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Abstract:

This paper examines various causes for privatisation in India. Five major dimensions--which are changes in international and domestic politics, performance of public sector undertakings, magnitude of fiscal compulsion and external debt, external pressure of the donors, and inherent efficiency of private sector companies--were taken for the study to find out whether or not there have been sufficient existence of reasons to substantiate the privatisation programme in the country. The analyses and discussions prove that there are viable reasons for the government why they implemented the privatisation and why they want to continue the same in the country. The paper calls for further research on comparative performance of enterprises in their pre-privatisation and post-privatisation era in order to significantly substantiate the reasons for privatisation in the country.

I. INTRODUCTION

Privatisation (1) has been adopted across the world as a part of structural adjustment programme as well as a measure towards greater involvement of the private sector in the growth process. It can, thus, be said that privatisation in broad terms encompasses involvement of greater market forces to ensure higher competition, and to reduce the role of the state in the economic sphere, and thus to bring in greater private involvement into government activities. In its strict sense, privatisation refers to transfer of ownership from state to private entity. It may be a sale or transfer of the majority portion of the shares in a public enterprise to a private entity. The major motive behind privatisation is to ensure greater efficiency in the system as a whole. In some countries, privatisation has also emerged because of the lack of political will to bring about reforms in the public sector.

Privatisation as a part and parcel of economic reforms seems to be a new phenomenon to many Indians despite its induction into our economic stream in the beginning of the 1990s. India dominated the Asian region, selling forty-seven companies for USD 17 billion between 1991 and 2002 ((Ahluwalia, 2002). Indian Petrochemicals Corporation Ltd. was amongst the first Public Sector Undertakings (PSUs) to make an initial public after the announcement of the Structural Adjustment Reforms in June 1991. The country foresaw its effect for 2003-04 which would provide the exchequer for USD2.9 billion as revenues from privatisation.

Having been implemented for one and a half decade, the privatisation programme is found to be a strong economic measure thanks to a firm belief of many economists that economic reforms would not become complete in the absence of privatisation. As a result, the governments since 1991 have implemented the programme on case-by-case basis within their limits in spite of lots of controversies. Most of the controversies erupted from a section of people who in deed doubt the necessity and claims for privatisation. Hence, the attempts are made to examine the hypothetical statement: "Is the Policy of Privatisation justified for India?"--may also be a research question to be answered.

The data was collected from the economic indicators and reports of the Asian Development Bank (ADB), World Bank, Disinvestment Commission and Reserve Bank of India. The data used for this study ranges between 1980-81 and 2005-2006. The paper is divided into four sections: Next section examines the magnitude of Indian privatisation; in section three, the analyses and discussions on causes are made, and the last section concludes the paper with some remarks.

AdChoices

II. MAGNITUDE OF PRIVATISATION IN INDIA

Privatisation policy emerged in India as a result of the Industrial Policy announced in 1991. The then government decided to disinvest up to 20 per cent of its equity in selected PSUs in favour of mutual funds and financial or investment institutions in the public sector. The Industrial Policy Statement of the Government of India (1991) holds that "in the case of selected enterprises, part of Government holdings in the equity share capital of these enterprises will be disinvested in order to provide further market discipline to the performance of public enterprises". The discussions and recommendation of high empowered committees such as Arjun Sengupta Committee (1984), Abid Hussain Working Group(1989), Standing Committee of Government Secretaries (1990) and Rangarajan Committee (1993) were considered as strong inputs and pre-requisites to privatisation. At the helm of privatisation programme, a Disinvestment Commission was set up in 1996 which subsequently made recommendations for privatising 58 PSUs through a shift from public offerings to strategic/trade sales with transfer of management. Eventually the country privatised about one hundred and twenty six enterprises over 1991/92-2004/05. Data set for the Indian privatisation is summarised in Table 1.

Table 1 reveals that the total amount realised through privatisation proceeds was USD7,860 million which fluctuated extremely between zero value and USD 1,495 million over the study period, 1991/92-2003/04. The programme started with forty six maidentransactions, contributed USD1,172 million in 1991/92 fiscal year. The volume of privatisation proceeds went down to USD627 million and zero transaction respectively for 1992/93 and 1993/94. On an average, the government disinvested nine PSUs for USD601 million every year.

Table 1 also shows the privatisation magnitude, which is calculated in terms of privatisation proceeds in per cent to Gross Domestic Product (GDP), is taken for this study in order to measure the size of privatisation. The annual average of magnitude accounted for 0.15 per cent over the study period. The magnitude in none of fiscal years crossed even one per cent, exhibiting its meagre size. The highest magnitude of privatisation was found in 1994/95 with 0.5 per cent, whereas, the lowest recorded for 1993/94 with zero magnitude, followed by 0.02 per cent in 1995/96. Not only is the magnitude, there has been failure in realisation against the target which was only 28.3 per cent (GoI, 2006).

III. CAUSAL ANALYSIS

Almost in all cases of privatisation in the developing countries, the reasons (causes) are crystal clear: (a) the change of political thought and economic shift towards free market economic model in the 1980s (b) higher fiscal pressure on governments (high budgetary deficit, large domestic public debt, and large external debt), (c) higher dependency on loans from international organizations (WB and IMF), (d) a large share of PSUs in total investment, (e) poor performance of PSUs in production and profitability, and (f) unstable and insignificant growth. These causes are the main syndromes for privatisation of PSUs in LDCs. Many studies have proved that privatisation occurs in countries with higher financial problems, such as large budgetary deficit and external debt in per cent of GDP.

In the Indian context, privatisation is conceived as an important ingredient of the transformation from a command to a market oriented economy aftermath of Soviet collapse; for alleviation of problems such as managerial inefficiency and poor performance of PSUs; for reduction of alarming budget deficit and external debt; for the benefit of inherent advantages of private sector. It is also said that Government of India(GoE) keeping these objectives in mind adopted privatisation as an immediate reform measure to redress the economy being affected from ill-syndromes. The forthcoming causal analysis, therefore, attempts to examine whether or not the privatisation in India is in need and indeed.

Cause 1: Pressure from Political Changes

The 1960s and 1970s were decades of unprecedented economic nationalism, a growing role for state interventions in the economy and experimentation with variants of socialism and self-reliance. Comprehensive development planning was widespread, and the prevailing model of development through out much of Latin America, Asia and Africa emerged then as a variant form of state interventionmodel which was largely inward-oriented import-substitution industrialisation. It was also socially re-distributive, at least in rhetoric. Hence, these countries were contemplating to take steps either to make PSUs as profit earned ones or simply privatise them.

In the 1980s and 1990s, by contrast, there have been major changes in the political economy of these countries. Two trends have been evident. First, a wave of democratic revolutions swept the world. In country after country, totalitarian governments collapsed, to be replaced by democratically elected governments that were typically more committed to free market capitalism than their predecessors had been. The change was most dramatic in Eastern Europe, where the collapse of Communism brought an end to the Cold War and led to the break-up of the Soviet Union, but similar changes were occurring through out the world during the same period. Second, there has been a strong move away from centrally planned and mixed economies, and toward more of a free market economic model (Hill, 1997: 62-3). India is the best example of this fashion brought to the mixed economy after the collapse of Soviet Union, and now has gradually been stepped to a free market economic model since 1990.

Not only is the external factors, there have been strong waves for structural adjustment within the economy since the embarking of liberalisation policy in 1991. The government led by the Indian National Congress (INC) made headway to privatisation programme. But, against the plan, a little was done owing to a lot of resistance from the communist parties. In 1999, a collation of National Democratic Alliance (NDA) government led by the Bharathia Janata Party (BJP) came up with better vision on the programme and made an impressive record in privatisation (Dastidar et al., 2006:4). The 2004 general election brought again the INC-led government, the United Progressive Alliance(UPA) supported by the Communist parties. The communist waves in then government put down the BSE index by six per cent the following day of the convincing victory of the coalition which reflected the concern about the economic policies of the UPA likely to be influenced by the communists. After senior members of INC reassured the market on future reforms and the relatively reformist Dr. Manmohan Singh was announced as Prime Minister on May, 18, the market surged by nine per cent over the next two days, However, the data provided in Table 2 reveals the INC's inability to make impressive record on privatisation compared to BJP led-NDA government. This evidence supports the notion that the role of electoral turnover is a potential influencer or threat to privatisation.

Another significant barrier to privatisation stems from the often volatile politics in countries attempting to implement large scale privatisation. The reasons are many but the most obvious and clear one is the multi-party system. The critics are nobody, but the leaders within the government hails from different political background--seem to be ridiculous and funny despite they have common minimum programmes. The tussle and heated debate between Congress Party and Communists along with other regional parties on the issues of privatisation and economic reforms is a regular phenomenon turned out to be day-to-day events in mass media. Union Minister for Railway, Mr. Lalu Prasad Yadav, a key political partner in the UPA government, comments, "Privatisation is not a solution for everything. I don't agree with this. We have allowed limited private participation in the railways and this would be done in future too" (The Hindu, 2006). Let alone the inter-party conflicts, there existed an intra-party confrontation between the Ministry of Petroleum and Disinvestment Commission in the previous National Democratic Alliance(NDA) government which hindered commission to go ahead with the privatisation initiatives of Oil and refinery. The political occurrences of such types, no doubt, havoc confidence of investors in particular and investment climate of the country in general. Perotti (1995) also agrees that the multi party variant coupled with a varied manifesto is considered a threat to investors. No matter whether the government is led by BJP or INC, it can be understood that there is no halt for privatisation programme thanks to their pro-reforms policies.

Cause 2: Performance of Public Sector Undertakings

Not only is the political trend, there is also inefficiency in PSUs resulted in drainage of capital, excessive burden of debt. These syndromes subsequently weaken the government's exchequer that makes a great necessity for economic reforms including privatisation. Public Sector Undertakings all around the world performed poorly, in spite of their relative monopolistic competitive advantage. Capacity utilisation was poor, labour productivity was low and overall profitability was insignificant. What worse is the fact that their inefficiency affected the respective economies as a whole because of their forward and backward linkages. Sastry (1988) says,

"They all got vexed up with the non-performance of these state owned enterprises and started demanding improved quality of life from their respective governments".

Shirley (1995) added to this fact that in Egypt, Peru, Senegal, and Turkey a mere five per cent reduction in PSU operating costs would reduce fiscal deficit by about one third. PSUs often capture a disproportionate share of credit, squeezing out private-sector borrowing. In Bangladesh, PSUs take about one-fifth of the domestic credit, although PSUs output accounts for less than three per cent of GDP. In many developing countries, PSUs absorb large amounts of funds that could be better spent on basic social services. In Tanzania, central government subsidies to PSUs equal 72 per cent of central spending on education and 150 per cent of central government spending on health.

Public Sector has become a force in India since the industrial policy revolution of 1948 and 1956. In the beginning of 1950s, the PSUs accounted for five in number with investment of Rs.290 million. The picture looked entirely different in 2000 when the PSUs surged to a total of 240 with investments of USD53.74 (GoI, 2003). Over the time, the central government experienced grave financial constraints owing to the continuous losses of most of the PSUs. As per the report of the Department of disinvestment (2003), nearly a half of the PSUs owned by the central government were loss making. The public sector's profit by the 1980s was consistently falling short of the levels projected in successive plan exercises. Many public sector enterprises were making large losses while a few only were marginally profitable. The only enterprises making substantial profits were those in the petroleum sector. Excluding these profits, the rest of the public sector taken together was making a net loss (Ahluwalia, 2002).

The reasons for failure of these PSUs are so clear from various empirical evidences. Mukherjee and Sachdeva (2003); Kaur (2004) & Gupta (2001) agree that the bureaucratic ways of managing business, lethargy towards modernisation and innovation, lack of professionalisms, unwanted intervention of government and politicians, and still worse the first-degree corruption vested in these enterprises are the causes for turmoil of PSUs. The interest in privatisation stems from both the belief and experiences that privatisation eliminates or at least minimises these inherent obstacles of PSUs. Privatisation is also aimed at enhancing competition and efficiency figured prominently in the initiatives launched to reform PSUs in the country (Kaur, 2003). From the social perspective, public funds spent on the weak PSUs at regular intervals could have been utilised for the poor may not be over looked.

Cause 3: Fiscal Deficit and External Debt

One of the major problems facing Indian economy is the large fiscal deficit and surging external debt. Feldstein (2004) in his Memorial Lecture for the Reserve Bank of India viewed the same and accepted the severity of problems with worrying figures. Budget deficit is considered as a perennial problem which affects all segments of a society, particularly tax payers. The pressures are not only from the stakeholders within the country but also from outside. IMF often calls on India to reduce budget deficit and insists the country to hold the deficit at 10 per cent including the losses of PSUs (AsiaPulse News, 2004).

Empirical evidences from many developing countries show that privatisation is one of the structural adjustment programme used for minimizing fiscal problems. Many governments have used privatisation to mitigate such crisis through the sales proceeds of PSUs. It has been observed across the world that from 1979 to 1998 over 60 national governments raised USD500 billion through about 600 separate public sales of stock in PSUs, which helped them to settle their fiscal crisis (Megginson, 1998). Garnering revenues from privatisation can also be used to retire government debts and improve the government's finances in the medium term. It is well known from the latest observations of statistics that many governments have noticed their debt cutting down on the account of privatising their PSUs. Some Latin American governments raised large sum from privatisation transactions, up to 15 per cent of total annual revenue (Young, 1998). World Bank (1997) recommends privatisation in the view that it boosts the foreign investor involvement.

Table 3 provides the data about fiscal deficit and external debt between pre-privatisation and post privatisation of the country. The arrived results of fiscal deficits and external debt are found to be in favour of the cause why the country initiated the privatisation programme in the country. The gross fiscal deficit coupled with the balance of payment crisis in the 1980s was an alarming symptom where the bankrupt economy found it difficult to finance unviable PSUs. The immediate alternative was privatisation. Privatisation is one of the current wave of changes seem to reflect the considered views of the Arjun Sen Gupta Committee, which in turn coincide with the current thinking of the World Bank and the IMF in regard to public sector reforms (Ratnam, 1998).

The fiscal deficit and debt to GDP declined from 7.44 per cent to 5.53 per cent and 6.77 per cent to 3.7 per cent respectively over the period taken for comparison. There was a substantial reduction in the gross fiscal deficit and external debt in the post privatisation segment. The result is not a surprised one because it is found to be consistent with the statements of many economists like Srinivasan (2000) who advocates privatisation as an option for such fiscal rectitude.

Cause 4: Pressure of External Agencies

Privatisation has been critically debated for more than two decades in the context of a measure forced by the West or the International Financial Institutions such as the World Bank and IMF. World Bank (1995) contains strong evidence for having privatisation as an important feature in the Bank's adjustment lending from the mid-1980s. This reflected both the concurrent ideological shift in favour of private ownership as well as the Bank's long, and painful experience with failed attempt in reforming PSUs. Indeed, more African countries undertook privatisation in an effort to assuage donor fears over domestic reform commitment than their ideological or economic conviction (Mugerwa-Kayizzi, 2002).

Abu Shair (1997: 86-7) states in his empirical literature that privatisation is an invention of the industrialised countries. Bayliss (2000:1-14) reveals in her study that the World Bank has played a key role in the implementation of privatisation in low-income countries attaching privatisation to aid disbursements and promoting a pro-privatisation culture. It is also widely observed that those economies, which are highly indebted, have been directed to adopt privatisation as one of the structural adjustment programme. Furthermore, in recent years, donors and multinational agencies have made privatisation a key conditionality.

India is no exception to this conditionality as the external debt has been a chronic worry for many decades. It is also found that the magnitude of burden was much severe in the 1980s (Table 3). The moderate pro-privatisation politics coupled with the pressure of these external agencies have been a great role in divesting the PSUs in the country.

Cause 5: Inherent Strengths of Private Sector

Over the past couple of decades, economists' preferences have been shifted to private over public ownership, motivated by a large body of the theoretical and empirical work exhibiting the inefficiencies stemming from the state ownership. The growing need toward privatisation is so fast, and has been accelerated by the fact that the private sector's net long-term resource to developing countries in 2001 was USD160 billion, which was almost a three-fold increase as compared to 1991, but official flow accounted for USD36.5 billion showing only a two fold increase as compared to 1991 (Keefe, 2003). This was a surprise trend within a decade.

Furthermore, the inherent efficiency of private enterprises cannot be underestimated. The pattern at which they work in the competitive environment with their unique features of management autonomy, market intelligence system, technology adoption, customer relationship management, quality consciousness and employee and compensation management is a basic account why they are naturally better than PSUs.

Table 4 shows the performance of private sector companies selected on a random basis. They were robust in performance as theirs' net sales recorded not less than USD2 Billion. The weighted average of operating profit and net profit ratio regardless the type of organisation was found to be significantly huge indicating these companies' ability to operate the business with sufficient success. The net profit ratio shows their remarkable performance exhibiting the earnings left for shareholders (both equity and preference). The foregoing evidence reveals the emergence of private sector companies in making success stories to which the economic reforms have been enormously supportive. Many agree with this fact. Narayana Murthy (2006), the mentor of Infosys Technologies, accepts that the economic reforms of 1991 were the most important turning point in the history of Infosys. According to him, his organisation grew from the net sale of USD1.3 Million in 1992 to USD2.15 Billion in 2006, a 1000 bold inherence. Such figures and phenomena are the robust evidences for the government to substantiate its stand on the transition to private-enterprise economy.

IV. CONCLUSION

The change in the international political and economic scenario, particularly break-up of the Soviet and emergence of globalisation paved a road for the privatisation programme in the country as a pursuit of economic reforms. Not only are the changes in international politics and economics across the globe, but also the pro-privatisation ideas in the mind of the key politicians ruled the country for the past sixteen years whether it is INC-led or BJP-led government. The other important cause for the programme owes to the fiscal compulsion and alarming increase of external debt as well as to the factor of inefficiency found in most of the public sector undertakings despite the advantage of their monopolistic environment on the product or service they provide. Most of the public sector enterprises in the country were unable to generate the minimum resources to renovate and upgrade their produces processes and plants resulting in their technology obsolete. This phenomenon cautioned the economists, and even made appeal to the commonsense of bureaucrats and politicians in the country that the public sector may not survive without special support from government budgets and financial aid.

External pressure from donor agencies cannot be ignored as the country's indebtedness to the World Bank and IMF is found to be high. It can be said that heavier the debt from these agencies, unavoidable is their pressure to implement their programmes and ideologies. The country has had no option, but to implement the privatisation. Nonetheless, the concept of operational efficiency of private sector companies at the market led economies may not be maximized in the country unless and otherwise the PSUs, ideally weak ones, are transformed into private ones. Privatisation is one of the structural adjustment tools by which such transformation is possible. It is, therefore, concluded that there have been sufficient reasons for the adoption and continuity of the privatisation programme in the country. This study recommends further research on the comparative performance of enterprises in their pre-privatisation and post-privatisation era which may in fact substantiate to great extent the reasons for privatisation in the country.

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Note

(1.) Most people use the word privatisation more broadly to include corporatisation, commercialisation and disinvestment. The term "disinvestment" is popular and widely used in India substituting the term, privatisation.

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Table 1

Privatisation Magnitude, 1991-92 - 2004-05

Year	PSUs Offered	Privatisation Proceeds (PP) (USD Million)	GDP * (USD Million)	PP / GDP (In Per centage)
1991/92	46	1,172.08	315,966.06	0.37
1992/93	29	627.4	281,797.31	0.22
1993/94	0	0.0	294,341.73	0.0
1994/95	17	1,495.53	301,822.05	0.5
1995/96	4	47.42	301,270.11	0.02
1996/97	1	104.93	307,133.02	0.03
1997/98	1	219.58	286,476.00	0.08
1998/99	3	1,247.33	454,900.14	0.27
1999/00	4	406.99	453,248.78	0.09
2000/01	4	396.27	454,418.31	0.09
2001/02	9	1,158.61	457,169.31	0.25
2002/03	5	719.54	577,150.23	0.12
2003/04	3	219.11	576,235.66	0.04
2004/05	NA **	534.24	643,582.77	0.08
1991/92-2004/05 (Annual Average)	9.69	559.76	407,536.53	0.15

Note: GDP at constant factor; **Not available

Source: GoE (2005) & ADB(2006)

Table 2

Privatisation Magnitude Under Political Changes, 1991/92-2004/05

Years	Party	PP (Annual Average in USD Million)	Privatisation Magnitude (PP / GDP) In Per centage
1991/92-1999/00	INC led-Government	523.85	0.18
1999/00-2003/04	BJP-led NDA Government	785.75	0.21
2003/04-2004/05	INC led-UPA Government	376.68	0.09

Source: GoI (2005) & ADB(2006)

Table 3
Deficit and Debt Between Pre-privatisation and Post Privatisation Period (Annual Average Growth in Percentage)

Variables	Pre-privatisation (1980-81-1990-91)	Post-Privatisation Period (1991-92-2004-05)

Gross Fiscal Deficit 7.44	5.43	
External Debt to GDP	6.77	3.7

Source: Asian Development Bank (2006).

Table 4
Performance of Private Sector Companies, 2005-2006

S. No.	Enterprises	Rank*	Net Sales (in Billion-USD)	Operating Profit (in Billion USD)
1	Reliance Enterprise	2	18.18	3.5 (19.25)
2	TATA Motors	8	5.34	0.72 (13.48)
3	TATA Steel	9	4.59	1.48 (32.24)
4	Larsen & Toubro	11	3.75	0.52 (13.87)
5	TCS	14	3.00	0.86 (28.67)
6	Sterlite IND	15	2.98	0.91 (30.54)
7	Adani Enterprises	16	2.80	0.13 (4.64)
8	BhartiAirtel	19	2.63	0.91 (34.60)
9	Hindustan Level	20	2.61	0.39 (14.94)
10	Infosys Technologies	27	2.15	0.72 (33.49)
	Weighted Average		4.8	1.01 (22.57)

S. No.	Enterprises	Net Profit (in Billion USD)
1	Reliance Enterprise	2.1 (11.55)
2	TATA Motors	0.38 (7.12)
3	TATA Steel	0.84 (18.30)
4	Larsen & Toubro	0.29 (7.73)
5	TCS	0.68 (22.67)
6	Sterlite IND	0.39 (13.09)
7	Adani Enterprises	0.05 (1.79)
8	BhartiAirtel	0.45 (17.11)
9	Hindustan Level	0.32 (12.26)
10	Infosys Technologies	0.57 (26.51)
	Weighted Average	0.61 (13.81)

Note: *Business Standard Ranking based on their consolidated net

sales
Figures in Parentheses indicate Operating Profit & Net Profit ratio
which is converted into per centage

Source: Business Standard, December, 2006