

TABLE 31.3. Average Annual Growth Rate of Industrial Production (Use Based) in Pre-Reform and Post-Reform Decade

<i>Use Based or Functional Classification</i>	<i>1980-81 to 1991-92*</i>	<i>Eighth Plan* 1992-93 to 1996-97</i>	<i>Ninth Plan* 1997-98 to 2001-02</i>	<i>Tenth Plan* 2002-03 to 2006-07</i>	<i>2005-06</i>	<i>2006-07</i>
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1. Basic Goods	7.4	6.8	4.1	6.6	6.7	10.3
2. Capital Goods	9.4	8.9	4.7	14.4	15.7	18.2
3. Intermediate Goods	4.9	8.5	5.8	6.2	2.5	12.0
4. Consumer Goods	6.0	6.6	5.5	9.6	12.0	10.1
(i) Durables	10.8	13.4	10.7	8.8	15.3	9.2
(ii) Non-durables	5.3	4.8	3.8	10.0	11.0	10.4
General Index	7.8	7.4	5.0	8.2	8.2	11.5

\*Simple average of the annual growth rates.

**Source:** (i) For column (2), Government of India, *Economic Survey*, 2000-01, Box 7.1. p. 130; (ii) For column (3) Reserve Bank of India, *Handbook of Statistics on Indian Economy*, 2000, 199, p. 409, and (iii) For all other columns, (4) Government of India, *Economic Survey*, 2004-05, Table 7.2, p. 142 and (iv) Reserve Bank of India, *Handbook of Statistics on Indian Economy*, 2006-07 (Mumbai, 2007), Table 237, p. 606 and Table 238, p. 607.

2. As is clear from Table 31.3, the rate of growth of industrial production in the Eighth Plan was 7.4 per cent per annum which was the same as the targeted rate of growth. Thus the performance was satisfactory on this count.

3. The rate of growth of industrial production in the Ninth Plan was only 5.0 per cent per annum which was considerably less than the targeted rate of 8.2 per cent per annum. Thus, the performance of the industrial sector was highly unsatisfactory during the period of the second half of 1990s.

4. The industrial sector registered a dismal performance in the last year of the Ninth Plan, 2001-02, with its rate of growth being just 2.7 per cent. This is the worst performance of the industrial sector over the entire decade 1992-93 to 2001-02 excepting the year 1992-93 when the rate of industrial growth was 2.3 per cent.

5. The post-reform period (upto the end of Ninth Plan, i.e. the year 2001-02) was marked by considerable fluctuations and thus showed a total lack of consistency in industrial growth performance. This would be clear from the following facts :

- (i) The rate of growth of industrial production was only 2.3 per cent in 1992-93. It rose to 6.0 per cent in 1993-94. The rate of growth shot up to as much as 13.0 per cent in 1995-96 (highest during the decade) but fell to 6.1 per cent in the very next year 1996-97. The rate of growth of industrial production was just 2.7 per cent in 2001-02.
- (ii) The capital goods sector registered a negative growth of -4.1 per cent in 1993-94 but a strong positive growth of 24.8 per cent in 1994-95. In 1998-99 it again registered a strong positive growth of 12.6 per cent but a very weak positive growth of 1.8 per cent in 2000-01. In 2001-02, it returned a negative growth of - 3.4 per cent.
- (iii) The basic goods sector registered a strong positive growth of 10.8 per cent in 1995-96. However, in the very next year, this rate of growth fell to 3.0 per cent. In 1997-98, the rate of growth rose to 6.9 per cent but fell to only 1.6 per cent in 1998-99.
- (iv) The rate of growth in the intermediate goods sector rose from 5.3 per cent in 1994-95 to 19.4 per cent in 1995-96 but slipped to 8.1 per cent in 1996-97. In 2001-02, the rate of growth was only 1.5 per cent.
- (v) The consumer durables goods sector recorded a massive growth of 25.8 per cent in 1995-96 (highest in the post-reform period). However, this slipped to only 4.6 per cent in the very next year 1996-97. In 2001-02 the rate of growth was 11.5 per cent.

The above examples of yearly growth rates during the post-reform period (upto the end of the Ninth Plan) show that the different sectors registered marked upheavals over the years. Thus, there was a total lack of consistency in industrial growth performance which caused great uncertainty and instability in the economy.

**Causes of Unsatisfactory Industrial Performance in 1990s.** The main causes for unsatisfactory performance of the industrial sector during the period of 1990s are as follows :

**1. Exposure to external competition.** According to the Planning Commission, the most important reason for lower growth rate during the Eighth Plan period as compared to the Seventh Plan period seems to be that “the industrial sector, which had been almost totally protected from both industrial as well as external competition during the previous four decades, was suddenly exposed to foreign competition through a significant liberalisation of imports and drastic reduction in import duties. The industry was hardly prepared for it and the slow-down was only to be expected....”<sup>14</sup>

**2. Slowdown in investment.** An important reason for the slow-down of industrial growth in 1990s was the slow-down of investment. It is a known fact that capital formation in the public and private sectors provides a stimulus for industrial growth in the form of both the direct demand or purchases that such expenditures involves, and the indirect demand resulting from income generation by investments. However, consequent upon the adoption of the ‘macro-economic adjustment’ programme of the IMF in 1991, the Government of India was forced to cut down public expenditure drastically. In physical terms, the decline in public investment is perhaps best captured in the precipitous fall in the growth of electricity generation capacity from 8-10 per cent in the 1980s to 4-6 per cent in the 1990s.<sup>15</sup> Since there is a strong complementarity between public investment and private investment, a reduction in the rate of growth of real public investment had a depressing effect on private investment as well.

**3. The infrastructural constraints.** Perhaps the most important reason for unsatisfactory performance of the industrial sector has been the deteriorating state of infrastructure. Industrial production has suffered not only on account of inadequate availability of infrastructure like power and transportation bottlenecks, inadequate handling facilities at ports etc., but also due to ‘poor quality’ of infrastructure like frequent and unscheduled power breakdowns, poor road conditions, unduly long handling time at ports etc. All these factors added to the real costs of manufacture and thus adversely affected the competitiveness of domestic industry.

**4. Difficulties in obtaining funds for expansion.** Orderly development of capital market is an important condition for industrial growth because in its absence, the private sector capitalists will face difficulties in raising resources for expansion. The period since 1991 has witnessed two stock market scams — one in 1992 and the other in March-April 2001. These scams seriously eroded investor confidence. Subscriptions to IPOs (initial public offerings) fell drastically leading to a setback to the ‘primary market.’ Trading in stock exchanges (*i.e.*, ‘secondary market’) also fell. Because of this, capitalists found it difficult to raise resources from the capital market for funding their expansion plans. The performance of financial institutions like IFCI (Industrial Finance Corporation of India Ltd.), IDBI (Industrial Development Bank of India Ltd.), etc. has been worrisome as non-performing assets (NPAs) have become quite large. Thus the flow of funds from the financial institutions to the corporate sector was also not adequate.

**5. Sluggish growth in exports.** In a number of years during 1990s, exports grew at a very low rate. This was due to increasing competition in the international market on the one hand and inability of domestic industry to meet external competition by ensuring quality products, keeping to delivery schedule etc. on the other hand. The outbreak of the East-Asian crisis in mid-1997 compounded the problems for Indian exporters as there was a sharp depreciation in the external value of the currencies of this region. This made Indian exports uncompetitive in international markets as against the exports from countries belonging to the East-Asian region.

**6. Anomalies in tariff structure.** According to the Ninth Five Year Plan, there were anomalies in tariff structure leading to large-scale imports of second-hand machinery, basic materials and intermediate products. This adversely affected industrial growth in these sectors. In the case of fertiliser sector and refineries, while the finished capital goods enjoyed ‘zero’ rate of import duty, the domestic manufacturers were subject to taxes and duties and import duties on intermediates and components.<sup>16</sup>

**7. Contraction in consumer demand.** There was acute contraction in consumer demand in 1990s. Three distinct explanations can be offered to explain this contraction.<sup>17</sup> *First*, the rural purchasing power was severely affected by lower agricultural growth and increased fluctuations in growth in the 1990s. *Secondly*, Indian industry was faced with depressed purchasing power not only from the rural sector but also from the urban sector. The substantial wealth erosion caused by the fall in the equities and real estate markets also hampered the average urban consumer’s proclivity to spend. *Finally*, there were distinct signs of growing inequalities in the distribution of income, and in the face of reduced employment growth as well as deterioration in the quality of employment, purchasing power in the hands of the vast masses of urban population possibly declined.

**The Period of Tenth Plan (2002-03 to 2006-07).** The period of the Tenth Plan has witnessed revival of

industrial growth. The rate of growth of industrial production was 5.7 per cent in 2002-03 (the first year of the Tenth Plan) and picked up considerably to 7.0 per cent in 2003-04, 8.4 per cent in 2004-05, 8.2 per cent in 2005-06 and to as high as 11.5 per cent in 2006-07. For the Plan as a whole, the average rate of growth of industrial production comes out to be 8.2 per cent per annum. Though it is less than the targeted rate of growth, yet it marks a considerable increase over earlier plans (excepting the Third Plan). In fact, *the rate of growth in industrial production at 11.5 per cent in the last year of the Plan, 2006-07, is the highest growth achieved since 1995-96 (13.1 per cent)*. Growth in this year was driven mainly by the manufacturing sector, which contributed 91.1 per cent to the industrial growth. "The growth of the manufacturing sector at 12.5 per cent in 2006-07 was the highest since 1995-96 (14.1 per cent). The 'machinery and equipments', 'basic metal and alloy industries', and 'chemicals and chemical products' groups remained the main drivers of growth, contributing almost 50 per cent to the manufacturing growth. At the two digit level classification, 16 out of 17 manufacturing industry groups registered positive growth during the year."<sup>18</sup>

*What is significant from the point of view of economic growth is the marked acceleration registered by the capital goods sector.* The rate of growth of this sector has averaged 14.4 per cent per annum over the Tenth Plan period and was as high as 18.2 per cent in the last year of the Plan, 2006-07. The continued robust expansion of the capital goods sector facilitated substantial capacity additions across a number of industries (see Box 31.1).

### BOX 31.1. Capacity Addition in Indian Industry : Role of the Capital Goods Sector

In view of strengthening of growth in the manufacturing sector since 2002-03, the capacity utilisation has remained high. This is being exhibited in the double-digit growth in the domestic production of

capital goods and robust growth in the import of capital goods (Table A). Growth in imports of capital goods has also been boosted by the phased reduction/rationalisation of import tariffs.

TABLE A : Select Indicators of Industrial Performance

Category	(Growth rates in per cent)					
	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
1	2	3	4	5	6	7
1. IIP*	2.8	5.8	7.0	8.4	8.2	11.5
2. Capital goods production	-3.4	10.5	13.6	13.9	15.8	18.2
3. Machinery and Equipment	1.3	1.6	15.8	19.8	11.9	12.8
4. Capital goods imports	10.5	36.6	35.4	37.5	49.9	40.6
5. Project under implementation	10.6	-1.4	5.4	13.5	12.2	54.2
6. Project addition	7.6	-5.6	-0.8	29.2	44.2	51.0
7. IEM**	-24.4	13.8	91.7	87.0	32.0	80.9

\*IIP : Index of Industrial Production; \*\* IEM : Industrial Entrepreneurs Memoranda.

Some of the capital goods such as metals, machine tools, and machinery, among others, have witnessed strong growth both in terms of domestic production and imports. For example, production of textile machinery increased by 50.3 per cent in 2005-06 and by 35.8 per cent in 2006-07. Production of material handling equipment in these two years increased by as much as 90.0 per cent and 115.5 per cent respectively. Imports of machinery (except electrical and electronics) rose by 46.8 per cent in 2005-06 and by 38.4 per cent in 2006-07. Imports of machine tools rose by as much as 79.4 per cent and 39.3 per cent respectively in those two years.

*Capital goods are durables, which are used as accessories, equipments, plant and machinery in industrial sectors for production (directly or indirectly) as well as for rendering various services.* Broadly, these comprise industrial machinery, electrical and non-electrical machinery, machine tools, automobiles, construction equipment and plant equipments, which have witnessed robust performance in recent years that supports the ongoing capacity expansions. Other indicators such as the cost of projects announced, number of proposed projects and the projects under implementation

also point towards increased investment expenditure on adding new capacities. The capacity addition is well diversified across most sectors of the industry. In terms of cost of projects which are under implementation, the manufacturing sector constitutes a major component followed by electricity, services and construction sectors. Within the manufacturing sector, metal and metal products, machinery and chemicals are amongst the major industries that have recorded robust growth in capital expenditure.

The robust performance of the capital goods sector in the current cycle is in contrast with the previous period of strong industrial growth witnessed during 1993-96 when the sector did not play a significant role. *The ongoing trend in capital goods production, growing imports and increasing capital expenditure by corporates highlight the new capacity addition, which are expected to further strengthen the growth performance of the Indian manufacturing sector.*

Source : Reserve Bank of India, Annual Report 2006-07 (Mumbai, September 2007), Box 1.6, p. 24.

### ■■■■ INDUSTRIAL DIVERSIFICATION — CHANGES IN INDUSTRIAL STRUCTURE DURING THE PLANNING PERIOD ■■■■

The process of industrial growth in India has been accompanied by substantial diversification. Thus the structure (or pattern) of industrial growth has seen marked changes. Important changes are as follows:

**1. Increase in the share of industrial sector in GDP.** The share of the industrial sector in Gross Domestic Product has slowly but consistently increased over the planning period. For instance, the share of industry (includes manufacturing, construction, electricity, gas and water supply) in GDP at factor cost increased from 13.6 per cent in 1950-51 to 22.0 per cent in 1980-81 and further to 24.6 per cent in 2006-07 (at 1999-2000 period).

**2. Growth of infrastructure industries.** Modern industrial development is not possible without a substantial expansion of the infrastructure industries. The latter include (i) electricity, (ii) coal, (iii) steel (iv) crude petroleum, (v) petroleum refinery throughout and (vi) cement. These infrastructure industries have a weight of 26.7 in total industrial output (1993-94 = 100). Electricity or power is one of the major sources of commercial energy and plays a crucial role in industrial development. On account of this reason, it has been developed on a considerable scale in India during the last five decades. From 5.1 billion KWH in 1950-51, electricity generated rose to 662 billion KWH in 2006-07. The production of coal rose from 32.3 million tonnes in 1950-51 to 425 million tonnes in 2006-07. The production of crude petroleum which was only 0.3 million tonnes in 1950-51 rose to 34.0 million tonnes in 2006-07. The production of finished steel (including secondary producers) rose from 1.04 million tonnes in 1950-51 to 6.82 million tonnes in 1980-81 and further to 50.6 million tonnes in 2006-07. The production of cement which was only 2.7 million tonnes in 1950-51 rose to as much as 161.3 million tonnes in 2006-07.

**3. Building up of heavy and capital goods industries.** As noted earlier, the Second Plan based on the Mahalanobis model gave pride of place to the development of heavy machine building industries and capital goods industries with a view to strengthening the industrial base of the economy. Heavy investments have since taken place in this sector with the result that the industrial base of the economy is now much stronger than it was in 1950-51. A wide range of engineering goods, iron and steel, metals and metal based products, etc. are now produced within the country itself and dependence on the other countries has considerably declined.

**4. A well diversified industrial structure.** In the early 1950s, just four industries (food products, textiles, wood and furniture, and basic metals) accounted for *two-thirds* of production. However, their share has now declined considerably while the share of machinery sector (comprising electrical and non-electrical machinery), chemicals, transport equipment sector, etc. has risen at a fast rate. Thus, the country now has a well diversified industrial structure.

**5. Rapid growth of consumer durables.** Due to the policy of liberalisation pursued with great vigour by the government in recent years, the output of consumer durable goods has expanded at a fast pace. During 1981-85, the rate of growth of this segment was 14.4 per cent per annum which rose further to 16.9 per cent per annum during 1985-90. After a brief setback in 1991-92 and 1992-93, the consumer durables sector again bounced back. In fact, as is clear from Table 31.3, this sector recorded the highest rate of growth among all industrial groups (based on functional classification) in the Eighth and Ninth Five Year Plan periods (13.4 per cent per annum in the Eighth Plan and 10.7 per cent per annum in the Ninth Plan).

**6. Emphasis on chemicals, petrochemicals and allied industries in the 1980s.** Whereas the fastest growing sector in the earlier period was the industrial group comprising of basic metal, metal products and machinery (both electrical and non-electrical), the role of prime movers during 1980s was taken over by the chemicals, petrochemicals and allied industries. As a result, metal based products and machinery industries lost their primacy in industrial growth during 1980s.

**7. Emergence of public sector.** There was no public sector worth the name in the pre-Independence period. The entire range of activities in the industrial sector was controlled by the private sector. The post-Independence period saw the emergence and massive expansion of public sector. The number of central public sector units at the commencement of the First Plan was only 5 with a total capital of only Rs. 29 crore. The number of operating central public sector enterprises shot up to 230 in 2003-04 with a total capital employed of Rs. 4,52,250 crore — a tremendous expansion by all means. Public sector enterprises play a pivotal role in the production of fuels, basic metal industries, non-ferrous metal industries, fertilisers, communication equipment, etc.

## Changes in Industrial Structure in 1990s

Important changes have occurred in the industrial structure during the period of 1990s and some of them are the direct result of the policy of liberalisation being pursued vigorously by the Government of India since 1991. The main changes are as follows:<sup>19</sup>

**1. Shifts in favour of consumer goods and intermediate goods.** The structure of the industrial economy has shifted distinctly in favour of intermediates and consumer goods and reflects declining significance of basic and capital goods in the country's industrial economy. This would be clear from the fact that while the weight of basic goods and capital goods declined from 39.4 and 16.4 in the old index (base 1980-81 = 100) respectively to 35.6 and 9.3 in the new index (base 1993-94 = 100) respectively, the weight of intermediate goods and consumer goods increased from 20.5 and 23.6 in the old index respectively to 26.5 and 28.7 in the new index respectively.

**2. Structural changes within basic industries and capital goods industries.** At a somewhat disaggregated level, within the basic industries, it is primarily basic metals and alloys that have lost severely in terms of weight (from 9.80 in the old index to 7.45 in the new index), while most capital goods have suffered weight loss in more or less uniform manner.

**3. Changes within intermediate goods sector.** The gain in weight in the case of intermediates has been largely on account of chemicals and chemical products whose weight rose from 4.00 in the old index to 14.00 in the new index. On the other hand, the weightage of rubber, plastic, petroleum and coal products declined from 12.51 in the old index to 5.73 in the new index.

**4. Changes within the consumer goods sector.** In addition to a substantial gain in weightage in the overall index of industrial production, the consumer goods sector has witnessed remarkable changes internally. For instance, the weightage of the consumer durables sub-sector has increased by more than 100 per cent (from 2.6 in the old index to 5.4 in the new index). This is the direct result of the 'opening up' of the industrial economy. Growth in this sub-sector has been supported by easy financing facilities being extended by a number of finance companies for the purchase of consumer durables. Another point worth noting is that there has been a significant gain in the importance of food products industry (with its weight rising from 5.33 in the old index to 9.08 in the new index) and beverages, tobacco and tobacco products industry (with its weight rising from 1.57 to 2.38) at the cost of the traditional cotton textiles industry whose weight fell drastically from 12.31 in the old index to 5.52 in the new index.

**5. Declining role of public sector.** With increasing emphasis on liberalisation and privatisation, the Government of India is gradually withdrawing from the industrial sector. As noted in the chapter on 'Industrial Policy,' the Industrial Policy, 1991, has considerably de-regulated the industrial economy and industrial licensing has been practically abolished. The number of industries reserved for the public sector has been drastically pruned and the government has explicitly expressed its desire to bring down its equity in all non-strategic public sector undertakings to 26 per cent or lower, and to close down public sector units that cannot be revived. The emphasis of the government is now on privatisation of public sector enterprises via disinvestment.

The above analysis clearly brings out that the focus of the government in recent years has been on privatisation and consumer goods' led industrial growth. In fact, in view of the increasing thrust on encouragement to development of consumerism (via steps such as cutting down taxes and duties on consumer goods on the one hand, and reducing incentives to save by cutting down interest rates on the other hand), the government has made its intention clear to rely more and more on the consumer goods sector for the future growth of the industrial sector in the economy.

## ■■■■■ SOME PROBLEMS OF INDUSTRIAL DEVELOPMENT IN INDIA ■■■■■

**1. Gaps between targets and achievements.** Excepting the period of the 1980s when targets of overall growth in industrial sector were achieved, in the entire earlier period of planning, achievements were below the targets. It has been estimated that *the average shortfall in industrial achievement has been about 20 per cent in each plan period during the pre-liberalisation phase*. Commenting on the experience of industrial development in the pre-1991 period, Rakesh Mohan has observed, "The average industrial growth rate achieved over thirty-five to forty years has been about 6.2 per cent relative to the average of about 8.0 per cent projected. On an approximate basis, also accounting for higher associated growth in the primary and tertiary sectors, this would come to about 1.2 to 1.4 per cent lower annual growth in the per capita GNP on a cumulative basis over thirty-five to forty years. If at current prices, the per capita Indian income is around US \$ 300, it would have been about US \$ 500-550 had these consistent shortfalls in industrial and other growth not taken place."<sup>20</sup>

**2. Under-utilisation of capacity.** A large number of industries suffer from substantial under-utilization of capacity. Because of the difficulties in defining "capacity" there are vast differences in estimates of under-utilization of capacity in Indian industries. The estimates vary from 20-30 per cent to 60-70 per cent. However, it can be safely assumed that the average level of utilization in a number of industries in India fluctuates around 50 to 60 per cent. The causes of this state of affairs are multifarious and range from technical to raw material shortages, frequent power failures, governmental policies, labour disputes and demand factor etc.

**3. Performance of public sector.** We have noted earlier in this chapter the phenomenal growth of public sector in the planning period. However, the performance of public sector enterprises has raised many eyebrows. Undoubtedly, the performance of the public sector units cannot be judged by the yardstick of profits since their justification lies in fulfilling certain broader socio-economic objectives. But accumulation of large losses in the public sector units is indeed a serious matter and calls for immediate corrective action. The unremunerative pricing policies which these enterprises have been forced to follow have amounted to indirect subsidization of the private sector. Thus private profits have expanded at the cost of the public exchequer.

**4. Infrastructural constraints.** One of the major constraints in industrial development is poor quality and high cost of infrastructure particularly power and transport network. As far as power is concerned, share of coal in total energy consumption is 55 per cent while that of oil is one-third. Supply of coal is less than demand and this has an adverse impact on the power situation. For example, as against the requirement of 338 million tonnes in 2005-06, the availability was of 317 million tonnes. Non-availability of the desired level of coal resulted in generation loss of 1,512 million units during 2004-05. As far as gas is concerned, the country's requirements of gas (at 90 per cent Plant Load Factor) was 49.7 million cubic metres per day (mcmd). As against this, only 30.7 mcmd (which was only 62 per cent of demand) was supplied. Shortage in gas availability is estimated to have resulted in a generation loss of almost 35 billion units per annum, on average, during 2004-05.<sup>21</sup> As far as transport network is concerned, it also suffers from severe capacity and quality constraints. India has currently no inter-State expressways linking the major economic centres, and only 3,000 kilometres of four lane highways (China has built 25,000 kilometres of four-to-six-lane, access controlled highways in the last 10 years). Poor riding quality and congestion result in truck and bus speeds on Indian highways that average 30-40 kilometres an hour, about half the expected average. India's high-density rail corridors also face severe capacity constraints compounded by poor maintenance.<sup>22</sup> All such infrastructural constraints not only adversely affect industrial growth but will also reduce the competitiveness of Indian industries in the new global economic environment that is fast emerging.

**5. Growth of regional imbalances.** Industrial development in India has remained concentrated in a few States while other States continue to lag far behind. For instance, the three industrially advanced States of the country — Maharashtra, Gujarat and Tamil Nadu — accounted for 39.5 per cent of the total factories, 45.2 per cent of invested capital and 44.7 per cent of the gross output of the industrial sector in India in 2003-04.<sup>23</sup> Since the processes of economic development are closely linked with the processes of industrial development, it would not be illogical to argue that the process of economic development has more or less bypassed a number of poor States.

Though substantial investments in public sector were made in the relatively backward States of Bihar, Orissa and Madhya Pradesh, the expected 'trickling-down effects' of development were in no way evident and large tracts of these States remained untouched by planning. Schemes for developing backward areas were no more successful. Capital subsidies, fiscal incentives and other measures initiated to develop industries in backward areas were directed towards developing the backward areas of developed States and the demands of backward States were glossed over. Effective steps to reverse this process are called for urgently.

**5. Industrial sickness.** A number of industries are plagued by 'sickness' which in some cases is due to bad and inefficient management. Also, as noted by the *Sixth Five Year Plan, 1980-85*, "the pattern of industrial development has not been sufficiently guided by cost considerations. In a regime of protection from international competition, industries have tended to get established at sub-optimal capacities, leading to a high cost industrial structure. Adequate attention has also not been given to improvements in technology and quality of products. Some of these factors have led to the emergence of sickness in certain industries particularly when market conditions tend to generate a measure of competition within the economy."<sup>24</sup> At the end of March 2003, there were 1.71 lakh sick industrial units involving an outstanding bank credit of Rs. 34,816 crore.

**6. Emerging challenges.** As a founder member of the World Trade Organisation (WTO), India has withdrawn all quantitative restrictions on imports. This is bound to result in intense competition with imports in coming years forcing a number of industrial units to close down. The 'pressure of competition' will be

particularly harsh on many small-scale units as they simply cannot withstand competition from resource rich and technologically advanced multinational companies. In fact, even our large private sector companies are just pygmies *vis-a-vis* MNCs and many of them also may find the going tough. As far as the basic goods and capital goods industries are concerned, they might receive a set-back as the end-use industries will now have full access to cheaper imports. Things will not be easy for the end-use industries as well as they will have to compete with foreign goods on both price and quality fronts.

#### ■■■■ NOTES ■■■■

1. Data on 'industry and minerals' considered in this chapter do not include the data on 'village and small scale industries' as this is the normal practice. The latter group of industries are dealt with in a separate chapter.
2. Government of India, *Economic Survey*, 2003-2004, (New Delhi, 2004), Statement 2.7, p. S-41.
3. *Ibid.*, Statement 2.9, p. S-43.
4. Government of India, Planning Commission, *Tenth Five Year Plan*, 2002-07 (New Delhi, 2003), Volume II, p. 665. Emphasis added.
6. S.L. Shetty, "Structural Retrogression in the Indian Economy since the Mid-Sixties", *Economic and Political Weekly*, Special Supplement, 1978, p. 8.
7. For the analysis of the causes of industrial retrogression the reader may refer to (i) Deepak Nayyar, "Industrial Development in India: Some Reflections on Growth and Stagnation," *Economic and Political Weekly*, Special Number 1978; (ii) Ashutosh Varshney, "Political Economy of Slow Industrial Growth in India," *Economic and Political Weekly*, September 1, 1984; (iii) Isher Judge Ahluwalia, *Industrial Growth in India—Stagnation since the Mid-Sixties* (Delhi: Oxford University Press, 1985); (iv) C. Rangarajan, "Industrial Growth: Another Look," *Economic and Political Weekly*, Annual Number 1982; and (v) R. Ramana, "Performance of Capital Goods Sector in India 1955-79," *Economic and Political Weekly*, Annual Number 1984.
8. Vijay L. Kelkar and Rajiv Kumar, "Industrial Growth in the Eighties," *Economic and Political Weekly*, January 27, 1990, p. 211.
9. Isher Judge Ahluwalia, *Productivity and Growth in Indian Manufacturing* (Delhi: Oxford University Press, 1991), p. 211.
10. R. Nagaraj, "Growth in Manufacturing since 1980: Some Preliminary Findings," *Economic and Political Weekly*, July 1, 1989, pp. 1482-3.
11. Isher Judge Ahluwalia, *op. cit.*, p. 92.
12. Sanjaya Baru, "Fiscal Liberalism and Industrial Growth," *The Economic Times*, September, 22, 1990.
13. R. Tharmarajakshi, "Intersectoral Terms of Trade Revisited," *Economic and Political Weekly*, March 31, 1990, Table 3, p.A. 50.
14. Government of India, *Ninth Five Year Plan 1997-2002* (New Delhi, 1999), Volume II, p. 589.
15. R. Nagaraj, "Industrial Policy and Performance since 1980. Which Way Now ?" *Economic and Political Weekly*, August 30, 2003, p. 3713.
16. *Ninth Five Year Plan*, *op. cit.*, p. 590.
17. S.L. Shetty, "Reviving the Economy: Some Explorations," *Economic and Political Weekly*, July 28, 2001, p. 2825.
18. Reserve Bank of India, *Annual Report, 2006-07* (Mumbai, September 2007), pp. 22-3.
19. T.K. Bhaumik, "A Decade of Structural Change," *The Economic Times*, April 17, 2000, p. 14.
20. Rakesh Mohan, "Industrial Policy and Controls," in Bimal Jalan (ed.), *The Indian Economy: Problems and Prospects* (New Delhi, revised edition 2004), p. 116.
21. Reserve Bank of India, *Annual Report 2006* (Mumbai, 2006), p. 115.
22. World Bank, *India: Sustaining Reforms, Reducing Poverty* (New Delhi, 2003), p. 69.
23. Tata Services Ltd. *Statistical Outline of India, 2006-07* (Mumbai, 2007), Table 163, p. 148.
24. Government of India, Planning Commission, *Sixth Five Year Plan, 1980-85*, p. 260.

# INDUSTRIES (DEVELOPMENT AND REGULATION) ACT, 1951 AND INDUSTRIAL LICENSING

## *Objectives of the Act*

### *Scope and Coverage of the Act*

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- Restrictive Provisions • Reformative Provisions

### *Central Advisory Council*

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- Functions of the Development Councils

### *Working of Industrial Licensing Policy*

- Licensing and Underutilisation of Capacity • Licencing and Concentration of Economic Power • Licensing and Regional Imbalances

### *Industrial Licensing Policy 1970 and After*

### *Abolition of Industrial Licensing*

Regulation of industrial development was considered necessary in India to ensure that such development takes place according to the plan priorities and objectives and in accordance with the directions laid down in the industrial policy resolutions. For this purpose, an Act was passed by the Parliament in October 1951. Known as the 'Industries (Development and Regulation) Act, 1951', this Act came into force on May 8, 1952. Though it aimed at both, development and regulation of private sector, it placed much more emphasis on the 'regulation' function over the years.

## ■■■■ OBJECTIVES OF THE ACT ■■■■

The objectives that the Industries (Development and Regulation) Act, 1951, sought to accomplish were as follows:

1. *The regulation of industrial investment and production according to plan priorities and targets.*
2. *Protection of small entrepreneurs against competition from large industries.*
3. *Prevention of monopoly and concentration of ownership of industries.*
4. *Balanced regional development with a view to reducing disparities in the levels of development of different regions of the economy.*

It was hoped that through the instrument of industrial licensing, the State would be able to (i) direct investment into the most important branches, (ii) correlate supply and demand in the domestic market, (iii) eliminate competition, and (iv) ensure the optimum utilisation of social capital.

## ■■■■ SCOPE AND COVERAGE OF THE ACT ■■■■

To fulfil the objectives stated above, the government assumed powers under the Act to issue licences for the establishment of new industries, for the expansion of old industries, production of new items by existing



industries, and for changing the location of an existing undertaking. The Act extended to the whole of India and its provisions applied to all "industrial undertakings" engaged in the production of any of the items included in the 'First Schedule' attached to the Act. The First Schedule consisted of 38 broad groups and each group was divided into a number of industries. The 38 groups of industries were as follows: (1) metallurgical industries, (2) fuels, (3) boilers and steam generating plants, (4) prime movers (other than electrical generators), (5) electrical equipment, (6) telecommunications, (7) transportation, (8) industrial machinery, (9) machine tools, (10) agricultural machinery, (11) earth-moving machinery, (12) miscellaneous mechanical and engineering industries, (13) commercial, office and household equipment, (14) medical and surgical appliances, (15) industrial instruments, (16) scientific instruments, (17) mathematical surveying and drawing instruments, (18) fertilisers, (19) chemicals (other than fertilisers), (20) photographic raw film and paper, (21) dye-stuffs, (22) drugs and pharmaceuticals, (23) textiles, (24) paper and pulp including paper products, (25) sugar, (26) fermentation industries, (27) food processing industries, (28) vegetable oils and vanaspati, (29) soaps, cosmetics and toilet preparations, (30) rubber goods, (31) leather, leather goods and pickers, (32) glue and gelatin, (33) glass, (34) ceramics, (35) cement and gypsum products, (36) timber products, (37) defence industries, and (38) miscellaneous industries (including cigarettes, linoleum, zip fasteners, oil stoves, and printing).

Only those industrial units or factories included in the above list were required to obtain industrial licence in which production was carried on—

- (i) With the aid of power, provided that fifty or more workers are working or were working thereon on any day of the preceding twelve months; or
- (ii) Without the aid of power, provided that one hundred or more workers are working or were working thereon on any day of the preceding twelve months and provided further that in no part of such premises any manufacturing process is being carried on with the aid of power.

#### ■■■■ PROVISIONS OF THE ACT ■■■■

The main provisions of the Industries (Development and Regulation) Act, 1951 can be divided into two categories: (1) Restrictive provisions, (2) Reformative provisions.

#### Restrictive Provisions

Under this category all measures designed to curb unfair practices adopted by industries were included. These provisions were divided into the following: (i) registration of existing industrial undertakings; (ii) licensing of new industrial undertakings; (iii) licence for producing or manufacturing new articles; (iv) investigation into scheduled industries or industrial undertakings; and (v) revocation and amendment of licences.

**Registration of existing undertakings.** Section 10 of the Act provided that undertakings of all those industries which are included in the First Schedule of the Act would have to be registered whether they come under the private sector or the public sector. On registration, the owner was issued a certificate of registration containing the productive capacity of the industrial undertakings and such other particulars as may be prescribed. While specifying the productive capacity in any certificate of registration, the Central Government was to take into account: (i) the productive or installed capacity as specified in the application for registration; (ii) the level of production immediately before the date on which the application for registration was made; (iii) the level of the highest annual production during the three years immediately preceding the introduction in Parliament of the Industries (Development and Regulation) Amendment Bill, 1973; (iv) the extent to which production during the said period was utilised for export; and (v) such other factors as the Central Government considered relevant including the extent of under-utilisation of capacity, if any, during the relevant period due to any cause.

**Licensing of new undertakings.** Section 11 of the Act required new industrial undertakings to obtain industrial licence. Such a licence or permission contained such conditions as the Central Government thought fit to impose in accordance with the rules made under Section 30 (pertaining to the power of or Central Government to make rules).

**Licence for producing or manufacturing new articles.** The owner of an individual undertaking registered under Section 10 or to whom licence had been granted under Section 11 was required not to produce or manufacture any new article unless (i) in the case of an individual undertaking registered under Section 10, he had obtained a licence for producing or manufacturing such new article; and (ii) in the case of an industrial undertaking in respect of which a licence or permission had been issued under Section 11, he had the existing licence or permission amended in the prescribed manner.

**Investigation into scheduled industries or industrial undertakings.** Section 15 empowered the Central Government to carry out investigation into any scheduled industry or industrial undertaking if (i) there had been a substantial fall in the volume of production of any article for which, having regard to the economic conditions prevailing, there was no justification; or (ii) there had been (or is likely to be) a marked deterioration in the quality of any article which could have been avoided; or (iii) there had been a rise in the price of the product produced by the industry, for which there was no justification; or (iv) it was necessary to take action for the purpose of conserving any resources of national importance. The Central Government could also carry out investigation if any industrial undertaking was being managed in a manner highly detrimental to the scheduled industry concerned or to public interest.

**Revocation and amendment of licences in certain cases.** If the Central Government felt that any person or authority to whom or to which, a licence had been issued under Section 11 had, without reasonable cause failed to establish or to take effective steps to establish the new industrial undertaking in respect of which the licence had been issued within the time specified therefor, it could revoke the licence. The Central Government was also empowered under the Act to vary or amend any licence issued under Section 11.

### Reformative Provisions

In this category, following provisions were included: (i) direct management or control of industrial undertakings by the government; (ii) management or control of industrial undertakings owned by companies in liquidation; (iii) control on supply, distribution, price, etc. of certain articles; and (iv) setting up of Development Councils.

**Direct management or control of industrial undertakings by the government.** Section 18A of the Act empowered the Central Government to take over the management of an industrial undertaking in the following cases: (i) if an individual undertaking to which directions had been issued in pursuance of Section 16<sup>1</sup> had failed to comply with such directions, or (ii) an industrial undertaking in respect of which an investigation had been made under Section 15 was being managed in a manner highly detrimental to the scheduled industry concerned or to public interest. The Central Government was empowered by notified order, to authorise any person or body of persons to take over the management of the whole or any part of the undertaking. Any such notified order was to have effect for such period not exceeding five years as may be specified in the order. Section 18AA empowered the Central Government to take over industrial undertaking without investigation under certain circumstances.

**Management or control of industrial undertakings owned by companies in liquidation.** According to Section 18FA, if the Central Government carried the opinion that there were possibilities of running or re-starting an industrial undertaking, in relation to which an investigation had been made under Section 15, and that such industrial undertakings should be run or re-started, as the case may be, for maintaining or increasing the production, supply or distribution of articles (or class of articles relating to the scheduled industry) needed by the general public, it could make an application to the High Court praying for permission to take over the management of the industrial undertaking (or to assign specified functions to such person or body of persons as indicated in the application).

**Control on supply, distribution, prices etc., of certain articles.** Section 18G of the Act empowered the Central Government to regulate, by notified order, the supply and distribution of any article or class of articles relating to any scheduled industry in order to ensure its equitable distribution and availability at fair prices. The notified order could provide for: (i) controlling the prices at which any such article or class thereof may be bought or sold; (ii) regulating by licences, permits or otherwise the distribution, transport, disposal, acquisition, possession, use or consumption of any such article or class thereof; (iii) prohibiting or withholding from sale of any such article or class thereof ordinarily kept for sale; (iv) requiring any person manufacturing, producing or holding in stock any such article or class thereof to sell the whole or part of the articles to such person or class of persons and in such circumstances as may be specified in the order; (v) regulating or prohibiting any class of commercial or financial transactions relating to such article or class thereof which was likely to be detrimental to public interest; (vi) requiring persons engaged in the distribution and trade and commerce in any such article or class thereof to mark and notify the price and total quantities of any such articles in stock; (vii) collecting any information or statistics with a view to regulating or prohibiting any of aforesaid matters; and (viii) any incidental or supplementary matters, including, in particular, the grant of issue of licences, permits or other documents and the charging of fees therefor.

**Setting up of Development Councils.** Chapter II of the Act dealt with the setting up of the Central

Advisory Council and Development Councils. Section 6 of the Act provided that the Central Government may, by notified order, establish for any scheduled industry or group of scheduled industries, a body of persons to be called a Development Council which could help in increasing the efficiency or productivity in the scheduled industry or group of scheduled industries, improve or develop the service that such industry or group of industries render (or could render) to the community or enable such industry or group of industries to render such service more economically. Development Councils are discussed in a separate section after the following discussion on the Central Advisory Council.

#### ■■■■ CENTRAL ADVISORY COUNCIL ■■■■

Section 5 (Chapter II) of the Act provided that the Central Government may, by notified order, set up a Council to be called the Central Advisory Council for the purpose of advising it on matters concerning the development and regulation of scheduled industries. The Central Advisory Council was to consist of a Chairman and such other members not exceeding thirty in number, all of whom were to be appointed by the Central Government from among persons who, in its opinion, were capable of representing the interest of (i) owners of industrial undertakings in scheduled industries; (ii) persons employed in industrial undertakings in scheduled industries; (iii) consumers of goods manufactured or produced by scheduled industries; and (iv) such other class of persons including primary producers, as in the opinion of the Central Government, ought to be represented on the Advisory Council. Section 5 stated that the Central Government shall consult the Advisory Council in regard to the making of any rules and in regard to any other matter connected with the administration of Act in respect of which the Central Government may consider it necessary to obtain the advice of the Advisory Council.

#### ■■■■ DEVELOPMENT COUNCILS ■■■■

Section 6 (Chapter II) provided that the Central Government may, by notified order, establish for any scheduled industry or group of scheduled industries, a body of persons to be called a Development Council which shall consist of members who in the opinion of the Central Government were: (i) persons capable of representing the interests of owners of industrial undertakings in the scheduled industries or group of scheduled industries; (ii) persons having special knowledge of matters relating to the technical or other aspects of the scheduled industry or group of scheduled industries; (iii) persons capable of representing the interests of persons employed in industrial undertakings in the scheduled industry or group of scheduled industries; (iv) persons not belonging to any of the aforesaid categories, who were capable of representing the interests of consumers of goods manufactured or produced by the scheduled industry or group of scheduled industries.

#### **Functions of the Development Councils**

'The Second Schedule' appended to the Act listed the following 16 functions that could be assigned to the Development Councils :

1. Recommending targets for production, co-ordinating production programmes and reviewing progress from time to time.
2. Suggesting norms of efficiency with a view to eliminating waste, obtaining maximum production, improving quality and reducing costs.
3. Recommending measures for securing the fuller utilisation of the installed capacity and for improving the working of the industry, particularly of the less efficient units.
4. Promoting arrangements for better marketing and helping in the devising of a system for distribution and sale of the produce of the industry which would be satisfactory to the consumer.
5. Promoting standardisation of products.
6. Assisting in the distribution of controlled materials and promoting arrangements for obtaining materials for the industry.
7. Promoting or undertaking enquiry as to materials and equipment and as to methods of production, management and labour utilisation, including the discovery and development of new materials, equipment and methods and of improvements in those already in use, the assessment of the advantage of different alternatives and the conduct of experimental establishments and of tests on a commercial scale.
8. Promoting the training of persons engaged or proposing engagement in the industry and their education in technical or artistic subjects relevant thereto.

9. Promoting the retraining in alternative occupations of personnel engaged in or retrenched from the industry.
10. Promoting or undertaking scientific and industrial research, research into matters affecting industrial psychology and research into matters relating to production and to the consumption or use of goods and services supplied by the industry.
11. Promoting improvements and standardisation of accounting costing methods and practice.
12. Promoting or undertaking the collection and formulation of statistics.
13. Investigating possibilities of decentralising stages and processes of production with a view to encouraging the growth of allied small-scale and cottage industries.
14. Promoting adoption of measures for increasing the productivity of labour, including measures for securing safer and better working conditions and the provision and improvement of amenities and incentives for workers.
15. Advising on any matters relating to the industry (other than remuneration and conditions of employment) as to which the Central Government may request the Development Council to advise and undertaking enquiries for the purpose of enabling the Development Council so to advise.
16. Undertaking arrangements for making available to the industry information obtained and for advising on matters with which the Development Councils are concerned in the exercise of any of their functions.

#### ■■■■ WORKING OF INDUSTRIAL LICENSING POLICY ■■■■

The actual operation of the industrial licensing policy in India has been a subject of much debate and criticism. The Licensing Committee worked in a very haphazard and ad hoc manner and there were no definite criteria adopted for acceptance or rejection of applications. This lack of explicit economic criteria was accompanied by the generally poor quality of techno-economic examinations conducted by the Directorate General of Technical Development (DGTD) which also took an unnecessarily long time for disposing of cases and submitting its recommendations to the Licensing Committee. These procedural criticisms apart, a general impression has been formed that the operations of the licensing policy led to (i) underutilization of capacity in some industries; (ii) expansion of large houses contributing to the process of concentration of wealth and economic power; (iii) accentuation of regional imbalances; (iv) dissipation of resources because though the power of granting licences could be used (and was used) to restrict entry into the industries where capacity creation target was fulfilled, there was no power to guide resources into other desired directions; and (v) promotion of inefficient enterprises in certain cases because the licences were granted on the basis of 'first come first served' and not on the basis of efficiency in production.

Because of these allegations, the government was led to constitute a Monopolies Enquiry Commission in April 1964 and in 1965, Dr. R.K. Hazari was asked to review the working of the Industries Act, 1951. Another Committee was appointed in July 1967 under the chairmanship of Dr. Subimal Dutt. The Committee submitted its report in July 1969.

**1. Licensing and underutilization of capacity.** Licensing was supposed to ensure creation of capacities according to plan priorities and targets. However, no clear priorities for private sector were laid down in plans and therefore the private sector chose those industries which appeared more profitable. In many cases these industries happened to be luxury industries and frequently they also satisfied the technical curiosity of the DGTD and were, therefore, granted licenses in defiance of the needs of essential industries producing commodities for mass consumption.

The grant of licence to an enterprise was no guarantee that the production capacity permitted would actually be installed. The government had the right to take away a licence only several years later. Because of this fact, capacity created, in some cases, was less than allowed. Many industries (especially those belonging to the large monopoly houses) indulged in such practices to restrict output and raise prices. Since the government had no guarantee that the licensed capacity would actually be installed within the stipulated time, it adopted the practice of granting licences for capacities far in excess of the plan targets, from the end of the Second Plan. In those cases where actual implementation was larger than expected (as, for example, in the case of paper industry, cement industry and ceramic production) a sizable unutilized capacity appeared. In some cases overlicensing of an industry deterred the licencees from implementing their full licensed capacities for fear of excessive capacity creation in the industry. As a consequence of this, industries over-licensed in the Third Plan were marked by under fulfilment of capacity.

**2. Licensing and concentration of economic power.** As noted by Aurobindo Ghose, in India: "It is

industrial licensing which limits the areas of private investment and also determines entry into specific industries. The total volume of licensable private investment is normally (though not always) fixed in relation to the Plan target of private investment in industry. This generally holds true of licensing in particular industries also; i.e. in correspondence with Plan targets of capacity in specific industries. In such a situation, oligopolistic rivalry proceeds principally through competition for investment opportunities at the state of entry into the industry itself."<sup>2</sup> This explains the behaviour of the large industrial houses in India who sought *pre-emption of investment opportunities through acquiring as much industrial licences as possible thereby ensuring an increasing share of new capacities created on the one hand, and one the other hand, keeping out potential rivals*. Since a major objective of the Industries (Development and Regulation) Act was the prevention of monopoly and concentration of the ownership of industries, it was expected to foil this attempt of the large industrial houses. However, as all Enquiry Committees have noted, the operation of licensing policy actually helped the large houses in achieving their ends in a number of ways. As noted by Dutt Committee, the licensing authorities many times used their discretionary powers in favour of the large houses. This "has been revealed through their different practices, e.g., their early intimation of impending licensing to an applicant, inadequate scrutiny and/or expeditious disposal of licence applications, 'on file decisions' without going through the Licensing Committee, reversal of earlier decisions, etc."

**3. Discretionary powers of licensing authorities.** In his study published in 2001, Martinussen pointed out that *because of the considerable discretionary powers vested in the regulatory agencies, the whole system tended to promote corruption, rent-seeking and discrimination based on personalistic relationships*.<sup>3</sup> In this context, Martinussen emphasised two features of the formal bureaucratic institutions functioning in India: *First*, "although separated from the rest of society by effective socialisation processes and specific rules which govern their behaviour, government officials often remain loyal to outside social networks. They are inclined in general to favour members of their own social network."<sup>4</sup> *Second*, "the individual government official at higher levels of the hierarchy is vested with considerable discretionary powers in his discharging of administrative functions. This has increased the scope for outside influence and for discrimination based on personalistic relationships."<sup>5</sup>

Because of the loyalty to outside social networks and personalistic relationships, a strong nexus between high government officials and managers of large industrial houses has emerged in this country. As a result, the actual functioning of the industrial approval system in India has favoured large industrial houses. Newcomers and smaller enterprises could rarely exploit personalistic relationships with the government officials and were therefore left out. Thus the industrial approval system impeded entry of new promoters and entrepreneurs, contrary to official objectives.

**4. Licensing and regional imbalances.** One of the avowed objectives of industrial licensing policy was the reduction in regional inequalities and imbalances. However, *the actual operation of this policy has accomplished just the opposite — it tended to increase regional inequalities*. As noted by the Dutt Committee, the four industrially advanced States of Maharashtra, Gujarat, West Bengal and Tamil Nadu benefited the most from the operation of this policy. For example, in the decade 1955-56, these four industrially advanced States accounted for 59.3 per cent of the applications and 62.42 per cent of the licences approved. On the other hand, the poor States of Bihar, Orissa, Uttar Pradesh and Madhya Pradesh received only 15.5 per cent of total licences approved. These trends continued in later years also. For instance, during the thirteen years period 1979 to 1992, the four industrially advanced States of Maharashtra, Gujarat, Tamil Nadu and West Bengal received 46.4 per cent of total licences issued whereas the combined share of Bihar, Orissa, Madhya Pradesh and Uttar Pradesh was only 16.2 per cent.<sup>6</sup>

**5. Delays in processing of applications.** Two developments added significantly to the burden on both the regulatory authorities and the private entrepreneurs. On the one hand, the coverage and degree of detail of the regulations was increased significantly (for instance an amendment to the IDR Act in 1953 made it compulsory for companies to obtain a licence for the production of any 'new article' while in 1956 industrial activity and products were defined in much greater detail, thus adding to the number of permissions required), while on the other hand, industrial growth and diversification increased the scarcity of resources allocated administratively. The outcome was increasing delays in the processing of applications.<sup>7</sup> Moreover, the Licensing Committee worked in a very haphazard and ad hoc manner and there were no definite criteria adopted for acceptance or rejection of applications. This lack of explicit economic criteria was accompanied by the generally poor quality of techno-economic examinations conducted by the Directorate General of Technical Development (D.G.T.D.) which also took an unnecessarily long time for deposing of cases and submitting its recommendations to the Licensing Committee. All these factors impeded industrial growth.

### ■■■■ INDUSTRIAL LICENSING POLICY 1970 AND AFTER ■■■■

As discussed above, there were several flaws in the working of the Industrial Licensing Policy. Thus licensing policy had: (i) failed to operate in accordance with plan priorities; (ii) worked in favour of large houses; and (iii) accentuated regional disparities instead of reducing them. In addition, the Dutt Committee found that the industrial licensing policy had operated against the spirit of the Industrial Policy Resolution. For instance, not only were the existing oil refineries in the private sector allowed to continue their operations, fresh licences were issued to them for establishing new oil refining plants. Schedule 'B' had included those industries where licences could be granted to both sectors, public and private, but whose development in the public sector should proceed at a faster pace. However, majority of licences in this field were granted to the private sector. For example, in the machine tools industry while public sector received only 9 licences, private sector got 226 licences. Similar tendencies were operative in many other industries like aluminium, fertilisers, synthetic rubber, drugs, dyestuffs, etc.

In view of the criticisms, Dutt Committee proposed a number of measures to improve the licensing system. It advocated that there should be a *core sector* consisting of industries of basic nature and the industrial houses should be restricted to this sector only. This would check the infiltration and proliferation of large industrial houses in a large number of products and industries and limit them to a few areas of lumpy investment. The Committee also recommended the setting up of a joint sector. In the course of its investigations, it had discovered that whereas the growth of public sector was not accomplished to the extent envisaged in the 1956 Resolution due mainly to lack of funds, the growth of private sector was financed to a considerable extent from the funds drawn from public financial institutions or from government. Also, while substantial public funds were being used for private profits, the government or these institutions had no say in the management of such private sector enterprises. The Committee recommended that to ensure the management of aided projects in accordance with the overall policies laid down by the government, the government should take an "active part in direction and control" of these enterprises. This was the basic concept of joint sector as envisaged by the Committee. However, how the State would play an active part was left unspecified "except for the possibility of conversion of public loan into equity and the necessity of creation of a cadre of trained full time Public Directors."

On the basis of the recommendations of the Dutt Committee, the government announced a new Industrial Licensing Policy in February 1970. The main features of this policy were as under:

1. A *core sector* consisting of basic industries and industries catering to defence requirements or otherwise of national importance, was defined. It included industries divided into 9 sectors as follows: (1) agricultural inputs, (2) iron and steel, (3) non-ferrous metals, (4) petroleum, (5) coking coal, (6) heavy industrial machinery (specified), (7) ship-building and building of dredgers, (8) newsprint, and (9) electronics (selected components). Such of these industries which were reserved for the public sector in the 1956 Resolution were to remain reserved for it while in all others, large industrial houses and foreign companies were allowed to participate.

2. The 1970 Policy defined another sector known as the *heavy investment sector*. This consisted of industries involving investment of more than Rs. 5 crore. Excepting the industries reserved for the public sector in the 1956 Resolution, all other industries in this sector were to be opened to the private sector. This was a major concession to large houses and foreign companies whose role was sought to be limited to the core sector by the Dutt Committee. This concession enabled large houses to enter into a number of luxury industries.

3. Industries involving investment between Rs. 1 crore and Rs. 5 crore were included in the *middle sector*. For these industries, licensing policy was to be considerably liberalised and licensing procedures considerably simplified.

4. Industries involving investment of less than Rs. 1 crore were put in the unlicensed sector since their setting up was not to require any licence.

5. The 1970 Licensing Policy adopted, in principle, the concept of joint sector advocated by the Dutt Committee. It was laid down that while sanctioning loans or subscribing to debentures, public financial institutions should in future have the option to convert them into equity within a specified period of time. Some specific guidelines were laid down for the purpose. Once convertibility clause was agreed to, the undertaking was required to appoint representatives of the lending institutions on company board.

The next important Industrial Licensing Policy statement came on February 12, 1973. In this policy statement, the major change announced was the adoption of a new definition of 'large houses'. In the 1970 policy, large industrial houses had been defined as those having assets of more than Rs. 35 crore. The 1973

licensing policy adopted the definition used under the Monopolies and Restrictive Trade Practices (MRTP) Act according to which a large industrial house was that which had assets of more than Rs. 20 crore. Two recommendations of the 1970 policy were kept intact in the new policy—one pertaining to the exemption from licensing (the exemption limit was raised from Rs. 25 lakh to 1 crore in the 1970 policy) and the second pertaining to the joint sector. The 1973 policy expanded the scope of the core sector which was now to include 19 industry groups in place of 9 industries as provided in the 1970 policy.

Increase in the number of industry groups from 9 to 19 in the 1973 licensing policy was a major concession to the large industrial houses. The list was now wide enough to include practically every industry in which these houses were interested. In fact, it included “even low priority but highly profitable industries like man-made fibres and synthetic detergents”. The claim that the 1973 policy would ‘net in’ more large houses was also not justified. Though the minimum size of assets for qualifying as a large industrial house was reduced from Rs. 35 crore to Rs. 20 crore, the definition of business house was also changed from the one adopted previously (which defined business house as consisting of “those business concerns over which a common authority holds sway”) to the one adopted under the MRTP Act (which defined a business house in terms of a group of “inter-connected undertakings”). Because of the difficulty of establishing inter-connection and the vague and loose criteria provided in Section 2(g) of the MRTP Act for the purpose, the net of coverage, in fact, shrunk.<sup>8</sup> *In 1985-86, the assets limit for MRTP companies was raised to Rs. 100 crore.*

Next important policy statement came in March 1978. The new statement carried the process of liberalisation a step further. The exemption limit was increased from Rs. 1 crore to Rs. 3 crore. The exemption limit was subsequently raised to Rs. 5 crore. *In 1988-89, the exemption limit was raised further to Rs. 50 crore for backward areas and Rs. 15 crore for non-backward areas subject to certain restrictions.*

#### ■■■■ ABOLITION OF INDUSTRIAL LICENSING ■■■■

As stated in the chapter on ‘Industrial Policy’, the Government of India announced a New Industrial Policy on July 24, 1991. This policy aimed at liberalising the industrial economy considerably and, with this end in view, announced a series of initiatives in respect of industrial licensing, foreign investment and technology agreements, public sector, and MRTP Act. As far as industrial licensing is concerned, the new industrial policy abolished all industrial licensing, irrespective of the level of investment, except for certain industries related to security and strategic concerns, social reasons, concerns related to safety and over-riding environmental issues, manufacture of products of hazardous nature and articles of elitist consumption. The 1991 industrial policy listed 18 industries for which industrial licensing was to remain compulsory. These industries were as under—coal and lignite; petroleum (other than crude) and its distillation products; distillation and brewing of alcoholic drinks; sugar; animal fats and oils; cigars and cigarettes; asbestos and asbestos-based products; plywood and other wood based products; raw hides and skins, and leather; tanned or dressed furskin; motor cars; paper and newsprint; electronic aerospace and defence equipment; industrial explosives; hazardous chemicals; drugs and pharmaceuticals; entertainment electronics; and white goods (domestic refrigerators, washing machines, air conditioners, etc.). With the passage of time, most of these industries have been delicensed. As of now, *licensing is compulsory for only 5 industries. These are alcohol, cigarettes, hazardous chemicals, electronic aerospace and defence equipment, and industrial explosives.*

#### ■■■■ NOTES ■■■■

1. This section empowered the Central Government to issue directions (after carrying out investigation as provided for under Section 15) to the industrial undertaking to regulate the production of any article or articles. The Central Government could also issue directions to the industrial undertaking to take such steps as were necessary for the development of the industry, prohibit the undertaking from acts that could reduce production, control prices, regulate distribution etc.
2. Aurobindo Ghosh, “Investment Behaviour of Monopoly Houses—Economics of Pre-Emption”, *Economic and Political Weekly*, November 2, 1974, p. 1868.
3. John Degnbol-Martinussen, *Policies, Institutions and Industrial Development* (New Delhi, 2001), p. 89.
4. *Ibid.* p. 89.
5. *Ibid.* p. 89.
6. Computed from Government of India, *Hand Book of Industrial Statistics*, 1992. Table 77, pp. 194-5, and *Hand Book of Industrial Statistics*, 1993, Table 100, pp. 192-3.
7. John Degnbol - Martinussen, *op. cit.*, pp. 88-9.
8. A.N. Oza, “Curbing Concentration of Economic Power—A Critique of the New Licensing Policy”, *Economic and Political Weekly*, April 21, 1973.

# PUBLIC SECTOR IN THE INDIAN ECONOMY

## *Division of the Economy Into Public and Private Sectors*

### *Role of Public Sector In the Indian Economy*

#### *Performance of the Public Sector*

• Expansion of the Public Sector and its Share in National Production • The Question of Profitability • Employment and Labour Welfare • Public Sector and Foreign Exchange Earnings • The Question of Efficiency

#### *Problems of Public Sector Undertakings*

• Price Policy of Public Enterprises • Under-utilisation of Capacity • Problems Relating to Planning and Construction of Projects • Problems of Labour, Personnel and Management

#### *Control Over Public Enterprises*

• Committee on Public Undertakings • Bureau of Public Enterprises • The Question of Autonomy

#### *Public Sector Reforms*

• Dereservations • Policy Regarding Sick Units • Memorandum of Understanding • Policy for 'Navratnas' • Privatisation and Disinvestment • Setting up of BRPSE

The present Indian economic structure is often characterised as 'mixed economy'. There are two fields of production in this structure—the private sector and the public sector. The original concept of mixed economy in India envisaged a greater role for the public sector and this sector was designed to ultimately control the 'commanding heights' of the economy. However, in recent years (particularly since 1991) the emphasis has shifted to the more rapid development of the private sector and the privatisation of public sector enterprises.

The main questions that we propose to discuss in this chapter are as follows:

- What has been the role and performance of public sector in the Indian economy ?
- What problems are faced by public sector undertakings in India ?
- What changes have taken place in the approach towards the public sector in the reform phase (*i.e.* the period since 1991) ?

## ■■■■ DIVISION OF THE ECONOMY INTO PUBLIC AND PRIVATE SECTORS ■■■■

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



public sector, the entire agricultural sector (which is the largest sector of the economy) was left for the private sector.

The important point that arises at this juncture is—why were the heavy and basic industries like iron and steel, heavy engineering, heavy electrical plant, etc., selected for development in the public sector while quick-yielding consumer goods industries were left for the private sector? The answer to this question has been attempted by R.K. Hazari according to whom *the industrial programmes of government that emerged after 1955 were built around two hypotheses:*

- (i) *private investment in relatively small goods would be promoted by shutting out imports as well as through excess capacity at home, with a consequent boost to profits; and*
- (ii) *public investment, being autonomous of profits, would take place in basic areas which had long gestation periods, low or no profits, a large foreign exchange component, complex technology and equally complex problems of coordination.<sup>1</sup>*

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

### ■■■■■ ROLE OF PUBLIC SECTOR IN THE INDIAN ECONOMY ■■■■■

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

**1. Public sector and capital formation.** The role of public sector in collecting savings and investing them during the planning era has been very important. During the First and Second Plans, of the total investment, 54 per cent was in the public sector and the remaining in the private sector. The share of public sector rose to 60 per cent in the Third Plan but fell thereafter. However, even then it was as high as 45.7 per cent in the Seventh Plan. With increasing trends of liberalisation in 1990s, the share of public sector in total investment fell drastically to 34.3 per cent in the Eighth Plan (*ie.*, only *one-third*) and further to 29.5 per cent in the Ninth Plan. This reflects the increasing importance that is now being accorded to the private sector. The nationalized banks, State Bank of India, Industrial Development Bank of India, Industrial Finance Corporation of India, State Financial Corporations, LIC, UTI etc., have played an important role in collecting savings and mobilization of resources.

However, savings in the public sector itself are not much. In fact, there has been a precipitous fall in the share of public sector in gross domestic savings. During the period of Sixth Plan as a whole, public saving was 23.7 per cent of total domestic saving and this fell to 14.8 per cent during the period of the Seventh Plan and just 9.2 per cent in the Eighth Plan (at 1999-2000 prices).<sup>2</sup> During the first year of the Ninth Plan, 1997-98, share of public sector in total savings was just 7.5 per cent. Savings in the public sector were negative in all other years of the Ninth Plan. The first year of the Tenth Plan, *ie.*, 2002-03 also recorded negative savings in the public sector. However, things have distinctly improved since. In 2003-04, savings in the public sector were Rs. 31,822 crore which rose significantly to Rs. 74,682 crore in 2004-05 and Rs. 71,262 crore in 2005-06. The share of public sector in total savings was 3.9 per cent in 2003-04 which rose significantly to 7.7 per cent in 2004-05 and stood at 6.2 per cent in 2005-06. The share of public sector in gross domestic capital formation (GDCF) which was 50.8 per cent during Sixth Plan fell to 36.0 per cent during Eighth Plan. It is estimated to have declined further to 29.2 per cent in the Ninth Plan and 23.6 per cent during the first four years of the Tenth Plan (at 1999-2000 prices).<sup>3</sup>

**2. Development of infrastructure.** The primary condition of economic development in any underdeveloped country is that the infrastructure should develop at a rapid pace. Without a sufficient expansion of irrigation facilities and power and energy, one cannot even conceive of agricultural development. In the same way without an adequate development of transportation and communication facilities, fuel and energy, and basic and heavy industries, the process of industrialization cannot be sustained. India had inherited an undeveloped basic infrastructure from the colonial period. After Independence, the private sector neither showed any inclination to develop it nor did it have any resources to make this possible. It was comparatively weak both financially and technically, and was incapable of establishing a heavy industry immediately. These factors made the State's participation in industrialization essential since only the government could enforce a large-scale mobilization

of capital, the coordination of industrial construction, and training of technicians. The government has not only improved the road, rail, air and sea transport system, it has also expanded them manifold. *Thus the public sector has enabled the economy to develop a strong infrastructure for the future economic growth.* The private sector also has benefited immensely from these investments undertaken by the public sector.

**3. Strong industrial base.** The share of the industrial sector (comprising manufacturing, construction, electricity, gas and water supply) in Gross Domestic Product at factor cost has increased slowly but steadily during the period of planning. The share of the industrial sector in GDP at factor cost rose from 13.6 per cent in 1950-51 to 22.0 per cent in 1980-81 and further to 24.6 per cent in 2006-07 (at 1999-2000 prices). This shows the increasing importance of the industrial sector in the Indian economy. Not only this, the industrial base of the Indian economy is now much stronger than what it was in 1950-51. There has been significant growth in the defence industries and industries of strategic importance. *The government has strengthened the industrial base considerably by placing due emphasis on the setting up of industries in the following fields—iron and steel, heavy engineering, coal, heavy electrical machinery, petroleum and natural gas, chemicals and drugs, fertilizers, etc.* Because of their low profitability potential in the short run, these industries do not find favour with the private sector. However, unless these industries are set up, the consumer goods industries cannot progress at a sufficiently rapid pace. Therefore the production of consumer goods industries in the private sector is also likely to suffer if the State does not invest in heavy and basic industries. As noted by A.H. Hanson, “Even the view that it is the function of the State to provide only basic ‘services’ leaves room for a great deal of public enterprise in manufacturing industry, as well as in power, transport, communications, etc. For consumer-goods industries, which are usually capable of attracting some private capital, depend on the ‘services’ of the producer-goods industries in which private capital is—at least initially—less interested. Hence one can argue, without any ‘socialistic’ overtones, that as—for instance—textile or food-processing industries need the support of native metallurgical and engineering industries (the necessary equipment not being available from abroad owing to foreign exchange difficulties, delivery delays, etc.) and as no private entrepreneurs show any inclination to pioneer the latter, the State must step in and do the pioneering itself”.<sup>4</sup>

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

**5. Removal of regional disparities.** The government in India has sought to use its power of setting up of industries as a means of removing regional disparities in industrial development. In the pre-Independence period, most of the industrial progress of the country was limited in and around the port towns of Mumbai, Kolkata and Chennai. Other parts of the country lagged far behind. After the initiation of the planning process in the country in 1951, the government paid particular attention to the problem and set up industries in a number of areas neglected by the private sector. Thus a major proportion of public sector investment was directed towards backward States. All the four major steel plants in the public sector—Bhilai Steel Plant, Rourkela Steel Plant, Durgapur Steel Plant and Bokaro Steel Plant—were set up in the backward States. It was believed that the setting up of large scale public sector projects in the backward areas would unleash a propulsive mechanism in them and cause economic development of the hinterland. These considerations also guided the location of machinery and machine tools factories, aircraft, transport equipment, fertilizer plants etc.

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

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

**7. Check over concentration of economic power.** In a capitalist economy where the public sector is

practically non-existent or is of a very small size, economic power gets increasingly concentrated in a few hands and inequalities of income and wealth increase. In most of the Plans in the pre-reform period (i.e. the period prior to 1991) it was said time and again that the expansion of public sector will help in putting a brake on the tendency towards concentration of wealth and economic power in the private sector.

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

### ■■■■ PERFORMANCE OF THE PUBLIC SECTOR ■■■■

It is usual to judge the performance of private sector units by the yardstick of net profit or loss since in their case, maximization of profit is the sole aim. This yardstick fails miserably in the case of public sector undertakings. Such units are frequently started in those sectors where profitability is low and gestation period long. For instance, investment in infrastructure and basic industries is not likely to yield early returns and, accordingly, profits in the beginning are likely to be very low and in some instances, may even be negative. Yet these investments serve important ends since they *create* the basis for expansion of industrial activities in the future. Because of considerations such as these, it is often maintained that *the performance of the public sector units should not be judged by what they earn in the form of profits but by the total additions they make to the flow of goods and services in the economy*. Thus, instead of profits, the yardstick should be the total value of the sales of an enterprise. For instance, if an iron and steel plant produces steel worth Rs. 5,000 crore in a certain specified period but makes no profit because its aim is to provide steel at low prices to the industries using steel as an input, it would be wrong to say that its performance is disappointing on this count alone. What is important from the point of view of the industrial development of the country is the fact that this plant has added steel worth Rs. 5,000 crore to the social pool of goods and services obtaining in the country.

### Expansion of the Public Sector and its Share in National Production

There has been massive expansion in the public sector after Independence. At the commencement of the First Five Year Plan in 1951, there were only 5 Central public sector enterprises with investment amounting to Rs. 29 crore. As on March 31, 2004, the number of central public sector enterprises was 230 which fell to 227 as on March 31, 2005. However, investment rose from Rs. 3,49,994 crore at end-March 2004 to Rs. 3,57,849 crore at end-March 2005 (an increase of Rs. 7,855 crore in a single year). The turnover was Rs. 1,33,906 crore in 1991-92 which rose to Rs. 5,87,052 crore in 2003-04 and further to Rs. 7,00,862 crore in 2004-05 (see Table 33.1). According to *Economic Survey, 2006-07*, the cumulative investment of all Central PSEs at end-March 2006 was Rs. 3,93,057 crore of which the share of manufacturing Central PSEs was 51 per cent followed by service central PSEs at 40 per cent, and by mining Central PSEs at 7 per cent.

As far as the share in national production is concerned, Central PSEs play a pivotal role in the production of coal and lignite, petroleum and in non-ferrous metals such as primary lead and zinc. For example, central PSEs contributed 85.52 per cent of coal production, 85.87 per cent of crude oil production and 74.51 per cent of petroleum refining in 2005-06.

### The Question of Profitability

Though we have pointed out earlier that profits are not the criterion for examining the performance of public sector enterprises, their financial performance is of wider interest and concern as they are set up at a huge cost to the national exchequer. As is clear from Table 33.1, profit before interest and tax increased from Rs. 13,675 crore in 1991-92 to Rs. 1,09,518 crore in 2004-05 while net profit increased from Rs. 2,356 crore to Rs. 65,249 crore over the same period. A little calculation on Table 33.1 shows that the ratio of profit before interest and tax to turnover rose from 10.2 per cent in 1991-92 to 15.6 per cent in 2004-05 while the ratio of net profit to turnover rose from 1.8 per cent to 9.3 per cent over the same period. As far as return on investment (i.e. the ratio of profit before interest and tax to capital employed) is concerned, it increased from 11.6 per cent in 1991-92 to 21.49 per cent in 2004-05.

TABLE 33.1. Performance of Central Public Sector Enterprises

(Rs. crore)

Year	Number of Operating CPEs	Turnover/ Operating Income	PBIT	Net Profit	Provision for Tax	Dividend Payment	Contribution to Central Exchequer	Gross Internal Resource Generation
1991-92	237	1,33,906	13,675	2,356	1,647	687	19,951	12,943
1995-96	239	2,26,919	27,587	9,574	4,047	2,205	30,878	24,198
2000-01	234	4,58,237	48,767	15,653	9,314	8,260	61,037	37,811
2001-02	231	4,47,529	63,190	25,978	12,255	8,068	62,866	52,544
2002-03	227	5,35,165	73,374	32,399	17,432	13,768	81,867	54,273
2003-04	230	5,87,052	99,053	53,084	22,134	15,288	89,035	75,409
2004-05	227	7,00,862	1,09,518	65,429	21,661	20,714	1,10,599	83,854
Growth in 2004-05 over 2003-04 (%)	(-1.30)	19.39	10.57	32.26	(-2.14)	35.49	24.22	11.20
Growth in 2004-05 over 1991-92 (%)	(-4.41)	423.40	700.86	2677.12	1215.18	2915.14	454.35	547.87

Note: PBIT—Profit before interest, tax.

Source: Government of India, *India—A Reference Annual 2007* (New Delhi, 2007), Table 181, p. 539.

What is more, the reliance of public sector enterprises on budgetary resources declined while their gross internal resource generation increased. Gross internal resource generation in 1991-92 was Rs. 12,943 crore in 1991-92 which rose to Rs. 83,854 crore in 2004-05. Despite all this, the fact of the matter is that the ratio of net profit/ capital employed continues to be highly inadequate looking at the colossal investments that have been made in the public sector (in a number of years in recent past this ratio has been in the range 2.0 to 2.5 per cent). Bimal Jalan has alleged that it is this 'low return on investment' in the public sector enterprises that is, to a large extent, responsible for the fiscal crisis of the Central government.<sup>5</sup>

### Employment and Labour Welfare

As far as this criterion of the performance is concerned, the public sector seems to have done exceedingly well. It has contributed to a significant extent in improving the overall employment situation in the country and has acted as a model employer by providing the workers with better wages and other facilities as compared to the private sector. The number of persons employed in the Central public sector enterprises as on March 1, 2005 was about 1.69 million. The industrial sectors which have a sizable number of employees in the public sector include coal, steel, textiles, heavy engineering, and medium and light engineering. The average wage per worker in public sector enterprises is also higher than in the private sector.

The public sector enterprises have also spent a considerable amount on the development of townships around them. These townships were provided with facilities like schools, hospitals, shopping complexes, etc. A substantial sum of money is spent annually on the maintenance and administration of these townships and social overheads. The employees of the public sector enterprises also enjoy medical amenities, subsidized canteen facilities, transport and educational facilities, etc.

### Public Sector and Foreign Exchange Earnings

Enterprises in the public sector have helped the economy in earning substantial amount of foreign exchange and also in saving the foreign exchange and expenditure via their efforts at import substitution. Capital goods, industrial machinery, and other equipment which were totally imported about four decades back are now being mostly manufactured in the country itself. This has saved valuable foreign exchange. The ONGC and Indian Oil Corporation have helped the country in reducing the dependence on foreign imports. The Hindustan Antibiotics Ltd. and the Indian Drugs and Pharmaceuticals Ltd. have entered the field of manufacture of drugs and pharmaceuticals in a big way. While this has helped in saving foreign exchange on the one hand, it has also enabled the country to break the stranglehold of foreign companies in this field.

As far as foreign exchange earnings are concerned, the public sector has contributed in three ways: (i) through direct export of items produced in the public sector, (ii) through services rendered by the public sector undertakings, and (iii) through trading and marketing services of the undertakings through which exports are canalized.

### The Question of Efficiency

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

According to G.K. Shirokov, efficiency of a public enterprise should not be judged on the basis of profitability alone. "The economic efficiency of a public sector industry manifests itself alone in the transformation of the industrial structure, modernisation, higher labour productivity on a country-wide scale etc."<sup>6</sup> *The fact is that a higher proportion of the value produced by the public sector industries is realised outside this sector, and it is, therefore, very difficult to estimate the efficiency of public sector enterprises in terms of cost and profitability.* Most of the critics of the public sector enterprises fail to take social costs and benefits into account and consider only net profits or losses. They are thus guilty of ignoring the right criteria for judging the performance of public sector enterprises.

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

Before we conclude this section, the following comments from Arif Sharif are in order: "*Now that decrying public sector performance has become fashionable, many seem to have forgotten the crucial role it has played in India's development since the Second Plan, which cannot be measured against the value of its output. The private sector never had to bear such responsibilities. Instead, it relied on the public sector to meet much of its technology and skilled manpower requirements.*"<sup>7</sup>

## ■■■■ PROBLEMS OF PUBLIC SECTOR ENTERPRISES ■■■■

The most important criticism levied against the public sector has been that, in relation to the capital employed, the level of profits has been too low. Even the government has criticised the public sector enterprises on this count. For instance, the Eighth Five Year Plan notes that the public sector has been unable to generate adequate resources for sustaining the growth process.<sup>8</sup> Of the various factors responsible for low profits in the public sector, the following are particularly important :

### Price Policy of Public Enterprises

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

*As regards the pricing policy of public sector enterprises, we can find two different approaches : (i) the public utility approach and (ii) the rate of return approach. The former implies a pricing policy that yields a no-profit-no-loss situation. This pricing policy was followed for a long period by many public sector enterprises. It obtained support from the fact that many public sector units were in the area of basic industries and unduly high prices of their products could cause cost increases over a large segment of the economy. Thus the pressure to adopt in some sense a minimal price policy was strong and persistent. On account of these reasons, administered prices were intentionally kept very low.*<sup>9</sup> For example, the price of steel was kept deliberately low. Similar practices were followed by Hindustan Machine Tools, Hindustan Shipyard and many other public sector enterprises in the initial stages of their operations.

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

*There has been a distinct change in the pricing policy of public sector enterprises after the announcement of the new economic policy in 1991.* The new policy relies less on command and control type mechanisms and more on market-based instruments of regulation. Price controls on a number of consumer goods have been lifted. Cement and steel prices have been decontrolled. In fertilisers, only nitrogenous fertilisers are now subject to price control. The new policy favours a more transparent policy for fixing prices and the government has already recommended the adoption of Long Run Marginal Cost (LRMC) based prices for public enterprises. The administered pricing policy will probably continue only in selected public utilities.

### Under-Utilization of Capacity

Under-utilization of installed capacity is another reason for the low level of profitability in public sector enterprises. A large number of these enterprises have operated at less than 50 per cent of their capacity for a number of years. We must ponder seriously why investments worth thousands of crores of rupees in the public sector were not utilized properly and resulted in substantial under-utilization of capacity. Some people have attributed this to the lack of foresightedness on the part of the government. However, the facts are somewhat different. As pointed out by Vijay Kelkar, after the Third Plan, public investments which till then were decided mostly on the basis of plan priorities, were influenced by various other pressures. *The public sector enterprises "became increasingly instruments for meeting immediate or ad hoc demands such as producing mass consumption goods, stimulating growth in economically backward areas or using locally available raw materials which were in some cases, like Khetri copper ore, of poor quality. Furthermore, a large number of industries which became sick under private sector management were taken over by the government with a view to maintaining production and protecting employment."*<sup>10</sup> Other factors that accounted for under-utilization of capacity in public sector enterprises include inefficient operation and poor management of some enterprises, political interference in day-to-day working, labour disputes etc.

### Problems Related to Planning and Construction of Projects

As far as the phase of planning and construction of projects is concerned, following problems had to be faced: (i) selection of site was not based on detailed soil investigation; (ii) there were serious omissions and understatements of several elements of the projects; (iii) the actual costs of projects far exceeded the original estimates; (iv) the projects took much longer time to complete than originally envisaged; and (v) the projects often embodied inappropriate technology or product mix. For instance, Bhagwati and Desai have argued that the site for Heavy Electricals Limited was selected without any explicit calculation of the cost of alternative locations and later was changed when found unsuitable. Similarly, a decision was made to locate a fertilizer plant within *each* State. This led to corresponding decisions to initiate construction at places which were unsuitable from the viewpoint of either demand or raw materials.<sup>11</sup>

As far as completion of projects is concerned, several of them were completed 18 months to 2 years behind schedule. Cost escalation has often been of the order of 10-15 to 80-90 per cent of the original estimate. According to Chaudhury,<sup>12</sup> cost escalation was due to the following two major causes: (i) last minute changes in project design sometimes due to a belated recognition that the product mix that was chosen originally was inappropriate to Indian market conditions. This required expensive modifications to plant. Sometimes changes were induced by the need to add vital parts of the plant which had not been included in the original contract; and (ii) lag in starting or finishing a project, which landed the projects with higher costs due to inflation in supplier countries. Very often aid contracts took much longer to complete than originally envisaged.

Also, because of the decision to locate large-sized industrial projects in hitherto backward areas the cost and execution of the project depended heavily on the creation of adequate infrastructure facilities. Delays in completion also occurred due to the interlinking of projects—steel plants with heavy engineering plants or with

coal mines or with railway facilities; electricity generation with the manufacture of electricity machinery, cables, transmission towers and so on by other public sector units; port development with the production of cranes and other berthing equipment by public sector enterprises.

### Problems of Labour, Personnel and Management

*Public sector enterprises are often plagued with undue political interference in their day-to-day working and this has demoralising effect on the management and other personnel of these enterprises.* Many appointments at the top are not made on grounds of professional competence or suitability but are determined by various political considerations. Often the management at the top is constituted of the traditional administrative services of I.A.S. These non-specialised, non-technical people are often unequal to the task of providing the requisite managerial competence in the complex, capital-intensive industrial projects in the public sector. Also, as noted by Bhagwati and Desai, with their civil service background, these officials inevitably tended to act with bureaucratic caution and unimaginativeness rather than in bold and inventive ways. The actual management was also hampered by traditional audit procedures and scrutiny of whether the expenditures incurred were within the framework of the authorizations.<sup>13</sup> The work ethic of a public enterprise is very much like that of a government office—over occupation with file work, rules-oriented practices, and keeping within the framework of prescribed rules and norms. The costs of this lengthy procedure or delays in decision often do not matter. Political considerations have also contributed to overstaffing of unskilled labour and payment of higher wages to such labour than in the private sector.

### ■■■■ CONTROL OVER PUBLIC ENTERPRISES ■■■■

Since public sector enterprises have been set up with the help of tax-payers' money, they are subject to government control and are accountable to Parliament. Government control is exercised in a number of ways like formulating general principles and policies with regard to the functioning of these enterprises, appointing the Chairman, General Manager and other members of the Board of Directors; requiring government approval for undertaking long-term investment and for carrying out major policy changes; calling for progress reports periodically to assess the performance of the enterprise; auditing the accounts of the public enterprises, etc. *Accountability to Parliament is ensured mainly through Parliamentary Committees—the most important being the Committee on Public Undertakings (CPU) set up in May 1964. In addition, the Bureau of Public Enterprises (BPE) set up in 1965 also monitors the growth and performance of the public enterprises.*

### Committee on Public Undertakings

The Committee on Public Undertakings is constituted of members belonging to both the Houses of Parliament. The functions of this Committee are as follows: (i) to examine the reports and accounts of public enterprises; (ii) to examine the reports, if any, of the Comptroller and Auditor-General of India on public enterprises; (iii) to examine whether the public enterprises are being managed in accordance with sound business principles and prudent commercial practices; and (iv) to perform such other functions as are vested in the Public Accounts Committee and the Estimate Committee in relation to public undertakings. It has also been specified that the Committee shall not examine and investigate (i) matters of major government policy as distinct from business or commercial functions of the public undertakings; (ii) matters of day to day administration; and (iii) matters for the consideration of which machinery already exists under the special statute establishing the particular undertaking.

The Committee on Public Undertakings has been examining in detail the performance of some selected public enterprises every year. After carrying out an in-depth study of the selected enterprises, the Committee has been submitting recommendations for improving their performance. The reports of the Committee are submitted to the Parliament. In addition to examining the performance of some selected public sector undertakings, the Committee has also undertaken studies covering wider issues concerning the public enterprises as a whole. These include studies relating to the role and achievements of public enterprises, need and scope of foreign collaboration, personnel policy, issues relating to financial management etc.

Parliament also exercises its control on the public sector undertakings via the provision that the annual reports and balance sheets are required to be laid on the table of both the Houses of Parliament within a specified period from the close of the accounting year. Moreover, Audit Boards functioning under the Comptroller and Auditor General also prepare their Audit Reports for the various public sector undertakings and these Reports (with comment of the Comptroller and Auditor General) are presented to Parliament annually.

### Bureau of Public Enterprises

The Bureau of Public Enterprises was set up in April 1965 in the Finance Ministry to provide a central point of reference and consultation on important aspects of management concerning the public sector enterprises. The functions of the Bureau are as follows: (i) to assist the concerned Ministries and the Finance Ministry in making an expert scrutiny and evaluation of feasibility studies and detailed project reports; (ii) to assist the Ministries in controlling expenditure on residential and administrative buildings, townships and ancillary facilities with a view to securing a measure of uniformity in provision of amenities to labour; (iii) to compile information on terms and conditions of service of employees with a view to ensuring uniformity; (iv) to act as a 'Data Bank' and as a clearing house of information on matters of common interest including information about organisational structure and pricing policies; (v) to furnish periodical report to Parliament and government on the working of public enterprises; (vi) to co-ordinate the work relating to examination of public enterprises by Parliamentary Committees; (vii) to maintain liaison with the Department of Administrative Reforms in respect of matters like work studies, operations research, and improved reporting systems; (viii) to assist the administrative ministries in making appointments to the boards of public undertakings through Public Enterprise Selection Board; (ix) to co-ordinate the arrangements for training the senior and top level managers of public enterprises; and (x) to advise public undertakings on matters on which advice is sought.

As is clear from the above list of functions, the Board of Public Enterprises operates on a very broad front. It is entrusted with the task of exploring all possibilities for the economical use of capital and minimising operating costs with a view to raising efficiency, productivity and profitability of public enterprises. It has taken the initiative for the promotion of sound management techniques by public enterprises. It has scrutinised many feasibility reports and project reports from techno-economic point of view in order to ensure the optimum use of resources in setting up the projects. Such scrutiny pertains to various aspects like project planning, cost estimates, control of project establishments, manpower building-up, improving productivity, demand projection etc. Achievements of the Bureau include securing economies in the costs of projects, more systematic planning and scheduling construction activities, better production planning and performance budgeting in many public sector enterprises, increased capacity utilization, introduction of management information systems, better use of scarce materials, evolving uniform yardsticks in the employment of personnel, etc.

### The Question of Autonomy

As is clear from the above discussion, the operations of public enterprises in India have been subject to a number of controls. Managements of many public enterprises feel that controls on their operations are too much and too frequent inhibiting the possibilities of independent action unduly. Even in routine matters, interference persists. This leads to a sense of insecurity and indecision in top management circles and a lot of time that could be utilized more productively is wasted on drawing up explanations to convince persons who matter. Critics also point out that the Bureau of Public Enterprises with its bureaucratic set up is ill-equipped to render advice on many matters to public enterprises. In fact, the technical and management capability in many public sector enterprises is far superior to the one possessed by the Bureau. In any case, management of a particular public enterprise is, in many instances, better placed to decide the further course of action on its own rather than follow the advice of the Bureau.

It is on account of the above reasons that managements of the public enterprises have been clamouring for 'more autonomy' and 'less control and accountability'. *In the context of a public enterprise, 'autonomy' refers to the freedom granted to the management to run it without interference of outside agencies.* Autonomy is especially important in the context of day-to-day operations of a public enterprise where many on-the-spot decisions may have to be taken on a variety of issues that crop up before the management. Interference in such daily work is neither feasible nor necessary. In fact, it can only create impediments on the one hand and demoralise the management on the other.

The government has, in recent years, accepted the importance of granting autonomy to the managements of public sector enterprises in running their companies. Following the recommendations of the 'Committee to Review the Policy for Public Enterprises' constituted under the chairmanship of Arjun Sengupta in 1985, the government introduced the concept of Memorandum of Understanding (MOU) in 1988. The main objective of MOU is to reduce the quantity of control, grant more autonomy to the managements and improve the quality of accountability. The emphasis is on achieving the negotiated and agreed objectives rather than interfering in the day-to-day affairs. The government has also announced a list of PSUs (public sector undertakings) classified as *Navratnas* and *Miniratnas*. These enterprises have been provided considerable financial and operational autonomy.



## ■■■■ PUBLIC SECTOR REFORMS ■■■■

The new industrial policy announced by the government in July 1991 emphasised the following four major measures to 'reform' the public sector enterprises : (i) reduction in the number of industries reserved for the public sector from 17 to 8 (reduced still further to 3 later on) and the introduction of selective competition in the reserved area; (ii) the disinvestment of shares of a select set of public sector enterprises in order to raise resources and to encourage wider participation of general public and workers in the ownership of public sector enterprises; (iii) the policy towards sick public sector enterprises to be the same as that for the private sector; and (iv) an improvement of performance through an MOU (memorandum of understanding) system by which managements are to be granted greater autonomy but held accountable for specified results.<sup>14</sup> In addition, there was a drastic reduction in the budgetary support to sick or potentially sick public sector enterprises.

### Dereservations

The 1956 Resolution had reserved 17 industries for the public sector. The 1991 industrial policy reduced this number to 8: (1) arms and ammunition, (2) atomic energy, (3) coal and lignite, (4) mineral oils, (5) mining of iron ore, manganese ore, chrome ore, gypsum, sulphur, gold and diamond, (6) mining of copper, lead, zinc, tin, molybdenum and wolfram, (7) minerals specified in the schedule to the atomic energy (control of production and use order), 1953, and (8) rail transport. In 1993, items 5 and 6 were deleted from the reserved list. In 1998-99, items 3 and 4 were also taken out from the reserved list. On May 9, 2001, the government opened up arms and ammunition sector also to the private sector. Thus, *now only 3 industries are reserved exclusively for the public sector. These are atomic energy, minerals specified in the schedule to the atomic energy (control of production and use order) 1953, and rail transport.*

### Policy Regarding Sick Units

The 1991 industrial policy brought the public sector units at par with the private sector units. As a result, the public sector units were also brought within the jurisdiction of the Board for Industrial and Financial Reconstruction (BIFR). Thus BIFR was given the responsibility to decide whether a sick public sector unit can be effectively restructured or whether it has to be closed down. Upto March 31, 2005, 295 cases of public sector units were referred to the BIFR. Of these, 211 (90 Central and 121 State) were registered. Of the registered cases, 42 cases were dismissed as not maintainable, revival schemes were sanctioned for 44 cases, while winding up was recommended in 72 cases (31 Central and 4 State). Seventeen public sector units (6 Central and 11 State) were declared "no longer sick" on successful completion of the rehabilitation schemes.

In the process of restructuring of the sick and loss making enterprises, the government has liberalised the Voluntary Retirement Scheme (VRS) to enable the Central public sector enterprises to shed their excess manpower. Cumulatively around 5.55 lakh employees have opted for VRS from Central public sector enterprises since October 1998 till March 2005.<sup>15</sup>

### Memorandum of Understanding

One of the major initiatives towards the public sector as outlined in the new industrial policy of July 1991 was to bring all public sector enterprises under the system of Memorandum of Understanding (MOU). The system of MOU envisages an arm's length relationship between the PSU and the administrative ministries. It gives clear targets to PSUs and ensures operational autonomy to them for achieving those targets. The MOU system was started in 1987-88 with four PSUs signing MOUs. It has now gone up to 102 MOUs signed in 2005-06 and 108 MOUs in 2006-07. As per evaluation of 99 PSUs which signed MOUs for 2004-05, 44 PSUs were rated 'excellent,' 33 as 'very good', 11 as 'good' and 10 as 'fair'. Only one PSU was rated poor.

### Policy for 'Navratnas'

In 1997, the government identified 11 public sector enterprises as *Navratnas* and decided to give enhanced powers to the Board of Directors of these enterprises to facilitate their becoming global players. These enterprises are BHEL, BPCL, GAIL, HPCL, IOC, IPCL, MINL, NTPC, ONGC, SAIL and VSNL. Two of these, namely, IPCL and VSNL, have since been privatised and presently there are only 9 *Navratnas*. The Boards of these *Navratna* enterprises have been professionalised by induction of non-official part-time professional Directors. These PSUs have been delegated substantial enhanced autonomy and operational freedom which include (i) incurring capital expenditure, (ii) entering into joint ventures, (iii) effecting organisational restructuring, (iv) creation and winding up of posts below Board level, (v) to raise capital from the domestic and international markets, and (vi) to establish financial joint ventures subject to equity investments with special limits.

The government has also granted financial and operational autonomy to some of the other profit making PSUs subject to fulfilling certain conditions. These enterprises are categorised as *Miniratnas*. The enterprises which have made profits continuously for the last three years and have earned a net profit of Rs. 30 crore or more in one of the three years, with positive networth are categorised as *Miniratnas* I. Category II *Miniratnas* should have made profits for the last three years continuously and should have a positive networth. Both these categories of public sector enterprises are granted certain autonomy like incurring capital expenditure without government approval upto Rs. 300 crore or equal to their networth whichever is lower (for category I *Miniratnas* companies) and upto Rs. 150 crore or upto 50 per cent of their networth whichever is lower (for category II *Miniratnas* companies). These enterprises can also enter into joint ventures subject to certain conditions, set up subsidiary companies and overseas offices, enter into technology joint ventures, etc. As on March 31, 2005, 45 enterprises had been categories as *Miniratnas*.

### Privatisation and Disinvestment

The Government of India has decided to withdraw from the industrial sector and, in accordance with this decision, it is privatising the public sector enterprises in a phased manner. The main approach of the government in this regard is to bring down its equity in all non-strategic public sector undertakings to 26 per cent (or lower) and close down those public sector undertakings which cannot be revived. For purposes of privatisation, the government has adopted the route of disinvestment which involves the sale of the public sector equity to the private sector and the public at large. All through the 1990s, successive governments at the Centre have advocated the sale of public sector equity as a means of public sector 'reform'. Equity sale, as the industrial policy statement of July 1991 argued, was a means of ensuring financial discipline and improving performance. However, as correctly pointed out by C.P. Chandrasekhar and Jayati Ghosh, the experience suggests that fiscal convenience was the prime mover of such disinvestments. The proceeds from disinvestments were used to finance budget deficits and thus to 'window-dress' budgets, "This meant that while there has been much talk of managerial reform, voluntary retrenchment, and greater public sector autonomy for meeting the new market environment, the thrust of public sector reform was almost entirely concentrated on the sale of equity."<sup>16</sup> The disinvestment programme is discussed in detail in the chapter on "Privatisation and Disinvestment."

### Setting Up of BRPSE

The UPA government at the Centre has set up a Board for Reconstruction of Public Sector Enterprises (BRPSE) to advise the government on ways and means for strengthening the public sector enterprises in general and to make them more autonomous and professional. The Board would consider reconstructing—financial, organisational and business—of Central public sector enterprises and suggest ways and means for funding such schemes. The Board would also advise the government on disinvestment/closure /sale in respect of chronically sick/loss making companies, which cannot be revived.

### ■■■■ NOTES ■■■■

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# PRIVATE SECTOR IN THE INDIAN ECONOMY

## *Role of the Private Sector*

### *Private Sector In the Post-Liberalisation Phase*

• Performance of the Corporate Sector • Private Sector Corporate Giants—Ranking in Terms of Net Sales • Private Sector Corporate Giants—Ranking in Terms of Market Capitalisation

### *Problems of the Private Sector*

As stated in Chapter 28 on 'Industrial Policy' and Chapter 33 on 'Public Sector in India', the Government of India opted for a mixed economy in which both public and private sectors were allowed to operate. For example, the 1948 Industrial Policy Resolution divided industries into four categories: (i) three industries in which State was given a monopoly; (ii) six industries where State was to have the exclusive right to set up new units but existing private sector units were allowed to operate; (iii) eighteen industries where regulation and direction was necessary; and (iv) all other industries (not included in the above three categories) where private sector was allowed freedom to operate. The 1956 Industrial Policy Resolution divided industries into three categories: (i) Seventeen industries (listed in Schedule A) whose future development was to be the exclusive responsibility of the State; (ii) Twelve industries (listed in Schedule B) where the State would increasingly establish new units and increase its participation but would not deny the private sector opportunities to set up units or expand existing units; and (iii) all other industries (not listed in Schedules A and B) where the private sector was given freedom to operate. However, the private sector had to operate within the provisions of the Industries (Development and Regulation) Act 1951 and other relevant legislations. In this context, the Industrial Policy Resolution 1956 stated, "*Industrial undertakings in the private sector have necessarily to fit into the framework of the social and economic policy of the State and will be subject to control and regulation in terms of the Industries (Development and Regulation) Act and other relevant legislation. The Government of India, however, recognise that it would, in general, be desirable to allow such undertakings to develop with as much freedom as possible, consistent with the targets and objectives of the national plan. When there exist in the same industry both privately and publicly owned units, it would continue to be the policy of the State to give fair and non-discriminatory treatment to both of them.*" The Resolution also emphasised the mutual dependence of public and private sectors. While State could start any industry not included in Schedule A and Schedule B, the private sector could be allowed to produce an item falling within Schedule A. In fact, the 1956 Resolution emphasized not only the mutual co-existence of private and public sectors but also provided for their mutual cooperation and help.

The private sector took full advantage of the loopholes and exceptions in the legislation and the 'elbow room' allowed by the 1956 Resolution to set up industries even in areas exclusively reserved for the State sector. In fact, with the passage of time, more and more concessions were granted to the private sector to expand its business activities. The working of the Industries Development and Regulation Act, 1951, was also full of flaws as the licensing committee worked in a very haphazard and *ad hoc* manner and there were no definite criteria adopted for acceptance or rejection of applications. Because of widespread criticism of the working of the Act,

the government considerably liberalised the industrial licensing policy as well. *The New Industrial Policy, 1991, ushered in a new era of liberalisation as industrial licensing was abolished, role of public sector diluted, doors to foreign investment considerably opened, and numerous incentives and initiatives granted to the private sector to expand its business activities.* The 1991 policy was therefore welcomed with unbridled enthusiasm by the private sector initially. It welcomed the thought of lower taxes, less red tape, less paperwork, more 'space' to work and less government interference. However, the 1991 policy had also opened the doors to multinationals and increased competition from abroad as tariffs were reduced substantially. Consequently, many domestic producers suddenly discovered their market shares shrinking drastically as their goods failed to meet foreign competition both on grounds of quality and price. The corporate world also saw significant changes with many old businessmen being knocked out from their top positions and a number of new entrants making their mark. While the new entrants are 'pro-liberalisers' and speak the language of free trade and unfettered investment, the old guard are now talking in terms of 'protection' to domestic industry from foreign competition — a drastic reversal of their earlier position.

In the present chapter, we shall discuss

- Role of the private sector
- Private sector in the post-liberalisation phase
- Problems of the private sector

### ■■■■■ ROLE OF THE PRIVATE SECTOR ■■■■■

**1. The dominant sector.** Despite the rapid progress of the public sector in the period of planning, private sector is the dominant sector in the Indian economy as would be clear from a glance at Table 34.1. Since government data on the industrial sector are available with some time-lag, the latest data are for the year 2003-04.

TABLE 34.1. Factory Sector by Type of Ownership, 2003-04

	<i>Factories Number</i>	<i>Employment '000s</i>	<i>Fixed Capital</i>	<i>Gross Output</i>	<i>Value Added</i>
<i>Rs. Crore</i>					
Public Sector	14,664 (11.4)	3,271 (41.6)	3,70,332 (78.2)	8,51,516 (66.1)	1,50,669 (74.3)
Joint Sector	2,132 (1.7)	284 (3.6)	8,573 (1.8)	27,184 (2.1)	2,395 (1.2)
Private Sector	1,08,743 (84.2)	4,194 (53.3)	93,381 (19.7)	4,01,911 (31.2)	48,925 (24.1)
Others	3,535 (2.7)	121 (1.5)	1,045 (0.2)	6,805 (0.5)	913 (0.4)
Total	1,29,074 (100.0)	7,870 (100.0)	4,73,331 (100.0)	12,87,380 (100.0)	2,02,932 (100.0)

*Note:* 1. Public sector includes Central government public sector enterprises (PSEs), State/Local government PSEs and Central and State/Local government PSEs.

2. Figures in brackets are percentage to the total.

*Source:* Tata Services Ltd. *Statistical Outline of India, 2006-07* (Mumbai, 2007), Table 61, p. 61.

As is clear from Table 34.1, the number of private sector companies in 2003-04 was 1,08,743 out of 1,29,074 total companies. Thus as many as 84.2 cent of the total companies were in the private sector, the share of public sector being only 11.4 per cent. However, in terms of fixed capital, gross output and value added, private sector's share was much lower. For instance, its share in fixed capital was only 19.7 per cent in 2003-04. Its share in gross output and value added was only 31.2 per cent and 24.1 per cent respectively in that year. In terms of employment, private sector's share was greater in 2003-04. It employed 53.3 per cent of workers as against 41.6 per cent employed by the public sector.

**2. Importance for development.** In western countries private entrepreneurs have played an important role in economic development so much so that Schumpeter has characterised them as the initiator and moving

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

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

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

### ■■■■ PRIVATE SECTOR IN THE POST LIBERALISATION PHASE ■■■■

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

#### Performance of the Corporate Sector

Table 34.2 provides information on the performance of the corporate sector in the post liberalisation period. As is clear from this Table, the average rate of growth of sales was 14.0 per cent per annum during 1990s (1990-91 to 1999-2000) and 14.6 per cent per annum during the period 2000-01 to 2006-07. Gross profits increased at an average rate of 12.5 per cent per annum during 1990s and at 20.0 per cent per annum during 2000-01 to 2006-07. What is most significant is the fact that the rate of growth of profits after tax which was 11.8 per cent per annum during 1990s increased to 35.6 per cent per annum during the period 2000-01 to 2006-07. The last year under review 2006-07 has been particularly good. Growth in sales in this year was 26.2 per cent as against an average of 19.0 per cent during the preceding three-year period (2003-04 to 2005-06). Growth in gross profits at 41.5 per cent during 2006-07 was also higher than the average of 26 per cent during 2003-04 to 2005-06, and outpaced the growth in sales by a large margin. Profits after tax increased by 45.2 per cent during 2006-07 on top of 45.1 per cent average growth during the three year period 2003-04 to 2005-06. Concomitantly, profit-margin — the ratio of profits after tax to sales — that fluctuated between 3.3 per cent and 7.8 per cent in the 1990s, improved from 5.9 per cent in 2003-04 to 10.7 per cent in 2006-07. Reflecting the sustained high profitability, internal sources now constitute a major source of funds. This has partly led to a reduced reliance on debt, and a decline in the debt-equity ratio to around 53 per cent by 2004-05 from more than 59 per cent during the 1990s.

TABLE 34.2. Financial Performance of the Corporate Sector

	1990-91 to 1999-2000	2000-01 to 2006-07	2002-03	2003-04	2004-05	2005-06	2006-07
1	2	3	4	5	6	7	8
<b>Growth Rates</b>	(Average)	(Average)					
Sales	14.0	14.6	8.5	16.0	24.1	16.9	26.2
Expenditure	14.0	13.9	10.2	14.9	23.6	16.4	23.5
Depreciation provision	17.3	9.4	4.9	6.0	11.2	10.2	15.4
Gross profits	12.5	20.0	9.8	25.0	32.5	20.3	41.5
Interest payments	15.8	-0.6	-9.8	-11.9	-5.8	1.9	17.4
Profits after tax	11.8	35.6	76.2	59.8	51.2	24.2	45.2
<b>Select Ratios</b>	(Min-Max.)	(Min-Max.)					
Gross Profits to Sales	(10.5-14.2)	(10.1-15.6)	10.3	11.1	11.9	13.0	15.6
Profits After Tax to Sales	(3.3-7.8)	(2.6-10.7)	4.2	5.9	7.2	8.7	10.7
Debt to Equity	(58.7-99.5)	(52.7-70.5)	64.7	58.6	n.a.	n.a.	n.a.
Internal Sources of Funds to Total Sources of Funds	(26.1-40.3)	(53.5-65.3)	64.9	53.5	n.a.	n.a.	n.a.
Memo:			(Amount in Rupees crore)				
Number of Companies			2,031	2,214	2,214	2,210	2,388
Sales			3,49,667	4,42,743	5,49,449	7,74,578	10,41,894
Expenditure			3,07,863	3,86,559	4,77,609	6,66,690	8,72,168
Depreciation Provision			18,306	20,406	22,697	28,883	37,095
Gross Profits			36,096	49,278	65,301	1,00,666	1,62,017
Interest Payments			17,276	15,143	14,268	15,789	21,500
Profits after tax			14,715	26,182	39,599	67,506	1,11,107

n.a. : Not available

Source: Reserve Bank of India, Annual Report 2006-07 (Mumbai, September 2007), Table 1.16, p. 30.

### Private Sector Corporate Giants - Ranking in Terms of Net Sales

Table 34.3 presents data on top 10 private sector companies in India in 2006 (ranked according to net sales).

TABLE 34.3. Top Ten Private Sector Companies (Ranked according to Net Sales)

Company	(Rs. Crore)							
	Net Sales		Operating Profit		Net Profit		Assets	
	2006	Percentage change over previous year	2006	Percentage change over previous year	2006	Percentage change over previous year	2006	Percentage change over previous year
1. Reliance Industries (D)	80,055	21.3	15,454	7.9	9,398	23.2	96,871	19.1
2. Tata Motors	23,588	21.3	3,282	25.5	1,687	25.0	18,066	21.3
3. Tata Steel	20,244	26.5	6,577	4.0	3,702	4.4	20,488	15.7
4. Larsen & Turbo	16,538	14.2	2,280	23.6	1,262	18.6	16,312	26.8
5. TCS (A)	13,264	35.7	3,798	48.5	2,967	50.1	8,489	61.7
6. Sterlite Industries	13,103	80.7	4,014	141.6	1,678	157.5	16,404	26.9
7. Adani Enterprises	12,336	17.7	636	68.7	135	10.7	4,322	18.9
8. Maruti Udyog	12,107	10.1	2,102	14.4	1,219	38.5	8,421	28.7
9. Hindalco	11,762	18.6	3,123	15.9	1,580	22.9	20,933	26.1
10. Bharti Airtel	11,664	43.8	4,066	38.1	2,028	67.4	19,420	37.2

Note : (A) Acquisition, (D) Demerger.

Source : "BS 1000—India's Corporate Giants", Business Standard, December 2006, pp. 56-7.

As is clear from Table 34.3, the largest private sector company in terms of net sales in 2006 was Reliance Industries with its net sales touching Rs. 80,055 crore. In terms of assets also, the company ranks first with its assets placed at Rs. 96,871 crore in 2006. Reliance Industries also ranks first in terms of operating profits and net profits. Its operating profits stood at Rs. 15,454 crore in 2006 and net profits at Rs. 9,398 crore. The second ranked company in terms of net sales is Tata Motors. Its net sales in 2006 amounted to Rs. 23,588 crore. The third ranked company in terms of net sales in 2006 was Tata Steel with its net sales placed at Rs. 20,244 crore. Operating profits of this company were Rs. 6,577 crore and net profits Rs. 3,702 crore. With net sales at Rs. 16,538 crore in 2006, Larson & Toubro occupied the fourth position in 2006. The fifth position in terms of net sales in 2006 was occupied by TCS with its net sales placed at Rs. 13,264 crore. In terms of assets, Hindalco was the second largest company in 2006 after Reliance Industries with its assets at Rs. 20,933 crore.

In terms of Table 34.3, the three top companies in terms of assets in 2006 were Reliance Industries, Hindalco and Tata Steel. In terms of net profits, the top three companies in 2006 were Reliance Industries, Tata Steel and TCS.

### Private Sector Corporate Giants - Ranking in Terms of Market Capitalisation

In recent years, the attention of many corporate sector observers has been shifting from sales recorded by a corporate enterprise to its market capitalisation. *Market capitalisation is simply the value assigned by the stock market to a firm.* On any particular day, market capitalisation is obtained by multiplying the number of outstanding shares of a company to the stock price on that particular day. However, since stock prices fluctuate from day to day and are manipulated by speculators, it is generally average market capitalisation for a period that is taken into account. For instance, a six-monthly average could be considered or an annual average could be considered. Information on top 10 private sector companies on the basis of market capitalisation is provided in Table 34.4.

TABLE 34.4. Top Ten Private Sector Companies-Ranked on the Basis of Market Capitalisation  
(Rs. Crore)

Rank	Company	Average Market Cap.	Average Market Cap.	Average Market Cap.
		2006-07	2005-06	2004-05
1.	Reliance Industries	1,60,393	98,819	67,036
2.	Infosys Technologies	1,04,532	68,483	38,122
3.	Tata Consultancy Services	1,03,974	70,130	48,116
4.	Bharti Airtel	97,891	57,833	27,758
5.	Wipro	77,686	57,405	37,257
6.	ITC	66,904	47,918	24,945
7.	ICICI Bank	63,486	40,347	19,825
8.	Reliance Communications*	61,150	37,260	N.A.
9.	Hindustan Unilever**	51,052	38,877	28,368
10.	Larsen & Toubro	36,884	20,459	N.A.

\* 15 months ended March 31,2007

\*\* Financial year ended December 31, 2006

N.A. Not Available

Source: "BT 500-India's Most Valuable Companies", *Business Today*, December 16, 2007.

As is clear from this Table, the largest private sector company in terms of market capitalisation is Reliance Industries. The average market capitalisation of this company more than doubled in a span of just two years (from Rs. 67,036 crore to Rs. 1,60,393 crore). Infosys Technologies occupies the second position in terms of market capitalisation with its market capitalisation in 2006-07 at Rs. 1,04,532 crores — 2.7 times its market capitalisation in 2004-05. Tata Consultancy Services occupies the third position followed by Bharti Airtel. Wipro with market capitalisation at Rs. 77,686 crore in 2006-07 occupied the fifth position. What is significant is the fact that the three top IT companies of the country—Infosys, TCS and Wipro—are among the five top companies in terms of market capitalisation.

### ■■■■ PROBLEMS OF THE PRIVATE SECTOR ■■■■

**1. Profit generation is the main motive.** Industrialists in the private sector operate with the sole motive of maximising profits. Consequently, they are interested in investing only in those industrial sectors where quick profit generation is possible. Therefore, they tend to invest in consumer goods industries and ignore investments that are crucial for building up a proper industrial infrastructure. Since lack of infrastructure and capital goods industries plagued the Indian economy after Independence, while private sector was reluctant to invest in these areas, the public sector had to step in. Thus, for a considerable period of planning, while the public sector bore the responsibility of developing the capital goods and basic industries and industrial infrastructure (electricity and power, transportation, communications etc.), the private sector concentrated on consumer goods industries where investments were low and profits high. Thus, a number of economists allege that in the initial phase of industrial development lasting for about three decades, the private sector was not willing to shoulder the responsibility of a *prime mover* of economic development processes.

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

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

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

**5. Infrastructure bottlenecks.** Severe capacity shortfalls, poor quality and high cost of infrastructure continue to constrain Indian businesses. *The most important infrastructural constraint is power.* Industry surveys have found that acute power shortfalls, unscheduled power cuts, erratic power quality (low voltage coupled with fluctuation), delays and informal payments required to obtain new connections, and very high industrial energy costs, hurt industry performance and competitiveness. Frequent and substantial power cuts (mostly unscheduled) have forced many units to operate their own (captive) generators, further increasing the cost of power for industry and reducing firm competitiveness. A World Bank - CII survey conducted in 2002 found that 69 per cent of the manufacturing firms surveyed across India had their own power generator, far more than the 30 per cent in China. For garments and electronics, energy costs in Indian firms were found to be twice those in Indonesia, the Philippines, and Thailand. In fact, industrial tariffs for larger firms in India are 8-9 cents/kWh, among the highest in the world (typical rates in Western Europe are in the range 6-7 cents/kWh while in China they are in the range 3-4 cents/kWh). Moreover, the 'quality' of power is also poor. Some 40 per cent of the industries surveyed in Andhra Pradesh reported damage to equipment due to the poor quality of power — with damage much more costly for industries with sensitive equipment, and process and quality heavily dependent on motor speed.<sup>1</sup>

*The second most important infrastructural constraint is transport.* While India has one of the most extensive transport systems in the world, there are severe capacity and quality constraints. It has currently no inter-State expressways linking the major economic centres, and only 3,000 kilometres of four-lane highways



(China has built 25,000 kilometres of four-to-six-lane, access controlled expressways in the last 10 years). Poor riding quality and congestion result in truck and bus speeds on Indian highways that average 30-40 kilometres an hour, about half the expected average.<sup>2</sup> India's high-density rail corridors also face severe capacity constraints, compounded by poor maintenance.

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

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

**8. Industrial sickness.** This is a serious problem confronting the small, medium and large units in the private sector. Substantial amount of loanable funds of the financial institutions is locked up in sick industrial units causing not only wastage of resources but, also affecting the healthy growth of the industrial economy adversely. As at the end of March 2003, the total number of sick/weak units in the portfolio of scheduled commercial banks stood at 1.71 lakh involving a bank credit of Rs. 34,816 crore. Causes of industrial sickness are many and are generally divided into two categories: (i) external and (ii) internal. The former include factors which originate outside the unit and are, therefore, not under the control of the unit such as power cuts, demand (or market) recession, erratic availability of inputs, government policies etc. The latter include factors which originate within the unit and can, therefore, be said to be under the control of the unit such as production, management, finance etc.

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

**10. Threat from foreign competition.** The process of liberalisation unleashed in 1991 has opened up the gates to foreign investors and the government has progressively introduced measures to 'open up' the economy to foreign competition. *This process of globalisation and 'integration' of the Indian economy with the world economy has led to an unequal competition — a competition between 'giant MNCs (multinational corporations)' and 'dwarf Indian enterprises'*. In the early euphoria of liberalisation, the private sector welcomed the measures of the government, but it soon came to realise that opening up the Indian economy to foreign competition meant not only more and cheaper imports and more foreign investment but also opportunities to the MNCs to raid and takeover their enterprises. Even the large Indian enterprises are just pygmies compared to the multinational corporations and while some of them have already been gobbled up by the latter, some others are awaiting their turn with bated breath. As once noted by an MP from West Bengal, the globalisation of the Indian economy is like integrating a mouse into a herd of elephants.<sup>3</sup> For a detailed discussion on the issue of unequal competition between MNCs and Indian enterprises please refer to the chapter on 'Globalisation and its Impact on the Indian Economy'.

#### ■■■■ NOTES ■■■■

1. World Bank, *India: Sustaining Reform, Reducing Poverty* (New Delhi: Oxford University Press, 2003), pp. 67-69.
2. *Ibid.*, p. 69.
3. Baldev Raj Nayar, *Globalisation and Nationalism* (New Delhi, 2001), p. 163.

# PRIVATISATION AND DISINVESTMENT

*Meaning and Rationale of Privatisation*

*Evolution of Privatisation Policy in India*

*Proceeds from Disinvestment and Methodologies Adopted*

*A Critique of Privatisation and Disinvestment*

• Undervaluation of Assets • Utilisation of Money from Disinvestment • Other Criticisms of Privatisation

In the present chapter, we propose to discuss the following questions :

- What is the meaning and rationale of privatisation ?
- How has the approach to privatisation evolved in the post-reform period ?
- What have been the proceeds of disinvestment and what methodologies have been adopted for disinvestment?
- What have been the weaknesses and failures of the disinvestment programme as adopted in India ?

## ■■■■ MEANING AND RATIONALE OF PRIVATISATION ■■■■

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

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

- 1. Improvement in efficiency and performance.** The private sector introduces the 'profit-oriented' decision making process in the working of the enterprise leading to improved efficiency and performance. Moreover, private ownership establishes a market for managers, which improves the quality of management.
- 2. Fixing responsibility is easier.** While personnel in the public enterprises cannot be held responsible (or accountable) for any lapse, the areas of responsibility in the private sector are clearly defined. This makes it possible to take people to task in the private sector units for any blunders committed by them whereas in public sector units, it is easy to pass the buck. Even when responsibility is defined in the public enterprises, there are too many pressures and forces operating to reduce its effective implementation.
- 3. Private units are subject to capital market discipline.** Private sector firms are subject to capital market disciplines and scrutiny by financial experts. In fact, the ability to raise funds in the capital market is crucially dependent on performance. Not so in the case of public enterprises. On account of government

ownership of these enterprises, they have easy access to credit and budgetary support irrespective of their performance. Thus there is no compulsion for these enterprises to perform well.

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

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

**6. Response time in the case of private sector is less.** In a quick changing business environment it often becomes necessary to take spot decisions without having to worry too much about not having consulted others. In fact, 'delayed decision-making is often equivalent to making no decision at all'. In public enterprises, the concept of response time is almost totally absent as no one is willing to disturb the *status quo*. Not so in the case of private sector enterprises. Because of the very nature of management in these units, it becomes easier to react to changing situations fast.

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

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

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

## ■■■■ EVOLUTION OF PRIVATISATION POLICY IN INDIA ■■■■

As stated in Chapter 33, there has been a marked change in the perception towards the role of public sector in the Indian economy since 1991. Some economists argued that the fiscal crisis of 1991 was a result of the public sector's inability to generate adequate returns on investment. The government's attitude also changed markedly as is clearly demonstrated in the following statement made in the New Industrial Policy, 1991: "After the initial exuberance of the public sector entering new areas of industrial and technical competence, a number of problems have begun to manifest themselves in many of the public enterprises. Serious problems are observed in the insufficient growth in productivity, poor project management, over-manning, lack of continuous technological upgradation, and inadequate attention to R & D (Research and Development) and human resource development. In addition, public enterprises have shown a very low rate of return on the capital investment. This has inhibited their ability to re-generate themselves in terms of new investments as well as in technology development. The result is that many of the public enterprises have become a burden rather than being an asset to the Government".<sup>2</sup> Consequently, the New Industrial Policy, 1991, advocated privatisation of public sector enterprises. For purposes of privatisation, the government has adopted the route of disinvestment which involves the sale of the public sector equity to the private sector and the public at large.

The evolution of privatisation policy in India since the start of economic liberalisation since 1991-92 can be outlined as below:<sup>3</sup>

**1. Interim Budget and Budget Speech, 1991-92.** The Government of India enunciated a policy to divest upto 20 per cent of its equity in selected public sector undertakings to mutual funds and investment institutions in the public sector, as well as workers in these firms. The stated purpose of the policy was to place equity across a broad base, improve management, increase resources to the enterprises, and to raise funds for the general exchequer. Initially as shown in Table 35.1, shares of different PSUs were bundled together and sold

to domestic financial institutions. Later in 1992-93, to ensure better prices, individual shares were auctioned separately.

**2. Report of Rangarajan Committee on Disinvestment of Shares, 1993.** The Government appointed a Committee on Disinvestment in Public Sector Enterprises under the Chairmanship of C. Rangarajan in 1993 to suggest the correct method of divestiture. The Committee recommended that the percentage of equity divested could be upto 49 per cent for industries reserved for the public sector, and that, in exceptional cases upto 74 per cent of the equity could be divested. In industries not reserved for the public sector, 100 per cent of the equity could be divested. Only the following 6 industries were reserved for the public sector: (i) coal, (ii) minerals and oils, (iii) armaments, (iv) atomic energy, (v) radioactive minerals, and (vi) railways. The Government of India did not act on these recommendations.

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

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

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

**6. Address by President to Joint Session of Parliament, February 2001.** In his address to the joint session of Parliament in February 2001, the President stated thus: "The government's approach to PSUs has a threefold objective: revival of potentially viable enterprises; closing down of those PSUs that cannot be revived; and bringing down government equity in non-strategic PSUs to 26 per cent or lower. Interests of workers will be fully protected through attractive Voluntary Retirement Schemes and other measures." As Table 35.2 shows, in some cases government's equity stake dropped below 26 per cent.

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

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

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

Industries and Public Enterprises announced that he had put on hold the decision regarding disinvestment in BHEL and other proposals (for disinvestment) in his ministry. The Finance Minister also ruled out the strategic sale route of disinvestment while keeping open the offer of sale route in 13 profit-making PSEs identified by the earlier NDA government. In June 2006 another attempt was made, this time for the sale of 10 per cent stake each in two non-navratna profit-making companies—NALCO (National Aluminum Company) in Orissa and NLC (Neyveli Lignite Corporation) in Tamil Nadu. However, following indefinite strike by NLC workers, the move was shelved. On July 6, 2006, the Prime Minister decided to keep all disinvestment decisions and proposals on hold, pending further review.<sup>4</sup>

### ■■■■ PROCEEDS FROM DISINVESTMENT AND METHODOLOGIES ADOPTED ■■■■

As stated earlier, the Government has adopted two methods of disinvestment: (i) selling of shares in select PSUs, and (ii) strategic sale of a PSU to a private sector company. The former method was used over the period 1991-92 to 1998-99 and, as in clear from Table 35.1, the government experimented with various variants of this method. From 1999-2000 to 2003-04, the emphasis shifted to the latter method which involved strategic sale of a PSU to a private sector company through a process of competitive bidding. After 2004-05, disinvestment realisations have been through sale of small portions of equity.

Table 35.1 gives the targets and achievements of disinvestment in different years and the methodologies adopted for the purpose.

**TABLE 35.1. Disinvestment in PSUs and Methodologies Adopted**

<i>Year</i>	<i>No. of Companies in which equity sold</i>	<i>Target receipt for the year (Rs. in crore)</i>	<i>Actual receipt (Rs. in crore)</i>	<i>Methodology</i>
1991-92	47	2500	3037.74	Minority shares sold by auction method in bundles of 'very good', 'good', and 'average' companies.
1992-93	29	2500	1912.42	Bundling of shares abandoned, shares sold separately for each company by auction method.
1993-94	—	3500	0.00	Equity of 6 companies sold by open auction but proceeds received in 1994-95.
1994-95	17	4000	4843.10	Sale through auction method, in which NRIs and other persons legally permitted to buy, hold or sell equity, allowed to participate.
1995-96	5	7000	168.48	Equities of 4 companies auctioned.
1996-97	1	5000	379.67	GDR (VSNL) in international market.
1997-98	1	4800	910.00	GDR (MTNL) in international market.
1998-99	5	5000	5371.11	GDR (VSNL), Domestic offerings with the participation of FIIs (CONCOR, GAIL). Cross purchase by 3 Oil sector companies <i>i.e.</i> , GAIL, ONGC and Indian Oil Corporation.
1999-00	5	10000	1860.14	GDR (GAIL), Domestic issue (VSNL), restructuring (BALCO), MFIL's strategic sale and others.
2000-01	5	10000	1871.26	Strategic sale of BALCO, LJMC; Takeover KRL (CRL), CPCL (MRL), BRPL.
2001-02*	8	12000	5632.25	Strategic sale of CMC (51%), HTL (74%), VSNL (25%), IBP (33.58%), PPL(74%) and sale of hotel properties of ITDC and HCI, receipt from surplus cash reserves from STC and MMTC.
2002-03*	8	12000	3347.98	Strategic sale: HZL (26%), IPCL (25%), HCI, ITDC, Maruti : control premium from renunciation of rights issue, put option MFIL (26%), shares to employees in HZL, CMC and VSNL.
2003-04	2	14500	15547.41	Jessop and Co. (72% strategic sale), HZL (18.92% call option) through public offer, Maruti (27.5%), ICI (9.2%), IBP (26%), IPCL (28.945%), CMC (26.25%), DCI (20%), GAIL (10%) and ONGC (9.96%).
2004-05	3	4000	2764.87	NTPC (5.25% offer for sale), IPCL (5% to employees) and ONGC (0.01 %).
2005-06			1567.60	By sale of shares to public sector financial institutions and public sector banks.
<b>Total</b>		<b>96800</b>	<b>49214.03</b>	

\* Figures are inclusive of control premium, dividend/dividend tax, restructuring and transfer of surplus cash reserves prior to disinvestment.  
 Source: Department of Disinvestment, <http://divest.nic.in>.

Initially in 1991-92, the government offered shares for sale in 'bundles' involving a combination of equity from poor and good performers. In practice rather than help the government divest shares in loss-making PSUs at reasonable prices, bundling resulted in the government obtaining a very low average price for each bundle, implying that prime shares were handed over at rock-bottom prices. In 1992-93, the government abandoned the bundling of shares and sold shares of each company separately by the auction method. In 1994-95, NRI and other persons were allowed to participate in the auction. In 1996-97 and 1997-98, GDRs (Global Depository Receipts) of VSNL and MTNL in international markets fetched Rs. 380 crore and Rs. 910 crore respectively. In 1998-99, alongwith GDR and domestic offerings with the participation of foreign institutional investors, cash-rich PSUs (like ONGC, GAIL and IOC) were forced to 'cross hold' shares in related PSUs by buying them from the government. From 1999-2000 to 2003-04, as stated earlier, the focus of the government shifted to the second method of disinvestment the strategic sale of a PSU to a private sector company. The government resorted to strategic sale of a number of companies—MFIL (Modern Foods India Ltd.), Videsh Sanchar Nigam Ltd. (VSNL), Indian Petrochemicals Corporation Ltd. (IPCL), Bharat Aluminium Company (BALCO), CMC Ltd, HTL Ltd., IBP, Indian Tourism Development Corporation (ITDC) (13 hotels), Hotel Corporation of India Ltd. (HCI Hotels), Paradeep Phosphates Ltd. (PPL), Hindustan Zinc Ltd. (HZL), Maruti Udyog Ltd. (MUL) etc.

As is clear from Table 35.1, the actual realisation from disinvestment over the period 1991-92 to 2005-06 was Rs. 49,214 crore as against the target of Rs. 96,800 crore for the period 1991-92 to 2004-05 (no target was set for disinvestment in the 2005-06 Budget). Thus, achievement has been very much less as compared with the target.

TABLE 35.2. Privatisations with Strategic Partners in India, 1999-2000 to 2004-05

No.	Name	Per cent of Government Equity sold	Realisation (Rs. in crore)	Profit/Loss
1.	Modern Food Industries Limited (India)(MFIL)	80	149.52	Loss Making
2.	Bharat Aluminum Co.	51	826.92*	Profit Making
3.	CMC	51	158.07	Profit Making
4.	HTL	74	55	Profit Making
5.	Lagan Jute Machinery Corporation	74	2.53	Loss Making
6.	ITOC-19 different hotels	90	691.63	All Loss Making
7.	IBP Co.	33.58	1153.68	Profit Making
8.	Videsh Sanchar Nigam Limited	25	3689*	Profit Making
9.	Paradeep Phosphates	74	151.70	Loss Making
10.	Hindustan Zinc	44.92	775.07	Profit Making
11.	Maruti Udyog	4.2	1000	Profit Making
12.	Indian Petrochemicals Corporation Limited	26	1490.84	Profit Making
13.	State Trading Corporation of India		40**	
14.	MMTC		60**	
15.	Jessop and Co.	72	18.18	Loss Making
Grand Total			10257.19	

\* Including dividend and dividend tax.

\*\* The receipt is on account of transfer of cash reserves.

Source: Department of Disinvestment, <http://divest.nic.in>.

## ■■■■ A CRITIQUE OF PRIVATISATION AND DISINVESTMENT ■■■■

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

### Undervaluation of Assets

A study of the data presented in Table 35.1 shows that the performance on the disinvestment front over the period 1991-92 to 2005-06 has been dismal. Only in four years—1991-92, 1994-95, 1998-99 and 2003-04, the targets for disinvestment were exceeded. In all other years, realisations from disinvestment were much less than the targets. The main reasons for this poor performance were as follows: