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Center-State Relationships in India & Brazil: Privatization of Electricity & Banking

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CENTER-STATE RELATIONS IN INDIA AND BRAZIL:

PRIVATIZATION OF ELECTRICITY AND BANKING

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Abstract

This essay uses four focused case studies to explore the following question: "When and why do state governments oppose (or support) privatization programs initiated by the central government?" We examine national privatization initiatives in the 1990s in India and Brazil in the fields of electricity and banking, and the varying responses of the state governments in each country's major industrial and financial capital, respectively, the states of Maharastra and S^{a}o Paulo. Possible explanations for state-level opposition to federal initiatives--as occured in the cases of Enron and Banespa--include: (1) personal beliefs and ideological commitments of state leaders, (2) differences of political party or coalition between the center and state government, and (3) an unequal distribution of costs and benefits from privatization between the two levels of government. We find that reason #3, real conflict of interests, best explains serious opposition, although the nature of politial party alliances (#2) and politicians' values (#1) can play a supporting role. Our conclusions suggest that seemingly irreconcilable policy stances often may be ameliorated by further center-state negotiations and some redistribution of benefits to make the package more attractive to state leaders.

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Privatization, or the transfer of economic activities from public sector ownership and/or management to private investors, has become increasingly popular over the past decade and a half in both industrialized and developing countries. Furthermore, politicians at all levels, from the central government to state and municipal elected authorities, have come in the 1980s and 1990s to embrace many of the hopes of the new global pro-market ideology of competition and private entrepreneurship as the road to economic prosperity. This shift toward economic liberalization has encompassed even traditionally socialist, or at least heavily state interventionist, countries such as India, most dramatically under the leadership of Prime Minister P.V. Narasimha Rao (1991-1996). Privatization and other market-oriented economic reforms also have in the 1990s come to the top of the nation's economic agenda in other large developing countries that, at the rhetorical level, have been significantly more pro-capitalist and pro-foreign investment than India--yet whose actual practices over decades also have led to the development of a large state-owned productive sector. Brazil, for example, had talked a great deal about privatization since the mid 1980s, but only began to make noticable changes under Presidents Fernando Collor de Mello (1990-1992), Itamar Franco (1993-1994), and now Fernando Henrique Cardoso (inaugurated 1995).

Where countries are large, federal entities, with significant ownership of public enterprises at both the central and state government levels, then the politics and economics of center-state relations often complicate the process of privatization. Furthermore, if the nature of national political competition is opening up--as in India from the mid 1980s because of the end of Congress Party hegemony or in Brazil because of redemocratization and the important changes in electoral rules in the mid 1980s--privatization can become an even more complex affair. This essay uses four focused case studies to explore the following question: "When and why do state governments oppose (or support) privatization programs initiated by the central government?" We examine privatization initiatives in the 1990s of the federal governments of India and Brazil in the fields of electricity and finance, and the varying responses of the state governments in each country's major industrial state and financial capital, respectively, Maharastra and S^{a}o Paulo.

Maharastra Chief Minister Manohar Joshi, elected in early 1995, cancelled the power plant contract with the American firm, Enron, which had been entered into by the national government of Prime Minister Narasimha Rao and Joshi's predecessor in Maharastra, Sharad Pawar. Through mid 1996 the Joshi government, however, had been quiet, and perhaps even vaguely supportive, of central government efforts to promote privatization and liberalization of India's financial sector. In contrast, the administration of Sªo Paulo Governor Mário Covas, inaugurated in January 1995, resolutely opposed the privatization of Banespa, the State Bank of Sªo Paulo, but was, by all outward signs, moderately enthusiastic about the central government's plans to privatize most of Brazil's electricity sector, including three firms in Sªo Paulo state. In both India and Brazil, that is, after the central government had announced a significant privatization program in an important economic sector, a newly elected state government had announced its opposition to the program and demonstrated its willingness to engage in a protracted public battle with the center. Also in both countries, the sector in which privatization had been announced but only minimally implemented by mid 1996--banking in India and electricity in Brazil--thus far had not provoked a major center-state political conflict. The possiblity of its arising in the future, however, could not be discounted.

We hypothesize that three important reasons may lead state governments to oppose federal governments over privatization: (1) State leaders are intrinsically and ideologically opposed either to privatization in general, or to some aspects of privatization, typically the involvement of foreign investors, (2) State leaders are of a different political party or coalition than federal government leaders and, for larger political reasons that have little to do with the issue at hand, have decided to try to gain electoral benefits from an obstructionist position, or (3) State leaders believe that the distribution of economic and/or political benefits between the center and the state governments is unfair to them. Frustrated central government liberalizers tend to assume that state leaders who oppose their plans either are obscurantists (reason #1) or opportunists (reason #2). In fact, often a greater willingness by the center to respect the perceptions and distributions of costs and benefits <u>as experienced by the state government</u> (reason #3) can help to resolve these conflicts.

In the four cases examined here (electric power and banks in India, and the same two sectors in Brazil), we find that the historical beliefs and commitments of key state leaders (reason #1) are, of course, relevant. Nonetheless, most politicians are pragmatists. Historical socialists have made dramatic shifts in economic policy preferences in both countries--including the Communist Chief Minister of the Indian state of West Bengal, Jyoti Basu; Narasimha Rao's finance minister, the left-leaning economist, Manmohan Singh; and internationally known sociology professor and "dependency theorist," who became Brazil's president in 1995, Fernando Henrique Cardoso. Our cases suggest the distribution of benefits at the state level (reason #3) to be the most compelling reason for state government opposition, with issues of electoral competition among members of rival parties and politicians (#2) playing a lesser but not negligible role.

The essay that follows has five sections. The first two provide general background for the topic: section one by clarifying what we mean by "privatization," and section two by comparing the contemporary context of center-state relations in India and Brazil. The third section discusses center-state conflict in India over privatization, beginning with the story of the electricity plant at Dabhol contracted for with the Enron Corporation, and following with observations on the slow progress of financial sector privatization and liberalization. Section four covers center-state interactions over privatization in Brazil, first focusing on the fight over the fate of Banespa and then summarizing the planned, though not yet implemented, electricity sector privatization in Brazil. The essay's conclusions draw out tentative comparative lessons.

I. A methodological note on comparing privatization experiences

We need to explain how we will define and compare privatization, given that our two country cases started, as of the late 1980s, from positions in which the forms and extent of government economic intervention differed. Since, for example, Brazil never experienced such formative Indian policies as industrial licensing or size restrictions on private enterprise (as under India's Monopolies and Restrictive Trade Practices Act), how are we to compare privatization in the two?

We define "privatization" to include all types and increments of transfer of ownership, partial or complete, from the government to the private sector.[1] Privatization also occurs when previously excluded persons or groups, such as foreigners or limited liability corporate entities, are recategorized as eligible "private" owners.

Usual practice is to understand privatization to mean "sale of state firms to new owners in the private sector." This definition implies that "ownership" is a dichotomous variable: either the government holds 51 percent of a firm's equity, or private persons do. The drawback is that we then have no way to conceptualize other changes in the percentages of public and private ownership. For example, a shift from 100 percent public ownership to 75 percent public ownership can be a very significant act to reduce the direct productive role of the state. Politically, divestment of 25 percent of equity may signal a new era of opportunity for private entrepreneurs. The purely economic impact may be even more substantial. Suppose the goal of allowing 25 percent private ownership is to increase economic efficiency within the state-owned enterprise (SOE). The requirement of maintaining the value of a bloc of shares freely traded in the country's capital markets easily can be a form of competitive pressure on the firm, even if management and majority ownership remains with the state.

"Privatization" more usefully might be thought of as a continuum of policies which share the characteristic of transferring ownership of production of goods and/or services from the state to the private sector. The continuum begins with near total government ownership of the firm and of the sector within which it operates. Defense industries, or electricity generation and distribution, are typical examples of state monopoly sectors even in many advanced capitalist societies. Not only is the firm itself government owned; all of its competitors and potential competitors are state-owned as well. The mid point on the continuum shows a wholly-owned public sector firm competing with private firms; entry to the sector is free (that is, privatized), but the firm itself is entirely public. The ownership continuum's far end shows minority state equity participation in one or more firms within a sector that also contains large, dynamic private firms. If the shares held by private owners are dispersed, a firm with state equity holdings of as little as 30 percent may operate under effective government management. On the other hand, if more than 30 percent of the 70 percent of equity in private hands is closely held by one entrepreneur or group, then the government's same 30 percent holdings may not yield de facto managerial control.

Strong functional similarity exists among three activities, each of which is "privatization" in terms of this essay's definition. These are: a) liberalization of the right of entry into an economic sector previously reserved to state production only, b) sale of equity in a state-owned and managed firm, and c) subcontracting out an organizational task previously performed by state employees, either within a state-owned enterprise or by a government administrative agency. In each case production of goods or services previously owned and controlled by the government passes to the profit-seeking private sector. Privatization of the sector or the organizational task implies the possibility of increased competition from potential new suppliers. Full or partial sale of equity in a state firm implies an enhanced role for transparent, market-based judgments about the true profitability of the unit. When either increased competition or transparency occurs, enterprise managers should be pressured into becoming more efficient. That is, the economic efficiency argument in favor of privatization applies with equal validity to opening up the space for private ownership in the sector, the firm, or the organizational task.

In fact, variations in cross-national use of the language of privatization reinforce the intuition that these are similar processes. Indian policymakers in the early 1990s talked of "privatizing" the steel sector: what they meant was for the first time permitting private entrepreneurs to open steel mills to compete with mills owned by the government. Argentine President Menem, meanwhile, boasted of his intention to "privatize" bill collection for urban utilities, that is, to contract out an organizational task. Interestingly, understanding the functional similarities of private entry into sector, enterprise, and organizational task, allows us to recognize privatization occurring even when governments have political reasons for preferring their transfer of production to the private sector to go unheralded.

Privatization has another dimension that also may go unnoticed. A nation's understanding of "private" owners often is continuous rather than dichotomous. A country's corpus of business law, in fact, usually distinguishes between three categories of enterprise owners: the state, nationals resident in the country, and other private persons. For example, Brazilian governments from the 1950s through the 1970s developed the public relations of managing the public-private, and simultaneously the national-foreign, ownership dichotomies into an art form with its famous "four-thirds" formula. The Brazilian government's contribution to equity investment was announced to be both "public" and "national." Similarly the multinational investor's contribution was dubbed both "private" and "foreign." Thus, the ideal-typical new heavy manufacturing plant in which the investment was a third foreign, a third state, and a third private local capital could be sold as promoting both Brazilian control of industry ("two-thirds Brazilian") and private ownership ("two-thirds private").

Countries also may discriminate among private owners on the basis of ethnicity. For example, countries such as Ireland, India, and Taiwan extend an intermediate category of privileges to expatriate nationals, former nationals, and their descendants, giving them access to certain kinds of property rights forbidden to ordinary foreigners. This is the important Non-Resident Indian (NRI) category in India. Israel offers citizenship, and thus ownership, privileges on the basis of religion. Finally, the familiar distinction made in every advanced industrial society (but not yet in every developing economy) between individuals as owners of firms (subject to unlimited liability for potential losses) and corporate entities as owners of firms (in which case the individual owners only are subject to limited liability) also illustrates the multiple, rather than dichotomous, nature of "private" ownership.

Logically, then, one ought to acknowledge as "privatization" all changes in national regulations that expand the allowable participation of private citizens in ownership of production of goods and services--including those policy changes prescribing movement from a more to a less restrictive definition of who is a legally admissible "private" investor. By the same logic, allowing previously forbidden institutional forms for private participation in a sector (or firm or organizational task) also qualifies as privatization. The economic efficiency rationale for favoring privatization operates identically in all of the examples just discussed. Extending the option of participating in entrepreneurship or minority share-holding to a previously excluded category of private citizens increases potential competition by enlarging the pool of potential entrants. This expanded definition allows cross-national comparisons.

II. Center-State Relations in India and Brazil

We can sum up the context of center-state relations in the early 1990s in India and Brazil under four themes: first, each country had a history of central government intervention in the country's overall economy; second, states were fiscally and financially dependent on the center; third, the late 1980s brought forth a growing desire on the part of wealthy states, in particular, to free themselves from central direction; and, fourth, from the mid 1980s onwards there was increased political competitiveness, both nationally and in state-level politics. The interaction of these four dimensions meant that, by the early 1990s in both India and Brazil, conflicts between wealthy states and the central government over economic regulations and rules of the game had become quite likely.

A first commonality is that, in both countries, the federal government had been self-consciously interventionist for decades, dominating almost all arenas of economic regulation, and monopolizing production in several important sectors as well. Both state governments and the private business sector often had resented the heavy hand of the center in guiding national economic development according to centrally mandated priorities. In India, from independence in 1947 till the beginning of sweeping, market-oriented reforms in 1991, economic relations between the centre and the states in India can be summed up in a single paradox: economic power was highly devolved to the States in principle, but highly concentrated in the hands of the centre in practice. Under the impact of the growing economic crisis through the seventies that led to the reforms of 1991, and then of the reforms themselves, this paradox, to which a considerable part of the slow, inward-looking growth of the economy during these years can be traced, has now begun to be resolved. There were two ways in which the center dominated individual states in the economic sphere: first, through the pervasive regulatory authority and direct ownership role of the national government and, second, by the fiscal and financial dependence of the states upon central government transfers.

Central encroachment into what, according to the Constitution, were the prerogatives of the states, has been most noticeable in the industrial sector. The encroachment took place through two acts that Free India had inherited from wartime British India, and by the adoption of Centralised planning for economic development. The acts in question were the Industrial Development and Regulation Act (IDRA) and the Essential Services Maintenance act (ESMA). The former gave the central government the right to determine both the establishment (product, and capacity) of industry, and its location. The latter gave the national government sweeping powers to intervene in pricing (price controls) and distribution. The IDRA gave birth to the instrument of industrial licensing, which required every investor in a venture above a minimum size to obtain the clearance of the central ministry of Industry or his project. ESMA created price and distribution controls not only on food grains and textiles, which had been its original wartime purpose, but its coverage was extended to cover a variety of key intermediate products, such as iron and steel, cement, molasses(for the alcohol based industries) edible oils, a variety of intermediate chemicals and paper. It also provided the intellectual justification and administrative framework for the wholesale nationalisation of import and export trade (to the tune of 85 percent of imports and 60 percent of exports) in the hands of specially created Parastatals like the State Trading Corporation, and the Minerals and Metals Trading Corporation, in the early seventies.

Both these acts were thus used extensively to achieve purposes that their wartime creators had not even dreamed of, but they controlled only the private sector. To speed up industrial development, the government also went in for centralised economic planning. This became the pretext for a further vast incursion into the territory of the states. By 1962, when the building of the command economy was perfected, the central government decided what was produced, by whom, and in how many units of what size. All that was left for the states to do was decide where precisely within their boundaries new projects might go up, and to provide the power and water connections for it. Since they were left to compete with each other in these limited spheres, they vied with one another to offer the most tempting rates for power, and water and raised no objection when the promoters of new industrial ventures picked the most scenically beautiful or commercially valuable spots for locating their enterprises. The clamour that this eventually raised among the public as prime forests were cut down to set up new industrial plants and rivers polluted or depleted of their stocks of fish, eventually made it necessary for the centre to set up a ministry of environment to give central clearance to all new projects. This may have reduced the rate of destruction of the environment, but it also further curtailed state and municipal-level inputs into decisions about industrial location and development. In addition, from the second Five Year Plan onwards, the central government progressively bestowed the responsibility for forcing the pace of industrial development on the public sector. The new enterprises it created for this purpose were almost exclusively under the control of the central ministries.

In most other arenas of economic regulation, national, rather than individual state-level, rulemaking has predominated in India. Most prices for agricultural goods, along with a great many prices for every type of manufactured item, but especially industrial inputs and capital goods, have been determined nationally. The tone, and many of the specifics, of management-labor relations in both the private and the public sectors have been a continual subject of central government legislation. This is true even where the formal rules of the game give regulatory power to state governments. For example, the Industrial Disputes Act of 1977 made it mandatory for factories employing more than 300 workers to get permission from the state governments before laying off any employees. In 1985, this was amended to extend the need for prior permission to establishments employing more than 100 workers. Although the power to say yes' or no' rested nominally with the state government the act itself was passed by the centre. By putting the state squarely in the middle of a contractual issue between employers and employees, it politicized the issue. Once that happened politicians found that they faced severely negative electoral consequences if they dared adopt the "anti-labor" position of sanctioning layoffs. (Incidentally, this posture forced many entrepreneurs into bankruptcy. More than one then closed his or her factory through the thoroughly extra-legal means of paying someone to torch it, enabling the owner to collect the insurance--while the erstwhile employees ended up equally as unemployed as had they been made redundant, and often without their severance and other benefits due them from the employer as well.)

In Brazil, over several decades the central government gathered increased economic regulatory power to itself, although this trend began to be reversed from the late 1980s. Throughout the postwar era, the central government has set the national minimum wage (in a context where the overwhelming majority of all wages and salaries are quoted not as an absolute figure, but instead as a multiple of the minimum wage), controlled many prices, had great influence over the financial system, and owned most utilities and a large chunk of heavy manufacturing and natural resource production (mining, petroleum). Major businesses and employers in many states have been federal public sector firms. In general, Brazil's private sector has been more lightly regulated than India's. The concept of industrial licensing, by which private

Indian businesses needed central government permission to open a new plant or expand an existing one, is unknown in Brazil. Similarly, although Brazilian public sector firms, and government administrations at every level. have had difficulty reducing staff, since the mid 1960s Brazil's private sector has been significantly more free to hire and fire than have their Indian counterparts.

Second, in India, as in Brazil, state governments in the early 1990s perceived themselves to be much too heavily dependent upon the central government for revenues and wished to have greater control over their own funds. In addition, state governments in both countries desired greater autonomy over their own economic regulatory structures at the state level than they had experienced in the past. There was, that is, some tendency to object to central government's plans on principle. A difference was that Indian state governments objectively had substantially greater <u>direct</u> dependence upon the federal coffers, both for direct transfers and permissions to borrow, than Brazilian governments did.

Indian states, although constitutionally assigned responsibility for numerous categories of expenditure--from agriculture, to public health, to the provision of drinking water--have been fiscally and financially dependent upon the central government. A complicated system evolved whereby certain taxes were assigned to the central government, others were shared according to a set formula, and still others belonged wholly to the states. Unfortunately, revenues collected by the different taxes have not grown at equivalent rates; many state-level politicians, in fact, believed that the central government purposely has been less diligent in collecting those taxes, including the personal income tax, from which they get a share, than in collecting other taxes, such as the "corporation tax" (corporate income tax), which goes entirely to the central government. In 1985-1990, the gross tax collection of the state governments (Rs. 90,380 crores) was roughly half that of the central government (Rs. 193,275 crores). In turn, the central government transferred, through various means--including direct revenue-sharing, plus "Plan" and "non-Plan" expenditures--about half of the revenue it collected, summing to Rs. 92,467 crores. That is, fully half of state revenues were transfers from the central government[2]. The thorough domination of India's financial sector by the central government also meant that any borrowing state governments did also was controlled by the central government, either through the Reserve Bank of India (which managed all public debt issues), the federally owned development finance institutions, or some other source. During the latter 1980s, borrowing funded from a third to a quarter of total state expenditures[3]. Very roughly, therefore, on average Indian states paid for their current and capital expenditures in the late 1980s about 40 percent by tax revenues coming directly to them, 40 percent by transfers from the central government, and 20 percent by borrowing. That is, states, on average, depended upon central government transfers or permission for around 60 percent of their revenues for current and capital spending. The adoption of a comprehensive system of centralised planning put the states in a strait jacket with respect to decisions about how to spend and invest their funds as well.

Borrowing was originally supposed to play only a supplementary role in financing planned investment in India. This was because during the first Five year Plan period (1951-56), Plan outlays were relatively small and unambitious, being confined mainly to agriculture, irrigation, the railways and power. There was also a substantial surplus from current revenues. But once the central government took upon itself the task of industrialisation, its outlays bloomed. A hectic rise in its non-developmental spending also made the revenue surpluses vanish. From 1962 onwards borrowed funds met most of planned investment. From 1974, even the current account was more often than not in deficit, and planned investment depended entirely on savings extracted from the household sector. From 1979, after the centre accepted the recommendations of the seventh Finance commission, the center was in permanent deficit. The states followed the center into permanent deficit in 1987.

In Brazil, many states and municipalities have been somewhat dependent upon fiscal transfers from the center. Tax reforms written into the 1967 Constitution promulgated by the military government centralized tax collection in the center, ostensibly for reasons of efficiency, but clearly also as an aid to political control by the central government. As of 1978, 68 percent of state revenues were collected within the states in the form of direct and indirect taxes and fees for services. Another 20 percent of revenues came from transfers from the center, and 13 percent from borrowing[4]. Since state governments book the majority of their loans from public sector banks owned and controlled at the state level, one might conclude that the central government effectively controlled only a relatively small 20 percent of total revenues--hardly comparable with the 60 percent of revenues of Indian states overseen by the center. However, in Brazil the revenues of municipalities, crucial for local and state-level politics, were more dependent upon the center than revenues of state governments. In 1978, transfers from the federal government contributed 40 percent of revenues of state capitals, while borrowing provided 12 percent. In addition, although state and municipal government borrowing in Brazil is not directly overseen by the central government, as it is in India, state-level public sector commercial and development banks operating with deficits rely upon refinancing from the Banco Central do Brasil (Brazilian Central Bank, or BC). With the opening up of democratic political competition from the early 1980s (beginning with gubernatorial and mayoral races in 1982), incumbent state governments begin borrowing heavily from state-level banks for campaign funds. By the mid and later 1980s, central government subsidies of insolvent state-level banks had become a significant source of center-state conflict in Brazil.

A third similarity is that in both countries the poorer states had relatively more to gain than richer ones from continuing the system of central collection of many taxes and then their reallocation to states (and, in Brazil, municipalities) at least partly in accordance with redistributive criteria. In India, funds transferred by the Finance Commission for "non-Plan expenditure," or on-going expenses not associated with new initiatives, have favored the "weaker" (that is, poorer) states. In Brazil, direct transfers from the center to the states were even more unequivocably redistributive. In 1978, for example, federal transfers going to the poorer north, northeast, and center-west regions were an unweighted mean of 90 percent of direct state tax collections in these states, while federal transfers to the wealthy southeast and south regions were only 15 percent of state tax revenues[5]. A similar pattern of interregional redistribution prevailed at the municipal level. States and municipalities together in the poor north, northeast, and center-west depended upon federal transfers to fund 50, 31, and 41 percent of their total current expenditures, while states in the prosperous southeast and south funded only 15 and 16 percent of their spending from such transfers[6]. Consequently, politicians in Brazil's poorer states have been strong supporters of the more centralized system of tax collection and distribution established during the recent twenty year military regime, while politicians in wealthy southeastern states like Sªo Paulo, Rio de Janeiro, Minas Gerais, and southern states like Rio Grande do Sul, have opposed it.

The opposition of wealthier states to centralized tax collection and redistribution, however, partially concealed a larger truth: the central government's explicitly developmental expenditures--expenditure associated with the Five Year Plans in India and a plethora of federal incentives and programs in Brazil--in both countries had tended to favor faster growing and wealthier regions. That is, although wealthy states like Maharastra and Sªo Paulo sometimes complained about subsidizing poorer regions, the net effect of all central government programs probably was not terribly redistributive, if it was so at all. The regionally concentrating effects of allocations, in Brazil, of agencies and programs such as the BNDES, the country's industrial development bank, or of incentives to manufactured exports, have been less noticable, in that they are not all collected together as they are in India's Five Year Plans. The significant political reality was that many citizens in the wealthier states tended to believe that, on balance, the central government's economic interventions had slowed their growth for the sake of redistribution toward poorer, less productive regions--whether or not the net result of all central government spending really had discriminated against them.

Finally, in both India and Brazil both the nation and individual states were experiencing greater political competitiveness. In India, this was due to the end of the Nehru/Gandhi family political dynasty's lock on national leadership, as well as the debilitation of the Congress Party which, after more four than four decades, no longer credibly could bill itself as the party of the victorious struggle for independence. As opposition parties won more state governments, of course, they became increasingly concerned to receive what they believe to be their "fair" share of public resources, and more likely to suspect that their political opponents in New Delhi may be withholding revenues for partisan purposes. In Brazil, redemocratization in the early 1980s exposed the weaknesses of the country's fractured political party system, leading to intense competition between a plethora of mostly regionally-based, personalistic new political parties. In both national cases, one consequence of these larger political changes was to intensify the potential for politically and electorally motivated conflicts between the central government politicians and state politicians (many of whom, of course, aspired to a national stage).

III. Center-State Bargaining over Privatization in India.

The context of center-state relations in India is in the process of shifting rather dramatically as Indian states, long quite tightly managed by planners in New Delhi, gain significantly greater economic decision powers at the state level. At the national level, a primary motivation for privatization appears to be the desire for achieving improvements in performance in the sectors to be liberalized. The relations between the center and the state governments, however, are influenced both by efficiency considerations--and by politicians' search for electoral advantage. In addition, state-level leaders, quite naturally, find themselves more absorbed by the consequences of a given development within their own home state than at the national level.

Privatization of electricity: Enron and the Dabhol generation plant.

At first sight the decision taken on August 5, 1995, by the newly elected BJP-Shiva Sena government in Maharashtra to scrap the 2000MW Dabhol power project, negotiated by its predecessor with the Enron power corporation of Houston, Texas, looked like a textbook example of unresolved ideological conflict in a democratic nation where the commitment to economic reform had been lukewarm at the best of times. The absence of a consensus on the need for, let alone direction of, economic reform had been a distinguishing feature of political debate in India, even before the Rao government came to power in June 1991. When Rao's predecessor, Mr. V.P.Singh, had sought to pass a small measure of industrial de-regulation on May 31, he was opposed not only by prominent members of his own party, the Janata Dal, but also by the Planning Commission whose member for industry wrote to him that deregulation would increase imports, especially of capital goods, and the opening India to foreign investment would make it vulnerable to foreign powers.[7]

When the Rao government came to power, opposition to structural (as opposed to fire-fighting) reforms was only slightly less pronounced. The Indian Left, which was heavily represented in the universities, remained far more concerned about the threat to India's economic sovereignty that was implicit in opening up the country to imports, and foreign investment, than about the consequences of a default on its international payments. This would have led to the suspension of suppliers' credit for imports, the consequent disappearance of essential commodities like diesel fuel from the market, and a breakdown of the distribution system within the country.

The Rao government had also encountered stiff opposition from within the bureaucracy, and from the organised trade unions. The former feared a loss of power, and therefore importance; the latter feared a loss of jobs in the organised sector of the economy. This opposition sputtered on throughout the first three years after structural reforms were initiated, and began to die down only in 1994, when the country emerged from a two-year period of stagnation and entered a phase of more than 6 percent growth, and when the state governments, which had first been somewhat befuddled by the spate of reforms in central policies, began to take advantage of the freedom to make economic decisions that deregulation had conferred on them.

By 1995, much of the initial opposition to reforms in the orthodox Left had dissolved. The Communist chief minister of West Bengal, Mr. Jyoti Basu, had become convinced that India, and West Bengal in particular, had to embrace radical structural reforms such as privatization, and to exert itself to change its image and become foreign investor-friendly.[8] But the refrain that India's economic sovereignty was under threat had been taken up by the Hindu nationalist Bharatiya Janata Party (BJP). In a meeting of the BJP's national executive in October 1993, a decision was taken to appropriate Mahatma Gandhi's 70 year old slogan of "Swadeshi" (be Indian, buy Indian) and use it to attack foreign investment, above all, in consumer goods industries. Thus when the BJP promised, during the election campaign in Maharashtra, to cancel the agreement for the construction of the Dabhol power project, alleging that Enron had inflated its capital costs with the connivance of the Congress party's leaders, whom it had bribed, most observers concluded that the BJP was turning its slogans into practice.

The real issue was very different. The cancellation of the Enron project had very little to do with ideology. Instead, it resulted from an acute conflict between center and state over control of privatisation. The conflict occurred at two levels: at one it was a straightforward tussle between the state of Maharashtra and the central government over the control of economic decision-making. But at the second it was a more abstract conflict between central and state authority. In an interesting twist, the latter also occurred within the ruling coalition in Maharashtra itself, taking the shape of a prolonged struggle within the state government because one of the coalition members, the BJP, aspired to rule at the center, while the other, the Shiva Sena, had no such ambitions and believed that its responsibility ended with ensuring that Maharashtra got a fair deal. As a state party the Shiva Sena wanted to renegotiate the project. But as a party with national aspirations, the BJP found itself caught on the horns of a dilemma: it could secure concessions from Enron in a renegotiation and thereby strengthen its position within the state, or continue to insist on cancelling the Enron deal in order to garner support in other parts of the country as a champion of India's economic sovereignty. Eventually it had to give way. Thus the prerogatives of the state prevailed over those of the center.

The Dabhol power project was in every sense a baby of the central government. From the seventh Five Year Plan (1985 to 1990) itself it had been apparent to the Rajiv Gandhi government that the resources at the command of the central and state governments, both from domestic savings and foreign aid, were simply not sufficient to meet the need for additional power generating capacity in the country. So, early in his tenure as prime minister, in 1986, Rajiv Gandhi opened the power sector to the Indian private sector. To the government's surprise, in the next five years it did not receive a single proposal from the private sector for the setting up of a power plant. There were a host of reasons for this. The most important was the state governments' monopoly over power distribution. Paradoxically, this monopoly weakened their capacity to set economic tarriffs for power, and to recover even the uneconomic ones from the consumers. Both sins were most in evidence in the supply of power to the agricultural sector. In 1992, when the average cost of power generation in India was Rs. 1.17 per unit, the average recovery from the agricultural sector, which consumed 26 percent of the total power generated, was a mere Rs. 0.17.[9] As a result, the loss incurred on the supply of power to agriculture was Rs. 8,384.66 ($2.67 billion) in 1993-94.[10] As the state governments showed little inclination to court disfavour with the powerful farm lobby by raising power tarriffs, their capacity to pay for the power they consumed became more and more open to question. Eventually, the World Bank, which had been the prime foreign investor in the Indian power sector throughout the 'seventies and 'eighties, decided that it would not fund any more power projects in states that did not raise their tarriffs to agriculture. Even this had an effect in only a handful of states. As a result, private investors did not feel that investment in power was safe.

However, a second reason for the absence of bids was that the central and state ministries of power, and the Central Electricity Authority, had very little idea of how to frame a project proposal in order to make it biddable. So long as power generation was a state monopoly, environmental and other clearances were not needed, land was acquired by the state government, usually at well below market prices, and tarriffs were fixed as far as possible on a cost-plus basis, with a heavy cross-subsidisation of agriculture and often the household sector too, by high tarriffs on industrial users. None of this was exactly good preparation for negotiating contracts with private companies.

By 1992, it had become clear that the country was all set to encounter a huge power crisis a few years down the line. During the seventh Plan, a total of 26,090 MW of power generating capacity was added to the existing capacity in the country.[11] Even this was 759 MW short of the target. The next two years of structural adjustment saw the annual addition to capacity fall to 2904 MW.[12] For the Eighth Plan (1992-97), the Central Electricity Authority estimated the need for an additional 38,000 MW of generating capacity. But this was scaled down first to 30,580 MW, and then, as it became clear that the state simply could not raise the money, to a mere 19,000 MW.[13] As a result, the ministry of energy estimated that depending on the nature of the monsoon, the peak power shortage in the country could rise from 16 to 20 percent in 1991 to 1995, to 27 percent in 1997-98.[14]

Private investment in power projects was therefore essential, and was needed as soon as possible. This was the sense of urgency that drove the Narasimha Rao government to send out a high powered delegation headed by the cabinet secretary, Mr. Naresh Chandra, to talk to power generating companies all over the world and entice them into investing in India. The end product of that initiative was that the central government signed memoranda of understanding with various foreign firms for eight large power projects. These were to be directly negotiated deals, where the accent was to be on speed. They therefore came to be known as "fast track" projects. However, their secondary purpose was to break the ground for the negotiation of other private power projects in the future. Enron was the first and largest of these projects.

Enron had first proposed a 2,000 MW power plant to be built in a single phase, but the World Bank, which acted as a consultant to the Indian government, pointed out that the Western grid, into which the power would have to be fed, could not take such a large input. Enron therefore agreed to implement the project in two phases. The first of 695 MW to be run on distillate, and the second of 1400 MW which, along with the first, when completed would be run on natural gas. The gas itself would be piped into Bombay from the Middle East or brought in as liquefied natural gas in ships. Breaking the project up into two phases raised costs in a number of ways. Much of the infrastructure for the second phase, including port facilities and a road to link the port to the power plant could not be divided and had to be built in the first phase. In addition, a re-gassification plant for the liquefied natural gas was also included in the first phase. As a result, when the first estimates of project costs for the first phase came out, they caused eyebrows to be raised all over the country. For even after various renegotiations, this got pegged at Rs. 42 million per megawatt of capacity created ($ 1.3 million). Power was to be provided at Rs. 2.40 (7.7 cents U.S.) per unit. Many commentators pointed out that this was higher than the going rate for coal based plants being sanctioned at the time. According to the Planning Commission, that was in the neighbourhood of $1.05 million.[15] Gas based power plants, the critics pointed out, should cost around 40 percent less than coal- based ones. Even after allowing for the more expensive ancillary and infrastructure facilities that such plants needed, they should turn out cheaper than coal-based ones. Gas based projects were being built by the National Thermal Power Corporation for Rs. 3.8 crores per MW and as little as Rs. 3.5 crores per MW by private investors.[16]

As has been pointed out above, there were sound reasons for the higher capital cost in the first phase. One that got almost completely overlooked till the project was on the verge of being cancelled, was that the Dabhol estimate was for December 1997, that is, four years after the reference projects being used to criticize it. But neither Enron nor and the Maharashtra government, then under the Congress chief minister, Sharad Pawar, made any attempt to explain the reasons for the higher apparent capital cost. As a result, the impression hardened in the country that Enron had taken India for a ride. In the corrupted political system that the country lived under, where there was no legal and audited source of the huge sums that political parties spent on elections and day to day expenses, this led automatically to the suspicion that Enron had been allowed to get away with gross overcharging, because it had paid a "kickback" to the Congress party in Maharashtra.

This became the launching pad for the BJP and Shiva Sena's attack on the project. Throughout the election campaign of February 1995, the BJP and Shiva Sena kept alleging that the deal was corrupt and that, if elected, they would cancel it at the first opportunity. When the coalition did come to power in March, its promise to cancel the Enron deal became an albatross around its neck. There is some evidence that despite its pre-election promises, the Shiva Sena was far from enthusiastic about cancelling the deal.[17] The BJP's position was also ambivalent. While the new deputy chief minister in Maharashtra, Gopinath Munde, was dead set on cancelling the project, many of the central leaders of the party, in New Delhi, were in favor of renegotiating it. However, the matter was taken out of the state government's hands when Business Line, an economic daily, published the contract that had been signed by Enron with the Maharashtra government. The cost details it contained gave firm grounds, for the first time, to critics who had been claiming that the project was overpriced. In an analysis of the agreement, Kirit Parikh, a well-known economist, claimed, on the basis of a comparison with an almost identical power plant set up in Hong Kong, that the project cost was 15 to 20 percent too high.[18] Parikh also pointed out that the terms of the power purchase agreement were unnecessarily loaded against the Maharashtra government. More specifically, since the Maharashtra State Electricity Board was committed to buying 86 percent of the power generated by the plant, to fulfill this commitment it would have to give preference to Enron during off-peak hours, over its own power plants, where it could have the power for no more than Rs. 0.6 per unit.

Both these observations turned out to be only partly correct. But they were sufficient to force the government to announce that it would "review" the Enron project, before deciding whether it should be allowed to continue or not. What followed was an elaborate shadow play. At one level, the Maharashtra government gave a host of seemingly plausible reasons for reviewing, and later cancelling, the project, of which not a single one stood up to close scrutiny. At another level, the reasons did not matter at all. What ensued was a naked struggle for power between the center and the state, in which the reasons given by the latter for overturning the previous decision, were intended only to mobilise support, mainly from the media.

During the election campaign the BJP and Shiva Sena had put forward four reasons for cancelling the Enron project: (a) the power station was overpriced; (b) it would cause damage to the environment; (c) the negotiations lacked 'transparency', and (d) Enron had indulged in corruption to obtain the contract. When the chief minister announced the actual cancellation, he left out only the allegation of corruption. However, by that time the media had given the earlier allegations so much play that the belief that there had been corrupt practice was set in cement. Enron initially made the tactical mistake of not countering the propaganda. By the time it did, the damage had been done. Nonetheless a close examination of the four allegations shows that there was very limited truth only in the first. The remaining three allegations were either false or were not of sufficient merit to warrant cancellation of the project.

A comparison with the investment cost of six other gas based plants that were at various stages of execution showed that Enron's cost was not unreasonable. In the other six, the investment cost per megawatt of installed capacity varied from Rs. 35.1 million and Rs. 40.0 million for two projects completed in 1993, Rs. 38.1 million for one completed in 1994, and Rs. 35.1 to Rs. 38.3 millions for three projects scheduled to be completed in 1996. The cost of the first stage of the Dabhol plant, scheduled for completion in December 1997 was coming to Rs. 36.8 million per MW.[19]

As for the allegation that the negotiations lacked transparency because the contract had not been awarded on the basis of a global tender, Enron pointed out that in the initial stages of privatisation projects had been developed through negotiations throughout the world. Indeed when Indian embassies abroad first tried to call prospective investors for meetings, in 1992, very few turned up.[20] What is more, this allegation was made in a writ petition filed by one Ram Das Nayak in the Bombay High Court on 17 February 1994, but had been dismissed by the High Court with the observation that "nothing was done secretly. There was total transparency at every stage of the negotiations". Lastly, the High Court also did not uphold a petition that the project would pollute the environment, but made the petitioners and the company agree to a procedure by which the ministry of environment to lay down additional conditions for the company to fulfill if it thought these were needed.

However, behind this smokescreen of flimsy accusations lay two very real complaints, neither of which received much attention from the press or the many front organisations that sprang up to 'fight Enron'. The first was related to the method used to calculate the cost of power for the Maharashtra State Electricity Board. In its anxiety to attract foreign investment in power, the central government had announced, early in 1992, that it would guarantee a 16 percent return on the equity capital invested in power projects. This had become the basis of all negotiations of the "fast track" projects, and those that followed. But it was a criterion that the state governments had absolutely no hand in framing!

Dissatisfaction with this criterion arose from the fact, pointed out instantly by many economists, that this gave the investors every incentive to pad their capital costs as much as they could. The dissatisfaction rose another notch when the States realised that the basis of calculating the returns was so generous that any half way efficient plant could earn far higher returns. In particular the basis for calculation of the power tariff was the capital cost incurred when the plant an at 68.5 percent of capacity. However, all private sector projects were confident of running at 80 and even 90 percent of capacity. This would raise their returns to 25 percent and even more. The chairman of one Indian private company which made a bid to enter the power generation field reported that along with very generous coal consumption norms, the low plant load factor ensured that his company would earn up to a 33 percent return on its equity capital.[21] Nearly all of the state government's complaints stemmed from the fact that while the decision on returns was taken exclusively by the center, the State Electricity Boards, and therefore eventually the state governments, would have to do the paying. Given their inability to stop subsdizing the sale of electricity to agriculture and the steady rise of agriculture's share of total power consumption, they had grave misgivings about being able to recover the cost of the power they would buy from private investors from the consumers. This explains why although the Enron dispute stole the headlines, it was not the only fast track project that came under fire when the state government changed hands. In Orissa, the Ib valley power project, in which the Janata Dal state government had sold a half completed 600 MW coal-based power plant to AES, an American consortium, with the intention of using the proceeds to complete a long stalled hydro-electric plant, came under fire after it too had been finalised, by the Congress Party government which got elected in March 1995. The new chief minister made exactly similar allegations to those made by the Shiva Sena-BJP government in Maharashtra, and demanded a renegotiation of the project to bring its cost down. AES agreed and recast the project, increasing its size in the process.

The second real problem, which was camouflaged in concern for the environment, arose from the fact that while the center decided the location of the Enron project, both the political and economic cost of providing the infrastructure fell upon the State government. The most sensitive part of this problem was the acquisition of land for the project. 650 hectares of land had been earmarked, of which 450 hectares were needed immediately and had been acquired by the state government. Farmers owning 300 hectares had not accepted the compensation offered to them and had gone to court. The process of acquiring land and then selling it to the prospective investor, was not only time consuming and fraught with judicial delay, but one that made the state government exceedingly unpopular. Yet the alternative, of withdrawing the State from such transactions altogether and simply allowing the project authorities to buy the land , reserving the power of acquisition for use only against especially recalcitrant or avaricious land owners, had been ruled out by a model land reform bill prepared by the central government in 1970, and enacted by the States over the next two years. This act forbade the sale of agricultural land for non- agricultural uses above a nominal amount. Thus for any large project the state had to acquire the land first.

Once again therefore, the underlying bone of contention was not the environment per se, but the fact that the state would have to bear the political cost of a decision made by the central government. That this too was a concern not limited to Maharashtra became apparent when the newly elected Chief Minister of the state of Karnataka, Mr. Deve Gowda, passed an amendment to the Karnataka Land Reform Act raising the ceiling on the sale of agricultural land for non-agricultural purposes from 5 to 100 hectares. In doing so he simply ignored the objections of the central government that this violated the 1970 Land Reform Model Act, and would require the President of India 's assent to become law. His justification, given to the press, was that with a raging power famine in the state, 12 power projects awaiting clearance and a 300 km super highway to build he could not wait for the Centre's permission, he simply could not wait for the President's assent. More interestingly, he justified his act in specifically pro-reform terms, by saying that since the purpose of liberalisation was to get the government out of transactions between individuals, he did not see what purpose was served by maintaining the ceiling on the sale of land.

New Delhi could have chosen to oppose the Maharashtra government's decision to cancel the project. It had every right to do so for not one but several reasons. The first was that although the various agreements to set up the Dabhol plant were between the state government and Enron, it had signed a counter guarantee agreement with Enron to pay Maharashtra's dues if the latter failed to pay. This had effectively made it a party to the entire deal. There were also more basic constitutional grounds. Power was a concurrent and not just a state subject. It had become more and more so as the projects became bigger, as the National Thermal Power

Corporation, set up by the central government, began to supply a larger share of the total power generated (in 1995 its share was 30 percent of thermal power generation), and as the transmission grids became interlinked into regional and national networks. The latter in particular meant that any shortage or breakdown in one state affected several others. This increased the center's mediatory role. Lastly, the responsibility for ensuring that the actions of any state government or other agency in the country did not affect the security of the country was pre-eminently that of the center. From the very beginning of the Enron crisis it was apparent to New Delhi that the cancellation of the project would severely affect all foreign investment in India, and therefore threatened the future development of the country. This became apparent from the tide of adverse reactions all over the industrialized world. The first was a statement from the US Department of Energy that it viewed with deep concern the attempts to reopen the Enron deal after it had been finalized. The statement expressed the fear that this would affect other projects that were also in the pipeline.[22]

The American decision aroused the latent xenophobia of a large section of the Indian middle class, and was therefore received with undisguised glee by the BJP. Western governments learned their lesson from this and decided virtually unanimously to refrain from any public statements. They also advised large corporations from making public statements. But the Japanese suffered from no such inhibitions. The Japanese Consul-General in Bombay minced no words and said bluntly that the decision would impede future investment in India, because it showed that, "State governments are unreliable."[23] This sentiment was echoed by Masahisa Naitoh, a senior adviser to the Japanese Ministry of Trade and Industry (MITI). Naitoh also made the remark that the cancellation of the deal "brought into focus center-state relations in India."[24] In subsequent weeks Mitsubishi, Mitsui and Marubeni, and Toshiba, companies that had power projects in the pipeline, announced that they would wait to see the outcome of the Enron issue, before proceeding further. A project to build an electronic city in Haryana also was put on the shelf.

The center was also fully aware that if the power crisis in Maharashtra became more acute not only it but also the four other large states linked together in the western electricity grid would be severely affected. In fact by July 1995, power breakdowns, which had been utterly unknown in Bombay, were occurring every three months.[25] The Rao government therefore had every conceivable reason for stepping in and preventing the cancellation of the project. Within the cabinet in New Delhi, the energy minister, N.K.P.Salve, argued strongly in favor of stepping in and taking over the project. He was supported by the former chief minister of Maharashtra who had signed the deal, Mr. Sharad Pawar of the Congress Party. But they were overruled by other colleagues and the prime minister, who pointed out that would play straight into the BJP's hands, and enable it to reinforce the impression, already strong in the public, that the Congress Party was trying to hide its misdeeds.[26]

As a result, when the prime minster heard of the cancellation of the deal on August 3, during a visit to Kuala Lumpur, he said before a packed assembly of businessmen and others that the agreement was between Maharashtra and Enron, and the center did not come into it. However, he added that agreements signed by a predecessor government had to be respected, he hoped Maharashtra would do so. With these few words, the center threw in its hand.

The Enron dispute reflected not only differences of opinion (and interests) between the central and state governments, but also within the ruling coalition in Maharastra. That there was a growing divergence between the objectives of the BJP and the Shiva Sena became apparent well before the state government cancelled the deal on August 3. These differences did not surface during the election campaign because their common goal was to oust the Congress Party and anything that helped them to do that was grist to the mill. But within a very short time after the new government was installed it became clear that, whereas the BJP's goal in pushing for the cancellation of the deal was to discredit the Congress and thereby improve its chances of coming to power in Delhi, the Shiva Sena's was primarily to show to the people of Maharashtra that it was a better guardian of their interests than the state unit of the Congress Party. As a result, from the very beginning Mr. Manohar Joshi the chief minister, and Mr. Bal Thackeray, the Shiva Sena supremo, made the specific complaint that the project was too expensive, and the tarriffs fixed in the power purchase agreement too high. Meanwhile, the BJP, and its economic chauvinist offshoot, the Swadeshi Jagran Manch (SJM- it can be translated as the Self Reliance Awareness Front) insisted that the project had to be cancelled because Enron had given the Congress Party hefty bribes to secure the contract and in the process obtained carte blanche to inflate costs.

Left to himself, Mr. Joshi would undoubtedly have preferred to renegotiate the Dabhol project quietly with Enron. Joshi found out, within a short time of coming to power, just how precarious the power position in Maharashtra was. The state had 10,772 MW of installed capacity and planned to add 7,922 MW by 2002. These plans were way behind schedule. Apart from Enron there were only three other private projects that had gone beyond the discussion stage. These would add 1892 MW to Enron's 2015MW. Thus Maharashtra needed to tie up another 4,000 MW worth of projects. Like the central government three years earlier, Mr. Joshi's thoughts had immediately turned to the US. He was in the act of finalizing a delegation to the US to solicit investment in power projects, when the publication of the details of the agreement between Maharashtra and the company forced him to announce a "review " of the project. He did his level best, however, to assure all concerned that Enron was a solitary case and that the Maharashtra government was keen to attract foreign investment, especially into infrastructure industries.[27] Mr. Joshi's reluctance to cancel the project deepened during his US trip where one chief executive after another assured him in unambiguous terms what would happen if a solemn contract was cancelled without due cause.

The BJP's, and more specifically the SJM's, target from the very start was corruption. It got what seemed to be tangible evidence of kickbacks when a newspaper published a report that in testimony before a committee of the US House of Representatives, Ms. Linda Powers, Enron Development Corporation's vice-president for global finance, admitted that the company had spent $20 millions, in "educating" Indians about how to go about securing private investment in power projects.[28] In India, "educating" immediately became an euphemism for "bribe". As is shown below, the statement Ms. Powers actually made was very different from what was reported in the Indian press, but the press report was sufficiently specific to excuse anyone from having second thoughts about the project and asking for an explanation. An honest enquiry was. in any case, the last thing on the BJP and SJM's (they were at that time on the same track) minds. The tone of a letter written by Ravindra Mahajan, convenor of the Swadeshi Jagran Manch, to the Dabhol Power company on July 14, makes this amply clear. It read:

> Your Ms. Linda powers is reported to have stated that ".Our company has spent an enormous amount of its own money, approximately $ 20 million on this education and project development process alone, not including any project costs". We request you to provide us the complete details of your interactions with the said Indian bureaucrats and bankers along with the expenditure in each case. Inter alia we require the following:
>
> - all items construing "educating Indians"
>
> -'type and content' of the education process
>
> - the chronological order and the names of the persons and the places including hotels and locations abroad where 'education' was imparted .
>
> - whether this 'education' was solicited by those Indians or whether Enron had to 'pursuade(sic)' them or whether it was offered and willingly accepted by them....."

and so on. In what its writers believed was a last supreme flourish of rhetoric the letter ended ,"We eagerly look forward to these details, inter alia, to evaluate what the nation has 'learnt(sic)'."[29]

That the BJP was not at that point interested in the truth becomes apparent from an examination of what Ms. Linda Powers actually said. Ms. Powers had made it clear at the very outset that her purpose was to persuade the US government to make its shrinking foreign aid allocations play a key supporting role to rising private sector investment in developing countries. To do this, she suggested the US should put its money into the Eximbank, OPIC (the Overseas Private Investment Corporation) and the multilateral development banks, and allow these to provide the loan finance for projects that the private sector was prepared to find the equity for. To persuade the Congressmen that this approach would enable the US to achieve more with less money, Ms. Powers described at length the profound shift that was taking place in the majority of the developing countries as they shed their wariness of foreign private investment and turned actively to it for developing their infrastructure and their capacity to export. Her precise words in are significant in view of what followed:

> "If we are successful, the results are not only the addition of valuable physical assets but the creation of "commercial infrastructure". These projects must be put together and financed using standard private sector tools. This process, which for the first round of projects is invariably painful and time consuming, forces government officials of the country in question to deal with the reforms needed in these key areas:
>
> 1. Property rights, including the enforceability of contracts......

2. Market pricing......
3.Regulatory reform........
4. Sound lending.....

These are the kind of important changes in laws. policies and practices that private sector led infrastructure projects are causing finally to be implemented."

Ms. Powers referred to the Dabhol power project as an outstanding example of the creation of this commercial infrastructure, continuing:

> Let me give you a real world example to illustrate these points. Just yesterday , Enron reached closing on a $920 million power plant in Dabhol, one of the poorest areas of India, just south of Bombay. ... This is the first privately developed independent power plant in India. Like most such projects it has taken three years to develop the project and arrange the financing. Throughout this process we have worked with the numerous relevant ministries of the government of India and the state of Maharashtra on a daily basis as well as with the foreign investment promotion board, the central bank, and the five leading Indian banks. We have had teams of specialists on the ground. addressing each set of issues(electricity sales, fuel supply, environmental requirements. site acquisition from over 600 landowners, construction arrangements, equipment procurement. financing, foreign exchange requirements, legal and tax issues , relations with surrounding villages. etc), and working to obtain the nearly 150 different kinds of permits and approvals required.
>
> Working through this process has given the Indian authorities a real and concrete understanding of the kinds of legal and policy changes needed in India, and has given the Indian banks a real and concrete understanding of sound lending practices . Moreover our company spent an enormous amount of its own money -- approximately $20 million -- on this education and project development process alone, not including any project costs.
>
> Thus in only one large project by one US company, we have already spent more money on the educational process than the US could afford to spend in public funds for this purpose. ...."[30]

What Ms. Powers was referring to could not have been more unambiguously put. It was the process of converting an entire legal and administrative system created to serve a centrally-planned economy to serving a market economy. Enron's $20 million had been used for, in essense, technical assistance consulting on broad organizational and institutional issues relevant to constructing a modern, internationally competitive, institutional and regulatory framework. Bribery could not have been further from Ms. Powers' mind.

Once Mr. Joshi had announced a review of the project, the differences between the Shiva Sena and the BJP shifted to the composition of the committee. The BJP deputy chief minister and energy minister, Gopinath Munde, got to head the committee and was able to ensure that it was composed of politicians and not experts. The committee was also not bipartisan. It contained no members of the Congress Party. The committee submitted its report to the government in the latter half of July and recommended the scrapping of the deal on the grounds that the costs were inflated and that this was because of corruption. It did, however, admit that it had not discovered any tangible evidence of corruption but had inferred its existence from the bloated costs.[31]

The Munde committee report began to force Mr. Joshi's hand. But in an effort to apply some counter pressure, he set up a task force consisting of six top Maharashtra officials in the power sector to review all the fast track projects located in the state. The task force told him, in completely unambiguous terms, that the cancellation of the Enron deal would bring all other negotiations for power projects to a halt.[32] In the final analysis Joshi was unable to stand up to the pressure exerted by the BJP. On August 3, he cancelled the Enron project. However, although the Munde report had stuck to its charges of corruption, Mr. Joshi made no reference to it. He also left a door open for renegotiating the project by saying that the government would not mind receiving a fresh offer of negotiation from Enron. His government also maintained that the power purchase agreement had not been cancelled.[33]

The rift between the Shiva Sena and the BJP widened further when Joshi realised, after a belated release of the Munde committee report, that it had not actually been drafted by the committee, but by the Swadeshi Jagran Manch of the BJP.[34] An opinion poll commissioned by the Times of India in nine Indian cities had, in the meantime, shown that even in Bombay, which had been exposed most to the BJP and Shiva Sena's pre-election propaganda, 55 percent of the respondents wanted the project to be saved, that is, renegotiated. The Shiva Sena's uneasiness grew as it realised that in Dabhol itself the loss of jobs was causing a backlash against the project's cancellation.[35]

During the course of August, and especially after a visit to Delhi on August 23-24, Ms. Rebecca Mark, of Enron, also concluded that the center had no more role to play in the project and that, if it was to be saved, she would have to talk exclusively to the government in Bombay. On august 30, 1995 she and her team of advisers called on the Shiva Sena supremo, Bal Thackeray, at his residence. Thackeray said that the Shiva Sena would reconsider the project if the cost of power could be brought down. He laid down three criteria for renegotiations: the project must be affordable; it must cause no damage to the environment, and it must not harm marine life in the sea around it. Thackeray's go ahead strengthened Joshi's hand in dealing with the BJP. But there had been second thoughts in that party also. The considerations that led it to soften its opposition were a growing awareness that there was no way of avoiding huge damages if it did indeed force the project to fall through; and that this outcome would leave Maharashtra with a bill that could run up to half a billion dollars, and no power. This became apparent when the solicitors for the Maharashtra State Electricity Board, Little and Co., asked for permission to withdraw from this position and advised the MSEB to obtain the services of another firm. The company had told Mr. Munde in the presence of several of his officers, that Maharashtra simply would not be able to defend the scrapping of the project in a court of arbitration; that 13 cases had already been filed against the project in the Bombay High Court on the various points raised in the Munde report and had all been dismissed, and that the state would lose at least $300 million if not more. Mr. Munde had reportedly lost his temper on hearing this, and had provoked the Company's solicitors to sever their connection with the MSEB.[36] The damages and the growing absence of power in Maharashtra, the party's leaders in Delhi began to calculate. would lose the BJP most of the political gains that it had made so far.

Enron too set a time limit for beginning the renegotiation process. The first meeting of the arbitrators was scheduled to take place on October 17. Both parties knew that once that happened the die would be cast. With this very much in mind, Enron wrote to the Maharashtra government on September 18, seeking a formal decision on renegotiation within a week. The government took only nine days to reply in the affirmative, but asked Enron to postpone the arbitration proceedings for a month. It too asked for an early response from the company.

Joshi made his first public statement that his government was willing to renegotiate the project on September 23. On October 5, after a weekly meeting of his cabinet, he repeated the statement . But elements of the Maharashtra BJP continued to fight a rearguard action in the cabinet. This took the form of Munde insisting that there should be politicians in the renegotiation committee, and not just experts.[37] Joshi, however, stood his ground, and finally had his way. An experts' committee was set up on October 30 to renegotiate the project. Unlike the Munde committee, which had contained three politicians and three largely decorative civil servants, the new committee contained, apart from the Chairman of the MSEB and the energy secretary to the government, Kirit Parikh, the economist who had first voiced objections to the cost of the project, and two of the best known power engineers in country. A sixth member, also a financial expert, was added later. The committee began its meetings with the Dabhol Power company representatives on November 11 and took only two weeks to submit its revised project.

Thus, after nearly four months of nerve racking uncertainty, and a quiet but grim war of wills, the Dabhol Power Project came back to life. The agreement was unusual, if not unique, because both sides emerged winners. The Maharastra government received a better deal. Originally the project was to have been implemented in two phases and only the first phase had been fully negotiated. The renegotiated agreement was for implementing both the phases simultaneously. Thanks to a small change in turbine design proposed by Enron, the overall installed capacity of the plant would go up from 2015MW to 2184 MW. Despite the increase in capacity, by implementing both phases of the project together, and passing on a fall in machinery prices to the Maharashtra government, Enron was able to reduce the overall cost of the project by $300 million. A decision to hive off a regassification plant (for turning liquefied natural gas back into natural gas) and make it a separate venture enabled Enron to lower capital costs by another $450 million, and lower the cost of power from Rs. 2.40 for phase I to a level Rs. 1.89 for the entire 2184 MW. This made the Dabhol power plant the cheapest of the large projects under negotiation or implementation. Lastly , a decision to replace distillate with naphtha as fuel in the first phase of the project made it even cleaner than it already was. The Maharashtra government gained in a third way: Enron agreed to sell 30 percent of its equity (20 percent more than its original offer of 10 percent) to the Maharashtra State Electricity Board or its nominee. This would reduce the outflow of dividends from the country in future years by $150 to $170 million a year.

Enron did not lose anything either. By combining the two phases the agreement made up a good part of the loss of time that the disruption had caused (as of June 1, 1996 work at the project sit had still not resumed). At Rs. 1.89 for the two phases Enron's overall profitability also has not suffered. It will now earn an estimated 20 percent return on the entire project. Although the detailed project report had forecast that Enron would earn at least a 25 percent return on the first phase of the project, in her testimony before the US House of Representatives, Enron's Linda Powers had admitted that various delays and cost escalation had reduced this estimate to around 20 percent. However, perhaps Enron's most important gain was the clearing of it's reputation.

Liberalization of banking and finance: a bone of contention to be?

Since finance in India primarily has been a national, rather than a state-level, arena of government activity, one might wonder at its inclusion in a discussion of center-state relations. The major reason for this decision is that Bombay (in late 1995 renamed Mumbai by the Joshi government, though we retain the better-known international name) is the undisputed financial capital of India, and aspires to become a premiere financial center for all of south Asia and perhaps even of all of south and southeast Asia in the years to come. Major changes in the financial sector, that is, have powerful effects in Maharastra, and especially in Bombay. Furthermore, any political conflicts that erupt over the national mandate for privatization, however qualified, of banking and finance are certain to provide opportunities to state-level politicians always in search of vote-getting issues.

The obvious link between liberalizing financial reform and center-state relations notwithstanding, the process of financial reform thus far has been quite low profile. There appear to be two major reasons for this outcome. The first, and ultimately less important, is that Bombay's large and influential private business community--which now includes a small but vocal presence of private financial interests in commercial banking, investment (that is, merchant) banking, and mutual funds management, as well as the long-established stock broking community--strongly supports most forms of financial liberalization. Were the state government to be tempted to take up the cause of the well-organized and historically politically powerful bank workers' unions, who tend to oppose financial sector reforms, the Maharastra government could risk alienating the even more politically and economically powerful business community. The second, but more important, reason that financial sector reform has remained comparatively unpoliticized, however, simply is that the central government, in the wake of the 1992 stock and securities scandal whose adverse political repercussions only began to subside in late 1995, has chosen to proceed very, very slowly on financial liberalization. In the future, the arena well may become more politicized.

Through the late 1980s the overwhelmingly majority of India's entire financial sector, from commercial banking to long-term industrial credit to the insurance industry, was owned and run by the central government.[38] It had been relatively adequate to India's centralized planning model of industrial and agricultural development up through the early 1980s, but thereafter had begun to suffer increasing, and increasingly justified, criticism for being both inefficient and inadequate to a modernizating economy, on the one hand, and in poor financial and profitability shape itself, on the other. After years of prodding and scolding by scholars and some members of the business community, as well as almost surreptitious innovations at the margins by private and occasional public sector financiers, the new government of Prime Minister P.V. Narasimha Rao decided to get serious about banking reform by setting up an expert commission to issue recommendations, which the Narasimham Committee, reporting in November 1991, promptly accomplished.[39] Its principal recommendations included "privatization" of the banking sector by liberalizing entry and deregulation, particularly in the areas of interest rate controls, high requirements for banks to invest in low-yielding government securities, and high requirements for banks to make loans, frequently subsidized, to targeted groups such as farmers or small businesses ("priority sector credit"). In addition, the two private sector members of the Narasimham Committee, both well-known academic economists with private consulting experience, strongly urged abolition of the banking department of the ministry of finance, which long had exercised centralized control over staff recruitment, remuneration, and other personnel policies.

The short-term response to the Narasimham Committee report was a nation-wide strike in early 1992, involved not only clerks in the nationalized commercial banks, but also by the bank officers' (middle management) unions in both the country's premiere development bank, the Industrial Development Bank of India (IDBI), and in the central bank, the Reserve Bank of India (RBI). Their fears were of job losses due to both increased competition and computerization. This strike action alone would not have deterred the Rao government from pushing ahead with deregulation. After all, many of the biggest public sector commercial banks (though not the State Bank of India, SBI, the grandaddy of them all) were bankrupt, although the general public was blissfully unaware of this fact.[40] Since different national political parties were close to competing bank workers' unions, one expected that any changes that adversely affected workers quickly would become a contested political issue.

However, in April 1992 India's largest ever financial scandal--in which the illegal trades and short-term liquidity problems of a single brash young investor cases caused investors and financial institutions, including several premiere public sector banks, to lose $1.2 billion--exploded. The huge public outcry, in which commentator after commentator linked financial deregulation to illicit profiteering, stopped banking reform in its tracks for a year, and limited it to slow, technical, and non-controversial reforms for several years thereafter.[41] In this case, the political explosion was national, as Congress Party Prime Minister Rao was attacked in parliament both from the BJP on the political right (for inadequate regulatory oversight and the presumed "corruption" of public sector banks taking disallowed types of risks with depositors' funds) and the National Front-Left Front on the left (for selling out to finance capital, national and especially foreign).

After that, the financial reformers in the central government, since 1994 chiefly RBI governor C. Rangarajan and his deputy governor S.S. Tarapore, trod carefully. Some decisions made back in 1992 and 1993 helped divide potential opponents of financial reforms and calm the waters. For example, the IDBI, India's leading development bank, whose staff feared that they would be made redundant, was given the task of developing a computerized National Stock Exchange (NSE), as a competitor to the long-dominant, and terribly clubby, Bombay Stock Exchange (BSE), long accustomed to reaping monopoly rents through assorted anti-competitive devices. One such was the BSE practice of restricting the number of brokers' licenses issued and permitting only individual brokers(!), rather than corporations with many brokers, to be members, thus forcing everyone but long-established members to subcontract all trades through those few fortunate enough to have become members of the club. The NSE, also based in Bombay, opened only in 1995, but by 1996 it already had become a serious rival to the BSE. Moreover, the IDBI turned out to be a more agile institution than many of its own managers and staff feared: since further access to central government subsidies ended in 1991, the IDBI has successfully improved its own finances, by early 1996 meeting about 60 percent of its needs through internal savings (generated from the repayment of past loans and its investment portfolio), and most of the rest by market borrowing. In July 1995, the IDBI sold its first equity to the public, in India's largest ever initial public offering, worth Rs. 21.8 billion, or about US$66 billion.[42] Although many in the BSE were annoyed with the reformists, some in the IDBI had come to look on the changes as a source of opportunity.

Given the political impossibility in India of improving public sector bank profitability through layoffs, the methods used thus far have been gentle and incremental. The central government found considerable sums of money to use to recapitalize the nationalized banks, putting in Rs. 15,700 crore, about US$4.8 billion, to end 1995. In 1994-1995 all but one of the twenty-seven nationalized banks showed a combined profit of Rs. 1,115 crore, as compared to a loss of Rs. 4,423 crore in 1993-1994.[43] The doubtful loan portfolio had been reduced to an average of 20 percent of all loans, still very high, but half of its 1991 level.[44] There is some considerable way to go, as evidenced by the fact that, as of December 1995, fourteen of twenty-seven nationalized banks were below the 8 percent capital to assets ratio, stipulated by the Basle Committee in the late 1980s as the international norm, an agreement the RBI in late 1995 wisely decided to impose on all Indian banks with an international presence.[45]

A second benefit to banks has been the central government's fairly impressive resolve to cut back on using them as a source of cheap government finance. By the end of the 1980s the total levies on banks (adding together obligatory holdings of cash and approved government securites) had reached an astounding 50 percent of deposits.[46] Not only have the statuatory requirements dropped, but the rate of return on government securities has began to approximate market levels. In the 1980s, the nominal rate of return on treasury securites was only 6 to 7 percent; in 1993 these returns became competitive enough to induce banks to hold more government securities in their portfolios than they were required to do by law. In December 1995 they were paying 14 percent.[47] Moreover, previous to 1993 the Reserve Bank of India imposed the requirement that 70 percent of all government securities in a bank's portfolio be held to maturity; as of late 1995 that ratio had been reduced to a minimum of 40 percent, with banks' portfolio managers free to trade the other 60 percent to optimize their mix of maturies and other conditions.[48] "Priority sector lending," or obligatory lending to sectors deemed socially useful (mainly farmers and small-scale industry) remained compulsory for about 40 percent of deposits, but interest rates, while not entirely free, had risen, and some new and attractive sectors, such as housing, have been included.[49]

Finally, deregulation and increases in competition have proceeded with all deliberate speed, as it were, in order to give bank managers as much time as possible to adjust. Thus, for example, the RBI freed lending rates for loans above Rs. 2 lakh [translate] in late 1994. In 1995 it freed banks to offer whatever interest rates they chose on deposits to be held for at least two years.[50] In a similar vein, commercial banks are now much freer to choose to seek funds in global markets. However, whereas once the RBI picked up the foreign exchange risk for them, now banks must assume it themselves.[51] There remained many areas in which banks retained a monopoly, however, including one potentially hot new area of the 1990s, money market mutual funds. Of course, as Ashok V. Desai noted in late 1995, the whole point--for the consumer--of a money market fund is that it both be linked to the bank's own earnings in the money markets per se and have high liquidity. Since the RBI still was trying to ensure the greatest possible stability in the financial markets, it only allowed fixed term (at least 46 days) money market accounts, thus reducing their attractiveness to both banks and potential depositors.[52]

Other public financial institutions also received privileges designed to enable them to compete with new and aggressive private sector entrants. For example, and as noted, the IDBI was allowed to design and manage the new National Stock Exchange. This benefit was in partial compensation for the fact that from 1993 it had private sector competitors, newly licensed merchant (investment) banks, most of which either were foreign or joint ventures of foreign and local capital, to compete in meeting the long-term financing needs of the most dynamic private companies. Similarly, the Unit Trust of India (UTI), a public sector mutual fund dating from 1964, long had had a monopoly--because individual savers had few other options, it always had attracted significant deposits. In the 1990s, the newly legal private mutual funds aggressively went after India's urban middle class, estimated at perhaps 150 million persons. The UTI, however, argued successfully that it ought to be exempted from regulation by the Securities and Exchange Board of India (SEBI), which was the watchdog over both the stock exchanges and private mutual funds.[53]

In 1994 the Reserve Bank of India decided to license new private banks. This change, too, was implemented in a very cautious manner. Previously, the only private banks were foreign banks whose agencies predated the 1969 bank nationalization decreed by Prime Minister Indira Gandhi, and those private banks too small to have qualified for nationalization then or in two subsequent waves in the early 1980s. Of around a hundred applications received, the RBI by end 1995 had agreed to extend only five or six licenses, of which one went to the former chairman of a small but agile private Indian bank, Vysya Bank, three to public sector financial institutions--the IDBI, the Industrial Credit and Investment Corporation of India (ICICI), and the joint public-private Housing Development Finance Corporation of India (HDFC)--and one to the Jains, owners of a large business house perhaps not incidentally linked in mid 1995 and after to a huge bribery (campaign finance) for government favors scandal.[54] Even the Reserve Bank of India itself received favors that might allow it to ease into the deregulated environment. One of its traditional roles had been to manage all flotations of public debt securities, of both the national and state governments. In the early 1990s large state-owned financial enterprises--from the industrial development bank, IDBI, to the agricultural development bank, NABARD, to India's Export-Import Bank--began to issue corporate bonds, which the public debt office of the RBI managed for them. When, in early 1995, the RBI itself decided to leave this function to merchant banks and other retail financial institutions, the RBI employees union, interestingly headquartered not in Bombay or even Delhi but in the union stronghold of Calcutta, threatened a strike, fearing that this was the wedge into reduction of their monopoly functions and the harbinger of subsequent job losses.[55] One might infer that the RBI had been allowed to manage debt issues for a few years perhaps as a way of reconciling its staff to India's new regulatory reality.

The more difficult task of financial sector privatization, as pointed out in a perceptive article by T.C.A. Srinivasa-Raghavan published in late 1995 in the magazine BusinessWorld, would be all matters related to personnel practices, including linking pay raises and promotion to performance, and getting agreement from the unions for urgently needed basic computerization.[56] It should be emphasized that all parties explicitly agreed that layoffs were not, and would not ever be, part of the package that unions would be obliged to accept. Srinivasa-Raghavan put it this way: "Middle and senior middle level bankers tend to view themselves as government officials and public servants. ... The agility associated with a commercial organization is missing. Instead, there is righteousness, usually the hallmark of a bureaucrat pretending to serve the commonweal. In the years to come, it is this lot which will have to be transformed into a skilled, competitive and aggressive management team."[57]

What are the implications for center-state relations of what must be described as creeping, incremental, but genuine progress toward financial sector liberalization and "privatization," in the sense of opening up a previously state monopoly sector to entry by both Indian and (presumably always with some restrictions) foreign private capital? The more politically challenging reform tasks have not yet been tackled including, for example, abolishing the banking department of the ministry of finance and instead giving control of hiring, promotion, and other personnel matters to bank presidents and their senior associates themselves. Since little progress has been made on the more politically challenging issues, their politics have yet to become evident.

The following reasonable observations can be made, however. If bank and other financial institution unions feel their jobs or perquisites threatened by liberalization and privatization, they will not be shy about taking to the streets, linking their particular troubles with other groups' related worries about virtually any aspect of economic liberalization (whether logically connected to bank privatization or not), and forging alliances with vote-seeking politicians and political parties. Within Maharastra, the Shiva Sena/BJP government will continue to be split, with Shiva Sena, on the whole, more concerned with the Maharastrian economy (within which the private financial sector is a very important player, particularly in Bombay) while the Bharatiya Janata Party, an aspirant to national power, might find it more convenient to take up the unions' cause--as long as the BJP is not currently governing at the center, of course! While financial sector privatization and liberalization thus far has proceeded very quietly and without great fanfare or political opposition, the future potential for the arena to become politicized remains very real, particularly so long as the center and Maharastra are governed by politicians of different parties. In April 1996 Narasimha Rao's Congress Party lost the national election. In June, after an abortive attempt by the BJP to form a national government, the center-left coalition of the National Front-Left Front (now renamed the United Front) formed a new national government under Prime Minister Deve Gowda, the pro-liberalization former chief minister of Karnataka.

IV. Center-State Bargaining over Privatization in Brazil

In Brazil, in contrast to India, most state enterprises in infrastructure sectors were considered to have been reasonably efficient through the 1970s.[58] However, central government finances deteriorated rapidly from about 1979, and were exacerbated by the Latin American debt crisis, which hit Brazil in late 1982.[59] Thereafter, public sector investment spending dropped off sharply. The gradual return to democracy--which officially occured in 1985, but may with equal reason be dated from the free elections for state governors and big city mayors in 1982--meant much larger expenditures at the state level as well, as incumbents appointed by the military spent large sums of public and quasi-public monies on their election campaigns. Finally, Brazil's new democratic constitution of 1988 transferred a large chunk of federally collected tax revenues back to the state level (from whence they had been grabbed during the military regime installed in 1964), but without also transferring spending responsibilities back to state governors. For all of these reasons, the overriding impulse to rapid privatization at the federal level in Brazil has been fiscal, with considerations of improved efficiency, access to modern technology, and so on coming only second. As of May 1996, the accumulated domestic federal debt in securities had reached around $138 billion, or 16.1 percent of gross domestic product. Adding other forms of domestic debt, including debt of state and municipal governments, domestic bank loans, suppliers' credits, and state-owned enterprise debt, the total figure was $220 billion, or almost 33 percent of GDP.[60] Despite a large foreign debt, of $157 billion in June 1995,[61] Brazil's external position was, for the moment, less worrisome, with foreign exchange reserves of $37 billion in early 1995 and almost $56 billion in April 1996.[62]

Also in contrast to India, in Brazil financial sector liberalization and privatization has progressed further than electricity privatization, also planned but thus far for the most part yet to be implemented. The center-state political conflicts over bank privatization thus are more acute, while those that later may appear in the electricity sector thus far remain latent.

Privatization of public sector banks in Brazil: The Banespa saga

Generalizing very broadly, the division of labor that evolved in Brazil's financial sector after the far-reaching liberalizing financial reforms of the newly installed military regime in 1964-1967 was that the more lucrative corners of the financial markets were left to the private financial sector, while public sector banks supplied those financial services that private banks shunned--particularly subsidized agricultural and residential housing credit, long-term financing of any type given persistent high inflation. For historical reasons the country's largest commercial bank was the federally-owned Banco do Brasil, whose background and current activities make it quite similar to the State Bank of India. (Both institutions, for example, in earlier incarnations date from the nineteenth century and once served as both commercial banks and national monetary authorities.) State governments also had state-level public commercial banks, which often doubled as industrial and agricultural development banks. Several of the bigger states had more than one. Banespa, the Banco do Estado de Sªo Paulo (State Bank of Sªo Paulo) consistently has been one of Brazil's top ten banks. If one looks only at commercial, investment (a.k.a. merchant), and development banks, the public and private sector each have approximately half the financial sector, whether measured by loans, assets, or net worth. If the state savings bank system (which accepts term deposits and funds mainly residential mortgage and construction lending, as well as municipal water and sewerage projects) is included, the public banks have a slightly larger share of deposits.

During the 1970s and 1980s Brazil's good economic growth, very high inflation, and the unique peculiarities of its financial legislation allowed commercial banks to profit and expand greatly.[63] By 1989, for example, financial services, by one measure, accounted for an astonishing 26 percent of the gross national product. In 1994, 18 percent of banks' earnings were due simply to their ability to profit from the inflation that harmed the rest of society. The end in mid 1994 to what by the 1990s had become four-digit annual inflation was essential for Brazil's economy--but very bad news for most banks and financial institutions. By 1995, their share of GDP had plummeted to only 6 percent, and inflationary earnings contributed less than 1 percent to their gross profits.[64] Not surprisingly, many Brazilian banks found themselves in serious trouble. Privately owned Banco Econômico, one of Brazil's top fifteen commercial banks, went down in early 1995 with losses of over $3 billion, followed by Banco Nacional, one of the top five private banks, whose losses in April 1996 were revised upwards to $6.7 billion.[65] In both cases, partly because of the too-big-to-fail principle (especially in the case of Nacional), and partly due to the strong political contacts of the banks (especially in the case of Econômico), the Banco Central do Brasil (BC) arranged mergers with healthy institutions and provided the necessary funds.[66]

Public sector commercial banks also had lived off of inflation for more than a decade. Even the venerable Banco do Brasil, which in 1985 held 24 percent of all bank deposits in Brazil,[67] announced a hole of over $4 billion in early 1996, requiring the BC to come up with a new cash infusion of $8 billion. (Problems in the Banco do Brasil were somewhat ironic, given that the BC, hard pressed by the banking crisis to provide liquidity, actually had enlisted the Banco do Brasil and one other large public sector bank, the Federal Saving Bank, or Caixa Econômica Federal, to backstop it as lender of last resort during several months in late 1995. Twenty-four hour emergency loans to other banks from the Banco do Brasil and the Caixa Econômica occasionally reached daily totals as high as $10 billion in late 1995.)[68] Not including the federal aid to the Banco do Brasil, by one estimate the central government had spent about $10 billion on five bank rescues through March 1996, approximately equal to the $9.5 billion received from all privatizations up to that point![69]

The problems of the state-level public sector banks, however, were of a different order. Although most of them, excepting S^ao Paulo's Banespa, were fairly small, their poor financial health went well beyond unwise dependence on inflationary earnings. As noted, the return of democracy and competitive elections in the 1980s had encouraged governors in virtually every state and from every political party to lean on them to give loans for political purposes, either directly to the state government or in the form of unscrutinized, unsecured, low-interest loans to large campaign donors. The ill health, for example, of Banerj, the state bank of Rio de Janeiro, one of Brazil's largest and most important states, had been an open secret in financial circles since the early 1980s. Banespa itself had absorbed Sªo Paulo's less solid state-level development bank, Badesp, in the late 1980s. In the early 1990s, under Presidents Collor (1990-1992) and Franco (1993-1994), two or three state-level public banks owned by small, weak states such as tiny Rio Grande do Norte had been "intervened," in Brazilian parlance, by the Banco Central and subsequently closed, over the loud but ineffectual protests of their comparatively powerless governors and congressional delegations.

Related to the looming problem in state-level public banks was the growing indebtedness of many states to the federal government, in some cases because of de facto bailouts of state-level banks by the BC, and in other cases due to other debts. By mid 1991 the total debt of state and municipal governments to the center was about $57 billion, of which the three wealthy southeastern states of Sªo Paulo, Minas Gerais, and Rio de Janeiro owed 53 percent.[70] Given the federal government's own debt problems, this situation by the 1990s had become unsustainable.

On July 1, 1994 then finance minister Fernando Henrique Cardoso inaugurated Brazil's seventh major stabilization program since the return to civilian, democratic national government in early 1985. Dubbed the "Plano Real," this stabilization program, like many of its predecessors, involved a new currency, de-indexation, a temporary wage and price freeze, and solemn promises of cuts to the federal government budget. It differed from the failed previous plans in that it used a "currency anchor" to the U.S. dollar that supposedly would force Brazil to adjust as the domestic tradables sector would have to cut prices to compete with now fairly free imported goods. The Plano Real resembled Argentina's successful, though draconian, "currency board" system, then in place for almost three years, and, despite some opt out clauses in Brazil's version, was rather similar to the pre-World War I gold standard. On the strength of the Plano Real--still in place and remarkably successful after almost two full years as of this writing in June 1996--Cardoso was elected president in October 1994, running at the head of a broad and heterogeneous coalition. The president's own small reform party, the Partido da Social Democracia Brasileira (Brazilian Social Democracy Party, or PSDB), though only in the middle ranks of the eighteen major political parties represented in the Brazilian congress, also elected several governors on Cardoso's coattails, including Marcelo Alencar in Rio de Janeiro and Mário Covas in S^ao Paulo, all of whom were to take office on January 1, 1995.

On December 30, 1994 governors-elect Alencar and Covas received phone calls from Pedro Malan, then president of the Banco Central, but who had been tapped as Cardoso's incoming finance minister, informing them that the new administration would announce BC intervention on the following day of both Banerj (Banco do Estado do Rio de Janeiro) and Banespa (Banco do Estado do Sªo Paulo).[71] Malan explained that one reason that the intervention--which meant that the deposits and other bank-related assets of all bank stockholders would be frozen until further notice and that the senior management now would be overseen by the Banco Central--was scheduled for December 31 was that this would enable the new governors to distance themselves from the federal government's decision, should this prove politically convenient. The subsequent reactions of the two PSDB governors hardly could have been more different.

Within his first month in office, Rio governor Marcelo Alencar announced his full support for the process of recapitalization and then privatization of Banerj, which had been given to a private financial bank and consulting firm, Bonzano, Simonsen, to carry through. He also announced planned privatization of ten other state-level public firms owned by the Rio de Janeiro government. Soon thereafter he convinced the state legislative assembly to grant him the blanket authority to privatize whatever public enterprises his administration saw fit to sell. By these moves Alencar staked out positions very different from his two predecessors, both members of the PDT (Partido Democrática Trabalhista, or Democratic Workers' Party) party headed by perennial presidential candidate, veteran campaigner against the military, and Rio governor both in the early 1960s (before the coup) and from 1982-1988, Leonel Brizola. Brizola, a longtime leftist, and, incidentally brother-in-law of deposed President Joªo Goulart (1961-1964), was a strong opponent of selling "the nation's patrimony." For example, during the Collor administration, Brizola had organized and personally led a demonstration in front of the Rio de Janeiro stock exchange on the day of the public auction for the controlling stake in what was Brazil's largest privatization to that point, the sale of the federal steel mill and conglomerate, Usiminas, which ultimately raised $1.5 billion. Despite the strength of the PDT and other left parties in the city and state of Rio, not to mention his own membership in the moderately left PSDB, Alencar bit the bullet and decided to take the lead on privatization. One benefit for Alencar was that the BC agreed to advance to the Rio government the expected proceeds for the privatization of Banerj (planned for 1997) and other enterprises to be sold, enabling Rio to pay off its debt to Brasilia.

Mario Covas in S^{a}o Paulo, on the other hand, despite a pro forma declaration of total support for President Cardoso's economic and political agenda, immediately went on the offensive, vowing that Banespa would never be privatized. The battle had been joined. In fact, Covas' views were in complete agreement with those of his two predecessors, Governors Orestes Quércia (1982-1988) and Luís Antônio Fleury (1988-1994), both of the PMDB (Brazilian Democratic Movement Party), the largest single party in Brazil. The PMDB had supplied the president in 1985-1990, José Sarney, but had been only one of many very loosely allied parties, that sometimes voted with the government but other times did not, during the presidencies of Fernando Collor and Itamar Franco in the early 1990s.

During all of 1995 Covas fought with President Cardoso, and especially finance minister Malan, over Banespa, both via public salvos and behind the scenes. The Cardoso administration, hoping for a political settlement, refrained from using its legal authority to go one step further than "intervention" and declare Banespa federal property, forfeited because it was "technically bankrupt" with a debt to the Banco Central that had been $9.7 billion when Covas took office, but, due mainly to very high prevailing interest rates that were part of the Plano Real stabilization program, had risen to $15 billion by December 1995. In the final month of 1995 a provisional solution was announced. The federal senate agreed to extend a $7.5 billion twenty year loan to S^{a}o Paulo; the other $7.5 billion would be paid off by the transfer to the federal government of S^{a}o Paulo's three major airports plus its state-owned railroad, Fepasa, all of which later would be privatized and the proceeds kept by the national treasury. In return, Banespa would not be privatized, but rather would be returned, recapitalized, to the government of S^{a}o Paulo.

Nonetheless, the conflict dragged on, despite the supposed deal. While various ostensibly minor points were being negotiated, Banespa's debt to the BC, being carried at market rates of interest, mounted from $15 billion to $18 billion. In April 1996 Alencar and Covas, along with other PSDB heavyweights from around the country, appeared with the president in Brasília, announcing that henceforth they would be more supportive of the president, who had recently met several defeats in getting congress to pass the necessary enabling legislation for his overall economic reform and liberalization program. In early May the state attorney general of S^{a}o Paulo announced he was freezing the assets of the two former governors, Quercia and Fleury, along with 107 former Banespa administrators, pending an investigation into Banespa's losses between 1989 and 1994, widely believed to have resulted from politicized lending practices under the two.[72] In May Covas went public with a complaint that the BC was discriminating against Banespa which, in his view, had received less favorable treatment than the private banks Econômico and Nacional.[73] Covas was particularly incensed over the additional $3 billion in interest obligations that had accumulated between December 1995 and May 1996. Meanwhile, the finance minister and others in Brasília felt that they could not be flexible--or perhaps even reasonable?--with the paulistas for fear of setting a precedent that other states with bankrupt financial institutions would insist on copying. As of this writing the exact details of the settlement had yet to be worked out. What was certain was that Banespa would not be privatized; the precise distribution between the central and state governments of the cost-sharing of the now $18 billion bailout had not been resolved.

Lest any reader feel too sorry for the Cardoso administration, however, it should be recalled that increasing efficiency in Brazil's financial sector was not the central government's main goal. The years of high and highly variable inflation had made Brazilian banks among the most agile in the world--even the comparatively flatter-footed public sector ones. The major impetus for privatization, from Brasília's viewpoint, was to get the states to pay off their debts to the central government--and, of course, to make it institutionally more difficult for them to rack up further debt, particularly by putting the Banco Central in the awkward position of having to decide whether or not to bail out a defaulting state-level public sector bank. If the debt of S^ao Paulo to the center could be taken care of, and better yet if the state government could be credibly warned off of using Banespa for politically-motivated lending in the future, then a substantial portion of President Fernando Henrique Cardoso's goals would have been obtained.

Still, an intriguing puzzle remains. What explains the different behavior of the two PSDB governors, Alencar of Rio de Janeiro and Covas of Sªo Paulo? Among those knowledgeable persons interviewed for this project in late May 1996 opinions as to Covas' motivations were divided. One prominent economic journalist with extensive contacts with Covas campaign and administration was of the opinion that the rift was largely personal, that Covas, himself a senior PSDB politician, had been offended that he was not consulted in advance about the Cardoso team's plans, but only informed when the decision already had been taken. Interviewees generally agreed that Covas long had been a believer in a strong state presence in production and infrastructure, although, of course, this description applied with equal force to a great many of Brazil's politicians, including the president.

The following additional considerations, which did not apply in Rio de Janeiro, seem to explain Covas' determined opposition to privatization, despite his close political ties to President Cardoso. First, the state of Sªo Paulo, only out of twenty-six states plus the federal district, alone was responsible for 35 percent of Brazil's gross national product. Sªo Paulo was not to be trifled with--even by a president who himself was a paulista. In addition, although the federal government had the legal right to simply take over Banespa and privatize it whether or not the state government assented, Covas possessed two specific bargaining chips not enjoyed by Alencar. Banespa's debt of $18 billion to the Banco Central was many times that of Banerj. Were the Cardoso administration to have carried out its full legal mandate of summarily assuming ownership of Banespa, the state government would have been justified in declaring the entire debt quits, to the fatal disadvantage of the federal government. Furthermore, Sªo Paulo had two state banks, Banespa and A Nossa Caixa, the state-level savings bank. Had the federal government legally snatched Banespa, the state government immediately could have transferred its business to its other state-level public bank, A Nossa Caixa, thus certainly provoking the precipitous and irredeemible crash of Banespa. As one informant put it, both the federal and state governments possessed "an atomic bomb," creating a stalemate and forcing both sides to bargain.

Moreover, the debt position of S^{a}o Paulo state was perhaps even more desperate than that of the federal government, despite the state's high growth and good reputation in international markets. As of May 1995 the state's total domestic and foreign debt summed to $68 billion![74] This fact of course might explain Covas' hardball bargaining over the distribution of costs with the BC, but hardly his refusal to privatize Banespa. For that, the explanation is first political and only secondly economic. Unlike Banerj, Banespa had an excellent reputation in its state, not only with small depositors subject to relentless advertising to use "their" bank, but also with the business and farming communities, and with politicians throughout the state, particularly in the hinterlands, less well served by the big private banks whose business concentrated in S^{a}o Paulo City. Covas, like his predecessors Fleury and Quercia, must have realized that the politician who sold Banespa might never be elected to anything again. Furthermore, the consensus among policy-influential paulistas, even those generally sympathetic to Cardoso's reform efforts, was that S^{a}o Paulo needed a commercial and development bank. In the words of a senior policymaker in the state government, "Once Banespa has been cleaned up financially, what's the point of selling it? After all, it wasn't Mário Covas who created Banespa's problem; it was Quércia and Fleury."

From the viewpoint of the federal government, of course, the points clearly were, first, that if it let Banespa off the hook, many other states would demand equally favorable treatment, and second, that there was no mechanism to prevent future Quércias or Fleurys from using the bank to make huge quantities of questionable loans that, in the name of the national interest (not to mention maintaining a winning legislative coalition in congress), the Banco Central, under orders from the president, would be obliged to rescue. There was, however, one additional factor that helped tip the equation in Covas' favor: given Banespa's large size and the special expectations its customers and the state and municipal governments had of it--could a buyer be found? Surely it would be foolhardy to try to try to sell the bank so long as the state government opposed that route. On most points, therefore, and its tough talk notwithstanding, the national government was obliged to yield. Governor Covas had succeeded in preventing the sale of Banespa.

President Cardoso and finance minister Malan clearly had hoped that the impending sale of a giant like Banespa would send a positive signal to international investors, but that plan had fallen through. The federal government needed S^{a}o Paulo's help on too many other urgent matters--notably a package of liberalizing economic reforms, from removing legal barriers to foreign direct investment to social security reform--some of which required a two-thirds majority in order to push through a constitutional amendment. Because the Cardoso administration had not managed to convince Covas that privatizing Banespa would be in São Paulo's interest, as opposed to Brazil's, the president's suasion had fallen on deaf ears.

Electricity privatization in Brazil: The Light, Eletropaulo, and Eletrobrás.

In many ways the status of privatization in Brazil's power sector, as of mid 1996, resembled privatization of India's financial sector: in both cases, the central government had moved ahead with a national plan that would deeply affect conditions in the country's major financial and industrial state--but, thus far, nothing much had changed. Whatever hard political battles would result were still ahead. In one other way, electricity privatization in Brazil resembled bank privatization in Brazil: in both cases, and in sharp contrast to India, the major "public sector" firms, whether majority owned by the federal or state governments, were actually joint public-private ventures, with controlling interest (usually but not always 51 percent) maintained by the government but large numbers of minority shareholders, or, in some cases, even large blocs of shares held by multinational corporations. (A Japanese consortium, for example, long had held about 20 percent of the federal steel company, Usiminas, privatized in 1991.) Privatization of the power sector would not mean simply allowing private firms, including multinationals, to enter: in Brazil, it would mean outright sale of the controlling interest. Furthermore, and unlike earlier privatizations in Brazil, mainly during the Collor and Itamar Franco administrations in the early 1990s, the buyers for power firms, or of the concessions to construct new plants, were likely to be multinational corporations, not local Brazilian companies.

Before the 1950s, virtually all of Brazil's electric power sector was in private, and overwhelmingly foreign, hands. From the 1950s, the Brazilian government gradually bought out the foreign investors, generally amicably, because the federal government had made it clear from the early 1950s that it intended to hold electricity rates down as a spur to industrialization. In addition, from the 1950s, the federal government made large new investments in the sector. In 1978, the federal government acquired from its then Canadian owners Brazil's then largest single generation and distribution company, popularly known as "a [the] Light," originally founded by British investors in 1898, and the main supplier for the states of São Paulo and Rio de Janeiro. The Geisel (1974-1979) government's initial intention had been merely to facilitate the sale of the Light to a consortium of twelve Brazilian private investors. The controversy aroused by this wanton betrayal of the public interest (as conceived of by the newly obstreperous national congress, which was just beginning to feel its oats as the military government began its deliberate, incremental process of political opening) caused Geisel to backtrack. The federal government bought the Light instead, in 1980 turning over the São Paulo portion to the state government there.[75]

As noted earlier, through the mid 1980s, Brazil's electricity sector expanded rapidly and was considered by most observers to be generally efficient. In fact, however, new investment virtually had ceased from the early 1980s, and by the later years of the decade, brown-outs and other indications of under-investment had begun to annoy residential and especially business consumers. Nonetheless, before the early 1990s the sector remained untouchable, for historic and patriotic reasons. Perhaps because the story of dramatically falling rates of public investment now is so well-known among Brazil's vocal group of policy-attentive urban elites, and perhaps also because electricity, unlike, for example, banking, is not a labor intensive industry with strong unions, by the early 1990s electric power no longer was seen by the majority of Brazilians as a core sector whose ownership must remain Brazilian for reasons of national pride and national security. (By contrast, although each of the last three presidents, Collor, Franco, and Cardoso, has at least raised the trial balloon of selling the state oil company, Petrobrás, the immediate storm of protest has led to quick retreats in all cases. Subsoil rights are still a particularly sensitive nationalist issue throughout Latin America, and have been so since Mexico's best loved president, Lazaro Cárdenas, ceremoniously threw out the foreign exploiters in the oil industry in the late 1930s.)

In 1993 through 1995, accordingly, Brazil's national congress passed a series of laws constructing the legal framework for electricity privatization, ranging from permission in 1993 for private industrial firms to build generating plants for their own use to 1995 legislation mandating competitive bidding for all new power concessions (that is, for the rights to build or operate a power plant or transmission or distribution grid). In late 1995, the Cardoso administration announced plans to privatize the entire electricity sector, according to one (high) estimate by the U.S. Department of Commerce worth up to $120 billion.[76] To mid 1996, there had been virtually no public outcry against either privatization per se--or, more surprisingly, against sale of the sector to foreigners. One reason is that the urban middle and upper classes, as well as the business community, have become very impatient with the marked deterioration in previously high quality services. The prospect of higher electricity tariffs also seems not to have caused significant outcry thus far either, although higher electricity bills could have the potential to become a populist rallying cry for a politician such as former Rio Governor Leonel Brizola at some future date.

Total installed generating capacity as of March 1996 was about 24,700 MW,[77] including the Itaipú plant jointly owned with Paraguay. Itaipú enjoys a generating capacity of over 12,500 MW, making it the world's largest hydroelectric facility. Brazil has estimated additional capacity needs of 2500 to 3500 MW annually for the next ten years.[78] At present the federal government through its holding company, Electrobrás, owns about three-quarters of the generating capacity, which often is located hundreds of miles from its ultimate users, as over 60 percent of total electricity comes from renewable resources such as hydroelectric power and ethanol. States and a few municipalities own the remainder. The Cardoso administration hopes to sell, either directly or through enlisting the state governments, virtually all of electricity generation. Transmission facilities are in federal hands. Due to the need for national planning and coordination among geographic areas, the tentative plan is for the federal government to remain dominant in transmission. Distribution, presently about 70 percent owned by state and local governments, also is slated for virtual full privatization. It is at this level that any future political problems are likely to appear. Of possibly great significance is the fact that, in 1993, utilities for the first time in decades were permitted to charge differential rates to customers in different parts of the country. Prior to that, federal fiat had made all electricity rates artificially equal, irrespective of actual costs. Brazil's average cost in 1993 was about 5 cents (U.S.) per kilowatt hour, as compared to 6.5 cents in the U.S.,[79] 4.4 cents in India--and 8.7 cents in Chile and 9.9 cents in Argentina, both of which recently have privatized electricity.[80] Since Brazilian utility managers thus far have been cautious about exercising this newly acquired right, the ultimate politics of electricity rates is not yet clear.

As noted, electricity privatization for the most part remains notional only. Only two firms, both state-level companies engaged primarily in distribution, have been sold thus far. The first, Ecelsa, is located in 1995 in the small state of Espírito Santo, interestingly governed by the Workers' Party, or PT, the furthest left of any of Brazil's major political parties. Ecelsa went for \$500 million. The second was none other than the rump (less the S^ao Paulo portion, hived off in 1980) of the Light. Along with his enthusiasm for eventual privatization of Banerj, Rio de Janeiro governor Marcelo Alencar pushed forward with this sale, accomplished in May 1996. The selling price for the 58 percent of the stock offered was \$2.2 billion, making it Brazil's largest single privatization to date, and bringing the total privatizations thus far, under all administrations, to a total of \$11.6 billion.[81] The French state-owned power firm Eletricité de France (EDF), in consortium with two private American firms, Houston Industry and AES, took just over 34 percent of the stock, giving it the controlling interest.

In Sªo Paulo, meanwhile, Governor Covas had given rhetorical support to privatizing his three state-level electricity firms, the largest of which, Eletropaulo, is a true giant, distributing about a third of all power in the country. Plans are (slowly) underway to break it up into four more manageable firms, to facilitate the job of finding buyers. Only time would tell whether electricity privatization remained a largely technical issue to be dealt with by the relevant central and state government "experts," or, instead, became another source of overt conflict between Brasília and Sªo Paulo.

III. Conclusions

The lessons for national governments that wish to privatize, thus, are relatively straightforward. First, the leftist ideology and beliefs of particular politicians, from Jyoti Basu, the Communist Party chief minister of West Bengal, to former Rio de Janeiro governor and longtime presidential candidate Leonel Brizola, may be a factor in shaping politicians' attitudes toward privatization, but it is unlikely to be determinant. Jyoti Basu in the early 1990s found it advantageous to court foreign direct investment in his state, and has done so with enthusiasm and success. Brizola got national attention from demonstrating at the auction of Usiminas in 1991 against "entreguismo" (handing over [Brazil's wealth] to foreigners), but was remarkably quiet about the even larger sale of the Light in mid 1996, perhaps because current governor Marcello Alencar had managed to make it popular. Successful democratic politicians are pragmatists.

Second, the overall political context, and particularly the alliance (or lack thereof) between the central and state government, does have an impact, but perhaps a smaller one than outside observers initially might expect to find. Thus, the political party differences between the Shiva Sena-BJP government in Maharastra and the Congress Party coalition in the center undoubtedly heightened tension in India. The more belligerant attitude of the Maharastra BJP than the Shiva Sena to the Enron deal clearly resulted from the national aspirations of the BJP, which the Shiva Sena did not share. Similarly, the fact that the newly elected Congress Party government of Orissa had replaced a Janata Dal Party predecessor may have contributed to that state's decision to criticize the power plant contract it had inherited. On the other hand, the political alliance between President Cardoso and Governor Covas did little to mute the genuine conflict of interests in Brazil over the disposition of Banespa. That is, reasons of political rivalry may have caused state governments to <u>initiate</u> opposition to the privatization plans of a political competitor, but political party affiliation did not determine outcomes in either country. Center-state conflict also, of course, is more likely if the state leader in question disposes of useful bargaining resources vis-à-vis the center, as the different responses of Rio's Marcello Alencar and Sªo Paulo's Mário Covas to the proposed sale of their state-level banks made clear.

Third, and most significantly, this essay has shown that center-state disagreements over privatization generally erupt when there are real conflicts of interest at stake. In some cases these may be primarily political, as when the state government fears being blamed for an unpopular policy that causes hardship to some constituents. Fear of being punished by constituents appears to have been important in arousing Sªo Paulo Governor Covas' opposition to sale of Banespa, for example, and is likely to be a primary reason that the Joshi government, or any successor in Maharastra, might oppose rapid financial sector privatization. In other cases, the distribution of economic benefits between the center and state appears to the state government either to be unfair, or not the best deal that it could get with hard bargaining. This motive clearly was important both in the Enron and Banespa cases. Both the Rao and Cardoso central governments legitimately can be faulted for being more attuned to the ramifications of these two, large projects as nationally useful symbols for would-be foreign investors than the central governments were sensitive to possibly excessive costs, monetary (as in Maharastra) or political (as in S^{a}o Paulo) at the state level. The future privatization of most of Brazil's electrical power sector, for example, will go more smoothly to the extent that both central and state governments are involved in shaping the terms of of any proposed deals.

Center-state conflicts, that is, in our cases seem not to be due primarily to state leaders' personal piques, ideological obscurantism, or even political opportunism--but rather to have arisen from genuine, and ultimately negotiable, conflicts of interests. More competitive national political environments, as in both India and Brazil from the early 1980s, gave state leaders the resources and opportunity to express legitmate dissatisfactions through a democratic if occasionally bumpy process, leading men like Joshi, Munde, and Covas to active participation in bargaining with both the central government and potential private investors. All in all, these are hopeful findings. They bode well for the future of both center-state relations and the gradual process of national economic liberalization in both countries.

ENDNOTES.

[1]See also Biersteker, 1992; Ghosh, 1991; and Scnneider, 1990 for useful attempts at cross-nationally comparative definitions of privatization.

[2]Mukherji, 1991, p. 31.

[3]Mukherji 1991, pp. 35-36.

[4]Mahar and Dillinger, 1983, p. 9.

[5]Graham 1987, p. 126 as cited in Willis 1992, p. 6.

[6]Shah 1991, p. 22.

[7]The correspondence passed through Prem Jha's hands, and a slightly garbled report appeared in the press. It is described more fully in Jha 1993, pp. 101 ff.

[8]From January 1994, the Government of West Bengal began to take out four page supplements annually in the Financial Times London, extolling the virtues of West Bengal as an investment destination. By March 1996, West Bengal had become the third largest destination for foreign direct investment in India.

[9]Figures provided to the authors by the Ministry of Finance, New Delhi.

[10]Centre For Monitoring the Indian Economy (hereafter CMIE) 1995, p.14. Even this figure is a gross underestimate, because the base price of Rs. 1.18 per unit is arrived at by taking the book value of power plant equipment, and not its replacement value.

[11]Ibid. p.2.

[12]Ibid.

[13]Centre for Monitoring the Indian Economy, Monthly Review of the Indian Economy, April 1966, p.12.

[14]This figure was given by the minister for energy, Mr. N.K.P.Salve, in an oral presentation at an economic editors conference in New Delhi, September 1995.

[15]This was the average rate used for the calculations of the cost of thermal power plants in the Eighth Plan estimates. Coal-based power projects cleared by the Central Electricity Authority in 1993 cost Rs. 3.25 crores per MW ($1.03 million). See CMIE 1995.

[16]CMIE 1995, p. 24.

[17]Reports in the press in the week before the project was cancelled on August 3, showed that chief minister Manohar Joshi was making a strong bid inside the government to prevent it. He had expressed his dissatisfaction with the report prepared by a cabinet subcommittee under the BJP hardline deputy chief minister Gopinath Munde, which had unambiguously recommended the cancellation of the project. In a bid to prevent the cancellation Joshi had set up his own committee of senior government and Maharashtra State Electricity Board officials to advise him. This committee had unambiguously told him that cancellation would be most unwise as it would affect three other projects whose negotiations were in the final stages. See The Hindu, Delhi edn., August 11, 1995, p.4; or Times of India, August 23, 1995.

[18]Times of India, April 1, 1995.

[19]Enron pointed out that the higher estimate of Rs. 40.6 crores included a jetty and fuel handling facility for the imported natural gas that would eventually fire the plant. Enron did, however, lower costs further because of a sharp fall in power plant equipment prices that took

place after the power purchase agreement with the Government of Maharashtra was signed in December 1993.

[20]Government of India background note circulated among journalists in late August 1995.

[21]Conversation with K.L.Chugh, Chairman of ITC in November 1994. ITC was contemplating setting up a 300 MW coal based plant at the time. Differences within the company eventually made it shelve its plans.

[22]Reported in the New York Times and International Herald Tribune, as well as virtually all Indian newspapers in early May 1995.

[23]Times of India, August 29, 1995.

[24]Ibid.

[25]Major breakdowns occurred on Auygust 17, 1989; November 24 1990; October 25 1991; and February 2, 1992. In 1995 there were breakdowns on April 19, in mid July, and on November 16. In other words, three major power failures occured even as the Enron project was being cancelled.

[26]Off the record discussions with a senior member of the central government cabinet. Energy minister Salve later made several strong statements in parliament and to the press, especially when it became clear that the Munde commitee had no found any proof of corruption in the project.

[27]Numerous statements to the press in April and May, 1995.

[28]Asian Age, June 24, 1995.

[29]Letter to the managing director, Dabhol Power Company. Dated July 14, 1995. Copy provided by the Dabhol Power Company.

[30]Testimony given by Ms.Linda Powers before the Committee on Appropriations, Subcommitee on Foreign Operations, of the U.S. House of Representtives. January 31, 1995. This evidence was given three months before the Dabhol power plant ran into trouble.

[31]See, for example, "Munde report indicates 'kickbacks' by Enron," The Hindustan Times, New Delhi, August 11,1995:

[32]Times of India, August 23, 1995. The newspaper reported that the task force had advised him that the three other projects, at Nagothane, Bhivpuri and Bhadravati would grind to a halt if Enron was cancelled. That is precisely what did happen.

[33]Ibid.

[34]Mahesh Vijapurkar, "Doubts over Munde panel working," The Hindu, August 18, 1995.

[35]India Business Intelligence, August 30, 1995.

[36]India Business Intelligence, August 30, 1995.

[37]Times of India, August 12, 1996.

[38]The major exceptions were the stock exchanges and a very few commercial banks, including local branches of foreign banks, which were private, and small state-level financial and development corporations run by state governments but which, in any case, received most of their funds (which they on-loaned to smaller firms) from nationally constituted institutions.

[39]The chairperson of the expert commission was former governor of the Reserve Bank of India, M. Narasimham, who was no relation to the prime minister.

[40]In late 1991, for example. non-performing assets comprised about 40 percent of the loan portfolios of the nationalized commercial banks (that is, all public sector commercial banks except the SBI). See Srinivasa-Raghavan 1995, p. 106.

[41]On the stock and banking scam, see Armijo 1996b, Chapter 1; Kabra 1992; Murthy 1995.

[42]"India's development bank: Seeking direction," The Economist, March 2, 1996, p. 69.

[43]Robin Abreu, "Public sector banks: Comeback trail," India Today, April 15, 1996, pp. 58-59.

[44]Srinivasa-Raghavan 1995, p. 104.

[45]Tamal Bandyopadhyay, "PSU banks in a flap over capital adequacy," Business Standard, December 21, 1995.

[46]Centre for Monitoring the Indian Economy, 1991, Table 17.1, n.p.

[47]Srinivasa-Raghavan 1995, p. 107.

[48]Srinivasa-Raghavan 1995, p.107.

[49]Srinivasa-Raghavan 1995, p. 105.

[50]"Deposit rates above 12.5 percent will hurt banks: Study," Business Standard, December 27, 1995.

[51]Srinivasa-Raghavan 1995, p. 107.

[52]Ashok V. Desai, "Late and still too little," Economic Times, December 26, 1995.

[53]Shobhana Subramanian, "Unit Trust of India: SEBI or not to be," Economic Times, April 29, 1993.

[54]R.C. Murthy interview, Bombay, December 29, 1995.

[55]"RBI employees threaten strike action from April 1," Economic Times, March 6, 1995.

[56]In early 1993, for example, it required over a week for a check drawn on one's own account in one's own branch of a particular bank to clear after being deposited at another branch of the same bank in the same city. Transfers between urban branches of the same bank in different cities could not be accessed in under two to three weeks; those going to different banks required commensurately longer!

[57]1995, p. 110.

[58]See Trebat 1983, Afonso and Dain 1987.

[59]See Fishlow 1989.

[60]Soraya de Alencar, "Dívida pública vai a R$138 bilh°es," Estado de S^ao Paulo, May 22, 1996. Note: The new currency adopted in July 1994, the "real" (plural "reais"), was fixed to the U.S. dollar, with a small trading band. For purposes of this essay, reais will be quoted in equivalent U.S. dollars.

[61]"Debt profile changes," Gazeta Mercantil International, May 13, 1996, p. 4.

[62]January 1995 figure from "Emerging Market Indicators," The Economist, June 1, 1996. April 1996 figure from "Conta externa tem superávit de R$4.1 bilh°es," Estado de S°o Paulo, May 22, 1996.

[63]That banks, a net creditor sector, should thrive under inflation may seem counterintuitive. For an explanation of the regulatory framework that made this outcome possible, see Zini 1992; Armijo 1996a.

[64]"De olho no porquinho," Veja, November 15, 1995, pp. 32-37.

[65]On Econômico, see "Dinheiro, notas frias, e voto," Veja, December 20, 1995, pp. 32-38; on Nacional, see "A cova é mais funda," Veja, June 5, 1996, pp. 102-104.

[66]Banco Excel took over Econômico; Unibanco acquired Nacional.

[67]Baer 1995, p. 256.

[68]"O socorro oficial," Veja, November 8, 1995.

[69]Rosenblatt 1996, p. 28.

[70]"Estados que mais devem s°o os do Sudeste," Jornal do Brasil, September 3, 1991.

[71]The information in the next several paragraphs, except where noted, comes from several interviews done by one of the authors in S°o Paulo in late May 1996. Interviewees included three well-known economic journalists, a senior economic policymaker and his top aide in the S°o Paulo state government, a former director of both the Banco Central and Banco do Brasil now employed as a private financial consultant, and a federal minister in the Cardoso government.

[72]See "Quércia's assets frozen," Gazeta Mercantil International, May 6, 1996, p. 3. Quércia and Fleury, naturally, claimed they were victims of a political vendetta. All of our informants, however, insisted that the attorney general was not acting under Covas' orders and, furthermore, that the investigation was fully justified.

[73]Ana Cristina Rosa, "Covas cobra soluç°o do Banco Central," Estado de S°o Paulo, May 22, 1996.

[74]Figure from interview with senior economic journalist CM, May 22, 1996.

[75]S°o Paulo was at the time presided over by appointed governor Paulo Maluf, in 1984 to become the military government's "civilian" candidate for president who was to have won the indirect electoral college vote of November 1984--except that the combined opposition outsmarted the country's military leadership at their own rigged game, electing the Tancredo Neves-José Sarney ticket instead. In 1990 Maluf, like most Brazilian politicians a flexible survivor, was elected mayor of S°o Paulo City. A vigorous man in his fifties, he certainly will try for the presidency again in the future.

[76]Rosenblatt 1996, p. 22.

[77]Altino Ventura Filho, "Utilities for sale," in Rosenblatt 1996, p. 30.

[78]Ibid., p. 33.

[79]Ibid., p. 33.

[80]"Draining power," India Today, November 30, 1995, p. 73.

[81]Marisa Castellani and Mônica Magnavita, "Investimento na Light será de US$200 milh°es," Estado de S°o Paulo, May 22, 1996.

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