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THE POLITICAL ECONOMY OF PRIVATIZATION IN INDIA

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The Political Economy of Privatization in India

written and presented
by

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1. Introduction

India has a huge public enterprise sector. It consists of nearly 1,300 enterprises, owned and managed by the central government, state and union territory governments, and local governments in the country. These enterprises manage, according to the World Bank (1994), as much as 55 % of the economy’s (excluding households’) capital stock and account for one-fourth of non-agricultural GDP. They dominate many sectors of the economy: surface irrigation; water supply in rural and urban areas; railways; river transport; ports; postal services; telecommunications; mining (including hydrocarbons and coal); one-third of registered manufacturing (particularly steel, petrochemicals, capital goods, pharmaceuticals, fertilizer); power generation and distribution; oil and gas production and marketing; air transport; one-third of bus transport; storage; and banking and insurance.

Although there are differences in the performance of individual public enterprises, most public enterprises are overstaffed’ and suffer from other operational inefficiencies. It is not merely public enterprises such as Bihar State Electricity Board, Uttar Pradesh Road Transport Corporation, Indian Iron and Steel Company, Scooters India Limited, Heavy Engineering Corporation, National Textile Corporation, Fertilizer Corporation of India and Hindustan Fertilizer Corporation, which are inefficient. Even seemingly well-positioned public enterprises are also operating inefficiently. A recent study (Gupta 1988) has shown that Rashtriya Chemicals and Fertilizers, which is considered by many to be one of India’s better-run public enterprises, has performed poorly: its pretax profits relative to its net worth ranged between 2.1% and 10.2% during the period 1978/79-1986/87, which is much lower than what the Government of India (GOI) effectively paid for the resources that it borrowed to invest in it, with inefficiency in the use of inputs (e.g., gas and power) being a major factor responsible for this outcome. Similarly, the GOI's National Thermal Power Corporation which received a rating of excellent for achieving its output target in 1991-92, in effect did poorly in that year: output indeed went up, but the use of material inputs rose even faster (The World Bank 1995).

Public enterprises have been a major contributor to India’s huge public sector deficit --

that is, deficit of all public entities in the country, including the central, state, union territory and local governments, departmental and nondepartmental public enterprises, and public entities such as the Oil Coordination Committee. According to a recent estimate (Gupta 1992), the deficit of public enterprises in the energy sector alone adds up to over 4% of GDP. The public enterprises' deficits have added to the country's current large stock of domestic and external public debt (India's external debt, at about $100 billion, is the third largest among developing countries), which in turn result in massive annual liabilities on account of interest payments -- the interest payments of the GO1 alone, which has financed much of the investments in the country's public enterprises, as also the losses that many of them have incurred, through borrowings on its account, added up to Rs. 520 billion, 4.8% of GDP, in 1995-96. Indeed, the GOI's interest payments currently eat up as much as 47.2% of its total current receipts', up from 39.1% in 1990-91 and 26.8% in 1985-86.

What is more distressing is the phenomenon of many public enterprises in India reporting losses despite being overprotected. This means that these enterprises' operational inefficiencies are so huge that they exceed the benefits resulting from the substantial protection that they enjoy and, as a consequence, they incur losses. With protection levels coming down, with competition increasing, and with many qualified people leaving public enterprises because of substantially better opportunities available in the private sector[3], the public enterprises' financial performance may worsen.

Many people vehemently disagree with the view that most of India's public enterprises operate inefficiently. G.V. Ramakrishna, Member of India's Planning Commission, for example, is reported to have claimed that thinking of all public enterprises as inefficient and unprofitable is fallacious, and to substantiate his claim, he is reported to have said that over 131 healthy public enterprises, including those in the infrastructure sector, are making annual profits of about Rs. 80 billion (*The Times of India* 1995c). Two points need to be raised here. First, what is the source of these profits? Is it efficiency in the use of inputs, or protection and/or monopoly or administered pricing? Further, how do the profits compare with what the government effectively paid for the resources that it borrowed to invest in the public enterprises in question? If one evaluates the performance of India's public enterprises in this manner, one will discover that most of them are operating inefficiently, as the study on Rashtriya Chemicals and Fertilizers, referred to above, illustrates.

Why are public enterprises in India so inefficient? The answer lies in the environment that public enterprises in India operate in, and in the effect this environment has on the public enterprise managers' incentives to develop new, better and less expensive products, develop new markets, minimize capital and current costs, and maximize profits. Iyer (1991) provides a graphical account of the unhealthily close and dysfunctional network of formal and informal links and relationships between the government and public enterprises, as also of some of the other components of the environment public enterprises in India operate in.

Descriptions which illustrate this environment include: the government's deep involvement in the actual management of public enterprises, with the concerned administrative ministries' tendency to function as if they were a kind of super-management on top of the Board of Directors"; Parliament's involvement in public enterprises' affairs in several ways, including through numerous questions and enquiries ranging from questions of overall performance and large policy issues to the minutest details of day-to-day functioning; and expansion of the horizon of Article 12 of the Constitution to treat even industrial, manufacturing and commercial public enterprises as "state" and thereby subject them to the various obligations that go with such a treatment.

Some people believe that the performance of India's public enterprises can be substantially improved. They assert that what India urgently needs is the putting in place of a program of public enterprise reform which, among other things, will have to include reform in government at both the political and bureaucratic levels. An objective assessment of the situation however suggests that public enterprise reform in India is not possible.

A recent study (Kikeri and others 1994) has documented what the public enterprise reforms that a number of countries have put in place, have aimed at, and the problems that they have faced. The reforms aimed to expose public enterprises to domestic and external competition and level the playing field by eliminating easy access to credit both from the budget and the banking system; by freeing public enterprise managers from noncommercial goals and government interference in day-to-day decision making; and by developing institutional mechanisms, such as contract plans (or MOUs) and performance evaluation systems, to hold managers accountable for results. In response to these reforms, some public enterprises have indeed performed better, but three problems persist. First, the reforms are technically and politically difficult to implement. Often, well-designed programs have fallen short in implementation.

Second, performance does improve when the full reform package is put in place, but the necessary steps are numerous and hard to coordinate, and entire reform programs have seldom been enacted. For instance, governments often discontinue budgetary support but continue to guarantee borrowings from banks, and pay and employment reforms have yielded little without increased managerial autonomy and accountability.

The third and more important problem of public enterprise reform is sustainability. Faced with a financial crisis or pushed by external forces, a government may initiate fundamental and far-reaching reforms in public enterprises that give managers the mandate and the power to run their enterprises in a commercial manner. As the reforms are put in place, economic and financial performance does improve, but as the crisis fades or the external pressure weakens, government ownership facilitates the revival of noncommercial objectives, which in turn often leads to renewed poor performance.

India's experience with public enterprise reform is no different. Indeed, India's biggest failure in its economic reforms program is that there has not been a single transformation in public enterprises. There have been some marginal changes in wage conditions, managerial autonomy and so on, but these are very limited. Even if something significant does happen, the chances are that it will not sustain.

It therefore appears that privatization is the only way out. Yet privatization has not made much of a headway in India. Why? The present paper attempts to answer this important question and in so doing it explores the political economy aspects of the privatization process in India. To be specific, the paper explores the incentives that influence the behavior of India's politicians and policy makers while dealing with the privatization issue in the country.

The paper is divided into five sections. Section 2 provides an idea of how properly designed and implemented privatizations may benefit India. Section 3 describes India's privatization experience and paves the way for Section 4 which explores the incentives that influence the behavior of India's politicians and policy makers while dealing with the privatization issue in the country. Finally, Section 5 presents some concluding remarks.

2. Benefits from Privatization

Privatization, if designed and implemented properly, may benefit India in six ways. First, it will improve the environment public enterprises operate in and thereby strengthen their managers' incentives tn he efficient, which in turn can contribute to making the Indian economy substantially more efficient, as can be seen from the available evidence on privatisations in India. The Government of Andhra Pradesh's Allwyn Nissan Limited (ANL), which incurred losses from the very beginning, in 1985, has done substantially better after its privatization in 1988: the market share of the company, renamed as Mahindra Nissan Allwyn Limited (MNAL) after privatization, in the fiercely competitive light commercial vehicle market rose from 17 % before privatization to 21% at the end of 1990-91; the company made an entry into the export market and improved its status from being a loss-making company to a net profit-making one in 1990-91 (Reddy 1992). The Board for Industrial and Financial Reconstruction has recently approved MNAL's merger with Mahindra and Mahindra Limited (*The Economic Times* 1994c). The merger is expected to enable Mahindra and Mahindra make a substantially more efficient use of MNAL's plant and equipment and of its dealership and other infrastructure.

Bajaj (1994) has documented the privatization of the Government of Uttar Pradesh's Auto Tractors Limited (ATL) which was established in Pratapgarh, a backward district of Uttar Pradesh, for manufacturing tractors and diesel engines. With ATL's losses accumulating to Rs. 479.4 million at the end of 1989-90 and there being no evidence of its being able to operate profitably, it was decided in November 1990 to close the plant down. The company was shortly thereafter converted into a joint venture with Sipani Automobiles Limited (SAL), with SAL taking over the possession of the plant in March 1991. SAL has concentrated on the production of engines. It produced 1,249 engines in 1991-92 and 1, 541 in 1992-93 (more recent information on this is not available), against 273 in 1988-89 and 267 in 1989-90, and has already started making a net profit.

Incidentally, Bajaj (1994) has reported that with ATL located in a backward district, posting as its chief executive was not considered an important position by senior civil servants. The result was that most of the time the civil servants posted to ATL were trying to get out. Politicians used the public enterprise as a source of patronage to enhance their influence by distributing jobs and favors. In this way they were seeking to maximize their influence rather than improve the performance of the enterprise. The interest of the enterprise was far removed from their mind.

No other privatization in India has been documented. But some recent studies (e.g., Megginson and others 1994) have compared public enterprises' performance before and after privatization in a number of countries. These studies show considerable efficiency gains that have resulted from privatization.

Second, privatization may create conditions for substantial additional investment as also, especially if privatization is accompanied by lab our market reforms, conditions for the generation of a large number of productive employment opportunities, which in turn may contribute to removing poverty. According to a recent study (Kikeri and others 1994), privatization revived a near-dead textile company in Niger, which now operates profitably at close to full capacity with a larger work force. The company exports much of its production and has won a large domestic market share against imports.

Third, consumers may also gain from privatization. A recent study (Gala1 and others 1994), which examined the welfare consequences of selling selected public enterprises in Chile, Malaysia, Mexico and the United Kingdom, found that, quite apart from any benefits from improved service, consumers for the most part gained or remained unaffected by privatization. In the five cases in which consumers did lose, the (generally small) losses were attributable mostly to prices moving closer to their scarcity values. The study concluded, for example, that consumers in Chile were unaffected by the sale of ENERSIS, the sole electricity distributor in Santiago: paying consumers were better off, but this gain was balanced by losses to those who had hitherto been getting the electricity free through illegal connections. Which means that if only those who had previously been paying for electricity had been considered legitimate consumers, and that's the way it should have been, the study would have shown substantial increases in consumer welfare. These findings are especially relevant for the Indian situation, given the substantial losses that public entities in the power sector suffer because of illegal connections.

Fourth, given the environment that public enterprises in India currently operate in, they can spread their sickness even to efficient private enterprises in sectors in which both public and private enterprises coexist. Thus, a sick mill belonging to National Textile Corporation, a GO1 enterprise, directed by the government to keep on running so as to keep its workers employed and to keep on selling its fabrics at a heavily subsidized price, can easily drive an efficient private sector mill producing comparable fabrics out of business. One can imagine what may happen to private investors currently planning to enter India's power sector if loss making state electricity boards continue to operate. Privatization can be of major help in addressing this problem and thereby in allowing the Indian economy to fully realize the potential benefits from industrial liberalization that has been put in place.

Fifth, privatization can be of help in reforming public intervention. India suffers from excessive public intervention, with public ownership and management of hundreds of enterprises being one form of public intervention. These enterprises are engaged in innumerable activities: manufacturing steel; building ships; generating and distributing electric power; running domestic and international airlines; exploring, producing and refining oil; operating domestic and international telecom network; running hotels; manufacturing polyester film; making condoms; producing fruit pulp and juice; running hanks as also life and general insurance and electronic entertainment businesses; and so on. Privatization will result in the correction of such distortions and allow the government to concentrate on things which it has failed to do but which it alone can do. As the recent outbreak of pneumonic plague in Surat and its rapid spread to other parts of India has highlighted, the government has failed to effectively intervene in the country's public health sector -- and, as *The Times of India* has commented in a recent (January 2, 1995) lead editorial, "a dirty country cannot be globalized."

And public health is not the only example of failure of public intervention in India. There are many such examples: protection of the environment, provision of primary education, maintenance of law and order, and so on.

Finally, privatization can be of major help in reducing India's huge public sector deficit. This can happen in three ways. To begin with, the proceeds from the sale of public enterprises can be used to finance the public sector deficit or, in case the proceeds exceed the deficit, to reduce the outstanding public debt, both domestic and external.[5] This in turn will reduce the burden of interest payments and thereby the deficit.

Another way in which privatization can be of major help in reducing India's public sector deficit is by substantially reducing, if not totally eliminating, the public enterprises' various demands on the country's public sector finances. These demands, which add up to substantial amounts, include demands for budgetary support to loss making public enterprises, on the ground that this will enable the concerned public enterprises to restart and produce goods. Consider, for example, the additional budgetary support of Rs. 1.1 billion that the GO1 has recently approved for the current fiscal year for the sick units of Fertilizer Corporation of India (FCI) and Hindustan Fertilizer Corporation (HFC), both GO1 enterprises. The GO I's Minister for Chemicals and Fertilizers is reported to have claimed that the additional budgetary support will enable the FCI's and HFC's factories to restart and produce urea (The *Times of India* 1994b). That amounts to saying that every sick enterprise in the world can produce goods if subsidized. But that is no reason to provide budgetary support to a sick enterprise. The same money can be used much more productively elsewhere. The Minister's game plan is simply to throw good money after bad to keep workers happy. Privatization will do away with all this nonsense and thereby help to reduce the deficit.

There is still another way in which privatization can be of major help in reducing India's public sector deficit. With privatization helping in putting the enormous assets, running into trillions of rupees, that public enterprises in India have built and acquired over the last nearly five decades, to substantially more productive uses, direct and indirect tax revenues from privatized firms can be expected to exceed by a wide margin the revenues on account of taxes and dividends currently received from public enterprises. The following two examples illustrate how this can happen. Malaysia sold a government sports lottery in 1985. By 1989 the revenues generated through levies on the privatized lottery were three times greater (in real terms) than the revenue from the former public enterprise (Gala1 and others 1994). In Chile the net annual receipts from ENERSIS, the sole electricity distributor-m Santiago, declined after privatization because the government no longer received dividends on its equity, but tax revenue increased as performance gradually improved (Gala1 and others 1994).

3. India's Privatization Experience

India's privatization experience can be discussed under six heads: selling a public enterprise's fractional equity, with the controlling ownership and management continuing to remain in the public sector; putting up of a public enterprise for sale, with the intention of transferring its control and management to the private sector, but the sale not going through; putting up a public enterprise for sale, the sale also going through, but scuttling the entire deal later; winding up a public enterprise; transferring the control and management of a public enterprise to the private sector, but with a substantial proportion of the equity, enough for managerial intervention, continuing to remain in the public sector; and complete privatization, or what Bhagwati and Srinivasan (1993) call true privatization, under which the control and management of a public enterprise is transferred to the private sector (though some public sector equity holding, without managerial intervention, may continue).

3.1 Selling Fractional Eauitv With Controlling Ownership and Management Continuing to Rcmnin in Public Sector

Beginning July 1991, the GO1 has put in place a program to sell a part of its equity held in selected central public enterprises. The Economic Survey 199596 (Government of India 1996) provides year and public enterprise-wise details of the equity sold during the period July 1, 1991-December 31, 1995. Three things emerge from these data. First, of the 246 nondepartmental central public enterprises (CPEs), only 40 CPEs' equity was sold during this period. Second, the quantity of equity that was sold did not add up to much: in 19 of the CPEs in question, the equity sold added up to less than 10 percentage points; in seven, between 10 and 20 percentage points; in six, between 20 and 30 percentage points; in seven, between 30 and 40 percentage points; and in one, between 40 and 50 percentage points. Finally, the controlling ownership and management of all the 40 CPEs continued to remain with the GOI.

That's not all. Most of the equity that has been sold so far, has been sold only to public entities in the financial sector, with the Unit Trust of India alone, for example, accounting for 69.4% of the total sales in 1991-92. This was done, as the Minister of Finance put it in response to a calling attention motion in the Kajya Sabha, "as it was the government's intention to ensure that the benefits accrued to public sector institutions rather than private entities in the event of the sales taking place at an underpriced level" (*The Times of India* 1993).

3.2 Putting Up a Public Enterprise for Sale. But the Sale Not Going Through

A review of the available material suggests many cases of public enterprises which were put up for privatization, but which could not be privatized. Examples are: Indian Iron and Steel Company, Scooters India Limited, and Great Eastern Hotel.

3.2.1 Indian Iron and Steel Company

The Indian Iron and Steel Company (IISCO), a subsidiary of Steel Authority of India Limited (SAIL), a GO1 enterprise, had accumulated losses of Rs . 8.9 billion as on March 31, 1994 against its paid-up capital of Rs. 3.9 billion; it thus had a negative net worth of Rs. 5 billion at the end of 1993-94. According to a GOI diagnosis (Government of India 1991), IISCO's problems included: technological obsolescence; ageing plant and equipment; outmoded operational practices; and overmanning.

With the IISCO management not able to raise on its own the resources required for turnarounding the company, and with the GOI also not in a position to provide the required resources through budgetary support, the GO1 decided to privatize the company and even found a buyer in Mukund Limited. But as IISCO, which earlier used to be in the private sector, was acquired by the GO1 under two acts of the Parliament (viz., The Indian Iron and Steel Company (Taking Over of Management) Act of 1972 and The Indian Iron and Steel Company (Acquisition of Shares) Act of 1976), parliamentary approval is necessary for the privatization to be put in place. Two bills to repeal these acts and thereby to seek the Parliament's approval for IISCO's privatization were listed for introduction in the Lok Sabha on December 23, 1993 but, given the vehement protest of the Left Front and other opposition members of the Lok Sabha, they had to be referred to a parliamentary committee. The GOI's Minister of State for Steel sought the support of the committee, called the Parliamentary Consultative Committee for Privatization of the Indian Iron and Steel Company, but his fervent appeal did not receive any favorable response.

In March 1994 the IISCO's case was referred to the GOI's Board for Industrial and Financial Reconstruction (BIFR). The BIFR, set up in 1987 to implement the Sick Industrial Companies (Special Provisions) Act of 1985, appointed the Industrial Development Bank of India (IDBI) as the operating agency. The IDBI received a plan for the revival of IISCO. The plan, submitted by SAIL, was contingent on the GOI's Ministry of Steel providing a budgetary support of Rs. 11 billion for reviving IISCO. But the GO1 has rejected the possibility of providing any budgetary support for turnarounding the ailing Burnpur (West Bengal)-based IISCO. Given India's political economy, this certainly is a bold decision -- some supposedly-well informed people were arguing that the ***ruling Congress*** Party ***at*** the ***Center*** had no alternative but to provide the budgetary support in question, because in case it did not it would lose West Bengal in the 1996 general elections.

But what will happen to IISCO now? According to a recent story in The Economic Times (*The Economic Times* 1995c), IISCO is now almost certain to be privatized, with the Mukund Limited, which earlier had offered to takeover IISCO, likely to bid again.

3.2.2 Scooters India Limited

The Scooters India Limited (SIL), a GOI enterprise, was incorporated as a public limited company in 1972 and started commercial production in 1975. It has two units located at Lucknow and New Delhi, with the Lucknow unit manufacturing two-wheelers and three-wheelers and the New Delhi unit, which is under lease, manufacturing electrical ceiling fans.

SIL has performed very poorly. Its accumulated losses amounted to Rs. 4.8 billion on March 31, 1994 against. its paid-up capital of Rs. 78.1 million; it thus had a negative net worth of Rs. 4.7 billion at the end of 1993-94, up from Rs. 2.5 billion at the end of 1990-91 and Rs.

0.7 billion at the end of 1985-86. According to a GO1 study (1991), SIL continued to be in a bad shape because (a) it had outdated plant and machinery, (b) it had excessive manpower, (c) it had poor marketing and servicing network, and (d) it was unable to compete in a highly competitive market.

The GO1 decided, in 1987, to sell the Lucknow unit to Bajaj Auto Limited, a major scooter producer in the private sector, but the decision could not be implemented because of the employees' opposition -- SIL's 3,125 employees opposed the GOI's privatization move because it was feared that it might result in a retrenchment of 1,625 employees (Business *Standard* 1988, cited in Pendse 199 1).

In May 1992 SIL was referred to the BIFR. A package for its rehabilitation and restructuring has recently been approved *(The Economic Times* 1995a). Complete details of the package are not available, but there is reason to believe that the package involves writing off of SIL's liabilities (interest and excise duty payable, and loan repayment) and voluntary retirement of workers. A joint management committee to oversee implementation of the package has also been set up.

3.2.3 Great Eastern Hotel

The Great Eastern Hotel, a Government of West Bengal (GOWB) enterprise, is an over 150-year old hotel, located in Calcutta. In 1994 the Communist Party of India (Marxist)led GOWB decided to privatize the hotel and transfer the control and management to Accor Asia Pacific, a subsidiary of Accor SA of France, which planned to convert it into a 250-room five-star hotel at a cost of about Rs. 950 million. Accor agreed to buy the hotel on the precondition that it will be allowed to retrench all of its 640 employees. The GOWB responded to this by offering the employees 36 to 40 months' salary, apart from provident fund and gratuity dues. But four labour unions, including those affiliated to the CITU and the INTUC, rejected the GOWB's offer.

Jyoti Basu, Chief Minister, GOWB had announced that the hotel would have to be closed if it was not privatized, given that the GOWB did not have the funds to subsidize it. But the CITU leaders are reported to have impressed upon the Chief Minister that the privatization of Great Eastern Hotel just before the Lok Sabha and State Assembly elections would not be politically wise. According to them, the Congress Party might use this as a weapon against the CPI(M), especially when the CPI(M) has opposed the privatization of Bailadila mines (The Times of India 1995d). This suggests that the issue of privatizing the Great Eastern Hotel may be revived after the elections, especially if the CPI(M)-led Left Front is returned to power after the Assembly elections.

3.3 Putting Up a Public Enterprise for Sale. the Sale Also Going Through? But Scuttling the Entire Deal Later[6]

There has been at least one such case: the sale of the Government of Uttar Pradesh's UP State Cement Corporation Limited (UPSCCL). The UPSCCL had accumulated losses of Rs. 1.6 billion as on March 3 1, 1990 against its net worth of Rs. 0.7 billion; it thus had a negative net worth of Rs. 0.9 billion at the end of 1989-90. The UPSCCL's problems included: inherent defects in plant design, inadequacy of trained technical personnel, poor maintenance, overmanning and recurring labour problems, low capacity utilization, and high cost of production.

Considering the mounting losses, the Government of Uttar Pradesh (GOUP) decided, in April 1990, to privatize UPSCCL. It found a buyer in Dalmia Industries. In February 1991 the GOUP and Dalmia Industries entered into a joint venture agreement which provided, among other things, for (a) the GOUP transferring 51% of UPSCCL's equity to Dalmia Industries, with the balance of 49% remaining with the COUP, (b) the joint venture taking over all the employees of UPSCCL, and (c) Dalmia Industries taking over the management of UPSCCL. The decision to transfer the equity and handover the management was opposed by the UPSCCL's employees. A petition was filed in the Allahabad High Court, which prohibited the GOUP from converting UPSCCL into a private corporation. The GOUP responded to this by transferring only 49% of the equity, with the stipulation that another 2% of the equity will be transferred after the Court's decision. The GOUP also handed over the UPSCCL's management to Dalmia Industries. But as there was labour unrest, the transfer of management could take place only with the help of the police. The police also had to resort to firing to control the workers, as a result of which nine workers died.

After some time, a number of labour unions of the employees filcd a pctition, stating that as the interests of workers had already been safeguarded by the specific provisions in the agreement that no worker will be retrenched and that the service conditions will not be changed to their detriment, the petition earlier filed by them may be dismissed.

The events, however, took a dramatic turn. There was a change in government in Uttar Pradesh, with the new government deciding to cancel the agreement with Dalmia Industries and resuming the equity shares transferred to it through an ordinance issued on October 11, 1991.

There has been a further deterioration in the UPSCCL's financial situation, with its accumulated losses on March 31, 1994 adding up to over four times its net worth. More recent information on its financial situation is not readily available.

3.4 Winding Up a Public Enterprise

As part of the country's economic reforms programme, the Sick Industrial Companies Act of 1985 was amended in December 1991 to bring public enterprises under the purview of the Board for Industrial and Financial Reconstruction (BIFR). Consequently, until the end of 1995, 138 cases of sick public enterprises were registered with the BIFR. The BIFR has recommended winding up in 14 of these cases[7]. The public enterprises which the BIFR has recommended for winding up include: NTC (Gujarat), NTC (Madhya Pradesh), NTC (Uttar Pradesh), NTC (West Bengal), British India Corporation, Cawnpore Textiles, Elgin Mills, Mandya National Paper Mills, and National Bicycle Corporation.

But none of these public enterprises has been wound up so far. Indeed, the government seems to have abandoned, at least for the time being, even the idea of winding up public enterprises. The GOI's Minister of Industry is reported to have announced that whenever the BIFR ordered the winding up of a sick public enterprise, the GOI did not accept the order as "final". According to him, no stones would be left unturned to restructure, revive and strengthen public enterprises and the route of winding up would be adopted only as the last resort (*The Times of India* 1995f).

3.5 Transferring the Control and Management of a Public Enterprise to the Private Sector, But With a Substantial Proportion of the Equity Enough for Managerial Intervention, Continuing to Remain in the Public Sector

There have been cases of public enterprises whose control and management has been transferred to the private sector, but a substantial proportion of their equity, enough for managerial intervention, has continued to remain in the public sector. The case of Maruti Udyog Limited (MUL) is an excellent example of this kind of privatization experience in India.

Until mid-1992 MUL used to be a public enterprise, with the GO1 holding 60% of its equity and Suzuki Motor Corporation (SMC) of Japan holding the remaining 40 % . Currently, SMC holds 50 % of MUL's equity, with the GO1 holding 49.74 % and MUL employees the remaining 0.26%. This allows the GO1 to effectively intervene in all decision making at MUL. One can argue that this is not necessarily a bad thing, provided the intervention is in MUL's commercial interest. And this is where the rub lies.

Consider, for example, the GOI's stand on the issue of MUL's proposed expansion and modernization program involving an investment of Rs. 19.1 billion. MUL wants to modernize and expand in order to withstand the increased competition resulting from the opening up of India's passenger car sector while tightening the grip over its market share. The GO1 wants MUL to finance the expansion and modernization programme through borrowings and internal accruals, while SMC wants to use these routes as well as equity through an increase in the paid-up capital. Responding to a question on SMC's objection to financing MUL's expansion and modernization programme only through borrowings and internal accruals, SMC President Osamu Suzuki said: "There will have to be a balance between borrowing, equity and internal accruals. If anybody suggests that borrowings and internal accruals can be enough, he does not know business. Maybe some people in India are happy with the impasse. Maybe some car manufacturers are behind it as they resent Maruti's monopoly" (*The Times of India* 1995g).

And what is the GOI's objection to raising part of the required resources through equity? The answer is simple: the GO1 wants to retain its equity holding at the current level of 49.74%) and in order to be able to do that it will have to shell out a substantial amount of money which it cannot afford tn do. Tt csnnnt shell out the mnney largely because of its current difficult fiscal situation, but also because of the perverse signals that this will send out to all those who were denied budgetary support for thc programs that thcy had supportcd (c.g., programme for IISCO's revival) -- they will argue that if the GO1 can manage to find resources for investing in MUL's equity, it must find resources for, say, IISCO's revival as well.

The bottom line is that while MUL is no longer a public enterprise, the GOI's current actions are being guided much less by commercial rationality than by its desire not to dilute its current 49.74% equity stake, so that it may continue to control MUL and effectively intervene in its affairs. The irony is that all this is being allowed to happen despite the noise that the GO1 has made in recent years about getting out of non-core areas.

3.6 Complete or True Privatization

Finally, India's privatization experience also includes cases of complctc or truc privatization, under which the control and management of a public enterprise is transferred to the private sector (though some public sector equity holding, without managerial intervention, may continue). Indeed, a careful review of the available evidence, including the results of a recent Economic Times survey on how fourteen state governments have dealt with the privatization issue (The *Economic Times* 1996a), clearly suggests many cases of complete or true privatization in India. The public enterprises that have been completely or truly privatized in India include: ACC Babcock, Allwyn Nissan Limited, Auto Tractors Limited, East Coast Breweries and Distilleries Limited, Goa Telecommunications Limited, Goa Time Movers, Haryana Breweries Limited, Hindustan Allwyn Limited's Refrigeration Division, Orissa Mining Corporation's Charge Chrome Plant, and Rajasthan State Tanneries. Information on the total value of the public enterprises that have been completely or truly privatized so far is not available, but there is reason to believe that it does not add up to much.[8]

The foregoing discussion reveals the variety of ways in which India's politicians and policy makers behave while dealing with the privatization issue. Why do they behave the way they do? To be specific, why doesn't the percentage of equity of the CPEs that the GO1 has sold during the last roughly five years, add up to much? Why didn't the GO1 privatize the ailing Indian Iron and Steel

Company (IISCO) (which had a negative net worth of Rs. 5 billion at the end of 1993-94) in 1994, even though it had announced its decision to do so and had even found a buyer in Mukund Limited? Why is the GO1 toying with the idea of selling IISCO to Mukund Limited now? Why didn't the GO1 privatize the ailing Scooters India Limited, even though it had announced its decision to do so and had even found a buyer in Bajaj Auto Limited? Why didn't the Communist Party of India (Marxist)-led Government of West Bengal privatize the ailing Great Eastern Hotel, even though it had announced its decision to do so and had even found a buyer in Accor Asia Pacific, a subsidiary of Accor SA of France? Why did the Government of Uttar Pradesh (GOUP) scuttle the deal involving the privatization of UP State Cement Corporation Limited? Why did the GOUP privatize Auto Tractors Limited? Why did the Government of Andhra Pradesh privatize Allwyn Nissan Limited and Hyderabad Allwyn Limited's Refrigeration Division? And so on.

I have developed a framework for addressing these issues. The framework explores the incentives that influence the behavior of India's politicians and policy makers while dealing with the privatization issue in the country. Section 4 presents the framework.

4. Incentives influencing the Behavior of India's Politicians and Policymakers

While India's politicians and policy makers have generally opposed privatization, they have also allowed the privatization of certain public enterprises. A politician or policy maker may oppose privatization on ideological grounds -- privatization is a bad thing; public enterprises can be reformed. A politician or policy maker may oppose privatization also because he/she perceives privatization as something which is not in his/her self-interest. A politician or policy maker may perceive the privatization of a given public enterprise as damaging, directly or indirectly, the chances of his/her election/reelection if that privatization is likely to affect adversely one or more of the following interest groups: the public enterprise's employees, input suppliers, output dealers, and customers accustomed to subsidized output. Further, to the extent that a public enterprise can be used as a Mitch cow or as a source of patronage, or as both, its privatization may be perceived by a politician or policy maker as a development which is not in his/her self-interest.

On the other hand, when a politician or policy maker allows the privatization of a given public enterprise, he/she may do so, one may argue, because of one or more of the following considerations: ideological grounds (privatization is good; it will benefit the economy in several ways), pressure from well-informed voters, and increasingly difficult public finance situation.

A careful review of the available evidence and discussions with knowledgeable people suggest that Indian politicians and policy makers' opposition to privatization has been influenced much less by ideological considerations than by considerations of self-interest. Indeed, the considerations of self-interest seem to have been so pervasive and overwhelming that it is these considerations which largely explain why the percentage of central public enterprises' equity that the GO1 has sold over the last roughly five years does not add up to much. why the GO1 is insisting that it must continue to control Maruti Udyog Limited (MUL) and effectively intervene in its day-to-day matters even though MUL is no longer a public enterprise, why the GO1 did not privatize Indian Iron and Steel Company, why the Communist Party of India (Marxist)-led Government of West Bengal did not privatize Great Eastern Hotel, and why the Government of Uttar Pradesh scuttled the deal involving the privatization of UP State Cement Corporation Limited.' Box 4.1 describes in some detail how India's politicians and policy makers use public enterprises to serve their self interests.

But this is not all. The increasingly difficult public finance situation has begun putting pressures on Indian politicians and policy makers to behave differently. They have begun to realize that many sick public enterprises will have to be privatized for releasing scarce resources for more pressing public purposes and/or for some populist schemes that they had announced in their election manifestoes. It is this recognition which, in my view, has triggered all the moves that have been made for complete or true privatization in India. Also, it is this recognition which explains why the GOI is toying with the idea of selling Indian Iron and Steel Company to Mukund Limited now.

But a given privatization move does not necessarily turn into a complete or true privatization. Much depends on how the process of transition from a privatization move to a complete or true privatization is managed. Given that most public enterprises in India are grossly overstaffed, a major consideration here relates to the employment implications of privatization. In the Haryana Breweries privatization case, the employment issue was handled by the buyer (Shaw Wallace and Company) and the seller (Government of Haryana) entering into an agreement which clearly stipulated that "there will not be any retrenchment or downward revision of pay scale of existing workmen or employees" (Government of Haryana 1994). Similarly, in the Allwyn Nissan Limited (ANL) privatization case, the employment issue was handled by the buyer (Mahindra and Mahindra Limited) and the seller (Government of Andhra Pradesh) entering into an agreement under which the buyer undertook to "protect the rights and service conditions of the employees on the payroll of ANL, abide by the written

Box 4.1

How India's Politicians and Policymakers Use Public Enterprises to Serve Their Self-Interests

The internal rate of return that the business of politics generates in India is pretty high. Politicians, therefore, want to get elected and re-elected. This explains the cut-throat competition for votes that one witnesses -- rates for getting elected or re-elected, for example, as an MLA (Member of (a State) Legislative Assembly) or an MP (Member of Parliament), and for getting elected or re-elected and then surviving as a Chief Minister or as Prime Minister. And it is here that public enterprises, which elected politicians use as milch cattle, come in handy: access to the public enterprises' helps politicians in getting votes. This can happen in a variety of ways. First, public enterprises can be used to create and provide jobs, often at wages/salaries higher than the market rates, to those who directly or indirectly help a politician in getting votes -- in India it is much easier to create a job in a public enterprise than in a government department. This explains to a large extent the phenomenon of gross overstaffing and the resulting inefficiency in public enterprises. To illustrate: the cost of producing sugar in the Government of Bihar's sugar mills recently ranged between Rs. 9 and 245 per kilogram -- six of the mills that were closed in 1992 were operating so inefficiently that their closure has enabled the Government of Bihar, even with the employees continuing to be paid their wages/salaries, to reduce its budgetary support to finance their loses by Rs. 70 million a year (Singh 1993).

Second, public enterprises can be used a sparking places for selected members of a rival group within a political party, or for such other people whose support may be critical for the continued survival of, say, a Chief Minister. These people can be nominated or appointed as chairpersons or as members of the management boards of selected public enterprises. This is a standard practice in India, with the recent appointments to the boards of Gujarat's public enterprises being an example -- the Gujarat Chief Minister is reported to have appointed supporters of one of his political rivals as chair persons of Gujarat's public enterprises such as Gujarat Development Corporation and Gujarat State Export Corporation (*The Economic Times* 1994a).

Finally, public enterprises can also be milked through leakages in, say, their spending under various heads, both current and capital. Thus, plant machinery required for implementing a public enterprise' investment projects, especially projects of a public enterprise operating in a regime of administered (cost-plus) pricing, may be acquired at inflated prices, with at least a part of the difference (between the market price and the actual price charged to the public enterprise) directly or indirectly accruing to an elected politician. And the resources to acquired can be used for facilitating the engineering of political defections, for financing the huge re-election expenses, and for may other purposes.

Given the above state of affairs, no wonder most politicians and policy makers oppose privatization of public enterprises, especially now when, thanks to the economic reforms e.g., substantial relaxations in the industrial licensing regime, remnval of some of the price and distribution controls) than have commitments of the present management to them and not envisage any reduction in the overall work force" (Reddy 1992). But in the GOI's Scooters India Limited case, the privatization move did not succeed as the employees opposed the move on the ground that it might result in retrenchment of roughly half the employees (*Business Standard* 1988, cited in Pendse 1991).

But all this does not necessarily suggest that in order for a privatization move to succeed, the buyer must agree to employ all the workers. In the Government of Uttar Pradesh's Auto Tractors Limited (ATL) case, privatization was not opposed even though the buyer (Sipani Automobiles Limited) had made it clear that while preference would be given to the ATL employees, it would employ only as many workers as it considered necessary. One may ask how such an outcome was managed. The answer lies in the fact that once it became evident that it would not be possible to operate ATL profitably, the Government of Uttar Pradesh (GOUP) decided to close the plant, retrench all of its about 1,230 employees and pay them compensation and benefits, totalling about Rs. 50 million, that they were entitled to, and it was only after all this had been done that the GOUP started exploring the options, including that of privatization, available to it, rather than exploring the privatization option while continuing to operate the plant (Bajaj 1994).

5. Where Do We Go From Here?

One may argue that although the progress on the privatization front so far has not been very encouraging, the momentum will pick up as time goes on, given the incentives for privatization that will result from a couple of pressures that are building up. First, the screw of budgetary support to finance public enterprise investments and losses is gradually being tightened -- witness, for example, the developments on the IISCO front. This reflects India's public finance situation which continues to be bad. "There is", as Little (1996) has put it, "a time-bomb ticking away, since borrowing is at unsustainable high levels. India is heading for another crisis."

Second, the mechanisms which earlier served to protect public enterprises from the workings of competitive markets now stand eliminated to a large extent and as a consequence public enterprises are experiencing difficulties in responding to the new environment -- witness, for example, the exodus of qualified people from Bharat Electricals Limited, National Thermal Power Corporation, Indian

Airlines, and so on. This, combined with the gradual hardening of the budget as also the reforms in the financial sector, may have the effect of substantially weakening the public enterprise employees' opposition to privatization -- indeed, some of them may even start openly demanding privatization.

While I do see a lot of merit in this argument, I believe that it will not be in India's interests to just wait for the above two pressures to work themselves out and thereby create the incentives for privatization.

I believe that something more needs to be done -- something that may make privatization happen in India before India is driven to the wall. I believe that a major initiative for turning India toward privatization needs to be launched. Its work programme will have four components, with the first component guided by the urgency of building and strengthening a constituency for privatization in India. This will be considerably aided by the widest possible dissemination of information about the various benefits -- benefits not just on the public finance front, but on the efficiency and other fronts as well -- that properly designed and implemented privatisations may bring to the Indian people. The people will have to be convinced that, given the extremely high opportunity costs, India cannot afford public sector misadventures in areas (e.g., running hotels, manufacturing polyester film, making condoms, and producing fruit pulp and juice) that properly belong to the private sector.

The second component of the work programme will address the issue of formulating a privatization policy for India. This is important, for once the necessary climate conducive for privatization has been created, it will be highly desirable to follow this up, as soon as possible, with the announcement of a properly structured and articulated privatization policy. The policy will need to clearly address at least the following issues: why privatize?; what to privatize? (India cannot afford to limit its privatization programme to certain sick public enterprises only; most of the other public enterprises (sick as well as non-sick) also will have to be privatized); when to privatize?; which organization will serve as the nodal agency for privatization and what will be its composition, powers and responsibilities?; what are the institutional mechanisms that will be put in place to gain public enterprise employees' support for privatization?; and what is the role that India would like foreign investors to play in its privatization programme?

The third component of the work programme will address the issue of capacity building for managing privatisations in India. Privatization is a difficult process: it involves reconciling the government's political objectives and the business needs of a given public enterprise with the need to interest private investors in the enterprise and to generate efficiencies (Donaldson 1995). It will therefore be absolutely necessary to come up with training programs designed to equip selected public enterprise managers and government officials in India with the knowledge and skills required for managing the various components of the privatization process.

Finally, the proposed initiative will address the issue of evaluating India's post-privatization experiences. This will involve rigorous work on estimating the impact of privatization on efficiency and investment, on public finances and balance of payments, on employment, on management practices and strategies, and on managers' skills, attitudes and behavior. Evaluations of post-privatization experiences along these lines may generate ideas which may help India maximize the gains from privatization.

<u>Notes</u>

Officials of Coal India Limited (CIL), a GO1 enterprise, are reported to have said that, under the national coal wage agreement, CIL is obliged to provide employment to the dependents of workers, irrespective of the vacancies, after the death of a worker while in service and after the termination of service of a worker on medical grounds after the age of 58. As a result of these provisions, CIL had to provide employment to over 62,000 people who are redundant (The Times of India 1995e). Available information suggests substantial overstaffing in many other public enterprises as well. A recent study (Banerji and Sabot 1994, cited in The World Bank 1995) reveals overstaffing of the order of 19-80% in telecommunications, 91% in Bombay Port (container section), and of more than 33 % in steel, chemicals and textiles.

2 Even this figure of 47.2% understates the GOI's true interest liability as interest payments are calculated on a cash basis rather than on an accrual basis.

3 At least 100 senior personnel from Bharat Heavy Electricals Limited, a GO1 enterprise, are reported to have jumped the fence to join its MNC competitor, Asea Brown Boveri (The Times of India 1995b). Similarly, National Thermal Power Corporation, another GO1 enterprise, is facing an exodus of its top brass (The Economic Times 1995d).

The Air India, a GO1 enterprise, is reported to have sought the Ministry of Civil Aviation's "final clearance" for chartering an aircraft for a wedding in the air (The Times of India 1994a) -- why couldn't the Air India's management decide the matter on its own? Then, HMT Limited, another GO1 enterprise, is reported to have sought the government's permission to file suits against TUSRC of Iran to recover expenditure incurred and damages for failing to honor the contractual obligations; it has also sought the government's approval to file a suit against a customer in Africa for overdue amounts against supplies (The Economic Times 1995b) -- why couldn't the HMT management take decisions on the issues involved on its own and go ahead with their implementation, without seeking the government's permission/approval?

5 The proceeds from the sale of public enterprises should be treated as a financing (below-the-line) item, not as a receipt (above-the-line) item. A major advantage of such a treatment is that it eliminates all possible incentives to reduce a given public sector deficit with no or relatively small fiscal correction (Gupta 1993; also see Gupta and Levy 1993; and United Nations Development Program 1993).

6 This subsection draws heavily on material in Bajaj (1994).

7 Of the remaining 124 cases of public enterprises registered with the BIFR, 26 were dismissed as non-maintainable, 29 were approved for revival, and 69 were pending for disposal.

8 The sale value of 76 % equity of ACC Babcock amounted to $16.5 million (EPW Research

Foundation 1995), that of 5 1% equity of Haryana Breweries Limited to Rs. 75 million (The Economic Times 1994b) and that of 74 % equity of Auto Tractors Limited to Rs. 55.5 million (Bajaj 1994).

The death of nine workers in the wake of transfer of the UP State Cement Corporation Limited's (UPSCCL's) management to Dalmia Industries added a new dimension to the issue. The Bharatiya Janata Party (BJP) took this up as one of the election issues and announced that it will scuttle the UPSCCL's privatization if it came to power. The BJP won the elections and accordingly the agreement with Dalmia Industries was canceled. If the elections were held sometime later, things probably would have been different.

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