CHAPTER I

STATE AND ECONOMIC DEVELOPMENT

1.1 Introduction

A study on the evaluation of the performance of public sector in a developing economy is inescapably linked with a host of questions such as the sheer size of the public sector, i.e., the type of society to be built; and the role of public sector in efficient management of the economy. The former is related to the conflict among different ideologies, most notably between Marxist and Liberal schools of thought. The latter, however, is concerned with different dominant classes, influencing the process of economic modernisation, which indeed is the ultimate motive of all developing economies.

In Great Britain, the first and foremost among the modern industrial economies, development may have come extempore. However, in later times especially since the end of the Second World War, the state has patronised development in most of the countries. Development experiences have, however differed from country to country. The experiences differed partly because of the divergent overall socio-economic structure of different countries and partly due to the fact that the process of industrialisation commenced at different
points in time, with varying degree of sector priorities in different countries.

A government may intervene in the process of economic development mainly in two different ways. It controls and regulates the private sector while abstaining from undertaking direct production. Alternatively, it prefers to undertake production but refrains from imposing controls on the private sector. The former is referred to as controlling state while the latter as producing state. However, in practice, a state is a mixture of both. Whatever may have been the historical tradition, it is seen that state intervention has induced, improvised, restrained and conditioned a variety of structural transformation in the economy, especially in the industry. Hence, an analysis of public sector performance automatically involves an evaluation of the role and effectiveness of state intervention in industrial development.

Theoretically, two broad conjectures are recognised on the nature of state intervention in a capitalist economy. The first may be described, in the words of Paul Sweezy, as the 'class-mediation theory' while the second would be 'class-domination theory'.


mediation theory takes the existence of a certain class structure for granted, and sees in the state an institution for reconciling the conflicting interests of various classes; class domination theory, on the other hand, recognises that the classes are the product of historical development and sees in the state an instrument, in the hands of ruling classes, for enforcing and guaranteeing the stability of the class-structure itself. Between these two broad strands, there are several versions, dominant among them being the 'Stamocap theories'. These theories assume a particular stage of capitalism characterised by fusion of monopoly forces with the bourgeoisie state which, in fact, becomes a single mechanism of economic exploitation and political domination. Our purpose is not to go into the details of these debates within Marxist and Liberal traditions. Suffice it to say that any prior theoretical construction on the nature and character of state intervention in a country would be restricted by the practical experience of the state in that particular economy depending upon spatial and temporal conditions. In different nation-states, the state intervenes in different ways at different points in time, conditioned by a plethora of socio-economic and historical factors. Consequently, uneven capitalist development follows. In this process, some states emerge as advanced or independent while others as subordinated, colonised or dependent. To mark this distinction, theoretical literature


4Ibid, p.32.
is presented in ‘dependency perspective’, particularly by Cordoso, Dos Santos, Paul Baran, A.G.Frank and Samir Amin. Again, details of this perspective could not be gone into by us in the present study. Suffice this to say that the state is constrained in its ability to realise objectives of capitalist development by a system of relationships, which are often, influenced by processes elsewhere in the world system.

1.2 State Intervention and the Present-day Advanced Countries

As mentioned earlier, there are different ways through which the state intervenes in the economic affairs of a country. For example, the relationship of state and capital would be different in an advanced country compared with that in a colonial or post-colonial country. It may be highly instructive to peep into the historical processes of how state intervention was adjudged a *sine qua non* for fostering industrial growth, especially after the end of Second World War when numerous ex-colonial countries started their march of independent economic development.

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Adam Smith advocated Laissez-faire capitalism, restricting the role of the state to defence, administration, justice and public works only.\(^6\) Since then, academic opinions changed and many economists favoured a varying degree of state intervention. Marx discussed state intervention in terms of classes and class-relations. Apart from Marx, state intervention found a serious place in Keynes' and Kalecki's works who favoured it in order to bring it out of the crisis and thus leading to a crisis-free capitalism.

Historically, the relationship of state with capital changes over time. Taking the classic case of Britain it is easy to point out that the relationship between state and capital has passed from one phase to another. From the early mercantilist capitalism, where the state played a conducive role in promoting merchant class; through the phase of industrial capitalism - where state withdrew itself from internal economy in favour of laissez-faire policy; and finally the state passed to the phase of monopoly capitalism, which is characterised by a highly interventionist state.\(^7\)

This is a systematic scheme of capitalist development. However, in actual practice, cases of capitalist development indeed,

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do not pass through all these phases; if, however, they do, the period involved in each case would be different. In the case of Britain, transformation to capitalism took several centuries including a long period of capital accumulation in which state played a significant role. But in the late industrialising countries such as Germany and Japan, such a stage was hardly witnessed. In fact, from the very beginning the state intervened in a significant manner in the industrialisation of late industrialising countries. In Germany, Friedrich List put forward the concept of nation-state and favoured state intervention through protection to local industries as against foreign competition in order to achieve rapid industrialisation. Similarly, in Japan, the Meiji State played a crucial role in protecting domestic enterprise and providing basic infrastructure for industrial development.

An important aspect to note about Germany and Japan was that the state was coming forward to sponsor industrialisation not only because of the disadvantages of late industrialisation but also because of technological advancement to attain high degree of influence over the world system. This resulted in the extra-ordinary

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development in the production forces and led to modern capitalism or mixed economies incorporating large monopoly corporations both public and private. Therefore, late industrialisation along with the premature growth of monopolies resulted in a relatively closer relationship between state and capital. However, even within this phase of capitalist development, many analysts differ with regard to the nature and degree of state intervention, particularly over time, space and socio-economic conditions of a country. For instance, during economic crisis, the very same monopoly capitalist state may become a highly authoritarian and fascist state or may acquire a benign socio-democratic character and become a welfare state by offering a series of concessions to various social groups.\textsuperscript{11}

One point that needs to be noted here is that the state does not and need not always intervene in the interest of dominant classes.\textsuperscript{12} If it does, either the desired objectives do not materialise or it may serve completely different motives rather than the ones, which have been intended for. As Kalecki\textsuperscript{13} pointed out, increased budgetary deficits


\textsuperscript{12}R.Miliband (1983) "State Power and Class Interests", New Left Review, no.138, March-April, pp.57-68. Miliband discusses, state power and class interests in terms of state autonomy and the contradictions between self-interest and national interest. His final view is that "an accurate and realistic model of the relationship between the dominant class in advanced capitalist societies and the state is one of partnership between the two different separate forces, linked to each other by many threads yet each having its own separate sphere of concern" (p.65).

\textsuperscript{13}M.Kalecki, "Determinants of Profits", in Kalecki, op.cit.
apart from expanding employment would also enhance capitalists' profits.

Keynes believed that state intervention in itself would be a sufficient condition to deal with the crisis-ridden economy. But he did not recognise the tendencies of recurrent crisis inherent in a system. Kalecki recognised this and analysed it in terms of business cycle and political business cycle.¹⁴ But the fact is that Keynes-Kalecki paradigm strongly favours the role of state intervention in the capitalist economy, which is not restricted to the provision of financial and infrastructural support but also of correcting the system whenever there is crisis.

1.3 State intervention in a developing economy

The motive of industrialisation for developing economies is built into the world historical processes. It is pre-determined for the economically backward societies. As Marx had stated, "the country that is more developed industrially, only shows to the less developed, the image of its own future."¹⁵ Despite the fact that means of its development have been varied among different underdeveloped

¹⁴Kalecki, "Theory of Economic Dynamics", in ibid.

countries, this process has been accomplished through state protection and encouragement of indigenous industry. The underlying assumption is that in a developing country, the market mechanism systematically misallocate resources between different uses at a given point in time and therefore capitalist state seeks recourse to state intervention, especially for setting the prices right.

1.3.1 State intervention in a colony

Historically, most of the developing countries are post-colonial societies. In a colony, as against the advanced countries, where the relationship between state and capital is determined by the internal mechanism; an interjection exists between state and domestic capital. The colonial state intervenes on behalf of metropolitan capital and contradicts the domestic capital. Thus domestic capitalism develops in a colony in spite of and not because of state intervention.

The nature of such economic relationships helps in understanding the problems of post-colonial societies, which despite being capitalists, take such a peculiar shape which is distinct from those that exist in developed societies as well as countries under colonial domination. As Hamza Alvi puts it, "the state as in post-colonial society is not the instrument of a single class. It is relatively autonomous and it mediates between the competing interests of three
propertied classes namely the metropolitan bourgeoisie, the indigenous bourgeoisie and the landed classes."\textsuperscript{16} The state intervenes on behalf of them all to preserve social order and harmony and to shape the development policies, in a variety of ways. The more important among them are, like in many advanced countries setting of public enterprises, direct control through industrial licensing and pricing policies, and participation in the planning process; and so on.

There are two different viewpoints on the role of state in British India. The nationalist and marxian historians have underlined the aspect of drain of economic surplus from India. According to them, the impact of colonial rule has been to deindustrialise the local Indian economy.\textsuperscript{17} R.C.Dutt points out, "In England, in Germany, in the United States, state widens the income of the people, extends their markets, opens up new sources of wealth and identifies it with the nation, grows richer with the nation. In India, state has fostered no new industries for the people, on the other hand it intervenes at each recurring land settlement to take out what it considers its share out of


the produce of the soil." On the other hand, various liberal historians have put forward the beneficial impact of British rule on the growth of Indian modern industry.\(^{19}\)

Practically, the whole of pre-World War-1 period was marked by the policy of free trade. It was characterised by the development of those industries, which could provide raw material to the metropolitan industry. The First World War took a break from a policy of non-intervention. In India too, the state followed the policy of discriminating protection. This policy gave some stimulus to private industrial investment.\(^{20}\) However, the years followed by the Great Depression of the thirties witnessed by and large the multilateral dependence on the advanced capitalist countries. As stated above, it was primarily connected with imports of industrial goods from metropolitan country combined with the export of raw material conducive to the development of metropolitan industries. This dependence was also reflected in the metropolitan country's industrial,

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scientific and technological base and therefore, in importing machinery equipment.

The activities of metropolitan government resulted in slowing the development of industry and industrial capital in the colonial India. This manifested itself in the decay of traditional artisans and handicrafts leading to agrarian overpopulation. Merchant-moneylenders capital, on the other hand, did not always take the form of independent enterprise. The capital was partially invested in the companies sponsored by foreign capital with a very specific role. Indian shareholders of these foreign enterprises were not industrial entrepreneurs but remained interest bearers on loan capital. Such a situation resulted in tremendous concentration and centralisation of capital, mainly in the hands of foreign (and very few big Indian) entrepreneurs. This was amply reflected in the operation of joint stock enterprises and managing agencies at that time.21

Thus, state intervention in the colonial economy was mainly assisting metropolitan industries in their export expansion activities on the Indian market. Government intervention, therefore, did not generate the basic conditions for a wide development of domestic private enterprise. The development of industrial capital took place "in

spite of rather than 'because of' state intervention. It was only during the World War II that state introduced control over prices and distribution of goods and licensing of production of important goods such as steel, cement, coal, machines, sugar, etc. But all these measures were necessitated by the emergent circumstances created by war. Similarly, the narrow framework of British policy in India limited state enterprises. The largest enterprises belonging to colonial government were construction of railway network and public irrigation works.

1.3.2 State Intervention in a Post-Colonial Society

In the post-colonial regime of a country, the twin problems of industrialisation and development necessitates a fair degree of active state intervention. The India's situation throws up many interesting features in this regard. Influenced by Soviet Union along with the desire to get rid of the curse of dependence, the Indian state undertook to play a significant role in the economic development programme, characterised by the policy of 'self-reliance' within the range of 'mixed economy'. The form of state intervention is generally enveloped in the demand for planning. However, it must be

emphasised here that the desired content of planning varies from planner to planner. As Bagchi\textsuperscript{23} explains, for some, it means simply state action in support of private enterprise, for some others as in the case of Indian planners, it is the entry of the state into such fields which private capital finds unprofitable to explore, for yet another group, it is a slow process of replacement of private enterprise by collective or joint enterprises.

Indian capitalist class which, however, accumulated large amount of capital after Great Depression of thirties and Second World War, was not in a confident position to face foreign competition or to commence the process of industrialisation without planning for state intervention.\textsuperscript{24} Therefore, the state undertook the task of developing basic industries which, in fact, was seen as a means of reducing income and regional inequalities in the otherwise amputated economy, that India was, on the eve of independence.\textsuperscript{25} Hence in order to reduce dependence on foreign capital, state played an interventionist-but-developmental role, primarily with the objective of achieving import-substitution and providing crucial economic infrastructure.

\textsuperscript{23} Ibid, p.220.


\textsuperscript{25}K.S.Gil (1985) Evolution of Indian Economy, NCERT, New Delhi, chapter 2.
Consequently, in a situation with acute deficiency of capital, low propensity to save, limited use of savings for productive purposes and underemployment and disguised employment in agriculture, Indian planners stressed on the development of industry, particularly heavy industry. This is most ostensibly reflected by Mahalanobis Model adopted in the second five-year plan (1955-60). It is noteworthy here that Indian planners were putting forward the idea of supply-side view of planning. "For them, the growth process was unlikely to lose steam so long as public investment was growing at a fast pace".26 This idea necessitated looking around for avenues in which public funds could be invested more fruitfully in the long run. It could either be directed towards infrastructure or agricultural or industrial development. Planners in India obviously opted for all the three. The first five-year plan focussed on public funds to be invested in infrastructure and agriculture. The second and third five-year plans emphasised on the need for investing in capital goods industry. Meanwhile, the Industrial Policy Resolution, 1956 delineated clear cut though not watertight compartments for public and private sectors.

The regulatory role or the indirect state intervention was also quite evident. With the adoption of various licensing and industrial policies, enactment of such acts like MRTP (Monopolies and


However, it was observed that the rate of growth of value-added in the industrial sector, as a whole was quite low. It was 5.5% during 1966-80 compared with 7.6% per annum in pre-1966 period. One of the many reasons provided for this phenomenon was slowing down of public investment.\(^27\) Thus, the period especially after mid-70s led to a conscious effort, on the part of the government of India to change the policy. This process of drifting away is slow though continuous and has become most visible since mid-80s. The origin of this process goes back to mid-60s, when the country had to cope with the military and agricultural crisis followed by the industrial crisis. In spite of this shift in the strand, along with the inherent contradictions of the system, one cannot deny the fact that the Indian state has been intervening in a significant manner in the economic development and modernisation of the post-independence India.

In nutshell, state intervention in a colonial economy like India under the metropolitan regime was extremely limited. It mainly took

place in the development of infrastructure to the extent and in the
directions dictated by the military-economic and strategic
requirements of metropolitan government and for the benefit of
dominant groups of foreign businessman. Rather than assisting in
overcoming the colonial character of the socio-economic structure; it
helped to conserve it and in the process resulted in the emergence of
a few economically powerful classes. As in India, the emerging major
classes were landlords and big capitalist farmers in the rural areas;
industrial capitalists and big merchants in the urban areas along with a
section of bureaucrats running the state apparatus and public
enterprises.\textsuperscript{28}

In the post-independence Indian economy, Despite the recent
policy shifts the state has intervened in a significant manner. It has
intervened not only directly through state capitalist enterprises but
also indirectly through various regulations and policies and
consequently, the public sector has emerged as an important factor in
the development of such a post-colonial state.

\textsuperscript{28} P.Bardhan (1984) \textit{Political Economy of Development in India}, Basil Blackwell,
Oxford, Chapter 5 and 6.
1.4 Public Enterprises - An Instrument of State Intervention

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

Thus, the rationale for establishing state capitalist enterprises stems from the imperfections in the product as well as factor markets, lack of information and reluctance on the part of private entrepreneurs due to high risk and low returns. Moreover, in order to earn revenue,

governments prefer to own monopolies, nationalised industries especially in public utilities, railways and communications.

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

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

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

Since 1980, the intervention by the state through state owned enterprises has been undergoing a scrutiny in many developing countries including India. Due to tremendous fluidity of finance capital, governments find themselves into several fiscal deficits and it has become increasingly difficult to raise funds at home and abroad while the state capitalist enterprises were absorbing a large chunk of government funds in the form of subsidies which, in fact, has resulted in the misallocation of resources brought about by diversion of savings. So there is a hunt for remedies in the developing economies and a recourse has been found by most of them including India in the form of deregulation, liberalisation contracting out and franchising. Comparison between private and state capitalist enterprises thus assumes great policy significance.

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Most of the literature analysing the state enterprises comes out with factors such as lack of competitive environment, lack of financial and managerial autonomy and accountability and vague objectives that hamper their performance.\textsuperscript{31}

In his endeavour to develop a theory of economic growth that takes root in the economic and political realities of the late capitalist society, O'Connor points out that, the capitalist state must accomplish two basic but contradictory functions - accumulation and legitimation. It means that the state must create conducive environment for the capitalist accumulation. It must also generate conditions for social harmony.\textsuperscript{32} These two concepts point out two significant and interrelated aspects of social reality. And the performance of the state, particularly state capitalist enterprises, needs to be assessed under these two broad categories, as they are additional and important policy instruments to move the process of development in the direction determined by the state.


\textsuperscript{32}James O'Connor (1973) \textit{Fiscal Crisis of the State}, St.. Martin's Press New York, p.6. While suggesting the functions of the state he states that "A capitalist state that openly uses its coercive forces to help one class, accumulate capital at the expense of other classes, looses its legitimacy and hence undermines the basis of its loyalty and support".
Various approaches have been suggested for the evaluation of state enterprises major among them being: (i) financial profitability and (ii) social profitability using accounting prices. The former approach in itself is not a sufficient condition to frame judgement on economic performance. As Chokshi points out, "Any general comparison between public and private enterprises based on the use of financial efficiency (profitability) is not meaningful... as no two enterprises operate in precisely comparable circumstances."³³ Many of the state capitalist enterprises fail either due to faulty planning or due to excess capacity created or because of the non-optimal choice of location which serve the purpose of regional development. Similarly, excessive political interference and lack of managerial interests (autonomy) hamper the performance of state enterprises. Based on the above strands of thinking, there are various theories on assessing the performance of state enterprises. One of them is 'property rights theory', which revolves around the 'principle-agent problem'. This problem emanates with the development of monopoly capitalism, incorporating large modern corporations, which have brought about with itself the separation of ownership and management. This theory maintains that efficiency depends on ownership pattern; firms under

private ownership are more efficient compared with those under public ownership.\textsuperscript{34}

Another theory revolves around the political dynamics. It takes the strand that public sector is exposed to political manipulations. State Capitalist enterprises are an instrument of intervention in the hands of politicians in developing countries but hidden from public surveillance. The presence of coalition groups is a factor responsible for the poor performance of state enterprises, which serve as a source of power in the hands of bureaucrats and managers.\textsuperscript{35}

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

However, whether it is the level of capitalist development or the presence of coalition groups, state intervention through public


enterprises will depend upon the social fabric of a given society. As Shepherd comments, "whether or not public enterprises does reasonably well in financial terms seems to be more a function of country concerned than of economic sectors or organisation of the enterprise." It is not fair, however, to expect any single theory to encompass all aspects connected with the performance of public sector enterprises.

1.5 Objectives and Scope

The present study, primarily concerned with public-private sector debate in India is addressed to the issue of wholesale privatisation without the consideration of surrounding environment and is pursued at two different levels (a) public sector as a whole and (b) individual public sector enterprise within a key industrial sector. The former is approached indirectly with the interaction of changing industrial and economic policies and state capitalist enterprises under different regimes. The second aspect, however, is dealt with through exploring the working of cement industry in the non-metallurgical core sector. The choice of cement industry has been influenced largely by the possibility of a comparison with the private sector enterprises in

the industry. It has been observed that state often constitutes monopolies in particular economic and industrial sectors. If that is so, it necessarily restricts our choice. However, a proper and adequate test of performance of the public sector requires a comprehensive comparison between the two sectors. This comparison is more productive if done at the micro level. Therefore, this study envisages a comparison between Cement Corporation of India (CCI) and Associated Cement Companies (ACC) in the public and private sectors, respectively.

The objectives of the study are to:

(i) know whether the ownership structure has any bearing on the performance of the industrial enterprises;

(ii) review the policies of regulation and deregulation enacted towards public sector in general and cement industry in particular;

(iii) understand the structure of competition, in the cement industry of India;

(iv) find out if the regional self-sufficiency has been achieved in India in the field of production and distribution of cement;

(v) analyse the impact of policy shifts towards cement industry in terms of structural ratios, employment and financial indicators;

(vi) determine if the shifts towards privatisation and liberalisation show any evidence of decreasing cost of production;
(vii) see if there takes place any displacement of labour with privatisation in a labour abundant country of India; and

(viii) see if any change in production efficiency (technical or allocative) takes place when the industry shifts towards deregulation.

Hence, without committing ourselves to any dogmatic position or ideological prediction, we take recourse to the following commonsense statements which, in any case, come under empirical scrutiny one after the other:

(a) that public ownership is not inherently less efficient than its private counterpart;

(b) that the structure of competition, policies of regulation and deregulation, not only of the industry, under study but also of the forward and backward linking industries, has a critical bearing on the performance of the enterprises whether in public or private sectors;

(c) that not only the level of development of society as a whole but also of particular area, in which a capitalist enterprise is located, affects its performance;

(d) that irrespective of the form of ownership, inefficiency is bound to occur unless structural bottlenecks are resolved;
(e) that policy shifts have resulted in similar changes, whether in
cost of production or in financial indicators, in the enterprises
irrespective of the form of ownership; and

(f) that inefficiency-allocative and technical- continue to persist
despite policy shifts towards liberalisation and deregulation.

Thus, taking into account the shift in the role of the traditionally
dominant economic force or the state, the present study, intends to
look into the performance of the selected enterprises in the public and
private sectors of cement industry in India i.e. CCI and ACC for the
period 1975-76 to 1991-92. Apart from historical and analytical
analysis the statistical and econometric methods used include:
calculation of growth rates, ratios, percentages, index numbers and
fitting a translog cost function. Details of the methods adopted have
been dealt with chapterwise. Moreover, since the whole analysis is
based on the time series analysis, the data used is at the constant
prices.

Data sources for the present study are the annual reports for
different years, of the companies under study, RBI Bulletins, Plan
Documents, Annual Survey of Industries for various years, data
obtained through personal visits from ACC and CCI other than annual
reports, cement statistics and data on cement provided by cement
industry.
The thesis adopts the following scheme of chapterisation. Chapter one introduces the study, by a brief review of the historical as well as theoretical aspects describing state intervention and development. It states the purpose, scope and methodology of the study. Chapter two provides a concise picture of the interaction of government policy and the public sector. Chapter three reviews the historical background of cement industry in India since its inception. Chapter four looks into the performance of the industry as a whole over the years. Chapter five examines the public and private sectors in cement industry. Chapter six analyses the enterprises' financial aspects. Chapter seven deals with the cost analysis of the enterprises concerned while chapter eight with the production analysis involving both technical and allocative efficiency. Lastly, chapter nine gives the major conclusions of the study and helps in drawing some useful policy implications.