes confusion and delay in decision-making as nobody is sure how the new incumbent will act (or react) on the policy decision being undertaken. Such a situation does not exist in private sector enterprises as the heir-apparent is identified early on and groomed to take over the reins when the time actually arrives.

6. In a quick changing business environment it often becomes necessary to take spot decisions without having to worry too much about not

having consulted others. In fact, 'delayed decision-making is often equivalent to making no decision at all.' In public enterprises, the concept of response time is almost totally absent as no one is willing to disturb the status quo. Not so in the case of private sector enterprises. Because of the very nature of management in these units,; it becomes easier to react to changing situations fast.

7. Private sector firms are more subject to liquidation, threat of takeover, and loss of assets for owners than public sector enterprises. When owners stand to lose control over assets, there is greater likelihood of remedial measures being taken earlier.

8. According to Bimal Jalan, efforts to improve managerial efficiency in public enterprises by administrative measures are generally short-lived and, unsustainable as, sooner or later, political considerations take precedence over economic or commercial considerations. This has happened in many countries including Italy, France, Korea, India and Pakistan.

9. The very survival of private sector enterprises depends on customer satisfaction since only such satisfaction can ensure more widespread and repeat buying. As against this, so the: argument; goes, caring for the customer is generally not a priority with public sector enterprises. Once privatisation occurs, the need to create and sustain markets Will lead to a sea change in the attitude of these enterprises towards customers. Hence, quality of services will improve.

4.3.2 Methods of Privatisation

The first major programme of privatisation was adopted in U.K. by the conservative government of Margaret Thatcher during 1980s. In this swift and widespread programme, a large number of public sector companies that dominated a wide swathe of industry and services in UK. including railways, aerospace, oil, telecommunications mining, and bus: services were sold off. This was followed by privatisation in France and many other OECD countries,

former communist Countries, and developing nations. The methods of privatisation used by these countries were frequently one or a combination of the following methods.

1. Initial Public Offering (IPO). This is the most important method used for privatisation in UK and OECD countries. Under this method, the shares of public sector undertakings (PSUs) are sold to the retail investors and institutions. The government may, in some cases, sell shares of a PSU in international market also. The IPO method is the best method in the case of those countries which have a strong capital market. In fact, OECD countries raised as much as two-thirds of all their privatisations proceed in 1990s through IPOs. The main advantage of the IPO method are as follows: (i) it ensures wide participation of retail investors and thus helps in a broad-based control of the public sector entity at the same time as it helps in the widening and deepening of the capital market; (ii) it is likely to face less resistance from the PSU employees as there is a continuity in the management; (iii) it can be used to offer shares to the employees; and (iv) it can be employed usefully in those cases where .the government wants to raise resources but does not want to lose control of the enterprise. However, the main problem in this method is the problem of 'valuation' - i.e., what should be the 'price' of the share? Since in most countries shares of public sector undertakings are not traded on the stock exchanges, it is not possible to find out the right price at which the government should sell the shares of a PSU. As we shall point out later in this chapter, as a result of this problem, the Government of India actually obtained much less through disinvestment as it could have had (because in many cases. the shares were undervalued). Moreover, this method cannot be adopted in small countries with weak capital markets and institutions.

2. Strategic Sale. In this method, the government sells its share in the PSU to a strategic partner. As a result, the management passes over to the buyer. The advantages claimed for this method are as follows: (i) the performance and efficiency of the enterprise is expected to improve as the private partner introduces better management practices on the one hand, and

the unit is freed from government shackles on the other hand; (ii) the government may realise a better price as the strategic partner may be willing to pay more because of the synergy he perceives in combining the PSU business with his own existing business; (iii) the strategic partner would be willing to inject more capital into the PSU and modernise its business operations as he would be keen in generating profits; (iv) loss-making PSUs will be unattractive to the public whereas a strategic acquirer can have the skills to turnaround the business even after paying a reasonable price; and (v) this method is the most important method of disinvestment in small countries with weak capital. markets and in those countries where shares of PSUs are not traded (and hence it is not possible to know the 'share price'). However, this method has a number of disadvantages: (i) this method is 'unfair' as many ordinary citizens cannot participate in it; (ii) the whole process of selecting a strategic partner and setting the terms of sale depends on the ministers and officials. Thus, the whole process is non-transparent and arbitrary. Since it is very difficult to assess the 'actual' value of the enterprise, the strategic partner often connives with government officials to get control over the company at a value far less than the actual value of the enterprise. As a result, the government gets a far less realisation from the sale vis-a-vis the actual value; (iii) the acquisition of a PSU with a significant market share by a partner in a similar business can lead to a monopolistic or oligopolistic situation, which could be harmful to consumer interests; (iv) there is a serious risk of employees losing their job as the strategic partner is likely to restructure the PSU business to align with his existing business; and (v) once even a small part of the equity is sold to a strategic partner, other potential bidders will be put off, thereby lowering the value of the rest of the PSU's shares.

Smaller countries, especially those in the former Soviet Union and Eastern Europe (the so-called 'transition economies') have often relied more on the method of strategic sales to privatise their PSUs. This is due to the reason that most of these countries did not have well developed capital markets and shares of PSUs were not traded. Therefore, it was not possible to find the correct share price of a company. This method has also been followed by some OECD countries during the last few years. In some cases, a

combination of IPO method and strategic sales method is adopted. Two approaches are followed in these instances: (i) first a controlling stake is sold to a strategic buyer through a direct sale in order to provide the company with a good management and then subsequent stakes are sold through a public offering to retail and institutional investors as a means of developing the equity market; or (ii) first a share in the company is sold on the stock markets, and once its 'market price' is determined, a controlling stake is sold to a strategic partner. This is closer to what is happening in the case of our oil companies.

In most OECD privatisations, a portion of the shares are allocated for sale to employees, in order to ensure their participation in privatisation and to gain their support. Poland's sale of a stake in telecom company TPSA, for instance, involved a series of steps including a strategic sale, subsequent public offering and a share going to the employees.

3. Sale to Foreigners. This is a variant of the strategic sales method where the buyer is not a domestic company but a foreign company. In small countries, the amount of domestic private capital is often limited. Therefore the government sells its stakes to a foreign company. At times, sales to a foreign company are preferred as the expectation is that the foreign company will bring with it world-class technology and expertise to run the PSU. For instance, Hungary received $ 12 billion through privatisation over the period 1990 and 1998 and, of this, as much as 60 per cent was contributed by foreign investors. The countries of South America have also seen many key companies, including two water companies in Chile, pass into foreign hands in the 1990s. In cases where the government has set up a PSU in collaboration with a foreign company, it may simply sell its stake to the latter. This is what the Government of India has done in the case of Maruti Udyog Ltd. where it has sold its stake to the foreign collaborator Suzuki company of Japan.

4. Equal-Access Voucher Programmes. This form of privatisation involves distribution of vouchers across the population and attempts to allocate assets approximately evenly among voucher holders. Such

programmes excel in speed and fairness. However, they raise no revenue for the government and have unclear implications for corporate governance. Mongolia, Lithuania, the former Czechoslovakia, Albania, Armenia, Kazakstan, Poland and Romania (in its 1995 programme) followed this method of privatisation. The Czech Republic's equal-access voucher programme has been the most successful to date. In two successive waves, the Czech transferred more than half the assets of public enterprises into private hands. Citizens were free to invest their vouchers directly in the firms being auctioned. However, to encourage more concentrated ownership and to create incentives for more active corporate governance, the programme allowed the free entry of intermediary investment funds to pool vouchers and invest them on the original holders' behalf. More than two-thirds of the voucher-holders chose to place their vouchers with these competing funds. This led to concentrated ownership of the Czech industrial sector in these large funds. These funds are now participating actively in monitoring managerial performance, imposing financial discipline on the firms they own, trading large blocks of shares among themselves or selling them to new strategic investors, etc. Thus, the Czech experience shows how a well designed voucher-programme can overcome many problems. "It can depoliticize restructuring, stimulate development of capital markets, and quickly create new stakeholders with an interest in reform." However, as correctly pointed out by the World Development Report, while funds monitor the functioning of firms, the question is who will monitor them? Supervising financial agents is difficult even in established market economies and is even more problematic in transition economies, where norms of disclosure and fiduciary responsibility are weak and watchdog institutions are still in a highly underdeveloped state.

5. Management - Employee Buyouts. In this route to privatisation, managements and employees themselves buy major stakes in their firms. This method has been; widely used in Croatia, Poland, Romania, and Slovenia. In addition, several voucher-based programmes, such as those of Georgia and Russia, gave such large preferences to insiders that most privatised firms were initially owned! mainly by managers and employees. The

advantage of this method is that it is easy to implement, both politically and / technically. It might also be better for corporate governance; if insiders have better access than outsiders to the information; needed to monitor managers. However, as pointed out by the World Development Report, the risks and disadvantages.; of the method are many, particularly in large-scale buyout; programmes that include many unprofitable firms in need? of restructuring. One important disadvantage is that benefits? are unevenly distributed: employees in good firms get valuable; assets while those in money-losers get little or nothing of value. The second disadvantage is that government tends to charge low prices to insiders and thus realizes little revenue? Finally, managers or employees can connive to block entry of outsiders. At times, outsiders may hesitate to investing firms with significant insider ownership legally or illegally acquired because of potential conflicts of interest between insiders and outside owners. In Russia's mass privatization programme of 1992-94 (which, despite the use of vouchers, was basically a management-employees buyout programme because of its preferential treatment of "managers and workers), insiders ultimately acquired about two-thirds of the shares in the 15,000 privatised firms (accounting for 60 percent of industrial assets) while outsiders obtained only 20 to 30 per cent (about 10 to 15 per cent each went to investment funds and industrial investors), and rest remained in government hands. This exercise soon became politically unpopular as the masses felt that they had been left with the dregs while managers engaged in 'asset stripping', and effective control of the best companies passed into the hand of a chosen few.

4.3.3. Evolution of Privatization Policy in India

As stated in the chapters on 'Industrial Policy' and 'Public Sector in the Indian Economy', there has been a marked change in the perception towards the role of public sector in the Indian economy since 1991. Some economists argued that the fiscal crisis of 1991 was a result of the public sector's inability to generate adequate returns on investment. The government's attitude also changed markedly as is clearly demonstrated in the following "statement made in the New Industrial Policy, 1991: "After the initial exuberance of the public sector entering new areas of industrial and technical competence, a

number of problems have begun to manifest themselves in many of the public enterprises-. Serious problems are observed in the insufficient growth in productivity, poor project management, over-manning, lack of continuous technological upgradation, and inadequate attention to R & D (Research and Development) and human resource development. In addition, public enterprises have shown a very low rate of return on the capital investment. This has inhibited their ability to re-generate themselves in terms of new investments as well as in technology development/The result is that many of the public enterprises have become a burden rather than being an asset to the Government". Consequently, the New Industrial Policy, 1991, advocated privatisation of public sector enterprises. For purposes of privatisation, the government has adopted the route of disinvestment which involves the sale of the public sector equity to the private sector and the public at large.

The evolution of privatisation policy in India since the start of economic liberalisation since 1991-92 can be outlined as below:

1. Interim Budget and Budget Speech, 1991-92. The Government of India enunciated a policy to divest upto 20 per cent of its equity in selected public sector undertakings to mutual funds and investment institutions in the public sector, as well as workers in these firms. The stated purpose of the policy was to place equity across a broad base, improve management, increase resources to the enterprises, and to raise funds for the general exchequer. Initially, as shown in Table 31.1, shares of different PSUs were bundled together and sold to domestic financial institutions. Later in 1992-93, to ensure better prices, individual shares were auctioned separately.
2. Report of Rangarajan Committee on Disinvestment of Shares, 1993. The Government appointed a Committee on Disinvestment in Public Sector Enterprises under the Chairmanship of C.Rangarajan in 1993 to suggest the correct method of divestiture. The Committee recommended that the percentage of equity divested could be upto 49 per cent for industries reserved for the public sector, and that, in exceptional cases upto 74 per cent of the equity could be divested. In industries not reserved for the public sector, 100 per cent of the equity could be divested. Only the following 6 industries were reserved for the

public-sector: (i) coal, (ii) minerals and oils, (iii) armaments, (iv) atomic energy, (v) radioactive minerals, and (vi) railways. The Government of India did not act on these recommendations.

3. Divestment Commission Recommendations: February 1997-October 1999. The Government constituted a five member Public Sector Disinvestment Commission under the Chairmanship of G.V. Ramakrishna in August 1996 for drawing a long-term disinvestment programme for the PSUs referred to the Commission. The Commission recommended divestment of 58 different PSUs. Moreover, in a break from a past policy of share public offerings, the Commission recommended strategic sales with transfer of management. By 1996-97, sales were open to NRIs and foreigners, and through global depository receipts (GDRs) in the international markets.

4. Budget Speech, 1998-99. In the Budget Speech, 1998-99, the Finance Minister stated that “Government has decided that in the generality of cases, the government shareholding in public sector enterprises will be brought down to 26 per cent. In cases of public sector enterprises involving strategic considerations, government will continue to retain majority holding. The interests of workers shall be protected in all cases.”

5. Strategic and Non-Strategic Classification, 1999. Reflecting the- report of the Rangarajan Committee from some six years earlier, the government announced the classification of industries into strategic and non-strategic areas. Strategic industries were limited to: (i) arms, ammunitions, and related defense industries; (ii) atomic energy; (iii) mining of minerals for the atomic industry; and (iv) railway transport. All other industries were classified as non-strategic. For all PSUs in non-strategic industries, government stakes could be dropped to as low as 26 per cent on a case-by-case basis. Since three-fourths majority is needed to pass certain important board resolutions, for control reasons government set a lower limit of 26 per cent of the equity.

6. Address by President to Joint Session of Parliament, February 2001. In his address to the joint session of Parliament in February 2001, the President stated thus: "The government's approach to PSUs has a

threefold objective: revival of potentially viable enterprises; closing down of those PSUs that cannot be revived; and bringing down government equity in non-strategic PSUs to 26 per cent or lower. Interests of workers will be fully protected through attractive Voluntary Retirement Schemes and other measures." As Table 31.2 shows, in some cases government's equity stake dropped below 26 per cent.

7. National Common Minimum Programme, 2004. The National Common Minimum Programme (NCMP) of the UPA coalition government was released on May 28, 2004. NCMP confirmed the commitment of the UPA government to a 'strong and effective public sector' and laid down the following guidelines as far as privatisation of Central PSEs is concerned: (i) all privatisations will be considered on a transparent and consultative case-by-case basis; (ii) generally profit making companies will not be privatised; (iii) the government will retain existing 'navratna' companies in the public sector while these companies can raise resources from the capital market; (iv) while every effort will be made to modernise and restructure sick public sector, companies and revive sick industry, chronically loss-making companies will either be sold-off, or closed, after all workers have got their legitimate dues and compensation; and (v) the government believes that privatisation should increase competition, not decrease it. Therefore, it will not support the emergence of any monopoly that only restricts competition.

The government approved the constitution of a National Investment Fund (NIF) from April 1, 2005 comprising of proceeds from disinvestment of public sector undertakings. 75 per cent of the annual income of NIF will be used to finance selected social sector schemes, which promote education, health and employment, The residual 25 per cent of the annual income of NIF will be used to meet the capital investment requirements of profitable and revivable Central PSEs that yield adequate returns, in order to enlarge their capital base to finance expansion/diversification.

On May 26, 2005, the Finance Minister announced the intention to disinvest 10 per cent of government-owned equity in the navratna company BHEL (the residual government-owned equity share exceeded 51 per cent after sale). However, after protests from the Left parties, this move was

dropped. The Minister of Heavy Industries and Public Enterprises announced that he had put on hold the decision regarding disinvestment in BHEL and other proposals (for disinvestment) in his ministry. The Finance Minister also ruled out the strategic sale route of disinvestment while keeping open the offer of sale route in. 13 profit-making PSEs identified by the earlier NDA government. In June 2006 another attempt was made, this time for the sale of 10 per cent stake each in two non-navratna profit-making companies — NALCO (National Aluminum Company) in Orissa and NLC (Neyveli Lignite Corporation) in Tamil Nadu. However, following indefinite strike by NLC workers, the move was shelved. On July 6, 2006, the Prime Minister decided to keep all disinvestment decisions and proposals on hold, pending further review. However, in recent times, interest in disinvestment has again revived. During 2009-10, the shares in many PSEs like Oil India Ltd., NHPC, NTPC and REC (Rural Electrification Corporation), NMDC etc., have been sold and the government expressed its intention to raise Rs. 125,000 crore through this means. In the Budget for 2010-11, the Finance Minister has kept a target of Rs. 40,000 crore for disinvestment.

Proceeds from Disinvestment and Methodologies Adopted

As stated earlier, the Government has adopted two methods of disinvestment: (i) selling of shares in select PSUs, and (ii) strategic sale of a PSU to a private sector company. The former method was used over the period 1991-92 to 1998-99 and, as in clear from Table 31.1, the government experimented with various variants of this method. From 1999-2000 to 2003-04, the emphasis shifted to the latter method which involved strategic sale of a PSU to a private sector company through a process of competitive bidding. After 2004-05, disinvestment realisations have been mostly through sale of equity.

Table 4 gives the targets and achievements of disinvestment in different years and the methodologies adopted for the purpose. Initially in 1991-92, the government, offered, shares for sale in 'bundles' involving a combination Of equity from poor and good, performers. In practice'' rather than help the government divest shares in loss

Table 4

Disinvestment in PSUs and methodologies adopted, 1991-92 to 30-9-2009

Year	Target receipt for the year (Rs.in crore)	Actual receipt, (Rs.in crore)	Methodology
1991-92	2,500	3,037.74	Minority shares sold in Dec. 1991 and Feb. 1992 by auction method in bundles of 'very good', 'good' and average companies.
1992-93	2,500	1,912,51	Shares sold separately for each company by auction method.
1993-94	3,500	—	Equity of 6 companies sold by auction method but proceeds received in 1994-95.
1994-95	4,000	4,843.10	Shares sold by auction method.
1995-96	7,000	168.48	Shares sold by auction method.
1996-97	5,000	379.67	GDR –VSNL
1997-98	4,800	910.00	GDR – MTNL
1998-9$	5,000	5,371.11	GDR - VSNL; Domestic offerings of CONCOR and GAIL; Cross purchase by 3 Oil sector companies, i.e., GAIL, ONGC and IOC.
1999-2000	10,000	1,860.14	GDR - GAIL; Domestic offering of VSNL; capital reduction and dividend from BALCO; strategic sale of MFIL.
2000-01	10,000	1,871.26	Sale of KRL, CPCL and BRPL to CPSEs; Strategic sale of BALCO and LJMC
2001-02	10,000	5,657.69	Strategic sale of CMC, HTL, VSNL, IBP, PPL, hotel properties of ITDC and HCI, slump sale of Hotel Centaur Juhu Beach Mumbai and leasing of Ashok, Bangalore; Special dividend from VSNL, STC, and MMTC; sale of shares to VSNL, employees.
2002-03	12,000	3,347.98	Strategic sale of HZL, IPCL, properties of ITDC, stump sale of Centaur Hotel Mumbai Airport. Premium for renunciation of rights issues in favour of SMC; Put option of MFIL; sale of shares to employees of HZL and CMC
2003-04	14,500	15,547.41	Strategic sale of JCL; call option of HZL; offer for sale of. MUL, IBP, IPCL, CMC, DCi, GAIL and ONGC; sale of shares of IC1 Ltd.
2004-05	4,000	2,764.87	Offer for sale of NTPC and spillover of ONGC, sale of shares . to IPCL employees.
2005-06	No target fixed.	1,569.6.8	Sale of MUL shares to Indian public sector financial institutions and banks and employees.
2006-07	No target fixed		
2007-08	No target fixed	4,181. 39	Sale of MUL shares to public sector financial instituions, public sector banks and Indian mutual funds and sale of PGCIL and REC ... shares through offers for sale.
2008-09	No target fixed		
2009-10	No target fixed	4,259.90	Rs. 2,012.85—NHPC and Rs. 2,247.50—OIL
Total		57,682.93	

making PSUs at reasonable prices, bundling resulted in the government obtaining a very low average price for each bundle, implying: that prime shares were handed over at rock-bottom prices. In 1992-93, the government abandoned the bundling of shades and sold shares of each company separately by-the auction method, In 1994-95; NRI and other-persons were allowed to participate in the auction. In 1996-97 and 1997-98, GDRs (Global Depository Receipts) of VSNL and MTNL in international markets fetched Rs. 380 crore and Rs. 910 crore respectively. In 1998-99, along with QDR and domestic offerings with the participation of foreign institutional investors, cash-rich PSUs (like ONGC, GAIL and IOC) wore forced to 'cross hold' shares in related PSUs by buying them from the government. From 1999-2000 to 2003-04, as stated earlier, the focus of the government shifted to the second method of disinvestment the strategic sale of a PSU to a private sector company. The government resorted to strategic sale of a number of companies — MFIL (Modem Foods India Ltd)., Videsh Sanchar Nigam Ltd. (VSNL), Indian Petrochemicals Corporation Ltd. (IPCL), Bharat Aluminum Company (BALCO), CMC Ltd, HTL Ltd. IBP, Indian Tourism Development Corporation (ITDC) (13 hotels), Hotel Corporation of India Ltd. (HCI Hotels), Paradeep Phosphates Ltd. (PPL), Hidustan Zinc Ltd. (HZL), Maruti Udyog Ltd. (MUL) etc.

As is clear from Table 31.1, the actual realisation from disinvestment over the period 1991-92 to 30-9-2009 was Rs.57.682.93 crore as against the target of Rs.96,800 crore for the period 1991-92 to 2004-05 (no target was set for later years). Thus, achievement has been very much less as compared with the target.

4.3.4 A Critique of Privatisation and Disinvestment

The policy of privatisation and disinvestment has been criticised on the following counts.

Undervaluation of Assets

A study of the data presented in Table 31.1 shows that the performance on the disinvestment front over the period 1991-92 to 2009-10 has been dismal. Only in four years — 1991-92, 1994-95, 1998-99 and 2003-04, the targets for disinvestment were exceeded. According to CP. Chandrashekhar and Jayati Ghosh, the success in 1991-92 was due to the decision to accept extremely low bids for share 'bundles' which included equity from PSUs which would have otherwise commanded a handsome premium. The average price at which more than 87 crore shares were sold in this year was only Rs. 34.83 as compared with the average price realisation of Rs. 109.61 since then. In 1994-95, success was due to the off-loading of a significant chunk of shares in very attractive and profitable PSUs like BHEL, Bharat Petroleum, Container Corporation of India, Engineers India, GAIL, MTNL etc. And in 1998-99 the success was due to the reason that cash-rich PSUs like ONGC, GAIL and IOC were forced to buy shares of other PSUs. “This amounted to forcing PSUs, that needed further investment themselves so as to be restructured, to face up to the more liberal and competitive environment, to hand over their investible surpluses to finance the fiscal deficit of the government.” The success in 2003-04 was primarily due to sale of 142.60 million shares in ONGC which fetched as much as Rs. 10,695 crore.

In all other years, realisations from disinvestment were much less than the targets. The main reasons for this poor performance were as follows:

1. The government earned out the whole exercise of disinvestment in a hasty, unplanned and hesitant way. Thus it failed to realise not only the best value but also the other objectives of the disinvestment programme.

2. The government launched the disinvestment programme without creating the required conditions for its take-off. This would be clear from the fact that it did not try to list the shares of the public sector enterprises on the stock exchanges. Thus, adequate efforts were not made to build-up the much needed linkage between the public enterprises on the one hand and the capital market on the other.

3. The government did not adopt suitable methods to oversee the disinvestment of public sector shareholding.

4. The Department of Public Enterprise and the Finance Ministry adopted techniques and methods which resulted in far lower realisation than justified.

On account of all these reasons, there was considerable “under-pricing” of public enterprises shares resulting in considerable loss to the government. This is clear from the three reports of CAG (Comptroller and Auditor General of India) that have appeared so far. In his first report (1993), the CAG pointed out that the extent of loss to the government in percentage terms varied from 127 per cent in the case of HPCL (its share having been sold for Rs. 243 against the market price of Rs. 550) to as high as 616 per cent in the case of NLC (its share having been sold for Rs. 11 against the market price, of Rs. 82). The average loss consequent upon the under pricing comes to about 256 per cent. If we apply this percentage to the divestiture proceeds for 1991-92 and 1992-93 we find that the potential proceeds would have been Rs. 12,554 crore as against the actual realization of only Rs. 4,951 crore. The second report of CAG (2005) which covered the sale of two hotels, the Hotel Corporation of India's (HCIs), Juhu Centaur and Airport Centaur, pointed out that the sale was finalised on the basis of a single bid and the methodology adopted for valuation had the effect of lowering the reserve price. The CAG's third and most recent report (2006) focuses on nine PSUs where majority shareholding was passed on to private parties through the strategic sale route. The main findings of CAG are as follows:

1.Valuation. In several cases where valuation was done under the asset valuation methodology, core assets like leasehold land, housing, township and plant and machinery and certain other properties were either not valued of ignored. This resulted in an undervaluation of PSUs, consequently fixing of lower reserve prices,

2.Insufficient competition. Competition was not generated to secure best price as at the final stage, financial bids were submitted by only one party

in case of MFIL, CMC, PPL and two parties in case of BALCO, HTL, VSNL, HZL, while in case of IPCL, Expression of Interest by three) international bidders was rejected without assigning any : reason.

3.The shareholders agreement. It was entered on terms adverse to government, as the strategic partner has been given right to purchase balance equity of privatised PSUs, in what is known as, call and put option. In case of HZL, the strategic partner used this option to purchase 79.9 million shares at Rs. 40.51 per share when the market price I was hovering around Rs, 119.10, giving it a windfall profit, Another company, BALCO has exercised its call option and remitted a sum of Rs. 1,098 crore by cheque to the government, based on some kind of ad hoc valuation of shares. The market value of the shares is several times higher.

4. Post-clearing adjustment clause. In the sale of four unlisted companies, MFIL, BALCO, HTL and PPL, an open-ended agreement has been entered, under which the government is required to pay the strategic partner any claims resulting from depletion of current assets of the company, between the date of the last audited balance sheet and the date of purchase of the shares. All the four companies have filed heavy claims against the government and in case of MFIL, the government has already paid Rs. 12.64 crore to the new management. In the case of PPL, while the government realised Rs. 151.70 crore through the sale, the buyers have lodged a claim of Rs. 151.55 crore under this clause.

Undervaluation of assets implies substantial losses for the government and therefore for the tax-paying citizens of the country. There is a basic problem with all privatization of public assets, which means that they tend to be associated ultimately with losses to the State exchequer rather than gains. If the government sells the asset that provides income or profit equal to or more than the prevailing interest on government securities, then the government would lose future income by selling it. On the other hand, from the private sector's point of view, it makes no sense to purchase an asset unless it provides at least a rate of return equal to the rate of interest on

government securities, because that is where the private investor could otherwise put the money. "This means that for such sales to occur, either (a) the private investor must believe that it is capable of generating more profits than the public sector — but that is essentially a management issue and there is no logical reason why the public sector cannot also employ managers to achieve this; or (6) the asset must be undervalued so that the actual rate of return for the private buyer turns out to be higher, which really means that the State exchequer has lost the money."

Utilisation of Money from Disinvestment

As shown above, the public sector equity has been sold for a fraction of what it could actually fetch. However, this is only one part of the story. The entire manner in which the proceeds from disinvestment have been used is objectionable. When the programme of disinvestment was initiated in 1991-92, the Finance Minister had stated that a part of the proceeds would be used for providing resources in the NRF (National Renewal Fund) which can be used for various schemes of assistance to workers to the unorganized sector. Moreover, these "non-inflationary resources would also be used to fund...special employment creating schemes in backward areas". In 1997, the first report of the Disinvestment Commission headed by G. V. Ramkrishna stated that the proceeds of disinvestment should not be used to bridge the budget deficit, but instead should be placed in a separate fund to be used for four purposes: (i) retiring public debt; (ii) restructuring PSUs; (iii) developing the social infrastructure; and (iv) voluntary retirement schemes. Similar sentiments were expressed in various Budget Speeches of the Finance Ministers in various years. For the year 2001-02, the Finance Minister had set the target for disinvestment at Rs. 12,000 crore of which Rs. 7,000 crore was to be used to provide "restructuring assistance to PSUs, a safety net to workers and reduction of (the public) debt burden" while the remaining Rs. 5,000 crore was to be used to provide "additional budgetary support to the Plan primarily in the social and infrastructure sectors". The list of objectives of disinvestment given earlier also expressed such lofty ideals. However, the actual experience with the utilisation of disinvestment proceeds during the last

decade belies all these declarations. The government has used the entire proceeds from disinvestment to offset the shortfalls in revenue receipts and thus reduce the fiscal deficit which it was required to do as part of the IMF stabilisation programme. In this context, the following comments of CP. Chandrasekhar and Jayati Ghosh are pertinent: "The experience suggests that fiscal convenience was the prime mover of such disinvestments. Having internalized the IMF prescription that reducing or doing away with fiscal deficits is the prime indicator of good macroeconomic management, the government found privatisation proceeds of PSUs to be a useful source of revenue to window-dress budgets". Thus, the resources generated from the disinvestment of PSUs have been used to meet current consumption needs. This amounts to frittering away of valuable public assets. It is like selling family silver to support a profligate lifestyle. Moreover, once a PSU is privatised, the government is deprived of the future yields from this enterprise. This could be a large long-term loss in the case of profit generating PSUs. This point to the shortsightedness of the government's disinvestment programme.

Others Criticisms of Privatisation

1. It is often assumed that following privatisation, markets arise quickly to fill up the gap whereas the fact is that many government activities arise because markets have failed to provide essential services. As stated in the previous chapter, many PSUs were set-up in India in the post-Independence period in those fields in which the private sector was either not able to set-up units because of paucity of resources or was simply not interested because of the long gestation period and/or low profit generation possibilities. As argued by CP. Chandrasekhar and Jayati Ghosh, "Public sector enterprises are not pure profit making machines, but instruments used by governments to achieve a range of objectives. These could vary from closing infrastructure gaps that may remain if investment was purely private to ensuring access to products crucial to development at appropriate prices. This would imply that investments are made even in areas where profits are low or non-existent because of the external benefits such projects deliver or

that profits are foregone in order to keep prices down in pursuit of other objectives. To ignore such possibilities and make profits, which contribute non-tax revenues to the government, the sole reason for establishing PSUs, is to conceal the actual grounds on which public capital formation has occurred in post Independent India or elsewhere in the world."

2. One of the genuine fears of labour is that privatization is bound to result in unemployment. Most of the privatisation experiments around the globe are testimony the fact that this indeed does happen. The Government of India has been repeatedly harping on the tune that as a result of privatisation there has only been a 'marginal' retrenchment of labour. However, the fact of the matter is that there is a strong pressure from the corporate sector to 'reform' labour laws to enable it to hire and fire workers as it wishes and indications are that the government is falling in line. This means that the future employment scenario for labour is a cause of worry. The fear of retrenchment and consequent unemployment is all the more as there is no safety net scheme for labour worth the name. How many workers will be able to get VRS (voluntary retirement scheme) and on what conditions is only a matter of speculation. In any case, VRS is no solution of unemployment. A retrenched, unemployed worker is a frustrated man. Moreover, as argued by Joseph Stiglitz, there are large social costs of unemployment manifested in its worst forms, by urban violence, increased crimes, and social and political unrest. But even in the absence of these problems, there are huge costs of unemployment. "They include widespread anxiety even among workers who have managed to keep their jobs, a broader sense of alienation, additional financial burdens on family members who manage to remain employed, and the withdrawal of children from school to-help support the. family. These kinds of social costs endure long past the immediate loss of a job. Moving people from low-productivity fobs in State enterprises to unemployment does not increase a country's income, and it certainly does not increase the welfare of the workers".

The above dangers are all the more serious in those cases where a PSU is sold to a foreign company as the latter will be more interested in maximising

the 'stock market value for its, shareholders rather than worrying about the, interest of local labour.

3. At times, sale of a PSU to a private company can only result in the substitution of a public monopoly by a private monopoly. In such cases, inefficiencies and monopoly power will merely be transferred to the private sector, with the costs being borne by the consumers. Or, "monopolistic exploitation by efficient private owners replaces the inefficiencies of public ownership." This danger is particularly present in the case of public utilities. For example, in Cochabamba, Bolivia's third largest city, water supply was privatised and sold to a foreign consortium Aguas del Tunari in 1999. The consortium resorted to huge increases in tariffs and at the same time, put restrictions on the use of water. This caused widespread resentment provoking riots. As a result, the government had no option but to put an end to the contract.

We have already discussed the issue of undervaluation of assets of PSUs earlier. Such undervaluation points to the prevalence of widespread corruption on the one hand, and complicity between sections of the government and particular business groups on the other hand (in the case of strategic sales). In this context, the comments of Joseph Stiglitz are pertinent, "Perhaps the most serious concern with privatisation, as it has so often been practiced, is corruption. The rhetoric of market fundamentalism asserts that privatisation will reduce what economists call the "rent-seeking" activity of government officials who either skim off the profits of government enterprises or award contracts and jobs to their friends. But in contrast to what it was supposed to do, privatisation has made matter so much worse that in many countries today privatisation is jokingly referred to as "briberisation". If a government is corrupt, there is little evidence that privatisation will solve the problem. After all, the same corrupt government that mismanaged the firm will also handle the privatisation.

4. One of the important arguments in favour of privatisation of PSUs is the belief that this would improve their performance. However, some critics have pointed out that there is no positive relationship between ownership and

performance; Therefore according' to them, the belief 'that privatisation, by itself, leads to better performance is questionable. For instance, Pranab Bardhan and John E. Roemer state: "Our claim is that competitive markets are necessary to achieve an efficient and vigorous economy, but that full-scale private ownership is not necessary for the successful operation of competition and markets."[20] This claim is substantiated by the experience of China. The process of economic reforms was initiated in China in 1978; During 1978 and 1992, GNP grew at an annual rate of 8.8 per cent, while the industrial sector grew at a rate exceeding 10 per cent annum. As a result, China's GNP trebled, over the 15 year period 1978-92. This remarkable growth was achieved not as a result of privatisation but by marketisation and opening up new areas for competition between the State owned enterprises and the non-State sector. One source of evidence for this is the positive correlation between total factor productivity in Sate enterprises and the relative size of the non-State sector. Using provisional level data for China from 1982 to 1990, it has been estimated that a ten percentage point increase in the non-State sector share of industrial output yielded .an increase of 2.5 per cent to 4 per cent in total factor productivity in the State industry. As the non-State sector has grown, State enterprises have responded to the increased competitive pressure by becoming; more productive.[21] Thus the experience of China shows that to improve the efficiency of inefficient units it is necessary to create competitive market structure**.** It is a competitive environment, rather than ownership, that promotes allocative efficiency.

NOTES

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3. World Bank, World Development Report, 1996, p. 56.
4. Ibid,, p. 56.
5. Ibid., p..55.

6. Statement on Industrial Policy, 1991, reproduced in **Governmeiu** of India, Handbook of Industrial Policy and Statistics, 2001, pp. 12-13.

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8. Suresh D. Tehdulkar and T.A. Bhavani, Understanding Reforms-Post 1991 India, (New Delhi, 2007), p. 136.

9. CP. Chandrasekhar and Jayati Ghosh, The Market That Failed: A Decade of Neoliberal Economic Reforms in India (New Delhi, 2002), p. 89.

10. Ibid, p. 90. Also p. 92.

11. The first report was brouhgt out in 1993, the second in 2005 and the third in 2006.

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13. B.P. Mathur, "Audit Reports on Disinvestment", Economic and Political Weekly, December 16, 2006, p. 5115.

14. CP. Chandrasekhar and Jayati Ghosh, op.cit., pp. 90-91.

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16. Government of India, Economic Survey, 2002-03 (Delhi, 2003), p. 150.

17. Joseph Stiglitz, Globalization and Its Discontents (The Penguin Press, 2002), p. 57.

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19. Joseph Stiglitz, op.cit., p. 58.

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