Disinvestment in India : An Insight into its Rationale

Dipti Kumar Chakravorty
Reader, Department of Commerce,
University of Calcutta

Abstract

'Disinvestment' is in no way compatible with the constitutional imperatives of our country. Nevertheless, we have adopted it partly for internal, and partly for external compulsion. So, neither the objectives nor the policy of disinvestment in our country can claim to have any specific direction. Having pinpointed this lack of clarity, this paper has attempted to assess *inter alia* the achievement of the disinvestment programme in India made so far.

Key-Words : Commanding height ; Fun-munch garden of bureaucrats ; Drain on public exchequer ; Pendulum of political option ; Perestroika ; Profit repatriation ; Capital flight.

Disinvestment in India — A Backdrop

Right from independence, we were taught that the public sector in general, and the public sector undertakings (PSUs) in particular, were to reach the "commanding height" in Indian economy. It was also generally believed that "whether the Indian economy would either sink or swim would depend upon the efficiency with which PSUs operate" (Narain, 2003). On this belief, the number of PSUs and investment therein have increased by leaps and bounds during a period of forty years since 1948, when the first Industrial Policy Resolution (IPR) was adopted in our country. It is also true that through the efforts of PSUs alone, our country has become self-sufficient in the production of many of the basic and infrastructural goods like coal, steel, power, petroleum, fertiliser, etc. The Disinvestment Commission itself admitted in its report that "the country's ranking in terms of industrialisation with other developing countries is quite high. India's comparative advantages, such as a large pool of well-trained work-force, technical skills in manufacturing and chemical industries primarily stem from the public sector" (DC Report, 1997). But since the Seventh Plan particularly, it was observed that the PSUs had been converted into "centres of poor management" and "fun-munch garden of bureaucrats". The present day condition reveals that out of 227 operating central PSUs, more than 100 are loss-making units. One third of CPSUs work at less than 50% capacity utilisation. The share of

Table 1

Profitability of Manufacturing Enterprises — Public vs. Private Sectors

(PAT/Net Sales %)

As on 31st March	1991	1992	1993	1994	1995	1996	1997	1998
Public Sector Enterprises	–4.5	–5.3	–5.4	–6.9	–2.3	–2.4	–4.3	-3.9
Private Sector Enterprises	5.7	4.9	4.9	6.6	9.1	9.0	7.0	6.2

them to public debt is estimated at one-third of total debt of Union Government (Saxena, 2002).

The return on investment in PSUs, at least for the decades of 1970s and 1980s, was so poor that it was significantly lower than the rate of return for a time deposit in commercial banks. If the profits of the PSUs working in the monopoly environment were excluded, the picture would be more gloomy. In the post-reform era, when the PSUs are supposed to perform better, then also the performance of PSUs is truly disappointing in comparison to that of private sector (Table 1). PAT/net sales in PSUs are always negative during the period of study as conducted by the NCAER. Their performance on the productivity front with regard to manpower costs is also highly alarming as Table 2 shows that the wage costs per rupee of sales in public sector

Table 2

Wages / Net Sales

(per cent)

	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98
PSU minus petro	18.6	17.3	18.1	17.7	17.6	19.2	19.1	23.3
Private Sector	8.9	8.8	8.6	8.1	7.9	7.9	8.2	6.5

manufacturing activities are significantly higher than in comparable private secotr firms, despite the latter often paying higher wage rate than PSUs. In view of all these, the PSUs have been gradually characterised as overinvested with low return, over employed yielding low productivity, excessive capacity but low utilisation and excessive control but lower efficiency (Gangadhar and Yadagiri, 2003).

Initially, the economic performance of PSUs did not get so much importance on the plea that they were meant primarily to achieve social objectives rather than to earn profit. But gradually it is felt that the negative effect on profitability front outweighs the positive result on the achievement of social objectives. Nobel Laureate Dr. Amartya Sen also mentioned in one of his speeches that "India has too much government interference in some fields, but (simultaneously) it has insufficient and ineffective government activity in basic education, health care, social security, land reforms and the promotion of social change." As such, the Indian Government wants seriously to get rid of PSUs, the investment wherein has already been considered to be "a drain on public exchequer", and to devote primarily to the promotion of social sector. This intention of the Government has been strengthened further due to the following global imperatives.

By the mid-1980s, around the globe, the pendulum of political option was swinging decisively towards the view that the proportion of the GNP due to government economic activity should be reduced to the extent possible. The collapse of socialist economy of the Soviet block convinced the policy planners, around the world, that the role of State should be that of a regulator rather than the producer. USSR started the economic reforms under Perestroika. Privatisation brought the United Kingdom from near bankruptcy in 1979 to its re-emergence as one of the world economic leaders. China also introduced there economic reforms and it was recognised that public sector did not optimise efficiency and productivity of capital. Privatisation, thus, brought benefits to the vast majority of countries ranging from Eastern Europe to Africa, from South

Asia to South America. India, on the contrary, was facing an unprecedented crisis in 1991 when the Narashima Rao Government came to power. The then Finance Minister, Dr. Manmohan Singh told the Prime Minister that something immediate had to be done. According to Mr. Jairam Ramesh (2000), "On the second evening of Rao Government we talked how to approach IMF. I had taken with me a one-page policy statement which included reforms like the new trade policy, new industrial policy, foreign investment, etc. Rao saw the one-pager and asked me to fax it to our executive director in the IMF, who was to take it informally to the IMF managing director to show that we had embarked upon a course of major reforms, and to request the IMF to come to our support quickly. In a matter of hours, we were informed that the IMF would stand by us." The circumstances which forced the government to change the policy, need not be clarified further. The process of greater reliance on market forces and increasing integration with the global economy was not so much a matter of choice. In the unfolding scenario, the *country had no option* but to liberalise. The WTO framework, alongwith IMF, made it a *fait accompli*. These external pressures, along with the aforesaid internal imperatives, led India to adopt on July 24, 1991 a new Industrial Policy Resolution (IPR, 1991), which was basically an attempt to deviate from the avowed path and to resort gradually to privatisation. Of different forms of privatisation like denationalisation, deregulation and contracting out, the major plank of privatisation programme in India has been, however, the denationalisation, i.e., disinvestment of government equity in a select number of PSUs. But the fact is that the disinvestment process in India is never a smooth sailing. This has come out to be such a debatable phenomenon that the governments have failed to be decisive as to what actually should be done. Distrust and dissatisfaction about disinvestment have also loomed large over the common people of the country. In view of all these, an attempt has been made in this paper to look into the rationale of the objectives and achievements of disinvestment in India.

Objectives of Disinvestment — A Review

From the discussion so far made, it appears that the basic reasons given for privatisation by way of disinvestment are, firstly, the scarcity of public resources and, secondly, the inefficient operation of existing public enterprises. Thus, it is obvious that the broad mission of disinvestment would be firstly to improve public finance, and secondly to find growth by introducing competition and market discipline in PSUs. With these broad missions in view, the Department of Disinvestment (DoD) has spelled out some objectives of disinvestment in its June-2001-publication. But even though those objectives theoretically appear to be sound, in most cases they are self-contradictory and deficient in achieving the aforesaid missions. So, we feel the need to review the objectives as framed by DoD. For this, it is obvious to itemise first the objectives. These are as follows:

(1) Releasing the large amount of public resources locked up in non-strategic PSUs for redeployment in areas that are much higher on the social priority, such as, basic health, family welfare, primary education, social and essential infrastructure.

(2) Reducing the public debt that is threatening to assume unmanageable proportions.

(3) Stemming further outflows of the scarce public resources for sustaining the unviable non-strategic PSUs.

(4) Transferring the commercial risk to the private sector where the private sector is willing and able to step in.

(5) Releasing other tangible and intangible resources such as large manpower currently locked up in managing the PSUs, and their time and energy, for redeployment in high priority social sectors that are short of such resources.

(6) Disinvestment would expose the privatised companies to market disciplines, thereby forcing them to become more efficient, and survive or cease on their own financial and economic strength. They would be able to respond to the market forces much faster and cater to their business needs in a more professional manner.

(7) Disinvestment would result in wider distribution of wealth through offering shares of privatised companies to small investors and employees.

(8) Disinvestment would have a beneficial effect on the capital market ; the increase in floating stock would give the market more depth and liquidity, give investors early exit options, help in establishing more accurate benchmark for valuation and pricing, and facilitate raising of funds by the privatised companies for their projects and expansion.

(9) Opening up the public sector to appropriate private investment would increase economic activity and have an overall beneficial effect on economy, employment and tax revenues in the medium to long term.

(10) In many areas, e.g., the telecom sector, the end of public sector monopoly will bring relief to consumers by way of more choices, and better quality of products and service.

The first three objectives indicate that a huge amount will be available from disinvestment, and that can be utilised in social sectors, for reducing public debt and for sustaining sick PSUs. But, to get so much amount, mostly the profit-earning PSUs are to be divested, which are now providing good returns to the government in many cases. In view of this, Sengupta (1997) stated that the raising of funds through disinvestment may cut back the non-tax revenues of the government, and if the public equities are issued to foreign investors, the external balance may be negatively affected frustrating the objective of reducing foreign debt. The World Investment Report, 2004 of UNCTAD also states that, if profit repatriation continues for a long term, it may negate the short-term positive effect of foreign capital inflows.

According to the fourth objective, only those commercial risks will be transferred to the private sector that it actually is willing to undertake, i.e., where the return is more in compairson to risk. Then, only the low-yielding and riskier jobs will be in the hands of PSUs, frustrating further their economic viability. Otherwise, the infrastructural development will come down substantially, which may affect adversely the long-term growth of the country.

The fifth objective appears to be an exaggerated benefit of disinvestment, as the growth in social sector is not in any way being hindered due to non-availability of the right type of manpower, particularly in a labour-intensive country like ours.

According to the survey of Statistical Outline of India, 2000-01, the magnitude of industrial sickness in private sector in India is also very alarming. So, it cannot be guaranteed, as claimed by DoD, that the PSUs being privatised would be more efficient. Effective and regulated market system is the pre-condition therefor, which till now is lacking in our country. So, it is apprehended that the efficiency in privatised companies, if any, will mostly be at the cost of public interest. The unprecedented tariff hike in 2000 in the power sector of Andhra Pradesh is still vivid in public memory (Theodore, 2002).

The next objective is not also based on fact. The earlier sale of shares attracted the employees only to a limited extent, and was not friendly to the small investors and employees (Narain, 2003). A substantial chunk of shares divested were rather in the hands of financial institutions and banks. The present policy of disinvestment through strategic partner route will further aggravate the situation, as it would neither increase the floating stock in capital market nor there would be redistribution of wealth to the employees or public at large.

It has been envisaged by DoD that the opening of public sector to appropriate private investment would increase economic activity, having overall impact on economy, employment and tax revenues. But Hindustan Lever when taking over Modern Food Industries, stated categorically that it had no plan for any capital infusion in the acquired company (Times of India, July 17, 2001).

We are trying to reduce the public sector monopoly by way of disinvestment. But the wave of privatisation has possibly made us forget the stark relaity that the private monopoly is far more harmful than public sector monopoly. The monopoly in public sector has made the management inefficient, which is true. But the monopoly in private sector will make its entrepreneurs exploitative. A large number of sellers may not always lead to fair and full competition, as by forming business guilds or chambers of commerce, the private owners may work at their own interests alone. All these may result in greater disparities in income and wealth. The experience of Bangladesh, that carried out one of the largest privatisation programmes between 1975 and 1990, is a pointer to this, where the allocative efficiency was largely affected by privatisation (Basu, 1993).

In the light of all these, possibly, it is believed by a large section of people that "all efforts at public sector disinvestments are aimed at reducing only the budget deficit and not improving the efficiency of these enterprises or reinvesting the funds so realised in social sector" (Gangadhar & Yadagiri, 2003). How far this objective is being satisfied can be known from the next section, where an attempt is made to highlight the achievement of disinvestment programmes so far made.

Achievements of Disinvestment in India — An Appraisal

If we go through the target and investment proceeds since 1991-92 which is illustrated in Table 3, it will be evident that though there is increasing trend in the target, it is not essentially so in the achievements. Beginning from 1991, so far 15 rounds of disinvestment of grovernment equity have been completed in 49 central PSUs upto 2003. The disinvestment proceeds exceeded the target only in three years out of twelve years. The amounts realised were less than ten per cent of the target in three years, and those were more than ten per cent but less than twenty per cent in other three years. Prior to 2000, the policy of the Government of India (GOI) was only to sell minority stakes in PSUs. But experiencing lower realisations therefrom and anticipating that the lower realisations were due to non-transference of management control, the emphasis was shifted to "strategic sale" as part of modified policy of the GOI. But inspite of this shift, the achievement during four years after 2000 were only 18.3%, 18.7%, 46.9% and 27.9% of the respective targets. There may be a number of reasons for such low proportion of disinvestment proceeds as against the target set. But the reality is that "a decade of economic reforms saw very little activity on the disinvestment front, and tall promises were seldom put into action" (Prasoona, 2001).

Table 3

Disinvestment Target and Achievement in CPSUs

Year	Target (Rs. in crore)	Realisation (Rs. in crore)	Achievement (as % age of target)
1991-92	2500	3038	121.5
1992-93	2500	1913	76.5
1993-94	3500	—	—
1994-95	4000	4843	121.1
1995-96	7000	362	5.2
1996-97	5000	380	7.6
1997-98	4800	902	18.8
1998-99	5000	5371	107.4
1999-00	10000	1829	18.3
2000-01	10000	1870	18.7
2001-02	12000	5632	46.9
2002-03	12000	3348	27.9

Source : Department of Disinvestment, GOI ; Results Computed.

The government does not provide any break-up of the use of the money obtained from disinvestment. But from the failure of the BIFR route and setting up of a new body called Board for Reconstruction of Public Sector Enterprises, it is clear that the disinvestment proceeds have helped very little for the revival of sick PSUs. According to the budget speech of 2000-01, the other two purposes for which the disinvestment proceeds are to be utilised are — (i) for meeting expenditure in social sectors and (ii) for reducing public debt. But from Table 4, it

Table 4

Public Debt and Expenditure in Social Sectors

Year	Debt as a % age if GDP	Social Sector Expenses as % age of total expenditure
1990-91	55.3	20.3
2002-03	63.1	20.1
2003-04	64.6	19.8

Source : Economic Survey, 2003-04.

appears that neither in case of social sector nor in respect of public debt the disinvestment has been able to exert any impact. In comparison with the beginning year of economic reform, the debt position as a percentage of GDP has gone up substantially in 2002-03 and 2003-04. And, the expenditure in social sectors, which was supposed to go up, has come down gradually in 2002-03 and 2003-04. From this, it may be presumed that the main rationale behind the so-called reform is, to raise only the non-inflationary form of finance so that the fiscal deficit is bridged (Misra and Puri, 2001). But the figures in Table 5 reveal that the aim of the government to mitigate the deficit financiang too has not materialised through disinvestment process. The realisation from disinvestment is so meagre in proportion to the total deficit during the decade that it actually matters little whether disinvestment is resorted to or not. The last column of Table 5 also reflects that the so-called economic reforms during last decade have failed miserably to arrest the fiscal deficit within a reasonable limit. The ever-increasing trend in fiscal deficit as a percentage of GDP has indeed put a big question mark on the justification of privatisation by way of disinvestment.

So, the positive achievement of disinvestment is almost nil but the negative impact of it is easily discernible. Over the last ten years, there has been a net reduction in PSU workforce from a level of 2179 million employees in 1991-92 to a level of 1742 million in 2000-01, which amounts to a reduction of as much as 20%. According to the report of National Sample Survey Organisation (NSSO), the employment growth rate was 2.7% during 1983-94, which has come down to 1.07% during 1994-2000. The inequality in the distribution of income and wealth has

Table 5

Deficit Financing and Disinvestment Proceeds

Year	Disinvestment as % age of Fiscal Deficit	Fiscal Deficit as a % age of GDP
1995-96	0.6	4.2
1996-97	0.7	4.1
1997-98	1.0	4.8
1998-99	4.7	5.1
1999-00	1.7	5.4
2000-01	2.3	5.7
2001-02	3.6	6.2

Source : Economic Survey, 2003-04 ; Results Computed.

also widened alarmingly, and this is evident from the increasing cases of suicide by farmers particularly in Andhra Pradesh (January 4, 2005, The Statesman), which was once supposed to show the path to the rest of the nation in the field of privatisation. In view of such achievements from disinvestment in India, we can safely draw some definite conclusions.

Conclusion

A cursory look at the discussion made above will make it crystal clear that, though there is much cry about disinvestment during the last decade, we have got actually very little wool out of it. Lack of comprehensive policy on disinvestment is one of the significant reasons no doubt, but the greatest single cause behind negligible achievement of disinvestment is possibly the market condition of our country which is in no way favourable to disinvestment, nay privatisation. In fact, the divestiture policy, to be successful, "must match the level of complementary reforms, and that the interest rate, credit policies, bank appraisals, external sector policies, trade policies and legal and institutional frameworks should perfectly align with the divestiture policy" (Gupta, 2002). But these are not properly addressed before introducing a disinvestment programme in our country. Having understood this mistake possibly. Dr. Manmohan Singh as the present Prime Minister speaks differently from what he stated as Finance Minister of Rao Government. The "social objective" of IPR, 1956 was sidelined as the subsidiary to profitability in post-reform era. But now again the UPA Government headed by Dr. Monmohan Singh, is thinking over the "development with human face". With this object of saving the human face, the UPA Government has decided to retain existing "navratna" companies in the public sector, and not to privatise the profit-making companies. But in a haste to do something different, it has perhaps forgotten that such an attempt will lessen further the realisation from disinvestment, frustrating the objective of reducing fiscal deficit or public debt. As "the private enterprises may not show any interest in buying shares of loss-making and sick enterprises" (Kumar, Kaur and Gupta, 2002), the disinvestment programme then may come to a standstill. So, not the hasty decision, but an all-embracing comprehensive policy we need, to ensure "development with human face" by way of disinvestment. There should be no objection to setting off 49 percent of the shares, both in profit-making and loss-making PSUs and releasing thereby huge funds. But to go beyond that and give up the rein in favour of private giants will perhaps do more harm than good. Never mind what the IPR, 1991 proclaims about greater reliance on private sector initiative or on foreign investment. All this does not mean downgrading Indian Public Sector in any sense (Ahmad, 1998). In a mixed economy like ours, the PSUs have to play always a complimentary role, even in commercial activities. It would be incorrect to think that the working of the private sector is definitely superior to that of the public sector. Rather, both the sectors, by their very nature, suffer from different kind of weaknesses. The private sector needs to be more humane and the public sector, more efficient. A level playground should be provided so that the two sectors can compete each other to be both humane as well as efficient. The change of ownership in favour of private sector will but weaken the public sector, and then, in absence of strong competitors, the private sector will not try to be 'humane'. The opening up of reserved areas for private sector is better in that restpect, as the scope of competition will be widened thereby, and the existing PSUs will remain as they were. However, the PSUs will then require complete autonomy so that they are not forced to run a handicap race.

Above all, there is the question of allocative efficiency. If we, in the name of so-called reform, facilitate concentration of economic power in the hands of a few private giants, the produced goods will go on piling up and there will be none to purchase it (Banerjee et al, 2002). Besides, income inequality fosters social discontent and unrest. The associated threats to property right depress productive investment, promote capital flight and ultimately reduce growth (Misra and Bernis, 2002). So, the stakes in PSUs are to be sold mainly to small investors and not through the strategic route, as proposed since 2000. In a survey of 1998-99, it was observed that there has been little redistribution of shares to the small investors / public at large either (Jain, 2002). The situation will be worsened if we adopt the policy of stragetic sale for disinvestment. True, the economic resurgence has been providing us with more and more television sets, motor cars, washing machines and mobile phones, but it cannot be denied that day by day the life is getting harsher for the poor. This problem can be solved only if a proper balance is drawn between public and private sectors. The private sector in no way should be given the upper hand. The public sector managers in turn must justify themselves right now by demonstrating their ability for growth, diversification and competitive skill.

References

Ahmed, A. (1998) *Public Enterprises & Economic Development,* Anmol Publications, New Delhi, p. 135.

Banerjee et al (ed.) (2002) *Economic Environment & Human Resource Management*, Dept. of Commerce, CU, p. 43.

Basu, K. (1993) "Structural Reform in India", *Economic and Political Review.*

Gangadhar, V. & Yadagiri, M. (2003) "Disinvestment in Public Sector Enterprises", *The Management Accountant*, May.

Gupta, S.P. (2002) "Need for New Strategy to Strengthen Public Enterprises in India", *The Chartered Accountant*, February.

Jain, R. (2002) *Manual of Disinvestment in Public Sector Policy and Procedure,* Vidhi Publishing, New Delhi, p. 180.

Kumar, A., Kaur, S. & Gupta, N. (2002) "Disinvestment in PEs in India," *Indian Journal of Public Enterprises,* Allahabad, Dec.

Misra, R.K. and Bernis, G.D. (ed.) (2002) *Privatisation of Public Enterprises,* ICSSR, New Delhi, p. 12.

Misra, S.K. and Puri, V.K. (2001) *Indian Economy,* Himalaya Publishing.

Narain, L. (2003) *Public Enterprise Management and Privatisation,* S. Chand, New Delhi, p. 324.

Prasoona, D.G. (2001) "Balco Disinvestment — Dirty Politics Play Spoil Sport." *Chartered Financial Analysis,* April.

Ramesh, J. (2000) "Speech of Economic Advisor to PM" *India Today,* October 16.

Saxena, A. (2002) "Trends, Problems & Prospects of Restructuring PEs", *Indian Journal of Public Administration,* Jan. & March.

Sengupta, A.K. (1997) "Financial Disinvestment of the PEs in India", *Indian Accounting Review,* June.

Theodore, S. (2002) "Liberalisation in Andhra Pradesh". *The Statesman,* February 26.