(II) SECRETARIAT'S PRELIMINARY STUDY

Introduction

1. Most of the developing countries in Asia and Africa achieved their political independence in 1950s as a culmination of the process of decolonisation set in motion by the United Nations soon after its inception in 1945. After attaining political emancipation, one major challenge before the newly independent States was to select a development model which could revitalize their depressed economies since little, if any, meaningful development had taken place in these countries during the colonial era. The development model that was chosen by most of these countries was that of a mixed economy consisting of the public sector and the private sector in which primacy was given to the public sector. All basic, strategic and infrastructural industries were entrusted to the public sector whilst the private sector was intended to play a complementary role. The rationale for lending primacy to the public sector was that the State should have a definite say in shaping economic policies and that welfare of the masses could be achieved only through socialism.

2. India became the chief proponent of this development model and it inspired a number of other developing nations in the region to adopt economic systems based on this model. To begin with, India, in 1951, had only five central public sector enterprises with an investment of Rs. 290 million.[1] Since then the public sector has registered a phenomenal growth. By March 1988, the number of PSEs had risen to 231 with an investment of Rs. 712,990 million[2]. At present, nearly 55 per cent of the PSE investment is in steel, coal, minerals and metals, electricity and petroleum. Products include such items as bread, paper, footwear and contraceptives; air, sea, river and road transport; national and international trade; consultancy, construction activities; hotels and tourism services.[3]

3. Although this model of development had the advantage of industrializing the country and making it largely self-reliant, it is now being realized that the overall performance of the public sector has not been satisfactory. In 1990, India had a total of 248 central public enterprises, out of which 103 had incurred losses to the tune of Rs. 17450 million during 1989-90. Out

1 Venkateswaran, R.J. "Aspects of Privatization. The Public Sector" in the *Hindustan Times*, New Delhi, dated 23 November 1991.

2 Prabhu, A.N. "Privatisation. How to make it work here" in the *Hindustan Times*, New Delhi, 2nd June 1991.

3 Dutt, R.C. *State Enterprises in a Developing Country. The Indian Experience 1950-90*, New Delhi, 1991.

of these loss-making units, 40 were chronically sick and their revamping required writing off losses worth Rs. 62,000 million while fresh investments in only 28 units (which were to be rehabilitated) were expected to involve additional outlays of Rs. 33,000 million.[4] In addition thereto, compensation in the event of closure was to involve a similar amount. In other countries of the region, the experience has not been dissimilar. The reasons that have been advanced for the overall failure of the public sector are along sthe following lines :

(i) Some of the PSEs have virtually become social welfare organisations with no accent on efficiency and productivity. They have become breeding grounds for corruption, patronage, inefficiency and bureaucracy, guzzling huge resources from the larger economy.

(ii) The PSEs are incurring continuous and staggering losses on account of their producing goods and services at high cost and of indifferent quality.

(iii) Their freedom of operation is severely curtailed due to excessive interference by Governments, formally or informally.

(iv) They have bred a culture of no work.

4. Since the PSEs have become a drain on the exchequer, of late pressures are being brought to bear on the governments to diminish the role of the public sector and increase the role of the private sector through industrial restructuring and privatisation. Since most of the governments in the region have been suffering from increasing budgetary gaps year after year while at the same time facing mounting external indebtedness, pressures are being exerted on them in particular by the international financial and monetary institutions to close down the chronically sick PSEs and reorganize or privatise the remaining ones if they wish to be favourably considered for developmental assistance. Since governments would face the prospect of industrial unrest in ordering closure of sick units, they are being promised by these agencies financial assistance to enable them to meet the cost of retrenchment and other monetary benefits to be given to the workers of such units.[5]

5. Probably, it is in response to these pressures coupled with the overall unsatisfactory performance of the public sector, that privatisation and deregulation of national economies have become the watchword in about 50 countries around the world. In fact, deregulation, relaxation of State control and the withdrawal of State from certain economic processes is already in process in India, Pakistan, Sri Lanka, China, South-East Asia, Angola, Algeria, Ethiopia, Kenya, Mexico, Chile, Western and Eastern Europe and the USSR. There have been other factors also which have aided and abetted this development. Firstly, the successful British experience, Mrs. Thatcher, former Prime Minister, privatised over two dozens PSEs in UK including giants in steel, air and telecom services and showed that there was a no panacea save for trusting her people. The second is the crumbling of the concept of public sector in the Soviet Union and East European bloc which are now switching over to the market oriented systems and contemplating privatisation of the majority of their public enterprises. Thirdly, most of the developing countries have now come out of the time-honoured managing agency system fostered by the British. Large private sector companies are now in the hands of professional managers and a new entrepreneurial class has come up. Fourthly, in several developing countries, there is now in place an industrial and technological base and a fairly good infrastructure and heavy industry have been well set. Fifthly, the capital market, by and large, is growing in a number of countries of the region. Sixthly and lastly, the recognition that withdrawal of the State from economic process is one of the keys to further development since new industries such as micro-electronics, computers, auto-revolution, information technology, automation of textiles and several other industries need less interference from the State.

6. However, a crucial question that arises in this context is in the manner and at what pace can the public sector be privatised since the private sector even now has neither the resources nor the competence to take over all public enterprises. If privatisation is taken to mean selling away the assets of the public sector, partially or fully, to some individuals or to some private companies including foreign enterprises, however efficient or financially sound, that will not be in the interest of the developing economies since no country or government would be willing to risk the political fallout that will be generated if any such step is even contemplated. Privatisation in the present context should, therefore, mean only disinvestment of PSE's shares to the public at large including workers – partially, substantially or fully. Even in this restricted sense, full privatisation, given the present state of economies in the countries of the region, would not be in a position to absorb the shock of full privatisation without a fundamental restructuring of national economies. Moreover, taking into account the experiences of the privatisation in Latin America and UK, it appears that privatisation works only to the degree that the rest of the economy works. If the general economy suffers from a overdoze of bureaucratic controls, rules and regulations, permits and licences, it would make only a nominal difference whether an enterprise is in private or public sector.

7. It is contended that four preconditions have to be satisfied before privatisation can be successful :

"(i) The economy should be globalised. Inranational and international competition should be fully encouraged. Otherwise privatisation will result in the replacement of inefficient public monopolies by exploitative private monopolies.

(ii) Subsidies will have to be abolished. Full privatisation in a regime

4 Mitra Chenoy, Kamal A. "Privatizing India" in *Mainstream*, New Delhi. Vol. XXIX. No. 41, dated 3 August 1991.

5 The Government of India has been promised $ 1 billion of this score by the World Bank.

of subsidies will be an absurdity.

(iii) Administered prices and privatisation is an equally glaring contradiction. No privatisation with simultaneous price controls can ever work.

(iv) Internal and external protection through non-tariff measures will have to be abolished. Whatever tariffs are needed have to be fully rationalized, otherwise efficiencies will deteriorate and the consumer and tax payer will become the victims. Privatisation in essence means competition.[6]

8. These are major microeconomic issues and involve restructuring of the national economies and a fundamental change in the overall historical perspective. Alleviation of poverty, equitable distribution of goods and services and maintenance of regional balances continue to be the major demands in the States of the region needing subsidies through the mechanism of administered and retention prices. Since Governments are likely to take time in taking a position on these major issues, full privatization of the public sector at the moment should remain a long-term objective.

9. However, within the present framework a partial divestment is possible and desirable if the objectives are to : (a) improve the efficiency of performance of the PSEs; (b) make available funds to PSEs for modernization, expansion and corporate growth; and (c) distance government from day-to-day functioning of the PSEs. A partial divestment is feasible without affecting major policy changes and without waiting for a total restructuring of the economy. A divestment of upto 49% should pose no problem as the governments would still be able to retain effective policy control. This is essential because experience indicates that the success of late industrialisers like Japan or the Republic of Korea was based, not on indiscriminate investment by private investors pursuing market signals, but industrialization guided by the State that influenced the number of units, the size of each, and the technology and marketing strategy adopted in each industry. At a later stage divestment even up to 60% can be tried provided the equity is distributed amongst a large number of shareholders including the workers of the enterprise.

10. However, it will not be possible to divest the shares of all PSEs, particularly those which are industriallly sick as nobody would be interested to invest in them. The remedy for the sick units should be the same as for sick private enterprises. First, give an opportunity to the workers to run the units. If they cannot, one must face the unpleasant task of closing them down, with appropriate measures for relocation and rehabilitation of workers. The capital raised by disinvestment of selected PSEs should not go into the exchequer but should go into a separate Fund with the following objectives : (i) For reinvestment in the public sector for modernization, expansion and corporate growth; (ii) For assisting ailing PSEs and turning them around; (iii) To create a social security scheme to safeguard the rights of workers; and (iv) For intervention in the market to sustain public confidence in this equity. Such a Fund should be governed by a select body consisting of government nominees, public sector chiefs, chiefs of financial institutions and eminent economists from the public and private sectors, who would have all the authority to manage the Fund for the objectives listed.

11. Once partial disinvestment has been achieved, the next logical step would be restructuring of the management of PSEs. Their Boards should be reconstituted to give representation to the general shareholders. The government should avoid the temptation to use its large shareholding to get its nominees elected as this will defeat the purpose of partial privatisation. Today, the annual general meetings of the PSEs are closed meetings between the Chairman and Managing Directors of the enterprises and a representative of the Government. There is really no accountability and transparency in their operations in the true sense of the word. In fact, accountability of the PSEs should be looked at from the viewpoint of accountability for efficiency, productivity and profitability rather than from day-to-day operations. The management of the PSEs should not be the responsibility either of politicians or bureaucrats. They should be given independence and then made accountable for their performance. Unless, governments consciously adopt this approach, no amount of industrial restructuring of public enterprises would ever succeed.

12. From the foregoing account, the inescapable conclusion that can be derived is that Governments in the region in their transition from the mixed economy to that of a market-oriented economy will have to sequence their privatisation programmes in a phased manner keeping in mind the national interest as well as the need to align their economies with the global economy.

Legal Aspects

13. In any programme of privatisation, four stages can be contemplated. The first stage is 'partial privatisation' which consists in the initial sale of shares of a PSE to the public at large including the workers. The initial divestment is generally limited to 20 to 25%. The second stage consists in the sale of shares of a partially privatised PSE in which such divestment is limited to 49%. The third stage, which may be called 'effective privatisation' consists in the sale of shares to the extent of giving away control of a PSE to the private companies. The last stage is "total privatisation" which means complete withdrawal of the State from the enterprise. In stages I and II, the State control relatively remains intact but in stages III and IV, it is either minimised or completely eliminated.

14. For implementing stages I and II of privatisation, which can be characterized as partial privatisation, there is already in place in most of the countries of the region the requisite legal framework, although a few changes will be required in certain legislation and a few fresh legislation

6 Moosa Raza. "Exploding the Efficiency Myth" in *The Economy*, Vol. I — *Crisis and Adjustment*. New Delhi, 1991.