DISINVESTMENT IN INDIA DURING POST-REFORM ERA

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The policy of the government on disinvestment has evolved over a period of 16 years. The disinvestment of public sector enterprises(PSEs) is an important component of structural reforms. This is one of the ways to make the economy market-friendly and the preference for a market driven economy where state has no specific role to play. Everything is decided by the market forces. Disinvestment started with the selling of minority shares in 1991-92, and the pace of disinvestment has quickened since 2000 through the adoption of strategic sales in identified PSEs, along with the transfer of management control, to strategic partners. Disinvestment meets the dual objectives of increasing the availability of resources for government and of enhancing the efficient use of capital. The government owned enterprises(GOEs) have taken several measures for disinvestment, and have setup an administrative machinery to implement its disinvestment programme. This disinvestment process involves valuating assets, selecting appropriate modalities, and inviting bids. The disinvestment of PSEs in practice is not encouraging. The amount of proceeds realised is only 50.84% of the target of the disinvestments for the period of 1991-2005. The employment in central PSEs did decline in the post-reform period. However, the decline in the disinvested enterprises was no greater than the overall decline. Further, the decline in employment was more closely linked to the market structure in which the enterprises operated than to the structure of ownership. The public sector's unfriendly policy stance and inadequate budgetary support also lowered employment. Apart from this, the implementation of the present disinvestment policy has shown the tremendous benefits of privatisation to the economy, the stock-market, and employees.

I- Introduction

The economic reforms and new economic policy in India have given rise to a significant focus on disinvestments or privatisation of public enterprises. The policy of the government on disinvestment has evolved over a period of 16 years. The basic objective of this process was to mitigate the budget deficit of the government on the one hand and to reduee the burden of financing public enterprises through budgetary support on the other hand. Disinvestment started with the selling of

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minority shares in 1991-92 and has continued with an emphasis on strategic sales. The disinvestment in practice of the central government enterprises(PSEs) is not encouraging. The amount of proceeds realised is only 50.84% of the target of the disinvestments for the decade of 1991-2005. The overall performance of the Government with regard to disinvestment is not much appreciable. Apart from this, the implementation of the present policy has shown the tremendous benefits of privatisation to the economy, the stock-market, and employees. This paper analyses these benefits and tries to provide a bird's-eye-view on the disinvestment programme. Our study is organised as follows- Section-II presents the philosophy behind setting up public sector units(PSUs) and the past performances of PSUs in India, Section-III gives the meaning, reasons, and objective of Disinvestment/Privatisation, Section-IV deals with the recommendations of various committees on disinvestments, Sections-V deals with disinvestment with regard to policy, procedure and proceeds since 1990, Sections-VI shows the benefits and losses of disinvestments, and Section-VII presents the conclusions of what we have studied.

II- PSUs and their Past Performance

Prior to independence, the public sector had a minor role in the Indian economy, but post-independent India has been no different from the rest of the world in adopting a pattern of economic development best described as state-led growth. During the post-World-War and post colonial period, the capital requirements of the most economy have been so large that no entity other than the state could be considered capable of harnessing the required resources. All that changed with the advent of Nehru-led socialist model for our country. At the commencement of the First-Five Year Plan in 1951, there were only five public sector undertakings with a total investment of a mere Rs. 29 crore. As mentioned in the Industrial Policy Resolution (IPR) of 1956, PSUs would lead in the economic industrial development of the nation and build the required infrastructure under the presumption that the private-sector lacked necessary resources or a long-term investment perspective. Income redistribution, job creation, and balanced regional growth were other objective of the IPR, besides the normal expectation of profits from business ventures. Underdeveloped international capital markets, significant trade barriers, and the hangover of sovereignty issues ensured that the nation planned for economic self-sufficiency and a speedy economic development with social justice became the overriding goals for the government. The Prime Minister Pandit Jawahar Lal Nehru called the public sector undertakings as 'Modern Temples'. In 1981, the Prime Minister Mrs. Indira Gandhi advocated the public sector for three reasons: to gain control of the commanding heights of the economy, to promote critical development in terms of social gains or strategic values rather than primarily on considerations of profits, and to provide commercial surpluses with which to finance economic development further.

There are some specific objectives at the micro level. These objectives are said to be the responsibilities of the public enterprises to (1) consumers - competitive price. right quality, and assured supplies; (2) workers - fair and reasonable compensation including social security measures; (3) shareholders- return on capital investment to dividends; (4) state - contribution to exchequer by way of taxes, duties, and other revenues, (5) environment- ecological and environmental balance, and pollution control; and (6) posterity- conservation of non-renewable natural resources by adequate spending on research and development activities so that posterity could be assured of a continuous economic growth.

A look at the objectives of public enterprises and the role assigned to them clears that at that time the public sector enterprises were given a great importance. It was felt that they would pave the way for the future development of the Indian economy. The public sector grew organically, and was enlarged by the numerous nationalisations. Now, the public sector accounts for about one-fourth of the GDP. The number of centrally owned public sector enterprises is now around 242 with a massive investment of Rs. 3, 49,209 crore.

It is rather surprising to note that the government has invested an enormous amount of Rs. 3,49,209 crores of public money in 242 public sector units without creating a sufficient employment for the people. The Economic Survey for 2003-04 very clearly presents that there has been a deceleration in the growth of employment in the public sector. According to this survey, only 10% of the workforce is employed in the centrally state owned enterprises(SOE's). Apart from accommodating an extremely low percentage of the labour force, a majority of the public sector units run into losses. In 1991, there were 236 operating public sector enterprises, of which only 123 were profit making. The top 20 profit making public sector units(PSUs) accounted for 80% of the profits, implying that less than 10% of PSUs were responsible for 80% of the total profit. The return on public sector investment for the year 1990-91 was just over 2%. The scenario is even worse at the state level, where about 90% of the 946 units are declared to be sick.

The performance of a very large number of public sector industries is disappointing. Performance is particularly poor in public sector manufacturing industries. For the period 1990-91 to 1997-98, the Indian public sector units involved in manufacturing yielded significantly lower profits than private firm, as shown in the following table:

Table- 1: PSEs Profitability Compared to the Private Sector PAT/Net Sales (percent)

As on march 31'st	1990 -19	1991 -92	1992 -93	1993 -94	1994 -95	1995 -96	1996 -97	1997 -98
Pure manufacturing CPSUs	-4.50	-5.30	-5.40	-6.90	-2.30	2.40	-4.30	-3.90
Manufacturing private sector	5.70	4.90	4.90	6.60	9.10	9.00	7.00	6.20

Source – NCAER Report.

Table-1 indicates that, every year, the manufacturing PSUs incurred a negative profit margin on the average; while, private firms showed healthy positive margins.

On the other side, in all cost categories, the PSUs had higher costs compared to private firms, as depicted in the following table:

Table- 2: Comparison of Cost Structure of Manufacturing PSU and Private Manufacture Firms (as percentage of sales)

As on 31st March	1990 -91	1991 -92	1992 -93	1993 -94	1994 -95	1995 -96	1996 -97	1997 -98
Power and fuel / net sales								
PSUs	10.3	10.9	12.7	13.5	12.0	13.3	14.9	19.5
Private	6.8	7.0	6.9	6.6	6.2	6.5	6.6	5.0
Wages/ Net Sales								
PSUs	18.6	17.3	18.1	17.7	17.6	19.2	19.1	23.3
Private	8.9	8.8	8.6	8.1	7.9	7.9	8.2	6.5
Interest/ Net Sales								
PSUs	8.8	9.9	11.3	11.5	9.0	9.1	9.8	11.7
Private	6.0	6.7	6.0	5.2	5.2	5.8	5.9	4.7

Notes:- Costs are given as a percentage of sales. The petroleum PSUs are excluded.

Sources: - NCAER Report

Furthermore, there is a discernible trend among private firms to cut costs over time; while, the PSUs appear to be unsuccessful in controlling their expenses. Also, the rate of saving in the public sector is very low. In fact, the ratio of savings in the public sector to GDP has declined to a negative value for several years as indicated by the following table:

Table- 3: Domestic Saving (at current prices)

	Item	1993 -94	1998 -99	1999 -01	2000 -01	2001 -02	2002 -03	2003 -04
1	Gross Domestic saving	193621	374659	468681	490049	532274	642298	776420
1.1	House hold share	158310	326802	404401	452268	513110	574691	671692
1.2	Private Corporate sector	29866	65026	84329	86142	81076	94269	114157
1.3	Public Sector	5445	-17169	-20049	-48361	-61912	-26652	-9499
2	Net Domestic Saving	110268	206593	286322	292154	314595	409346	522783
2.1	House hold share	129369	269551	342587	386187	436288	492164	579917
2.2	Private Corporate sector	12838	21443	35655	30579	22920	31489	46747
2.3	Public Sector	-31939	-84401	-91920	-124612	-144613	-114307	-103891
3.	Net Capital Flow	4791	18362	21988	8130	-18731	-32010	-49552
4.	Gross Domestic Flow	859220	1740985	1936831	2089500	2271984	246324	2760025
5.	Rate of gross saving	22.5	21.5	24.2	23.5	23.4	26.1	28.1
5.1	House hold share	18.4	18.8	20.9	21.6	22.6	23.3	24.3
5.2	Private Corporate sector	3.5	3.7	4.4	4.1	3.6	3.8	4.1
5.3	Public Sector	0.6	-1.0	-1.0	-2.3	-2.7	-1.1	-0.3

Source: – Central Statistical Organisation (CSO).

Also, the deteriorating performance of PSU companies has forced the central government to give huge subsidies in the form of equity, loan guarantees, and waivers, etc. In comparison, the income to the government by way of dividend earned from PSUs has been meager, as the following table shows.

Table- 4: Performance of PSUs in terms of Dividends Declared

(Rs. in crore)

Year	Total investment in CPUs (Equity and loans)	Budgetary support equity and loans	Guarantees for loans LCs/ other payment	Waiver of loans LCs/ other payment	Total Liability	Dividend declared
1997-98	76591/154433	7137	5372	556	13065	3609
1998-99	80313/158853	7230	4059	1769	13058	4932
1999-00	84436/168309	8406	6094	6191	20691	5455
2000-01	89337/184777	8896	14651	1830	25377	8260

Source:- Finance Ministry (Budget document) CAG Report, DPE survey.

There are several studies on the performance of central public sector enterprises(CPSEs). Joshi and Little (1994) attempted to estimate the real rates of return to investment in the public and private manufacturing sectors. Their estimates do not take account of technological diversity. Instead, changes in output are explained as resulting entirely from investment, and changes in the quantity and quality of labour. In this regard, we shall consider the following table:

Table- 5 Real Return to Investment (public & private sector)

	1960-61 to 1975-76 manufacturing		1976-77 to 1986-87 manufacturing	
	Public	Private	Public	Private
r1	2.1	11.1	5.1	22.6
r2	0.1	7.7	3.1	16.7

According to Table-5, the public sector shows a little change between the two periods; while, in both the period, the returns are extremely low. The record of private sector organised manufacturing is much less dismal. The improvement in the efficiency is impressive, and probably brings returns to this sector in line with those that achieved in industrialised country. Management is definitely implicated in the underperformance of state owned enterprises, a situation that is likely weakened by political factors. Some of the public industries have done extremely well, but these industries are in monopoly sectors like petroleum, power, and telecom, where prices are determined by government on cost-plus basis. Once these monopolies go, public enterprises come under a severe pressure, and generally become loss making entities. SAIL is a classic example where the company started making heavy losses after it had to complete with private sector industries and imports. VSNL is now under a similar competitive pressure. MTNL and BSNL face also similar challenges.

Now, PSUs in India have become a drain on the public exchequer, asking for huge subsidies in the form of equity and loans, guarantees, waivers, etc. A sector which has excessive investments but gives poor returns, over-employment but yields low productivity, excessive capital equipment but under-utilises its capacity, excessive controls but shows a lower efficiency, massive unproductive assets but lacks resources, and lots of talent but under-utilises it. There are many similar enterprises which the government wants gets rid off. The government is neither in a position to improve their performance nor is able to liquidate them. On account of this phenomenon, many public sector enterprises have become more of a burden than an asset to the government.

III- Disinvestment: meaning, reasons, and objectives

The socialist experiment of PSUs has not met the expectations of India. The Indian disinvestment programme was an offshoot of an unprecedented macro-economic crisis during 1990-91. This was mainly due to the large imbalances in internal and external accounts, making the economy highly vulnerable. There was a worsening of the fiscal deficit from 1985-86 onwards due to a steady increase in government expenditure and a deterioration in balance of payments. The fiscal deficit of the central government rose to 8.4 percent of GDP in 1990-91. The ratio of public debt to GDP increased to 62.9 percent in 1990-91. During 1990-91, the rate of inflation rose to 10.3 percent per annum and the consumer price index went to 11.2 percent per annum. The ratio of external debt to GDP was 5.5 percent. The foreign exchange reserves went down to an all time low level, a level which could buy imports only for three months. The insularity of the economy could be gauged from the fact that India's share in world exports come down from 1.85 percent in 1950 to 0.42 percent in 1980. The consequence of all these adverse factors was a deep economic crisis that gripped the economy in early 1991. Such factors as the gulf war in late 1990 and the political instability in the country at that time worked as positive catalysts in accentuating the already grim situation in the country.

It was argued that the main cause of this fiscal crisis was the failure of the public sector to generate profits and unbridle non-plan government expenditure. This situation arose because of a variety of problems such as an inefficient and non-competitive industrial structure and infrastructural bottlenecks. In order to get over this appalling situation, the only way out was to introduce economic reforms. The conditions were so desperate that the country was pushed towards introducing economic reforms. As a result, it was in July 1991 that a package of economic reforms was introduced, comprising mainly macro-economic stabilisation and structural reforms. Macro-economic stabilisation basically implies cutting down the fiscal deficit, straightening the position of balance of payments, focusing on the control of inflation, etc. The structural reforms aim at improving the supply side of the economy, and focusing on trade, capital flows, financial sector, industrial deregulation, and disinvestment of public sector undertakings.

As we have already said, the disinvestment of PSEs is an important component of structural reforms. This is one of the ways to make the economy market-friendly. Apart from all this, disinvestment also achieves another major objective connected with the functioning of the government. The government's job is not similar to business. It is more or less connected with governance of the country, provision of internal security and protection from foreign attacks, and regulation of market forces in the interest of the country. It is thought that, when the government has gone through the process of disinvestment, it will be able to concentrate more on its primarily roles.

Disinvestment is a process of selling public units to the private enterprises partially or fully. It also implies liquidation of a public firm, which is the opposition of acquisition or merger. In India, disinvestment and privatisation mean the same, implying the government's withdrawing from all the commercial activities of the economy. Disinvestment leads to privatisation when the government's holding of equity is reduced to a level where the public enterprise no longer remains a government company.

In real sense, disinvestment encompasses a broad spectrum of possibilities between nationalisation at one end and market discipline at the other extreme. It may broadly consist of divestiture and non-divestiture options. Non-divestiture options could be viewed as an intermediate step towards the ultimate sale of an enterprise by demonstrating the commercial viability of the public enterprise to be sold out. Non divestiture options range from corporatisation to management contracts, and involve removal of subsidies, and the exposure of the public enterprise to private discipline and competition.

The stress on disinvestment as privatisation is significant. Privatisation aims at shrinking the role of the state in economic activities. Disinvestment, on the other hand, has a much wider connotation as it could either involve dilution of government's stake to a level that would result in a transfer of management or could also be limited to such a level that would permit government to retain control over the organisation. Disinvestment over 50% involves transfer of management; whereas, disinvestment below 50% would result in the government continuing to have a major stake in the undertaking.

There are basically two main factors in support of disinvestment. One is to provide fiscal support and the other is to improve the efficiency of the enterprises. The argument for fiscal support emphasises that the resources raised through disinvestment must be utilised for paying off past debts, thereby bringing down the interest burden on the Government. The second argument to improve the efficiency of public enterprises through disinvestment is the contribution that it can make to improve the efficiency of the working enterprises. There have been many such serious problems as poor project management, over-manning, stagnant technology, inadequate attention to R&D and human resource development, delayed decisions, inefficient management, red tapism and bureaucracy, lack of autonomy, lack of business outlook, etc.

Finally, the main objectives of the disinvestment process set by the government are to raise revenue for the state, promote economic efficiency, reduce government interference in the economy, promote a wider share ownership, provide the opportunity to introduce competition, and subject state owned enterprises to market discipline

IV- Institutional Framework

The industrial policy statement of 24 July 1991 and the budget speech of July 1991 (Interim Budget of 1991-92) announced that the government would disinvest a part of the government equity (up to 20%) in selected PSUs, which would be offered to mutual funds and financial/investment institutions in public sectors. In this regard, government appointed a Disinvestment Committee under the chairmanship of V. Krishnamurthy in February 1992. The committee could not complete its work, so the Government reconstituted the Disinvestment Committee in November 1992 under the chairmanship of Dr. C. Rangarajan, which submitted its report in April 1993. The report gave recommendations regarding modus operandi of disinvestment, criteria for valuation of equity shares, target clientele for disinvestment, and other related issue. The report also distinguished between the short-term and long term goals of disinvestment and advised the government not to sacrifice the long- term goal for the sake of fulfilling the short-term objectives.

The disinvestment involves the valuation of shares, and modalities to be adopted for sale of such shares. There are three broad methods which are suggested by the committee for valuation of shares:

1. Net Asset Value Method: This will indicate the net assets of the enterprise as shown in the books of accounts. It shows the historical value of the assets. It is cost price less depreciation provided so far on assets. It does not reflect position of profitability.

2. Profit Earning Capacity Value Method: The profit earning capacity is generally based on the profits actually earned or anticipated. It is an accounting profit. It is the excess of earnings over expenditure. It does not really indicate the intrinsic value of an enterprise.

3. The Discounted Cash Flow Method: This technique is popularly used to evaluate the viability of an investment proposal: In this method, the future incremental cash is converted into present value by applying the cost of capital rate. This method indicates the intrinsic value of an enterprise. This method is more comprehensive and complicated in reflecting the expected income flows to the investors.

Out of these three methods, the Discounted Cash Flow Method is the most relevance though it is the most difficult to implement.

There are four modalities which are broadly accepted and recommended by committee for sale of such shares.

1. Offering shares of public sector enterprises at a fixed price through a general prospectus. The offer is made to the general public through the medium of recognised market intermediaries.

2. Selling equity through auction of shares amongst pre determined clientele, whose number can be very large. The reserve price for an enterprise's equity can be determined with the assistance of merchant bankers.

3. Determining the fixed price for sale of a public enterprise, inviting open bidders, and accepting the highest quotation for sale.

4. Making strategic sales of a public sector enterprise after making a lot of deliberations and experiments with different forms of disinvestment. Department of Disinvestment proposed strategic sales of almost all PSUs in the non-strategic areas to the highest bidders, who would be allowed to purchase up to 74% of government equity in the PSUs.

Besides the methods of valuation of shares and modalities for disinvestment, the committee has given the following recommendations too:

- The percentage of equity to be disinvested should be over 74% for industries not reserved for public sector, and 49% disinvestment should be from the industries reserved for public sector in industrial policy.
- The PSUs Board should be constituted with non-government representation.
- Regarding the use of disinvestment proceeds, 10% of the proceeds should be set apart by the government to lend to the PSUs on concessional terms to meet their expansion and rationalisation needs.
- In place of yearwise targets, a clear action plan for disinvestment should be evolved.
- An independent regulatory commission should be set up for the concern sector.
- A scheme of preferential offer of shares to workers and employees in PSUs should be devised.
- Regarding the method of valuation of shares, focus should be made on social responsibilities rather than pure commercial consideration.
- A standing committee on PSU disinvestment should be constituted to oversee the action plans for reforms, restructuring, disinvestment, monitoring, and evaluation of progress made.

Keeping in view the recommendations of these committees, the Government set up a Disinvestment Commission as an advisory body in August 1996. It was located in the Ministry of Industry. The Chairman of the Commission was Mr. G. V. Ramakrishna. The primary terms of reference were to draw up an overall long-term programme, recommend a mode of disinvestment, supervise the sale process, and monitor the progress of disinvestment. In its three-year tenure, the commission submitted its thirteen reports to the Government. The Disinvestment Commission was abolished in November 1999. The Disinvestment Commission was reconstituted in July 2001 under the Chairmanship of Dr. R.H. Patil. There were five more reports given by it.

The mechanism available to the Disinvestment Commission in terms of administrative support and professional technical inputs has been inadequate and doubts its successful functioning. In the light of this, the Government set up a new Department of Disinvestment in December 1999. It was renamed on the 6th of September 2001 by the Ministry of Disinvestment to speedup and to give pace to the process of disinvestment in a transparent manner. Furthermore, the Government of India constituted the Cabinet Committee on Disinvestment(CCD) on the 11th of October 2000. The CCD, which was chaired by the Prime

Minister, comprises various ministers, and has super power to take a decision on any kind of matter related to disinvestment.

V- Disinvestment: policy, practice, and proceeds

The policy of the government on disinvestment has evolved over the last decade. It started with the sale of minority shares in 1991-92, and this process has continued with some modifications till now. In the beginning, government even directly avoided mentioning privatisation, calling it disinvestment instead. But, over time, scope of the programme has fully expanded to embrace privatisation. The policy changed around March 31, 2000, and the change was announced by then Finance Minister in the Budget speech of 2000-01: "Government have recently established a new department for disinvestment to establish a systematic policy approach to Disinvestment/Privatisation, and to give a fresh impetus to this programme which will emphasise increasingly on strategic sales of identified PSU".

In accordance with this decision, all the disinvestments since 2000 have been strategic sales with few conceptual constraints on (i) what size of equity stake was to be divested?, (ii) what industries were too strategically important to be allowed into private hands?, (iii) who would be allowed to buy PSU?, and (iv) whether or not the PSU was profitable?. Strategic sale is defined as a sale of equity by government, where the management control of the entity is handed over to the strategic partner. Typically, the strategic partner is required to purchase an equity stake which is large enough to ensure a workable majority. This policy was implemented vigorously.

Behind this trend lie a variety of reasons even as the government faced budget deficits, and the poor performance of the PSUs required continuing subsidies. There was also a greater ideological acceptance of privatisation. Notably, there were several different governments in power during this period. Therefore, Congress initiated the programme in 1991, the United Front formed the disinvestment Commission, the National Democratic Alliance government set up the Department of Disinvestment, and Congress established a national investment fund for channeling privatisation revenues. Labour and left–oriented parties managed to go along.

The evolution of privatisation policy since the start of economic liberalisation in 1991 can briefly be outlined as follows:

- In 1991-92, the government enunciated a policy to divest up to 20 percent of its equity in selected PSUs to mutual funds and institutions in the public sector. The stated purpose of the policy was to place equity across a broad base, improve management, increase resources to the enterprises, and raise funds for the general exchequer. Initially, shares of different PSUs were bundled together and sold to domestic financial institutions. Later in 1992-93, to ensure better prices, individual shares were auctioned separately.

- Rangarajan Committee(1993) recommended that the percentage of equity divested could be up to 49 percent for industries reserved for the public sector, but, in exceptional cases, up to 74 percent of the equity could be divested. In industries not reserved for the public-sector, 100 percent of the equity could be divested. Only the following six industries were reserved for the public sector: Coal, Minerals & Oil, armaments, atomic energy, radioactive minerals, and railways.
- In February 1997-Oct 1999, Disinvestment Commission recommended disinvestment of 58 different PSUs. Moreover, in a break from a past policy of share public offerings, the Commission recommended strategic sales with a transfer of management. By 1996-97, sales were open to non Indian residents(NRIs) and foreigners through global depositary receipts in the international markets.
- According to the 1998-99 Budget-speech by then finance minister, Yashwant Sinha, "Government has decided that, in the generality of cases, the government shareholding in public sector enterprises will be brought down to 26 percent. In cases of public sector enterprises involving strategic considerations, government will continue to retain majority holding. The interests of workers shall be protected in all cases."
- In 1999, Strategic and non-strategic classifications were made: "Reflecting the report of the Rangarajan Committee, the Government announced the classification of industries into strategic and non-strategic areas. Strategic industries were limited to (i) Arms, ammunitions, and related defense industries, (ii) atomic energy (iii) mining of mineral for the atomic industry, and (iv) Railway transport. All other industries were classified as non-strategic. For all PSUs in non-strategic industries, Government stakes could be dropped to as low as 26 percent on

a case-by-case basis. Since three-fourths majority is needed to pass certain important board resolution, Government, for control reasons, fixed a lower limit of 26% of the equity."

- In March 2000, Government established a new department for disinvestment to establish a systematic policy approach towards disinvestment and privatization, and to give a fresh impetus to this programme.
- In October 2000, the Government further appointed a Cabinet Committee on Disinvestment (CCD). The CCD, which was chaired by Prime Minister, consisted of Minister for disinvestment, Minister for Industries, and Finance Minister as its members. The main function of CCD was to decide on cases where there was disagreement between the recommendations of the disinvestment commission and the views of the ministry of disinvestment.
- In 2001, President K.R. Narayanan addressed the joint session of parliament, "The government approach to PSU has three objectives: revival of potentially viable enterprises, closing down of those PSUs that cannot be revived, and bringing down Government equity in non-strategic PSUs to 26 percent or lower. Interest of workers will be fully protected through attractive voluntary retirement scheme and other measures."
- In 2002, in a challenge to the sale of profitable PSU, the Supreme Court handed down a landmark verdict against opponents of privatisation. The court legitimised the privatisation procedures, and refused to second the Government with respect to its privatisation policy.
- In the 2003-04 Budget speech, Jaswant Singh said, "Disinvestment is not merely for mobilising revenue for the Government, it is mainly for unlocking the productive potential of those undertakings, and for re-orienting the government away from business and towards the business of governance."
- The government decided to establish a board for the reconstruction of public sector enterprises to advice the government on ways and means for strengthening public sector enterprises in general, and to make them more autonomous and professional. The board would consider reconstructing public sector enterprises, and suggest ways and means for finding such schemes. The board would also advice the government on disinvestment/course/sale in respect of chronically sick/ loss making companies which cannot be revived

- The Government also has given 'in principle' approval for listing of currently unlisted profitable PSEs each with a net worth in excess of Rs 200 crore, through an initial public offer (IPO), either in conjunction with a fresh equity issue by the PSE concerned or independently by the government on a case by case basis, subject to the residual equity of the government remaining at least 51 percent and the government retaining management control of the PSE.
- In January 2005, National Investment Fund said," A fund is to be established with proceeds from sales of minority shareholding of the government in profitable PSUs. The fund, which is to be professionally managed by public sector financial entities, would generate return that can be applied to investments in education, health, employment, and support of profitable or revivable PSUs."

A listing of yearly privatisation activities is given in the following table:

Table- 6: Chronology and Methodology of Disinvestment in India from 1991 to 2005

Year	No of transactions with equity sold	Target Receipts (Rs Crore)	Actual Receipts (Rs Crore)	
1991-92	47	2500	3037.74	Monthly share sold in Dec 1991 & Feb 1992 by auction method in bundles.
1992-93	29	2500	1912.42	Share sold separately for each company by auction method.
1993-94	-	3500	0.00	Equity of six companies sold by open auction but proceed received in 1994-95.
1994-95	17	4000	4843.10	Sale through auction method, in which NRIs and other persons allowed to participate.
1995-96	5	7000	168.48	Equity of four companies auctioned.
1996-97	1	5000	379.67	GDR(VSNL) in international market.
1997-98	1	4800	910.00	GDR(MTNL) in international market.
1998-99	5	5000	5371.11	GDR(VSNL)/domestic offering with the participation of FIIs (CONCOR, GAIL). Cross

				purchase by three oil companies, i.e GAIL, ONGC, IOC.
1999-00	5	10000	1860.14	GDR (GAIL,VSNL) domestic issue, BALCO restructuring, MFIL, strategic sale.
2000-01	5	10000	1871.256	Strategic sale of BALCO, LJMC, Takeover – KRL (CRL),CPCL(MRL),BRP .
2001-02#	8	12000	5632.25	Strategic sale of CMC- 51%, HTL-74%, VSNL-25%, IBP-33.58%, PPL- 74%, and sale of hotel properties of ITDC and HCI, receipts from surplus cash reserves from STC and MMTC.
2002-03#	8	12000	3347.98	Strategic sale: HZL(26%), IPCL(25%), HCI, ITDC,Maruti: control premium from renunciation of right issue, put option MFIL(26%), shares to employee in HZL,CMC,& VSNL.
2003-04	2	14500	15547.41	Jessop & Co (72%) Strategic sale), HZL(18.92% call option), trough public offer Maruti (27.5%), DCI(9.2%), IBP(26%), IPCL(28.94%), CMC(26.25%), DCI(20%), GAIL(10%), & ONGC(9.96%) .
2004-05	3	4000	2764.87	NTPC(5.25%), IPCL(5% to employee), & ONGC (0.01%) .
2005-06	-	-	1567.60	By sale of shares to public sector financial institutions and public sector banks.
Total		96800	49214.03	

Figures are inclusive of control premium, dividends/dividend tax restructuring, and transfer of surplus cash reserves prior to disinvestment.

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

But, the strategic sales over the period 1999-2005 are listed in the following table:

Table- 7: Privatisation with Strategic Partners in India from 1999 to 2005, (Rs. crore)

No	Name	Percent of GOI Equity sold	Realisation Money	Profit/ Loss
1	Modern Food Industries Limited(MFIL)	80	149.52	Loss Making
2	Bharat Aluminum Co.	51	826.92^	Profit Making
3	CMC	51	158.07	Profit Making
4	HTL	74	55	Profit Making
5	Lagan Jute Machinery Corporation	74	2.53	Loss Making
6	ITDC – 19 different hotels	90	691.63	Loss Making
7	IBP Co	33.58	1153.68	Profit Making
8	VSNL	25	3689^	Profit Making
9	Paradeep Phosphates	74	151.70	Loss Making
10	Hindustan Zinc	44.92	775.07	Profit Making
11	Maruti Udyog	4.2	1000	Profit Making
12	IPCL	26	1490.84	Profit Making
13	State Trading Corporation of India		40^^	
14	MMTC		60^^	
15	Jessop & Co	72	18.18	Loss Making
	GRAND TOTAL		**10257.19**	

^ Including dividends and dividend tax, ^^ The receipts are on account of transfer of cash reserves.

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

It is clearly evident from Table-7 that the cumulative proceeds of total disinvestments from 1991 to 2005 stood at 49,214.03 crores against a hefty target of 96800 crores. The proceeds realised against the target set were only 50 percent. The disinvestment proceeds were encouraging and in excess of the targets set in 4 out of 16 years.

VI- Benefits and Welfare Gains

In the Post-1991 period, the Indian economy was gradually liberalised and restructured. It is characterised by simplification of administrative intervention, phased induction of domestic and import competition, facilitation of participation by the private sector, public sector reforms, reforms of financial system, etc. The results have been positive. The economy grew at around 6% per annum, and the real per capita income at around 4%. The incidence of poverty declined from 44% to 26%, and the life expectancy at birth grew significantly from 48 years to 64 years. In the external sector, the share of India's exports in world exports rose from 0.42 to 0.67%. The ratio of external debt to GDP declined from 5.5% in 1990-91 to 2.6% in 2000-01. The ratio of short-term external debt to total external debt declined from a peak of 10.2% in 1991 to 2.8 % at the end of 2000.

The government's equity stack was about Rs 80,000 crore on March 31, 2000. The increase in the level of available PSE Stock in the market has resulted in an upsurge in the share prices of disinvesting companies and also in the overall market capitalisations of PSE shares. The market capitalisation of listed PSEs increased by 73.5 percent, i.e. from 96,063 crore to Rs. 1, 66,672 crore as compared to a 14 percent increase in total capitalisation of all BSE listed companies between January and May 16, 2002. The market capitalisation in 32 listed PSUs tracked by BSE has increased in value by about Rs 70,000 crore in four months. Government share-holding has thus gained about Rs. 50,000 crore. If this performance can be improved by initiation of more privatization, significant benefits would accrue to the economy. This will also catalyse improvement in the performance of our stock markets.

VI-1: Gains through strategic sale

Before the year 2000, the government primarily sold minority shares in public sector companies. During the period 1991-99, through this method of sales of shares, Rs 18,638 crore was realised, which means an average of Rs. 2,071 crore per year. The price earning ratio on the basis of the sales value realised by the government even in blue-chip companies like IOC, BPCL, HPCL, GAIL and VSNL was 4 to 6.

Over two years 2000-01 and 2002-03, more than Rs. 11,315 crore was realised through strategic sales or at an average of 4,526 crore per year with very a high price earning ratio between 11 and 63. Table- 8 indicates price to earning ratio.

Table- 8: Price to Earning Ratio – sale of shares Vs strategic disinvestment

S.No	Companies	Sales of Shares 1991-99 (P/E ratio)	Strategic disinvestment	Price earning ratio 2000-02
1.	IOC	4.9	BALCO	19
2.	BPCL	5.7	CMC	12
3.	HPCL	5,9	HTL	37
4.	GAIL	4.4	MFIL	Very high as earning per share was negative
5.	VSNL	6.0(in monopoly days)	LJMC	Do
6.			PPL	Do
7.			JESSOP	Do
8.			IBP	63
9.			VSNL	11
10.			HZL	26

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

The experience gained so far seems to justify the assumption that the strategic sale discovers the fundamental, long term value of the company as opposed to the sale of small lots of shares in the market which gets valued on short-term considerations linked to the current expectations of the market. The strategic sale reflects the control premium, which the investor is willing to pay for managing the company.

For example, half of the equity of Maruti Udyog, which was given to Suzuki of Japan in 1994, was sold at a price of Rs. 269 per share. While foregoing the Rights Issue and transferring management control to Suzuki, the government realised a price of Rs 3,280 per share in May 2002. The government has now received RS 1000 crores as a control premium in the case of Maruti. The market sale of the residual stock of the government of India in Maruti as 66 lakh shares will fetch additional gains for government and economy.

Since the CPSUs have not performed well except where public sector has a monopoly, the share prices of public sector units have performed badly. Often these shares have been termed as non-performing shares in the market, leading huge losses to investors in such shares. With increasing liberalisation of the Indian economy, the areas of monopolies are fast diminishing. Hence, the disinvestment policy of the government should be implemented at a very fast pace. This policy was implemented with vigour during the last few years. This has led to a huge upside in the market for CPSUs shares. Let us go through the table given below:

Table- 9: Capitalisation of PSU Listed Companies

	Market Cap- BSE-Total	BSE-PSU Index	BSE-PSU Market Cap.	% to total Market Cap.
Jan 31, 2002	529998	998.09	82101	15.5
April 12, 2002	63 7460	1602.40	160620.68	25

Source - Finance Ministry (Budget document), CAG Report, DPE Survey.

Table- 9 shows that the public sector shares have almost doubled in value over the last three months of 2002, and, if this performance could be improved, there would be huge benefits to the economy.

During the last few years, the government has sold about 1 percent of its total equity yielding more than 11,000 crores through strategic sales. While a simple extrapolation may be misleading and inexact, it indicates that off loading the entire stock of PSE entity held by government could result incremental capital resources of about Rs 10,00,000 crore.

The government has received around Rs. 11,335 crores from strategic sales. The government of India's long term interest rate for market borrowing is around 10 percent. Using this average rate for market borrowing, the avoided interest cost of borrowing Rs 11,335 crore is Rs 1,133 crore every year in perpetuity. As against this benefit, the dividends received by government on its equity, which has now been sold, average Rs 52.41 crore during the last eight years. However, in the case of two companies of the total sixteen PSEs sold, there was an average annual outgo of Rs 126 crore. Thus, the government lost Rs 74 crore every year (Rs 126 crore outgo plus Rs 52 crore equity inflow) due to its majority presence in these companies. The sale of part equity in 16 companies would bring an annual real benefit to the economy to the tune of Rs 1,133 + 74 = Rs 1,207 crore. Clearly, strategic disinvestment in these sixteen PSEs has proved beneficial to the government.

Also, the value added to capital employed ratio as indicated by Table-10 reveals the efficiency of the manufacturing CPEs, manifesting an improvement in this ratio during the liberalisation period. This ratio increased from 51.87 percent in 2001-02 to 59.62 percent in 2002-03. This increase clearly reflects the enhancement in the conversion efficiency of the CPEs and also a promising trend for the future.

Table- 10: Value Added to Capital Employed in CPEs

Year	Value added	Capital Employed	% of value added to capital employed
2001-02	106387.17	205100.35	51.87
2002-03	129706.85	217552.64	59.62

Source – Public sector survey 2003-04, volume I.

VI-2: Gains from disinvestment of profitable PSUs

It is often argued that the government should not sell profit-making enterprises. These examples will suffice to illustrate the point:

- BALCO was a profit making company, which pays the government an average dividend of Rs 5.69 crore every year on the equity sold. The avoided interest cost on Rs 826.5 crore received from strategic sale is Rs. 82.65 crore every year. The net gain for government is nearly Rs 75 crore per year.
- CMC was also a well-managed and profitable company, yet the average dividend was only 0.80 crore per year. The avoided interest cost for government on the Rs 152 crore realised from its sale is Rs 15.2 crore, and net gain is 14.40 crore.
- Maruti Udyog gave an average return of Rs 13 crore annually through dividends to government. In comparison, the avoided

interest cost on the realisations received through the strategic sale of share is Rs 242 crore per year.

- IPCL gave dividends at an average of Rs 16.24 crore per year. In comparison, the avoided interest cost on the realisations received through the strategic sale of shares is Rs 149 crores per year.
- During the period 1991-2000, the sale of minority shares of PSEs led to the realisation of about Rs 19000 crores for Government. Most of these shares were bought by financial institutions. UTI was such an institution, which picked up substantial quantities of such stock. However, the prices of these shares fell in a number of cases, with the result that UTI lost Rs. 5,056 crore on an investment of Rs. 6,403 crore made by them. However, with the market prices of PSU shares picking up after a few major disinvestments, the loss to UTI on PSU portfolio decreased to 3,673 crore by March 1, 2002. Increasing BSE-PSU index allows UTI to recover its losses even further.

VI-3: Welfare and benefits to employees

Privatisation so far has shown that the fears of losing jobs are totally unfounded. Of a total workforce of about 350 million in this country, the employment in the public sector CPSEs is about 2 million. Without any privatisation or strategic disinvestment, this workforce reduced from 2.18 million in 1991-92 to 1.74 million in 1994-2000 on account of economic pressures. Privatised companies have not retrenched a single person. In the process of restructuring, some of these companies are giving VRS to their employees, at the terms which are normally better than the government VRS. Very often additional recruitment also takes place in privatised companies, and the wages are raised. To give an example, wages have been increased by an average of Rs 1,600 per employee in Modern Food Industries. In BALCO, wages have not been increased after April 1, 1999, even though a revision has been due. Despite a loss of about Rs 200 crore due to strike, an ex-gratia payment of Rs 5,000 was made to all employees. A long term wage agreement between private management and employees was made for a period of five years. The agreement guaranteed a benefit of 20 percent of basic pay to each employee, besides increasing a number of allowances.

But, the levels of employment in the organised private sector were stagnant in the 1990s. This is evident from the following table:

Table- 11: Employment in Organised Public and Private Sector (in Lakhs)

Year	Public Sector	Private Sector	Grand Total
1972	112.10	67.70	179.80
1982	159.50	75.50	235.00
1990	187.72	75.82	263.54
1991	190.57	76.76	267.33
1992	192.10	78.46	270.56
1993	193.26	78.51	271.77
1994	194.45	79.30	273.73
1995	194.66	80.59	275.25
1996	194.29	85.12	279.41
1997	195.59	86.86	282.45
1998	194.18	87.48	281.66
1999	194.15	86.98	281.13
2000	193.14	86.46	279.60
2001	191.38	86.52	277.90
2002	187.73	84.32	272.05
2003	185.80	84.21	270.01
Percent Growth			
1972-82	42	12	31
1982-92	20	4	15
1992-02	-2	7	1
1998-03	-4	-4	-4

Source: - Economic survey 2004-05.

Table- 11 shows that there has been a consistent decline in absolute employment level for both public sector and private sectors since 1998. Over the period 1998-2003, the employment in public sector fell by 8.38 lakhs; whereas, in the private sector, it fell by 3.27 lakh. The total decline of 11.65 lakh represents approximately 4 percent of the workforce in the organised sector.

We will now study the effect of the market structure on employment. To do this, the employment pattern in the disinvested competitive and monopoly enterprises over the period 1981- 2000 were studied, and the results are shown in following table:

Table- 12: Employment in Disinvested Competitive and Monopoly SOEs.

Year	Employment in disinvested competitive SOEs	Employment in disinvested monopoly SOEs	Total Employment in disinvested SOEs
1981-82	411849	89409	501258
1991-92	455805	133025	588830
1992-93	454263	132050	566313
1993-94	440317	131841	572158
1994-95	432482	129507	561989
1995-96	424994	127617	552611
1996-97	415492	126333	541825
1997-98	404490	125883	530373
1998-99	394551	125117	519668
199-00	372150	124501	496651
Average decline in employment per SOE per annum since 1991	456	80	335

Source – Data collected from various issues of PE Survey.

Table-12 shows that the employment declined in the post reform period for the complete sample of 28 enterprises (manufacturing) as well as for the enterprises operating in a competitive or monopolistic environment. However, the rate of decline was much higher for the enterprises operating in a competitive environment. In these PSEs, employment decreased from 4,58,883 to 3,72,158 over the 10-year period. This amounts to an average decrease of more than 8,000 employees per annum. Since there were 19 PSEs operating in the competitive environment, this amounts to an average decrease of 456 employees per PSEs in the competitive sector. On the other hand, the number of employees in the monopolistic enterprises decreases from 1,31,762 to 1,24,501 over the same period. This total decrease of 7,261 employees in the 10-year period amounts to an average decrease of 726 employees per annum. Since here were nine PSEs in the monopolistic sector, this amounts to an average decrease of only 80 employees per PSEs.

We will now discuss the break up of the employment in 240 PSEs in terms of employment in the disinvested and non-disinvested PSEs for the period from 1981-2000. The decrease in employment for the disinvested PSEs over the corresponding period was from 6 Lakh to 5.1 Lakh. The employment in non-disinvested PSEs came down from 15.8 Lakh to 13.5 Lakh over this period of 10 years.

To conclude, employment in central SOEs did decline in the post-reform period. However, the decline in the disinvested enterprises was no greater than the overall decline. Further, the decline in employment was more closely linked to the market structure in which the enterprises operated than to the structure of ownership. The unfriendly stance of the public sector and the inadequate budgetary support also led to a fall in employment.

VI-4: Privatisation and wages

We will study the wage-trend of employees in central PSEs and at the cost of some over simplification. This may be regarded as a representative of the wage trend in the organised sector because of limitations of data for the organised private sector. Let us consider the following table:

Table- 13: Per Capital Annual Emoluments in State Owned Enterprises (nominal and real terms)

Year	Per capita Emoluments (Rs)	Consumer Price Index	Per Capita Emolument Real terms (Rs)
1981-82	16158	91	17756
1982-83	18029	100	18029
1991-92	56508	219	25803
1992-93	64983	240	27076
1993-94	72043	258	27924
1994-95	82527	279	29576
1995-96	106876	313	24146
1996-97	110662	342	32357
1997-98	129582	366	35405

1998-99	138179	414	33377
1999-00	168339	428	39332
2000-01	219672	445	49364
2001-02	193554	468	41358
2002-03	224099	487	46016
Percentage change 1981-82 to 1991-92 (pre-form)	250	141	45
1992-93 to 2002-03 (post-reform)	245	103	70

Source: Economic Survey 2004-05.

Table-13 shows that the per capital emoluments for the employees working in PSEs increased by almost the same percentage, 250 percent, during the pre-and post-reform periods of 10 years each. However, since the percentage increase in the consumer price Index was lower in the post-reform period (103%) as compared to 141 percent in the pre-reform period, this resulted in an increase in real per capita emolument. It was higher in the post reform period by 70 percent as compared to a lower percent increase during the 10-year pre-reform period. The average annual per capita emolument, which was Rs 56,508 at the onset of reforms, stands at Rs 2,24,099 now, 2003.

We shall also consider the following table:

Table-14: Index of Per Capital Annual Emoluments in SOEs

Year	Consumer Price Index	Index of per capita Annual Emoluments in SOEs	Real increase in Annual emoluments.
1991-92	100	100	100
1992-93	110	115	105
1993-94	118	127	108
1994-95	127	146	115
1995-96	143	189	132
1996-97	156	196	125
1997-98	167	229	137
1998-99	189	245	129

1999-00	195	298	152
2000-01	203	389	191
2001-02	214	343	160
2002-03	222	397	178

Source: Data collected from Economic Survey & Public Enterprises Survey.

Table- 14 reveals that the index of per capita annual emolument in 2003 for PSEs employees was 397, almost four times the index in base year 1991; whereas, the consumer price index for the corresponding period increased from 100 to 222. As a result, the index for real increase in per capita emolument almost doubled. Thus, the real wage increased sharply in post-reform period.

However, this goes against the view that the disinvestment/ privatisation often reduces the power of negotiating a better pay package deal. Limited privatisation seems to be relevant to the Indian labour markets. During the period of liberalisation and privatisation, the change in the earnings of employees has been positive. It also shows that inflation has not been able to erode the increase in monetary wages and salaries of SOEs employees.

VII- Conclusion

1. Privatisation meets the dual objective of increasing the availability of resources for government and of enhancing efficient use of capital. It also represents an opportunity to increase the level of investments by bridging the gap between savings and investment through foreign direct investments. The experiences of other developing countries and the economic growth of India over the last three decades suggest that productivity enhancements generally come in association with a significant increase in private investments and foreign direct investments when there are domestic competition and export orientation.
2. The government has setup various procedures, committees, commissions, and a cabinet rank ministry for overseeing the disinvestments in CPSEs. The study reveals a very meager realisation of disinvestment proceeds against a hefty target. In 4 out of 16 years, the disinvestment proceeds were above the target, but, in other years, it was far lower than the target.

3. Present analysis suggests that there has been a uniform decline in the growth rate of employment in all disinvested and other SOEs during the post-reform period. The decline in employment was more closely linked to the macro policy changes than disinvestment.
4. The increase in the real wage rate in SOEs rose sharply in the post-reform period. The index of per capital annual emoluments in 2003 for SOE employee was 397, almost four times the index in the base year 1991, while the consumer price index for the corresponding increased from 100 to 222. As a result, the index for real increase in per capita emoluments almost doubled over the period.
5. It is quite evident that the initiations of disinvestment, which positively affect the economy as whole, need to be speeded up. Disinvestments can increase the efficiency through a better utilisation of resources, but the reckless privatisation may not provide the ultimate solution for a longer period of time. Efficiency may also be achieved by changing the quality of management and not by changing the ownership.
6. PSUs in India have underperformed. It does not mean that the role of the government in business ventures will get completely eliminated when all the public sector undertakings have been sold to the private sector. Some presence of PSEs is necessary to offer an effective competition to the private sector. In addition, PSEs will always have to play an important role in strategic areas like water, power, defense, and infrastructure.

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