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State Intervention and Economic Development

State intervenes in the economic development of an economy in a variety of ways within the contours of socio-economic and political circumstances. A government may intervene in the process of economic development mainly in two different ways. It controls and regulates the private sector while abstaining from undertaking direct production through enacting suitable economic policies. Alternatively, it prefers to undertake production but refrains from imposing controls on the private sector. The former is referred to as controlling state while the latter as producing state. However, in practice, a state is a mixture of both. Whatever may have been the historical tradition, it is seen that state intervention has induced, improvised, restrained and conditioned a variety of structural transformation in the economy, especially in the industry.

Theoretically, two broad conjectures are recognised on the nature of state intervention in a Capitalist economy. The first may be described, in the words of Paul Sweezy (1991), as the 'class-mediation theory' while the second would be 'class-domination theory' (p.243). "Class mediation theory takes the existence of a certain class structure for granted, and sees in the state an institution for reconciling the conflicting interests of various classes; class domination theory, on the other hand, recognises that the classes are a product of historical development and sees the state as an instrument, in the hands of the ruling classes, for enforcing and guaranteeing the stability of the class-structure itself." Between these two broad strands, there are several versions, dominant among them being the 'Stamocap theories' (Jessop 1982). "These theories assume a particular stage of capitalism characterised by fusion of monopoly forces with the bourgeoisie state which, in fact, becomes a single mechanism of economic exploitation and political domination" (Jessop 1982, p.32). Without going into the details of these debates within Marxist and Liberal traditions, it is suffice to say that any prior theoretical construction on the nature and character of state intervention in a country would be restricted by the practical experience of the state in that particular economy depending upon spatial and temporal conditions. In different nation-states, the state intervenes in different ways at different points in time, conditioned by a plethora of socio-economic and historical factors. Consequently, uneven capitalist development follows. In this process, some states emerge as advanced or independent while others as subordinated, colonised or dependent. To mark this distinction, theoretical literature is presented in 'dependency perspective' (Bottomore 1987, pp 115-17 and 500-3), particularly by Cordoso, Dos Santos, Paul Baran, AG. Frank and Samir Amin.

The intervention of state would be different in an advanced country as compared to that in a colonial or post-colonial economy. Different scholars have advocated various ways through which state can intervene in an advanced capitalist economy. Since Adam Smith advocated Laissez-faire capitalism, restricting the role of the state to defence, administration, justice and public works only; academic opinions changed and many economists favoured a varying degree of state intervention. Marx discussed state intervention in terms of classes and class-relations. In Keynes' and Kalecki's works, state intervention is not restricted to the provision of financial and infrastructural support but also of correcting the system whenever there is crisis thus leading to a crisis-free capitalism. Keynes believed that state intervention in itself would be a sufficient condition to deal with the crisis-ridden economy. But he did not recognise the tendencies of recurrent crisis inherent in a system. Kalecki recognised this and analysed it in terms of business cycle and political business cycle[1].

State Intervention in a Developing Economy is of different nature. The underlying assumption is that in a developing country, the market mechanism systematically misallocates resources between different uses at a given point in time and therefore capitalist state seeks recourse to state intervention, especially for setting the prices right. State intervention in the colonial economy was mainly assisting metropolitan industries in their export expansion activities on the Indian market. Government intervention, therefore, did not generate the basic conditions for a wider development of domestic private enterprise. The development of industrial capital took place 'in spite of', rather than, 'because of' state intervention (Bagchi 1982). In the post-colonial regime of a country, the twin problems of industrialisation and development necessitate a fair degree of active state intervention. India's situation throws up many interesting insights in this regard that we shall discuss as the present paper progresses.

State owned enterprises - An Instrument of State Intervention

As mentioned earlier, the state does intervene in the industrialisation of an economy depending upon a host of initial conditions. The formation of state capitalist or state owned enterprises (SOEs) for the production of goods and services is one manifestation of such an intervention. One may not discover a uniform set of reasons as to why such enterprises have been created in different countries. In some cases, their creation is attributed to the discernible limitations of market mechanism particularly when domestic capitalism is still in a nascent stage and private enterprise is weak. In some other cases, it is a deliberate response to the historically determined relationships perceived by many post-colonial societies. Yet in some other cases, their origin is grounded in ideology- the ideology of socialism.

Thus, the rationale for establishing state capitalist enterprises stems from the imperfections in the product as well as factor markets, lack of information and reluctance on the part of private entrepreneurs due to high risk and low returns (Gillis 1980). Moreover, in order to earn revenue, governments prefer to own monopolies, nationalised industries especially in public utilities, railways and communications.

In many developing countries, state enterprises are assigned the responsibility of fulfilling specific social goals, which have their origin in colonial period. Correcting regional and economic imbalances, providing employment and reducing the concentration of monopoly power in the economy are a few obvious examples. As a pre-requisite for balanced growth, the state controls the key sectors of the economy. This argument is popularly known as 'commanding heights' rationale and is normally associated with the ideology.

Whatever may be the idea behind the creation of such enterprises, they come into existence either by direct state investment or through nationalisation of private enterprises. The state intervenes through state owned enterprises in the countries where investment needs for different projects are large and the expected returns at least in the short run are too low to motivate private capital to invest.

In brief, we find various socio-political-economic and historical rationales, all different, but often entwined with each other for the creation of state owned enterprises. Hence, any research study aiming to evaluate the economic policies and the role of state sector in an economy cannot be separated from the general polity and social background of that economy. Also, it is imperative to go beyond an overall evaluation of state sector as a whole and to disaggregate it for the purpose of analysis. The dis-aggregation becomes all the more important if we have reasons to believe that (i) the performance is not uniform across the entire spectrum of state owned enterprises and that (ii) the state owned enterprises are not inherently inefficient.

Since 1980, the intervention by the state through state owned enterprises has been undergoing a close scrutiny in many developing countries including India. Due to tremendous fluidity of finance capital, governments found themselves struggling with fiscal deficits and making it increasingly difficult to raise funds at home and abroad. The state capitalist enterprises were absorbing a large chunk of government funds in the form of subsidies, which has resulted in the misallocation of resources brought about by diversion of savings. So there was a hunt for remedies in the developing economies and recourse has been found by most of them including India in the form of deregulation, liberalisation, contracting out and franchising.

In his endeavour to develop a theory of economic growth that takes root in the economic and political realities of the late capitalist society, O'Connor (1973) points out that, the capitalist state must accomplish two basic but contradictory functions - accumulation and legitimisation. It means that the state must create conducive environment for the capitalist accumulation. It must also generate conditions for social harmony[2]. These two concepts point out at two significant and inter-related aspects of social reality.

Various approaches have been suggested for the evaluation of state enterprises and thus making a case for privatisation; major among them being: (i) financial profitability and (ii) social profitability using accounting prices. The former approach in itself is not a sufficient condition to frame judgement on economic performance. As Chokshi (1979) points out, "Any general comparison between state owned and private enterprises based on the use of financial efficiency (profitability) is not meaningful as no two enterprises operate in precisely comparable circumstances". Many of the state capitalist enterprises fail either due to faulty planning or due to excess capacity created or because of the non-optimal choice of location, which serve the purpose of regional development. Similarly, excessive political interference and lack of managerial interests (autonomy) hamper the performance of state enterprises. Based on the above strands of thinking, there are various theories on assessing the performance of state enterprises.

One of them is 'property rights theory', developed by Armen Alchian, Ronald Coase, and Harold Demsetz,, which explains differences in organisational behaviour solely on the basis of the individual incentives created by the structure of property rights. In this view, property rights specify the social and economic relations that people must observe with each other in their use of scarce resources, including not only the benefits that owners are allowed to enjoy but also the harms to others that they are allowed to cause. A right of ownership actually comprises several rights, chiefly the rights to use an asset, to change it in form, substance, or location, and to transfer all or some of these rights. In so far as the state restricts these rights; they get diluted. Thus “the key issues for the theory are, first, to whom are property rights assigned? and second, how, if at all, are they attenuated?” (Starr 1988).

The theory holds that the form of ownership is the predominant explanation for the varying performance of different organisations. It takes the market as the standard for judging value and finds state owned institutions deficient because they fail to measure up to that standard, e.g., their "shareholders" cannot sell stock and finally it assumes that the market for corporate control is highly efficient and that the chief reason corporations are acquired is their management's poor performance. (Starr 1988).

Another theory revolves around the political dynamics. It takes the strand that state owned sector is exposed to political manipulations. State Capitalist enterprises are an instrument of intervention in the hands of politicians in developing countries but hidden from public surveillance. The presence of coalition groups is a factor responsible for the poor performance of state enterprises, which serve as a source of power in the hands of bureaucrats and managers. The theory owes its origin to Buchanan and Tullock (1962), "who apply the logic of microeconomics to politics and generally find that whereas self interest leads to benign results in the market place, it produces nothing but pathology in political decisions" (Starr 1988). Similar to property rights theory, the public choice theory assumes individualistic model of human behaviour and postulates that (1) democratic polities have inherent tendencies toward government growth and excessive budgets; (2) expenditure growth is due to self-interested coalitions of voters, politicians, and bureaucrats; and (3) state owned enterprises necessarily perform less efficiently than private enterprises.

Both property rights and public choice theories basically deal with the reassignment of rights. There is another perspective in economic theory that deals with relocation of economic functions as given by neoclassical economists. According to them imperfect information, externalities, increasing returns to scale, and inequalities of wealth prevent the market from achieving optimal performance. Thus when the market fails, some form of public ownership or regulation is justified. But as public choice theory has successfully risen the challenge 'where as markets fail, so, does the government'; indeed, the theory suggests that government's performance will only be worse. Charles Wolf (1979), refer it as "non-market failure." Thus the theory maintains that both markets and states have their weaknesses and thus according to this perspective, privatisation becomes a way to move activity from a less efficient to a more efficient form--a tool of economic adjustment rather than radical reconstruction (Yarrow 1986).

There is yet another theory, which is most widely discussed in the literature of industrial organisation and revolves around the superior efficiency of the markets, which are characterised by effective competition among firms.

Thus there exist near universality of the attack on state from both ends of political spectrum—Marxists and non-Marxists. Marxists critics of the role of state intervention find state as the captive of capitalist interests (Miliband 1969), existence of unproductive labour in state services sector (Gough 1979), and the tendency of government spending to exceed government receipts under the demands both from capital and labour for state funds and resistance to taxation (O'Connor 1973). Mainstream arguments claim that services including state services tend to be unproductive (Bacon and Eltis 1976) and that as economies progress, social security schemes tend to reduce aggregate capital accumulation (Feldstein 1974).

Hence all the theories and viewpoints are informative of the general theoretical case for privatisation. Special concerns are level of capitalist development, presence of coalition groups, managerial incentives and competitive forces. However, whether it is the level of capitalist development or the presence of coalition groups, state intervention through state owned enterprises will depend upon the social fabric of a given society. As Shepherd (1976) comments, "whether or not state owned enterprises does reasonably well in financial terms seems to be more a function of country concerned than of economic sectors or organisation of the enterprise". It is not fair, however, to expect any single theory to encompass all aspects connected with the performance of state owned enterprises.

Economic policy and the posture on state owned sector

To reiterate, economic policy making by the state requires balance of accumulation and legitimisation. Generally, the adopted economic policy serves the interests of a few major social groups. These dominant social groups react to the adopted policy and their reactions are normally taken into account while amending the existing policy or making the new economic policy. Thus in the process, a balance of accumulation and legitimisation is sought out.

The proper understanding of the economic policy of an economy like India necessitates its historical evaluation. Therefore, in this paper, the whole period of interaction of economic policy and state owned sector in the post-independence India has been divided into following four phases: (i) 1950-1965, (ii) 1966-1984, (iii) 1984-91 and (iv) post-1991 policy regime. During the first phase, i.e. 1950-65, the growth rates of the economy were generally high and state owned sector was occupying the position of 'commanding heights'. The second phase (1966-84) has been further sub-divided into two periods 1966-73 and 1973-84, because of various factors, discussed later in detail. Although the economy passed through a crisis during this phase, the state owned sector was by and large still enjoying a significant position. The second sub-period, i.e. 1973-84 recorded a slow process towards liberalisation, which culminated into an irreversible process of liberalisation of the economy through the third (1984-91) and during final phase (1991 onwards) of our study of the economic policy in India. In the present phase, state owned sector, no longer occupies the position of commanding heights. In addition, the old concept of socialism and mixed economy are replaced by the concepts such as liberalisation, privatisation, disinvestment and market-friendly approach.

Hence, these four phases of the economic policy making will enable us to understand the logic behind the establishment of state owned sector and assigning it the role of commanding heights; the subsequent change in thinking and the reasons behind such a change in policy.

First Phase (1950-65)

To begin with, in 1947, it was mainly the ideology of socialism that led the state owned sector to play a significant role in the rapid development of the economy. However, at that moment, it was very difficult to deny the existence of big monopoly capitalists. Consequently, the economy was essentially a mixed one comprising of both state owned and private industrial sectors. Two Industrial Policy Resolutions of 1948 and of 1956[3] were adopted during this period. Both these resolutions acknowledged the role of the private sector but excluded it from the basic and strategic sectors of the economy reserving them exclusively for the state owned sector. Many arguments were put forward in support of the role assigned to the state owned sector e.g. the provision of infrastructure for private sector; long gestation period of basic and strategic industries, lack of adequate funds in the hands of private sector to establish such industries. Private sector enterprises also welcomed this move on the part of the government, as they wanted protection against the national and foreign monopolists (Shirokov 1973).

State owned sector was not only serving the path to socialism of the future but also the mechanism to bring about India's industrialisation and modernisation. The economic strategy adopted in support of this argument was extensive import-substitution programme with a lot of emphasis on heavy industry and capital goods industry. This strategy was followed in the second five-year plan under the aegis of Mahalanobis heavy industry model and was carried on through the third five-year plan. The various instruments of this entire programme were centralised economic planning, heavy public investment, high protection tariffs and licensing policy.

However, state owned sector was not the only part of total project adopted in the Nehruvian era. The other important part was land reforms. It will be out of context to go into the details of this aspect. Suffice to mention here that the land reform measures adopted failed largely due to the lack of political will. In the opinion of some researchers, the ruling party proved to be a hindrance rather than help substantiating the argument that when interests of the important social groups are at stake, ideology loses its usual verve. “All these developments ultimately meant that the project of socialist society was reduced to a project of industrialisation with state owned sector being assigned the important role” (Mehta 1989).

Thus, in terms of Kalecki's 'intermediate regime', one can infer that economic policy of the 'Nehruvian era' was more a reflection of the aspirations of the urban middle classes. However, at the same time, it reflects the weaknesses of big monopoly capitalists in urban areas and power of the rich rural strata during that particular period.

Second Phase (1966-84)

The first phase of economic policy making registered a satisfactory industrial growth with a policy of import-substitution and self-reliance. It was only because of Indo-China war of 1962 and the Indo-Pak war of 1965 that India had to ask for foreign aid and consequently it came under the pressure of international agencies like the World Bank and IMF. This process was further aggravated by the agricultural crisis of 1965-67, when it experienced the worst drought.

There were conscious efforts on the part of the policy makers and political leaders to bring about a change in the economic policy and a different strand was taken. The emphasis was more on agriculture. (It was during this period that the adoption of the HYV strategy resulted in the Green Revolution in some parts of the country) rather than on heavy industry and massive state owned sector investments. In order to correct the balance of payments problem, rupee was devalued in June 1966. However, these changes could not solve the prevailing economic crisis. Inflation rate was alarmingly high and subsequent years witnessed serious budgetary crisis, which effectively put an end to the heavy industry strategy and a decline in state capitalist or public investments manifested itself in the slower growth rates of industrial output in Indian economy.

It was natural, therefore, that retrogression in the rate of growth of Indian economy that started in the mid-sixties, reached alarming proportions by the early seventies. Over the years, this slowing down of industrial growth rate generated a lively debate among the scholars who offered many explanations (Varshney 1984). One among all these explanations was declining public investment and infrastructural bottlenecks expounded by Bardhan (1984). He discussed this argument in two steps, i.e. (i) a decline in public investment and rising capital-output ratios were strongly related to the deceleration in Industrial growth; and (ii) these causes owe their genesis to the heterogeneous and conflicting nature of India's dominant coalition.

Because of this entire experience over a period of almost five years, i.e. 1964-69, the government reversed back to the radical conjecture that ensued with the nationalisation of banks in 1969 and the enactment of the Monopolies and Restrictive Trade Practices Act, 1969. This shifting from one stand to another was more a reflection of the politics of populism rather than a consistent strategy of growth. The experience of oil shock of 1973 and the realisation, on the part of government that the radical approach with its restrictions on private sector and relentless expansion of the state owned sector had not helped the growth of the economy; on the contrary, it had coincided with economic stagnation and inflation (Marathe 1986).

Consequently, the economic policy of the government took a turn towards liberalisation. New Industrial licensing policy was announced in 1973 with its partial liberalisation programme. Several concessions were granted to Indian as well as foreign capital. In concrete economic terms, a major consequence of the new policy was the giving up of the policy of import-substitution and relying on export-led growth strategy.

Further policies announced in 1975-76 included approval of additional capacity as an instrument in the process of modernisation, de-licensing of industries, automatic expansion of capacity up to 25 per cent over a period of five years in a few engineering industries (Marathe 1986). State owned sector was no longer conceptualised as an engine of growth; rather its role was understood as one of facilitating private sector's growth.

Again, in 1977, continuing with the policy of liberalisation, further relaxations were made. Stating the inadequacies of the 1956 Industrial Policy Resolution, this policy intended "to remove the distortions of the past so that genuine aspirations of the people can be met within a time bound programme of economic development" (Industrial Policy Resolution (IPR), 1977, para 2). It emphasised on the need for the development and application of technologies, "appropriate to our socio-economic conditions" (IPR 1977, para 15). Some selected industries, hitherto reserved for the state enterprises, were now thrown open to large monopoly capital such as organic or inorganic heavy chemicals and industrial machinery. However, rhetoric of state owned sector as a real encumbrance to the growth of large monopoly capital was made. "Apart from socialising the means of production in strategic areas, state owned sector provides a countervailing power to the growth of large houses and large enterprises in the private sector" (IPR 1977, para 21). The policy, therefore, proposed an "expanding role for the state owned sector in several such fields."

As against the 1977, Industrial Policy Statement that was a reflection of the break up with the past, the Industrial Policy Statement issued in July 1980 was initially a reiteration of past policies.[4] However, within two months, it not only allowed an automatic expansion of capacity at the rate of 5 per cent per annum over a period of five years for 19 basic and core industries (stated in IPR 1956) and 15 engineering industries (for which the automatic expansion had been allowed in 1975), but the existing capacity in these industries were also regularised (Marathe 1986, p.128).

The policy adopted in 1982 was a step forward towards the process of liberalisation. With the relaxation of the controls on both entry and expansion, the government effectively gave up the concept of socialism in India. The administered prices for pig iron were abolished and cement was partially decontrolled (Economic Survey 1982-83, pp. 25-30). The liberalisation trends were quite evident in electronics and telecommunications. The limit of automatic expansion of licensed capacity was raised to one-third of the total over a period of five years rather than just one-fourth as before. Another step-towards this drift away policy was liberalisation of manufactured imports. With the idea and justification for upgrading the Indian industry technologically; a number of foreign collaborations were approved. On an average, the number of foreign collaborations during 1980-84 (586) was more than double compared to those during

1970-79 (270) (Economic Survey 1982-83, pp. 25-30). This clearly revealed the changing mood of the government.

In state owned enterprises, a visible change in the attitude took place. The emphasis was now more on efficiency and internal resource generation. At least 10 per cent rate of return was expected on the investments made by the state. A former Deputy Chairman of the Planning Commission noted in 1982, "By and large state owned sector has become an appendix to the private sector, meant to ensure its smooth running by providing the needed infrastructure and the basic production facilities. As a result instead of striking a path of its own, the state owned sector has to subordinate itself to the logic and requirements of the private sector" (Lakdawala and Kurien 1982).

Therefore, this period of 1966-84 culminated in a total transformation in the economic policy. The economy was made predominantly dependent upon market forces rather than on the state. A transformation of a mixed economy from instrumental-socialist to instrumental-capitalist was patently underway (Mehta 1989, p.356). However, all this was being done under the popular and prevalent image of the government being socialist, "the government was not averse to being seen as acting, even though still not proclaiming, as if it were building a capitalist system" (Mehta 1989). Thus, in order to legitimise the activities of the government, the melodrama of socialism continued with all its anti-poverty and social welfare proclamations. Moreover, the changes made did not appear very drastic and were prima facie technical a reduction in limit here and expansion of restrictions there. "The attempt, it seems, was to depoliticise economic decisions as far as possible" (Kohli 1989).

Third Phase (1984-91)

The third phase of our study of economic policy had a better history to start with. The Fifth and Sixth Five-Year Plans' had recorded much better rates of growth. The growth rate that had been stuck at the average of 3.5 per cent per annum since the fifties, irrespective of the policy and leadership changes increased to 5.4 per cent and 5.2 per cent respectively in the fifth and sixth plan periods. Similarly, a remarkable increase in the savings rate from around 10 per cent in the fifties and mid-seventies to 23.3 per cent in 1984-85 indicated a big structural break.[5]

The industrial policy that was initiated in 1985 was the culmination of the process of drifting away, which started during the second phase of the economic policy in India. This policy, in the opinion of many analysts, marked the beginning of the 'total give in', of the earlier policy of self-reliance. The steps taken for 'rationalising and restructuring' of industrial policy included de-licensing of industries, broad-banding of production so that the industries can make rapid changes in the product-mix, which are necessary to adjust to the changing conditions of demand and technology, increase in the minimum asset limit of MRTP companies from Rs. 20 crores to Rs. 100 crores, introduction of a new scheme of re-endorsement of capacity, in order to maximise the capacity utilisation.

Another major shift in this policy was the replacement of the system of direct physical controls by indirect controls. Hence, instead of the policy that relied more on tariffs and tax mechanisms, a new long-term fiscal policy was adopted that sought to simplify the tax structure through MODVAT (Modified value-added Tax). Warning against the system of physical controls, which in official vocabulary had been branded as socialism in India, K.N. Raj (1985) observed that over the three decades the system had "ceased to perform effectively most of the functions, it was designed for" and "it had become a major source of political and bureaucratic corruption; and was being used by powerful vested interests" (Raj 1985). He further pointed out that, "It was wiser, therefore, to rather abandon the dishonesty and hypocrisy of it all than mainstream pretences... and create needless delays and inefficiencies all around" (Raj 1985).

A qualitative shift in the pattern of industrial growth was observed during this period. Industries like electronics, computers and computer software; telecommunication equipment etc. got the priority in this phase. State owned enterprises were asked to generate a substantial amount of funds internally in order to meet their investment needs and also to reduce their undue dependence on budgetary resources.

While glorifying the achievements of the economy, it became platitudinous to speak of inefficiency, over-manning and low productivity in the state owned enterprises. A long chain of reasons was pointed out for this state of affairs. Examples are: bureaucratic control of state owned sector, bottlenecks of licensing, non-remunerative prices especially under the administered price regimes, increasing incidence of capacity under-utilisation, dwindling magnitudes of ploughed back profits, corruption in many different forms at many different levels (Sathe 1989). While recognising the class character of the various revolutionary and liberal parties and the lack of political will on their part, Raj (1985) pointed out that "perhaps the most important reason why they have not been able to grow, in the manner once hoped and expected that there have not emerged any political force in the country genuinely interested in making such enterprises yield adequate profits and savings of their own"(p.18). He anticipated that the serious implication of such a situation would be a stronger case for private sector enterprises.

Post 1991, Policy Regime

Since July 1991, the country has witnessed a major policy reform programme consisting of considerable deregulation of industrial sector as well as liberalisation of foreign investment and technology imports. The major steps announced in this new package included: abolition of industrial licensing in all the industries except for certain security-related and strategic areas; automatic expansion of capacity according to market needs for existing industries; removal of the restrictions on investment by MRTP and FERA companies; automatic approval for foreign investment up to 51 per cent of equity subject to certain high technology and high investment priority industries; and liberalisation of capital market[6].

While emphasising that the practice of mixed economy would continue, the new economic policy embarked upon a few concrete changes in the sphere of state owned sector operations. Examples are: reduction in the list of industries reserved for state owned sector from 17 to 8 and then to 6. By December 2002, however, the list included only three areas reserved for PSUs: atomic energy, minerals specified in schedule to atomic energy (control of production and use) order, 1953 and Railway Transport. The number of items in respect of which industrial licensing is required, reduced to 15; disinvestment in the shares of state owned sector enterprises to promote general public and workers' participation in their ownership; announcement of a new policy of National Renewal Fund (NRF) in order to deal with the problems of sick state owned enterprises; making them more autonomous and accountable for results through a system of Memorandum of Understanding (MoU). In addition, automatic approval of foreign investment up to 51 % and foreign technology permitted for 35 priority industries, which account for about 50% value added in the manufacturing sector and so on. The Eighth, Ninth and Tenth Plan documents also suggested many policy initiatives regarding restructuring, modernisation, rationalisation of capacity, product-mix changes, privatisation autonomy, performance accountability and disinvestments policy[7].

Such policy shifts had generated a lively debate in India among the supporters of the liberalisation policy prescriptions and critics of the policy. The debate is still on; the emphasis however has shifted after almost a decade of policy implementation, and the assessment on the performance has started appearing. Now the stress is more on the market in association with the state, the latter being responsible for providing institutional and infrastructural set up.

In sum the earlier phase of heavy state spending, policy of protectionism, for example on setting up of financial institutions and investing in basic infrastructural sectors, was thought essential for providing a congenial atmosphere to indigenous capitalists and to facilitate the process of accelerated development of the economy. However, the fact that, in due course, the growing state investment and regulation of the economy resulted in increasing bureaucratisation, corruption, concentration of economic power in few hands, caused many analysts to think in new directions. It was natural that growing internal contradictions and consequently the rising complexity of the system strengthened the lobby seeking a more liberal economic environment in the country, especially when the international aid agencies and the mainstream economic view insisted on such opening-ups.

A perusal of the recent policy shifts has made it quite evident that a return to the radical regime of direct controls is now out of question. The role of the state is diminishing. For all practical purposes, the concept of state owned sector occupying the 'commanding heights' of the economy is abolished except for a rhetoric identifying it with the infrastructure and strategic industries of late. The role of the Planning Commission has faced a significant *de facto* decline. The movement of denouncing socialism that started in many parts of the world has influenced our policy makers as well. In concrete terms, the concepts of mixed economy, socialism, planned development are being replaced by market friendly approach, liberalisation, globalisation, privatisation, and disinvestment and so on.

Implications of Policy Changes for State owned Sector

As explained earlier, the shifting government strands on the economy could not leave the state owned sector unaffected. Shifting posture itself was, however, rooted in insensitive assessment of state owned sector. Particularly after mid-80s, it had become a fashion in official circles to indulge in unrestricted vilification of the state owned sector. The state owned sector was widely criticised as inefficient and the private sector was considered the hope for the future. Discontentment about the performance of the state-owned sector of Indian Industry has become the routine practice. Many studies evaluated the performance differences between state-owned and private sector industry. One school of thought (Majumdar 1995) found the state owned sector less efficient compared to its private sector counterparts. It was established that despite accounting for a major chunk of the capital investment, the state owned enterprises are systematically only two-thirds as efficient as private sector enterprises. Yet another school of thought was of the opinion that state owned and private firms facing similar competitive environment do not display any efficiency differences (Caves and Christiansen 1980). Still another school of thought[8] was of the opinion that despite state owned enterprises, on the whole, performing less than the potential and not up to the expectations, shortcomings of state owned enterprises have often been exaggerated.

In fact many studies have shown that ownership *per se* - state owned or private - is not the factor, which determines efficiency; it is rather the degree of competition. Thus, provided there is sufficient competition, there is no discrepancy in efficiency between privately and state owned enterprises (Williamson, 1969, 1970; Baumol, 1967; Alchian and Kessel 1962, Alchian and Demsetz, 1972; Furubotn and Pejuvich 1972). Therefore, in such enterprises where lack of competition is the major problem; a mere change of ownership might not lead to desirable results and improvement in efficiency.

Stiglitz (1997) cites the extraordinary performance of state owned enterprises in certain provinces of China to make the point that economic success is possible even under conditions in which property rights are ill-defined. He makes the point that generally in all big firms, whether in the state owned or the private sector, managers enjoy considerable discretion. Since managers can appropriate only a small fraction of any improvement in productivity, in neither sector do managers have any incentive to design good incentive structures. Martin and Parker (1997) put forward a number of other reasons why the suggestion of superior performance implied by the property rights and public choice theories as explained earlier literally need not be taken at face value. They argue that it is too simplistic to suppose that state owned and private sector companies are two distinct categories, each with a particular organisational design and orientation.

In Indian scenario Dholakia (1978), proved it in terms of total factor productivity. He constructed a time series of overall factor productivity of the state owned sector and the private sector separately from 1960-61 to 1974-75. The results have revealed that state monopoly capitalist enterprises have performed far better than the private monopoly capitalist enterprises. A. Ghosh

(1984) has proved it in terms of operating efficiency, physical norms of capacity utilisation and efficiency in the use of material and energy. Taking a few case studies, he found that Bhilai Steel Plant is as good as TISCO and Bokaro Steel Plant has a more efficient energy balance profile. He was of the view that if these plants are not making as much profit, as do the private sector plants, it is because of the exogenous policy constraints.

Despite such studies offered by many scholars, the recent policy shifts have changed the balance in favour of private sector. It is worth noting that for, the first time in the planning history of India, the Seventh Plan (1985-90) proposed larger planned outlays for the private sector as compared to the state owned sector. Following Table 1 shows that the share of state owned sector in total investment has continuously declined since 1980s. The relative shares of the state owned and private sectors during seventh, eighth, ninth and tenth plans clearly signal the rising importance of the latter at the cost of the former.

Table 1: Share of State owned Sector in Total Investment

Five Year Plans	State owned Sector Investments (as % of total investment)	
	Projected	Realised
V Plan (1974-79)	57.6	43.3
VI Plan (1980-85)	52.9	47.8
VII Plan (1985-90)	47.8	45.7
VIII Plan (1992-97)	45.2	34.3
IX Plan (1997 - 2002)	33.0	29.5
X Plan (2002-2007)	12.6	------

Sources: Eighth, Ninth and Tenth Five-Year Plans, Planning Commission, Government of India, New Delhi.

Apart from this, some of the enterprises in this sector are already open to the market to mobilise funds for their investment. The Ninth Plan has divided state owned sector enterprises into three categories (i) profit-making PSEs; (ii) PSEs making marginal profits and losses; and (iii) PSEs incurring substantial losses. Accordingly all the PSEs have been put in the suitable categories. Disinvestment Commission, started in 1996, primarily to discipline PSEs and make them result oriented, had been developed into a full-fledged Ministry for Disinvestment under the previous government, institutionalising the process of reforms and restructuring of PSEs[9].

The operations of state owned sector has resulted in a number of state failures such as over-manning and low work ethics, leading to low capacity utilisation, over-capitalisation, political and bureaucratic interference stifling the ability to innovate, take quick and timely decisions, burden of taken-over sick units. Apart from this, a serious charge against the operations of state owned enterprise is that they were used for private purposes deliberately ignoring the objectives for which they were established (Chaudhri 1994).

Once it has been established that privatisation of SOEs is no longer a choice but an imperative; the stage was set for privatisation of SOEs. Therefore any analysis of economic policy and state owned enterprises would be incomplete without going into the details of privatisation process and policies followed so far and its likely implications. Researchers have tried to analyse the private sector performance world over particularly after disinvestment. The empirical evidence, which is mixed, falls into three categories (i) Case studies. (ii) Cross-sectional comparisons of state owned and private sector performance. (iii) Statistical analysis of pre- and post-divestiture performance of enterprises (Mohan 2001). This mixed evidence is a warning against sweeping generalisations about the impact of privatisation. "In general, where privatisation is claimed to have delivered improvements; but given the methodological shortcomings of many of these studies, they should be taken into consideration with a pinch of salt" (*emphasis added*) (Mohan 2001).

Privatisation of State Owned enterprises: Trends

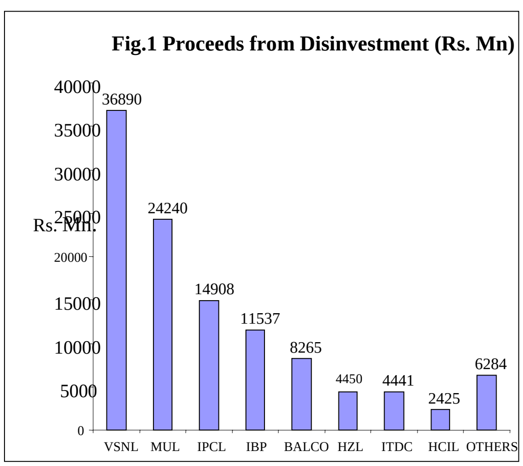
From 1991 to 2000, the emphasis of Indian privatisation was on disinvestment through offloading of government's shares to the state owned or financial institutions. During this period, the government offloaded shares in as many as 39 state owned enterprises. However, since March 2000 emphasis has increasingly been on strategic sales of identified state owned enterprises (SOEs). Strategic sale refers to outright transfer of control in SOEs to private management. This normally involves the sale of 26 per cent or more of government equity to a private party. Table 2 briefly summarises the amount realised and the number of SOEs disinvested or privatised till date.

Table: 2 Actual Disinvestment from April 1991 till November 30, 2003

		Sale of shares – 1991-92 to 1999-2000	**Strategic sale 1999-2000 till date**	**Total**
1	**No. of Companies**	**39 ***	**36 ***	**68 ***
2	Equity sold (Rs. million)	23475	8940	32415
3	As % of total equity of central Govt. and holding cos. (as on march 2000)	3 %	1.13 %	4.13%
4	Total Receipts (Rs. million)	195730	113440	309170

Note: * Seven companies are common in both modes
Source: Govt. of India; Department of Disinvestment: manual, 2003

Modern Foods Industries limited (MFIL) was the first SOE to be strategically sold. The second SOE that was strategic sold was Bharat Aluminium Company (BALCO). Fifty one per cent of its



Source: Based on the data from Department of Disinvestment: Manual 2003 shares were sold to Sterlite Industries for Rs 5,515 million. Following this sale, the government was quick to proceed with strategic sales in important firms by divesting 51 per cent of the shares in Computer Maintenance Corporation (CMC) to Tata Sons and 74 per cent of the shares in HTL, PPL and Jessop (for Rs 550 mn, Rs.1520 mn, Rs. 180 mn) to Himachal Futuristic Corporations, M/s Zuari Industries & M/s Ruia Cotex Ltd respectively (Govt. of India, 2003).

So far since 1999, 36 central SOEs have been strategically sold. Of these, nineteen are hotels of Indian Tourism Development Corporation (ITDC) and three are hotels of Hotel Corporation of India Ltd. (HCIL) Together, these hotels have contributed Rs. 6,866 million towards divestiture or disinvestment proceeds. For all the nineteen hotels, 100 per cent of the equity was sold (Naib 2004). In terms of individual sales, as shown in Fig 1, maximum proceeds (Rs.37 bn) were collected by selling 25 per cent of the equity in VSNL , followed by the contribution made by selling 27.5 per cent equity of Maruti Udyog-MUL (Rs24 bn), and by Indian Petrochemicals-IPCL(Rs 15 bn).

Implications of the Policy of Privatisation of State Owned Enterprises.

The whole process of privatisation of SOEs is not without issues and debates. From the very beginning the policy makers were cautious in the wake of vehement opposition of this idea of privatisation of SOEs. In how far it has been able to live up to the expectations and contribute productively to the growth of the country. A critical appraisal of this process raises many questions.

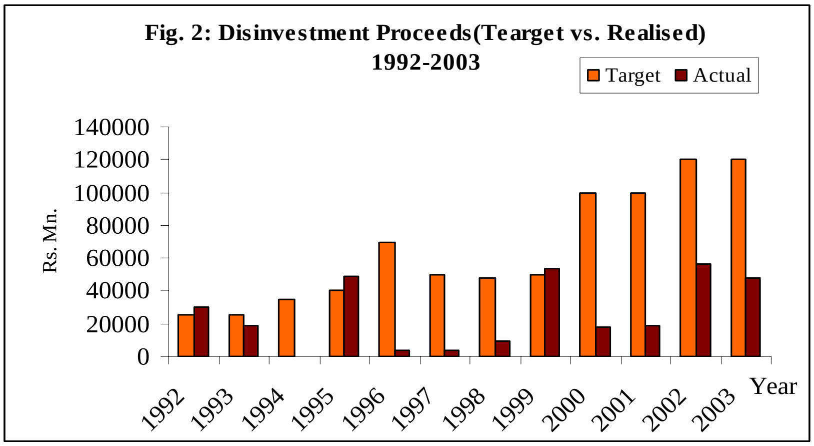
The foremost is issue of the methodology adopted for privatisation. The government has preferred under the ministry of disinvestment strategic sales with transfer of management as against a policy of market sale of shares in small lots. Researchers have referred to it as a lack of democratic privatisation in Indian scenario. In fact many researchers have gone to the extent of comparing the whole process of privatisation in India to that of other countries like UK and France. “This process is against the policy of privatisation adopted in UK, which has introduced innovations to market the shares of British Telecom to new buyers. Such a policy has also resulted in the widening of capital market in UK” (Naib 2004).

Table 3 Disinvestments during 1991 – 2003

Year	No. of SOEs in which equity sold	Target receipt for the year (Rs Mn.)	Actual receipts (Rs. Mn.)	%realised vs. targeted
1991-92	47	25000	30380	121.5
1992-93	35	25000	19130	76.5
1993-94	0	35000	0	0
1994-95	13	40000	48430	121.1
1995-96	5	70000	3620	5.2
1996-97	1	50000	3800	7.6
1997-98	1	48000	9020	18.8
1998-99	5	50000	53710	107.4
1999-00	4	100000	18290	18.3
2000-01	4	100000	18700	18.7
2001-02	10	120000	56320	46.9
2002-03	6	120000	47770	39.8
Total 1991-2003	68	783000	309170	39.5

Source: Department of Disinvestment, manual 2003

As Table 3 shows that in the Indian context, it is a matter of concern that the amount realised through disinvestment has fallen far short of the amount targeted. The total amount realised through disinvestment from 1991 to 2003 was Rs. 309 billion against a target of Rs. 783 billion leading to an average under subscription of more than 60 per cent.



Source: as given in table 3

The disinvestment proceeds (Target versus realised) is shown in Fig. 2. As the figure shows, there is a large gap between the revenues planned to be raised and the amount actually raised. In fact except for the years in 1991-92, 1994-95 and 1998-99; in no other year could the government realise revenues greater than the targeted level of disinvestment. The evidence, however, is that the proceeds of the previous financial year that were announced in the month of March during that year, which could only be realised in the subsequent financial years formed the basis of higher proceeds in these years particularly, 1994-95 and 1998-99. As the figure shows that in the years preceding 1994-95 and 1998-99; the proceeds realised were nil or very few. On an average only 39 per cent of the amount targeted could be realised in the 12 year period from 1992 to 2003.

These large gaps in the targets and actual achievements speak volumes about the internal criticism of this policy of privatisation. The government had to go slow on this aspect. Many studies emerged on the gradualism in the privatisation process in India. (Kapur and Ramamurti 2002; Ahluwalia 2004). Researchers have tried to give pros and cons with the gradual process of privatisation. They were of the view that while gradualism has disadvantages like sufficient time for critics to put forward their arguments; deteriorating performance of SOEs particularly in India (an opposite view is given by Yarrow, 1992 for British SOEs); shows unwillingness of the government and may have negative impact on the shares of SOEs in the market. The gradual process of privatisation also increases the chances of favoritism to self interested and rent-seeking politicians, bureaucrats and labour unions. Therefore, given these arguments privatisation of SOEs as such was not going to overcome some of the drawbacks of SOEs at least in near future.

However, the other view that gradualism has its own advantages as the government can learn from experience and change the policy accordingly was also put forward. It also gives the opportunity to the government to establish necessary regulatory framework first before actually disposing off SOEs. It gives policy makers time to generate support for itself. Moreover, since each state owned enterprise has its own set of problems, which are required to be taken separately case-by-case both at the policy level and at the implementation level a policy of gradualism towards privatisation works as a boom.

Another major issue that needs special attention is financing of budgetary deficit through disinvestment proceeds. At the time of launching a policy of disinvestment in July 1991, a three field objective was envisaged, that is, to raise the resources, to encourage wider public participation and to promote greater accountability. However, the statement given after is that the primary objective of disinvestment is to mobilise non-inflationary resources for the budget. Privatisation program began as a divestment program, whose aim seemed to be merely to reduce the government's holdings by up to 20 per cent, principally to raise resources to plug the budget deficit. Accordingly, the program was labeled "disinvestment" and the term "privatisation" assiduously avoided. The idea was to divest the amount up to 49 per cent. Since this would still leave the government with majority ownership, the fundamental character of the enterprise would be unchanged, while on the other hand even more resources could be mobilized to plug the budget deficit, which at the onset of the reforms exceeded 9 per cent of GDP.

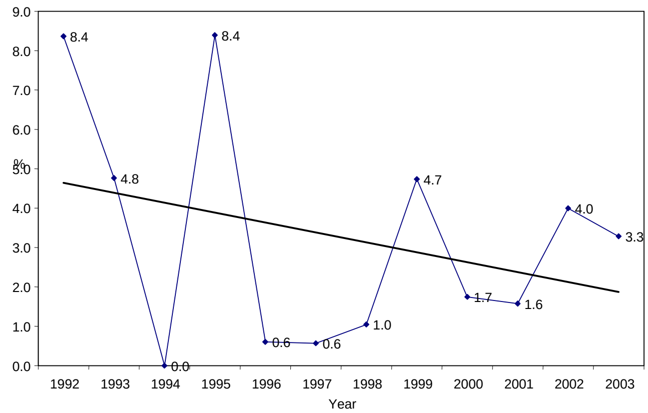
This makes it necessary to have a closer look at disinvestment proceeds and its relationship to fiscal deficit. As shown in Table 4 and Figure 3. The table reveals that the earnings (theough SOEs disinvestment) realised since 1991-92 are amount to Rs. 309 billion, while the fiscal deficit is equal to 10336 billion. This means on an average 3 per cent of the fiscal deficit has been financed through sale of SOE equity. The trend line in the figure shows that over the years the disinvestment as a per cent of fiscal deficit is declining. Therefore one can conclude that current level of disinvestment is of limited use for the fiscal deficit and is not a reconstruction.

Table: 4 Disinvestment and Fiscal Deficit

Year	Disinvestment (Rs. Mn.)	Centre's Gross Fiscal Deficit (Rs. Mn.)	Disinvestment as % of Fiscal Deficit
1991-92	30380	363250	8.4
1992-93	19130	401730	4.8
1993-94	0	602570	0
1994-95	48430	577030	8.4
1995-96	3620	602430	0.6
1996-97	3800	667330	0.6
1997-98	9020	863450	1.0
1998-99	53710	1133480	4.7
1999-00	18290	1047170	1.7
2000-01	18700	1188160	1.6
2001-02	56320	1409550	4.0
2002-03	47770	1454660	3.3
Total 1991-2003	309170	10336730	3.0

Source: Govt. of India; Department of Disinvestment: manual, 2003 and Economic Survey, various issues.

Fig. 3: Disinvestment as % of fiscal Deficit



Source: as given in table 4

Another important aspect that has policy implications is employment. Researchers have given arguments for and against employment implications of the liberalisation policy adopted in 1991 in favour include competition will improve efficiency and this productivity of labour it will have a positive impact on employment (Joshi and Little, 1996). The changes in the growth pattern towards more capital intensive and a policy of privatisation may work towards worsening of the employment situation, (Ghosh, 1995, Dutt, 1997).

Therefore it is interesting to know the employment implications of privatisation especially in the background of a famous case of strategic sale of BALCO in 2000 to a private party. In India the policy of disinvestment has been looked upon with skepticism[10].

The public sector in India until the late 1980s played a fundamental role in the development of the economy. It accounted for almost 70 per cent of the total employment in the 'organised sector'. Despite the process of liberalisation in early 1990's, the public sector continued to account for a large per cent of total employment in the organised sector. However, its share marginally declined from 71.2 per cent in 1990 to 69 per cent in 1999 (Public Enterprise Survey, Various Issues).

A glance at the level of employment in the 240 SOEs in terms of employment in the disinvested and non disinvested SOEs for the period 1981 to 2000 shows that the rates of growth of employment in the SOEs, divested SOEs and non divested SOEs were 15.15 per cent, 19.16 and 11.3 per cent respectively for the period 1981 to 1991. The corresponding figures for the post reform period (1991 to 2000) were minus 17.5 per cent, minus 17.8 per cent and minus 17.4 per cent respectively. This implies that the decline in employment in the post reform era was almost the same for the three categories. Moreover, the share of employment in disinvested SOEs to total SOE employment remained at 27 per cent in the 10-year period. This indicates that even though the absolute number of people employed in disinvested SOEs decreased from 0.6 million in 1990-91 to 0.51 million in 1999-00, it may have nothing to do with the policy of disinvestment *per se* (Public Enterprise Survey, Various Issues).

One major weakness of privatisation was lack of strategy on the use of the proceeds of disinvestment or privatisation. The money was used basically to plug the fiscal deficit. But as the analysis shows even that was minuscule. A better strategy would have been to earmark privatisation revenues *ex ante* for social sector and pro poor expenditures. The present disinvestment policy mentioned in the National Common Minimum Program May, 2004 does mention about the change in the policy whereby government expressed the need for selective and strategic focus on the focus of privatisation of SOEs. While maintaining that government will not encourage monopolies but rather prefer competition; the transparent and consultative case-by-case method is proposed to be adopted.

In 2005 govt. decided to constitute a National Investment Fund into which the realisation from the sale of government shares in profitable SOEs would be chanalised. The objective of the fund will be to invest those proceeds in social sector projects and also use such funds to revive selected revivable profitable state owner enterprises. Given universality of the problems at the implementation level of each and every programme and scheme, the results of such a policy, however, are yet to be seen. However the big question still remains that whether a policy of disinvestment of profit making SOEs will be followed or there will be a change in it? Disinvestment of such SOEs in Indian scenario, works as a disincentive for such enterprises as their efforts of earning profits are disregarded. The disinvestment of BHEL in May, 2005 is an example of this. A sale of worth 10 per cent shares to the market leaves 57 per cent with the govt. However, the enterprises are under constant threat of selling more shares and this works as disincentive for future performance. On the other hand the experience shows that given the right kind of environment leads to improved performance of the enterprises. The case of Hindustan Copper, which had been running at a loss for the past seven years and a half years, made a turn around in 2004-05 and posted a net profit of Rs. 52 crores against a projected loss of Rs. 67 crores. Similarly Mineral Exploration Corporation achieved a net profit of Rs. 244 lakhs after a gap of 14 years[11].

NOTES

1 Kalecki, "Theory of Economic Dynamics", in Kalecki (1972)

2 James O'Connor, (1973). p.6. While suggesting the functions of the state he argues that "A capitalist state that openly uses its coercive forces to help one class accumulate capital at the expense of other classes, looses its legitimacy and hence undermines the basis of its loyalty and support".

3 Guidelines to Industries, (1974-75). Government of India, New Delhi.

4 "Because of the change in the ruling party from Janta government to Congress government at the Centre in 1980. In fact, the document was an aggressively political document which, refused to accept any inadequacies in the earlier framework of policy or its implementation." S.Marathe, (1986). p.123.

5 Mid-term Appraisal, "Seventh Five Year Plan", Planning Commission, Government of India, New Delhi, p.9.

6 Economic Survey, (1991-92). Part II, Sectoral Developments, Government of India, New Delhi, and Economic Survey, (1992-93). Government of India, New Delhi.

7 Ninth Five Year Plan, (1997-2002). Vol. II, Planning Commission, Government of India, New Delhi.

8 See Nagaraja, (1991) 'Public Sector Performance In The Eighties: Some Tentative Findings,' Economic and Political Weekly, December 14, 26(50): 2877-83. Chaudhuri, (1994) 'Public Enterprises and Private Purposes', Economic and Political Weekly, May 29, .22:1338-47.

9 Ninth Five Year Plan, (1997-2002). op.cit. pp.583-601.

10 The strategic sale of BALCO in 2000, to a private party was met with a lot of resistance from the workers. They went on an indefinite strike, which lasted for over 60 days. They allowed Sterlite Industries (the new employers) entry into the premises only when the latter agreed not to retrench a single worker. Given this, the focus of this sub-section is specifically to examine the impact of disinvestment on employment levels in the Indian SOEs.

11 Hindu, Saturday, June 4, 2005. p.15

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