CHAPTER - IV

PUBLIC SECTOR - ORIGINS AND GROWTH IN DEVELOPING ECONOMIES

INTRODUCTION:

Most of the developing countries has been shifting from massive investment in the public sector. Much of the output of the public sector plants was in the production of capital and basic goods (the former includes machinery, while the latter includes basic intermediate products as fertilizers, heavy chemicals, cement, iron and steel, and non-ferrous metals). The larger private firms which came under the licensing and other control procedures of the Government were largely concentrated in the production of a few agro-based intermediate goods (non-capital and non-basic inputs) and final consumer goods. The results of earlier industrial policies in the developing countries were mixed. Despite public sector achievements of commanding heights and capital intensive diversified products of growth in the developing countries there were problems of structural retrogression and stagnation in the industrial sphere since mid sixties.

Apart from the statutory which were applicable to the public sector was subjected to additional controls, the expenditure of foreign exchange by the public sector enterprises was subjected to far greater scrutiny by govt. departments, than was the case with the private sector, the matter of pricing and distribution and even in respect of what it produced, the public sector was
subjected to far greater control than the private sector. The results in the public sector have been long delayed in decision-making, all too often very weak management, inability to reduce results in the public sector have been long delayed in decision-making, all too often very weak management, inability to produce labour costs, and a frequent high-cost, low-return operation. In addition, while originally, govt.-ownership was meant for capital goods and basic industries, public ownership has served as a last resort for manufacturing Formerly private firms that would have otherwise gone bankrupt are closed, adding to the local unemployment. In this chapter we are going to prove public sector in developing countries and how that would lead to present situation in the light of liberalization era.

1.1 ROLE OF PUBLIC SECTOR VS PRIVATIZATION:

There have been the rapid strides attaining commanding heights unchecked for growth in public sector investments in state owned enterprises (SOEs) in many developing countries like Malaysia, Malawi, Trinidad Tobago, Papua New Guinea, Kenya and India, during their post-independence period. This common feature to all was/is on account of some of those developing countries adopting socialistic systems, some adopted mixed and others even if they adopt capitalistic system; Wherein the role of public investments in critical and strategic sectors was / is not ruled out but more often found obligatory at least to serve as contra cyclical measure and to regulate and assist if not to control the role of public sector. Particularly in mixed economy
like India both the experience and policy have been that the public sector, in addition to its role of state-owned public enterprises to grow in command heights, served to assist, incentive, help-regulate re-invigorate, channelize and control, as per development plan priorities the private sector investments; and administering the supplies at reasonable control prices of public goods to the advantage of private sectors activities, i.e, stimulating effects rather than crowding-out effects to function both as complements but not as competitive substitutes irrespective of the above features of public vs private economic system and / or institutional setup and changes in the institutions and in their systems both the sectors are mutually reinforcing for their growth, both employ public investments can set for growth of private sector or corporate sector.

There have been rapid strides attaining commanding heights unchecked for growth in the public sector investments in SOEs in developing countries in the past. For many developing countries including those covered in the study the dominant feature of their post-independence economic history has been the rapid growth of the public sector. Public intervention in the economy was a since quanon of policy thought the 1960s and 1970s, and the SOE sector has been one of the most common instruments used to effect such intervention. The SOE sector has traditionally been a major consumer of resources and credit is responsible for a major share of fixed capital formation is one of the largest employers in many economies and accounts in many cases for a large share of the
Measurments relating to growth of public sector depends on data reliability and differences in definition and biased due to inter-agency transfers and other off-budget resource flows. Estimates vary widely but some strong trends emerge. Nellis \(^1\) conservatively estimated that for a sample of sub-saharan African countries, the contribution of the SOE sector to total GDP was 17%. He noted elsewhere \(^2\) that this might blow with a high variance, having many cases (even outside centrally planned economies) where the SOEs accounted for over 50% of total GDP. The public sector generally accounts for a similar proportion of gross investment, although in the smaller economies especially in Africa, the share is higher. The considerable presence of the SOE sector is offset, however, by the flow of funds to it from other sectors of the economy. The SOE sector is rarely a generator of surplus funds, and on average is a net debtor with respect to central government (and through the Govt. budget to the domestic and foreign private sector). A recent evaluation by the World Bank shows that, for a sample of 25 developing countries \(^3\) the


median SOE contribution to the overall public sector deficit was 48%. Its share of domestic credit has been estimated at around 30% with a similar share of total external debt. The SOE sector is however, frequently highly skewed and in general a small number of SOEs account for a large share of output, total employment and new profits or losses. For example, the aggregate total performance for the SOE Sector in Malaysia (which as a whole is profitable) is highly distorted by the size and profitability of the Nationak Oil Company (PETAONAS) whose turnover alone accounts for almost 30% of the total turnover of the 100 SOEs in the country. Behind this aggregate lies a large number of poorly performing companies. A similar example comes from Jamaica where the combined budget of the 21 largest SOEs were equivalent to the total Central Govt. Budget. The sector is similarly skewed in terms of its areas of involvement, especially in Africa. SOEs generally are dominant in the utilities sector for example 86% of utilities in Africa and 6% in Asia are publicly owned.

In Africa, however public ownership also tends to dominate in the transport (41%) and Mining (55%) and is also a major player in the Manufacturing sector (21%). Exposure in the manufacturing sector is significantly lower in Asia and the Caribbean where the


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The indigenous private sector is generally buoyant, the dominant presence of the SOE sector across many sectors serves to underline the fact that SOE performance is as much a matter of macroeconomic management as it is of microeconomic efficiency.

1.2 GROWTH PATH OF SOEs Vs PRIVATIZATION:

The state-owned enterprise sector in the countries broadly followed similar paths of specific experiences through different countries experience varying stages in development of each. The common experience reflects the main political and economic concerns facing all developing countries over the last 30 years or so. To some extent the various responses to the crisis of the SOE sector, especially privatization incentives, follow the same pattern in which divergence of approach mainly reflects underlying circumstances rather than fundamentally different objectives. Thus the privatization debate in developing countries is significantly motivated by the search for new instruments through which these same objectives can be pursued.

The facts of the growth of the SOE sector in the countries and its subsequent declining viability are presented as follows. The initial period following independence and lasting until the late 1960s saw only gradual growth in the sector, with the state taking an active role in the provision of naturally monopolistic services and, to some extent, in the purchase and marketing of

primary sector outputs. The pervading strategy in other sectors was one of Lessaiz-faire in which foreign capital and management played a dominant role what was known as industrialization by government invitation and participation outside its core areas being driven principally by reaction and political expediency rather than by an active policy of interventionist. By the late 1960s and the early 1970s, political thinking, often in response to measurably worsening income distribution and rising unemployment in these new economies, shifted towards more careful economic management, in which public sector investment and employment decisions were grounded in a more explicit welfare measures and in which the interests of the indigenous population were strongly represented. Particularly favorable economic circumstances of the early 1970s assisted in the promotion of a rapid (and ultimately unsustainable) growth in SOEs sector. Based on these ideas, strongly Govt. intervention, based on a mixture of Govt. investment in commercial activities and to a much lesser extent, outright nationalization, was financed through the combination of favourable shifts in the terms of trade facing developing countries in the mid-70s and a high inflow of official and commercial foreign capital by the end of 70s the SOE sector was the dominant player in many of these countries.

It was found that ownership, whether public or private, is not our evaluation but the key determinant of enterprise performance and the efficiency of resource allocation. As such the growth of the SOE sector need not be viewed strictly as a
problem. However, as is widely and broadly seen, the growth of the SOE sector during the 1970s has been matched by a decline in its level of financial viability and a concomitant rise in the net flow of resources to the sector. Its drain on public finances and the inefficiency of this large sector remained as one of the problems facing Govt.s in sustaining the SOE sector were not merely concerns about micro-economic efficiency but rather had macro economic effects on both the demand and supply sides of the economy. Consequently the sectors poor performance was seen as a major contributory factor to the alarming economic crisis.

By the end of the 1970s the SOE sector in many developing countries was performing very badly indeed. The problems of the sector is well known viz.,

1. Political interference
2. Political appointments were widespread
3. Public accountability was nominal
4. Control of management was weak and
5. Administrative functions overwhelmed commercial activities: contradictory objectives dominated. Investments were excessively capital intensive and often suboptimal responsiveness to market conditions was often non-existent.

Many of the firms that had been taken over by Govt. on the argument that a) they were being run badly by the private sector had no corporate plans for recovery, and b) often performed even worse under state ownership than under the private ownership from

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which they were supposedly rescued, c) on the top of this, it was not unusual for the sector to face chronic organizational deficiencies in its relationship with central govt., involving multiple controlling agencies, overlapping of functions, and an absence of performance criteria.

1.3 **SPECIFIC COUNTRY EXPERIENCES**— DISTINCT PHASES OF DEVELOPMENT IN SOE SECTOR:

A) **JAMAICA**:

Three distinct phases of development in the SOE sector can be differentiated for Jamaica. The first occurred up-to independence in 1962. During which the Government's role in the Economy focussed on the creation of regulatory regime and the development of the key infrastructural sectors. The main areas of operation at the eve of independence were in regulation and promotion, social and community services, and manufacturing sector was restricted to intervention through two development finance corporations, while all the public utilities, except the railways, water and the post office, were still foreign owned.

The second phase coincided with the era of the first post independence government (the Jamaican Labour Party's) and the creation of an explicit commitment to greater state participation in the economy. Although there was some growth in the fixe of the SOE sector during this period, the major growth did not occur.

*J.L.P. - The Jamaican Labour Party*
until the third phase following the election of the first PNP (Peoples National Party) Government in 1972.

The PNP Government committed to a socialistic economic strategy and adopted an aggressive industrial program aimed at direct control of the economy, and the achievement of income distribution goals. The growth of public sector during the late 70s was both precipitate and chaotic, and by 1980 accounted for around 20% GDP. Loss making SOEs abounded, accountability structures became amazingly diverse, while the financial control and monitoring system was moribund. Over staffing and the intricate weave of price controls to which the sector was subject rational resource allocation virtually impossible.

b) TRINIDAD & TOBAGO:

A Similar three phase development occurred in Trinidad and Tobago, the first phase from 1956 (the date of independence) to 1970, embraced an identical non-interventionist stance which combined the active promotion of private sector led industrialization with the creation of a regulatory framework, although a small number through bail outs. Following the Black Power Riots in response to increasing unemployment and worsening income distribution, the early 1970s saw a revaluation of the role of state intervention in the economy.

The second phase witnessed the shift to effective Government intervention through SOE sector development, this change in policy coincided with a rapid expansion of state revenue following the

\(^9\text{P.N.P. - Peoples National Party, Jamaica.}\)
1973 increase in the Oil Price and the discovery of the Natural Gas Offshore.

The Government was able to finance the expansion of the SOE sector throughout the 1970s and 1980s through a policy of both nationalization and Government, backed creation of new industries. By 1986, the Government was the majority shareholder in 46 firms, in 35 of which it had 100% ownership. By 1985, the total value added of the SOEs was 16% of GDP, SOE sector employment accounted for 13% of total formal sector and capital investment for 26% of the total.  

**c) MALAYSIA:**

In Malaysian economy the origins of the SOE sector are initially tied up with the new Economic Policy (NEP) developed in 1970 following riots in Kuala Lumpur in the previous year. The NEP is an affirmative action program designed to reduce and eventually eradicate poverty by raising income levels and increase in employment opportunities for all Malaysians, and to correct economic imbalances so as to reduce and eventually eliminate the identification of race with economic function. Prior to 1970s Government participation in the economy was limited to regulatory infrastructural and marketing operations.

The 1970s witnessed an unparalleled growth in equity acquisition by the Government and its holding companies. As a

result through viewed as being fundamentally a market oriented economy by 1980s the SOE sector in Malaysia consisted of approximately 1150 enterprises, comprising the traditional core sectors i.e, transport, communications, water and energy. Additional importance was given to services sector, finance sector, construction and manufacturing sectors. As a result of overall resources of the SOE sectors were hidden by the early 1980s the sector accounted for 25% of GDP.\textsuperscript{11}

d) SRI LANKA:

Economic policy in Sri Lanka since 1940s has been directed towards the reduction of unemployment and the alleviation of poverty. In the first 30 years after independence in 1947, the problem was addressed by expanding the agriculture sector, and by expanding the agriculture sector, and by promoting an import-substituting industrialization strategy built around a core SOEs. SOE sector grew from the late 1950s through nationalization in the plantation sector, transport and financial sectors.

In the 1970 Government business undertakings act came into effect, and in 1971 land reforms act paved the way for the creation a large number of Government owned business undertaking and accelerated the process of nationalization in the plantation sector. By 1977 there were 250 SOEs covering all areas of economic activity in the economy, accounting 20% of GDP and 35% of Gross Investment and 40% employment. However the growth in the

sector had slumped and employment creation had stagnated. In the 1977 liberalization of Sri Lankan economy contained the seeds for the latter attempts to rehabilitate SOE sector and to proceed towards privatization.  

e) KENYA:  
The origins of the SOE sector in Kenya extended back to the early 1900s, with the creation of the East African Railway System, linking Mombasa on the Coast with the inland cities of Nairobi and Kampala. After independence in 1963, public ownership was widespread in infrastructure, agriculture marketing and also in finance sector. Until the late 1970s attention shifted towards the role of the state in resource management, under the 'African Socialism'. This combined with the goal of Kenyanization i.e, rapid acceleration of the transfer of economic control/power from the hands of foreigners and Kenyan Asians to Kenyan Africans. By the 1980s the SOE sector in Kenya consisted of 150 SOEs accounting 15% of GDP in the late 1970s and similar proportion of Gross capital formation, 30% of employment and 50% of public sector capital formation but later 1970s the SOE sector revealed the critical state and gave way for liberalization reforms.  


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f) MALAWI:

In Malawi SOE sector is small in number of enterprises (it consists of 24 enterprises only) it accounts for a major share of GDP (25% in 1984). Malawi's SOE sector has evolved in a manner almost identical to that of Kenya. After independence of Malawi too got into public investments in infrastructure sector and development finance sector, in the early 1970s practical more interventionist stance pursued in the early 1970s and implemented through the operations of three large holding companies, the Malawi Development Corporation (MDC), the Agricultural Development and Marketing Corporation (ADMARC) and the Press Corporation, which were rapidly involved in the promotion of the manufacturing and service sectors. As with Kenya the 1970s were relatively favourable terms of trade which combined with low producer prices to generate large cash balances in the hands of ADMARC. These were invested in the non-traditional sectors. These investments were not self sustaining and the terms of trade reversal in early 1980s exposed weakness in the SOE sector, these weaknesses transmitted themselves into problems of macro-economic management.

g) PAPUA NEW GUINEA:

The SOE sector in PnG is the smallest in the countries we covered in study, both in absolute and terms to GDP. The SOE sector accounts for approximately 10% of GDP and 8% of total

capital formation and a similar proportion of employment. It consists of 40 enterprises, covering commodity marketing, commercial statutory authorities (CSAs) which cover the main utility sectors and finance and a number of smaller commercial enterprises. The SOE sector is profitable. In the 1980s the SOE sectors problems were dissimilar to that other countries. PNG is a mineral based economy and stands to enjoy a substantial boom in that sector. The challenge for the non-mineral sector is how to manage the consequence of a mineral boom so as to avoid the problems of non-mineral sector, and latterly in respect of privatization, it has been more an issue of optimal management for the future an issue of optimal management for the future than response to failures in the past.

h) INDIA :

Prior to 1947 there was virtually no public sector in the Indian economy. As on March 31, 1992 there were 246 Central Government organized enterprises, excluding banks, financial institutions and departmental understandings like the Railways, Posts etc. Out of the total investment of Rs.135,871 crores at the end of March, 1992 the share of enterprises producing goods amounted to Rs.102,713 crores (75%) and that of service enterprises was Rs.32,085 crores (23%). The balance of Rs.1,073 crores was accounted for by companies under construction.\textsuperscript{15}

i) PUBLIC ENTERPRISES UNDER STATE GOVERNMENTS:

As on March 31, 1992 there were 636 state level public enterprises functioning in 24 states. The investment in State Enterprises as on March, 1986 was of Rs.10,000 crores. The 1956 industrial policy resolution adopted the socialist pattern of society as national goal led to a enlargement of the role of public sector.\textsuperscript{16}

From the table III it may be noted that 48\% of total employment (i.e. 88 lakhs) in the public sector is in government administration and the balance is spread in other economic enterprises run by the Centre, State and Local Government, the share of public in total employment in the organised sector reveals that in transport and communication, electricity, gas and water and construction the share of public sector is in the range of 9-98 percent, a situation of total dominance with the nationalization of Coal sector and takeover of 20 major commercial banks these has been a significant improvement in the position of the public sector.

During the last three decades, the share of public sector in Net Domestic product (NDP) ha shown a steady improvement. Public sector accounted for 10.5 percent of NDP in 1960-61 its share in 1987-88 has risen to 25\%. The increase is significant one. The share of public enterprises, however, rose from 6.6\% in 1960-61 to 15.3\% in 1987-88.

Public enterprises survey (1992-93) has estimated the net profits earned by the profit making enterprises along with the looses suffered by loss incurring enterprises, during 1980-81 and 1989-90 there is a trend of decline in the ratio of losses and a serious reversal of trend has occurred during 1991-92 and this ratio has again jumped to 59.3%.

1.4 **SHORT COMINGS OF THE PUBLIC SECTOR:**

The main points which merit consideration are:

a) **MOUNTING LOSSES:** A review of working of public sector enterprises in India reveals that either the profits in them have been deplorably low or that they have been making losses. Consequently, the losses are mounting year after year. Data given in table VI for the public sector enterprises both by the Central and State Governments enterprises reveal that as compared with performance of the Central Government, the State Governments are having perennial loss-makers like irrigation works, state electricity boards and state road transport etc.

b) Political factors influence decision making in location.

c) Delays in completion and increase in costs of construction

d) In efficient management.

e) Higher capital intensive ness leading to lower employment generation.

1.5 **FUTURE DIRECTION OF POLICY:**

The principal problems facing the public sector in India are:
1) Excessive Bureaucratization and lack of autonomy and no accountability,
2) Political interferences and suggested,
a) Privatization of loss making units and reduction of controls,
b) Changing work ethos in public sector undertaking.

CONCLUSION

The performance of SOEs are becoming bad and leading to the inefficient economies in most of the developing countries. There have been adopting to Privatization programs as a panacea to the public sector's vices.

Experience of Industrially Developed countries in the context of SOEs is same, but the privatization context is not. Privatization experience over a decade in developing countries is not simple. Privatization and liberalisation have been mutually reinforcing and exhibit a complementary role to perform in developing economies. Privatization is strongly suggested for SOEs ills in coming chapters will dealt with privatization exclusively.