CHAPTER II

ECONOMIC POLICY AND PUBLIC SECTOR IN INDIA

2.1 Introduction

As outlined in the previous chapter one, state intervenes in the economic development of an economy in a variety of ways within the contours of socio-economic and political circumstances. The investment in public sector enterprises is one such manifestation. These enterprises work within the limits set by the economic policy of the state. Hence, the posture of the state towards public sector cannot be studied in isolation of economic policy, which also affects the private sector as well as the economy as a whole. Accordingly, this chapter studies the economic policy and the state posture on public sector.

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

The proper understanding of the economic policy of an economy like India necessitates its historical evaluation. Therefore, in this chapter, the whole period of interaction of economic policy and public sector in the post-independence India has been divided into following four phases: (I) 1950-1965, (II) 1966-1984 and (III) 1984-91 and (IV) post-1991 policy regime. During the first phase, i.e., 1950-65, the growth rates of the economy were generally high and public sector was occupying the position of 'commanding heights'. The second phase (1966-84) has been further sub-divided into two periods 1966-73, because of various factors, the details of which will be discussed later; the economy passed through economic crisis. However, the public sector was by and large still enjoying a significant position. The second sub-period, i.e., 1973-84 recorded a slow process towards liberalisation, which culminated into an irreversible process of liberalisation of the economy through the third (1984-91) and during final phase (1984 onwards) of our study of the economic policy in India. Public sector was, no longer occupying the position of commanding heights. In addition, the old concept of socialism and mixed economy were replaced by the concepts such as liberalisation, privatisation and market-friendly approach.
Hence, these four phases of the economic policy making will enable us to understand the logic behind the establishment of public sector and the assigning of the role of commanding heights to it; the subsequent change in thinking and the reasons behind such a change in policy.

2.2 First Phase (1950-65)

To begin with, in 1947, it was mainly the ideology of socialism that led the public sector to play a significant role in the rapid development of the economy. However, at that moment, it was very difficult to deny the existence of big monopoly capitalists. Consequently, the economy was essentially a mixed economy comprising of both public and private industrial sectors. Two Industrial Policy Resolutions of 1948 and of 1956\(^1\) were adopted during this period. Both these resolutions acknowledged the role of private sector but excluded it from the basic and strategic sectors of the economy reserving them exclusively for the public sector. Many arguments were put forward in support of the role assigned to public sector e.g., the provision of infrastructure for private sector; long

\(^1\)See Guidelines to industries (1974-75) Government of India, New Delhi.
gestation period of basic and strategic industries, lack of adequate funds in the hands of private sector to establish such industries. Private sector enterprises also welcomed this move on the part of the government, as they wanted protection against the national and foreign monopolists.²

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

However, public sector was not the only part of total project adopted in the Nehru era. The other important part was land reforms. It will be out of context to go into the details of this aspect. Suffice to mention here that the land reform measures adopted failed largely due to lack of political will. In the opinion of some analysts the ruling

party proved to be a hindrance rather than help; substantiating the argument that when interests of the important social groups are at stake, ideology loses its usual verve. All these developments ultimately meant that the project of socialist society was reduced to a project of industrialisation with public sector being assigned the important role.³

Thus, in terms of Kalecki's 'intermediate regime',⁴ one can infer that economic policy of the 'Nehru era', was more a reflection of the aspirations of the urban middle classes. However, at the same time, it reflects the weaknesses of big monopoly capitalists in urban areas and power of the rich rural strata during that particular period.

2.3 Second Phase (1966-84)

The first phase of economic policy making registered a satisfactory industrial growth with a policy of import-substitution and self-reliance. It was only because of Sino-Indian war of 1962 and the Indo-Pak war of 1965, that India had to ask for foreign aid and for the

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⁴It refers to the control of state power by the middle class of the urban and rural areas, i.e., urban middle classes and rich and middle peasantry in rural areas. See M.Kalecki (1972), "Social and Economic Aspects of Intermediate Regimes", in Essays on the Economic Growth of the Socialist and the Mixed Economy, Cambridge University Press, Cambridge.
first time it came under the pressure of international agencies like World Bank and IMF.\(^5\) This process was further aggravated by the agricultural crisis of 1965-67, when it experienced the worst drought.

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

It was natural, therefore, that retrogression in the rate of growth of Indian economy that started in the mid-sixties, reached alarming proportions by the early seventies.\(^6\) Over the years, this slowing of


industrial growth generated a lively debate among the scholars who offered many explanations. Our purpose is not to go into the details of this debate. However, suffice it to mention here that one among all these explanations was declining public investment and infrastructural bottlenecks expounded by Bardhan. He discussed this argument in two steps, that (i) a decline in public investment and rising capital-output ratios were strongly related to the deceleration in Industrial growth; and (ii) these causes owe their genesis to the heterogeneous and conflictual nature of the India’s dominant coalition.

Because of this entire experience spread over a period of almost five years, i.e., 1964-69, the government reversed back to the radical conjecture. This process commensurated with the nationalisation of banks in 1969 and the enactment of the Monopolies and Restrictive Trade Practices Act, 1969. This shifting from one stand to another was more a reflection of the politics of populism rather than a consistent strategy of growth. As with the experience of oil shock of 1973 and the realisation, on the part of government that the radical approach with its restrictions on private sector and


For a comprehensive review of the debate surrounding this issue see, A. Varshney (1984) op.cit

Pranab Bardhan (1984) op.cit
relentless expansion of the public sector had not helped the growth of the economy; on the contrary, it had coincided with economic stagnation and inflation.

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

Further policies announced in 1975-76 included approval of additional capacity as an instrument in the process of modernisation, delicensing of industries, automatic expansion of capacity up to 25 percent over a period of five years in a few engineering industries. Public sector was no longer conceptualised as engine of growth, rather its role was understood as one of facilitating private sector's growth.

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9 See S. Marathe, (1986). Regulation and Deregulation, Sage Publications, New Delhi, Chapter III and IV.

10 Ibid, Ch.IV
Again, in 1977, continuing with the policy of liberalisation, further relaxations were made. Stating the inadequacies of the 1956 Industrial Policy Resolution, this policy intended "to remove the distortions of the past so that genuine aspirations of the people can be met within a time bound programme of economic development."\textsuperscript{11} It emphasised on the need for the development and application of technologies, "appropriate to our socio-economic conditions".\textsuperscript{12} Some selected industries, hitherto reserved for the state enterprises, were now thrown open to large monopoly capital such as organic or inorganic heavy chemicals, industrial machinery. However, rhetoric of public sector as a real encumbrance to the growth of large monopoly capital was made. "Apart from socialising the means of production in strategic areas, public sector provides a countervailing power to the growth of large houses and large enterprises in the private sector". The policy, therefore, proposed an "expanding role for the public sector in several fields."\textsuperscript{13}

As against the 1977, Industrial Policy Statement that was a reflection of the break up with the past, the Industrial Policy Statement issued in July 1980 was initially a reiteration of past policies.\textsuperscript{14}

\textsuperscript{11} Statement of Industrial Policy, dated 23 December 1977, Government of India, New Delhi, para 2.
\textsuperscript{12} Ibid, para 15.
\textsuperscript{13} Ibid, para 21.
\textsuperscript{14} "Because of the change in the government from Janta Government to Congress Government at the Centre in 1980. In fact, the document was aggressively political
However, within two months, it not only allowed an automatic expansion of capacity at the rate of 5 percent per annum over a period of five years for 19 basic and core industries (stated in IPR, 1956) and 15 engineering industries (for which the automatic expansion had been allowed in 1975), but the existing capacity in these industries were regularised.\textsuperscript{15}

Policy adopted in 1982 was a step forward towards the process of liberalisation. With the relaxation of the controls on both entry and expansion, the government effectively gave up the concept of socialism in India. The administered prices for pig iron were abolished and cement was partially decontrolled.\textsuperscript{16} The liberalisation trends were quite evident in electronics and telecommunications. The limit of automatic expansion of licensed capacity was raised to one-third of the total over a period of five years rather than just one-fourth as before. Another step-towards this drift away policy was liberalisation of manufactured imports. With the idea and justification for upgrading the Indian industry technologically a number of foreign collaborations were approved. On an average, the number of foreign collaborations during 1980-84 (586) was more than double compared to those during

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\textsuperscript{15}Marathe, \textit{op.cit}. P.128.

1970-79 (270). This clearly revealed the changing mood of the government.

In public sector enterprises, a visible change in the attitude took place. The stress was now more on efficiency and internal resource generation. At least 10 percent rate of return was expected on the investments made by the state. A former Deputy Chairman of the Planning Commission noted in 1982. "By and large public sector has become an appendix to the private sector, meant to ensure its smooth running by providing the needed infrastructure and the basic production facilities. As a result instead of striking a path of its own, the public sector has to subordinate itself to the logic and requirements of the private sector."19

Therefore, this period of 1966-84 culminated in a total transformation in the economic policy. The economy was made dependent upon market forces rather than on the determination of the policy makers. "A transformation of a mixed economy from instrumental-socialist to instrumental-capitalist was patently

17Ibid.
However, all this was being done under the popular and prevalent image of the government being socialist, "...the government was not averse to being seen as acting, even though still not proclaiming, as if it were building a capitalist system." Thus, in order to legitimise the activities of the government, the melodrama of socialism continued with all its anti-poverty and social welfare proclamations. Moreover, the changes made did not appear very drastic and were prima facie technical: a reduction in limit here and expansion of restrictions there. "The attempt, it seems, was to depoliticise economic decisions as far as possible."²²

2.4 Third Phase (1984-91)

The third phase of our study of economic policy had a better history to start with. The fifth and sixth five-year plans had recorded much better rates of growth. The growth rate that had been stuck at the average of 3.5 percent per annum since the fifties, irrespective of the policy and leadership changes increased to 5.4 percent and 5.2 percent respectively in the fifth and sixth plan periods. Similarly, a

²⁰Mehta, op.cit. p.356.
²¹Ibid.
remarkable increase in the savings rate from around 10 percent in the fifties and mid-seventies to 23.3 percent in 1984-85 indicated a big structural break.  

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

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

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

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


29K.N.Raj, op.cit, p.18.

30Ibid.
2.5 Post 1991 Policy Regime

Since July 1991, the country has witnessed a major policy reform programme consisting of considerable deregulation of industrial sector as well as liberalisation of foreign investment and technology imports. The major steps announced in this new package include: abolition of industrial licensing in all the industries except for certain security-related and strategic areas; automatic expansion of capacity according to market needs for existing industries; removal of the restrictions on investment by MRTP and FERA companies; automatic approval for foreign investment up to 51 percent of equity subject to certain high technology and high investment priority industries; and liberalisation of capital market.31

While emphasising that the practice of mixed economy would continue, the new economic policy embarked upon a few concrete changes in the sphere of public sector operations. Examples are: reduction in the list of industries reserved for public sector from 17 to 8 and then to 6; number of items in respect of which industrial licensing is reduced to 15; disinvestment in the shares of public sector enterprises to promote general public and workers participation in their ownership; announcement of a new policy of National Renewal Fund

(NRF) in order to deal with the problems of sick public enterprises; making public sector enterprises more autonomous and accountable for results through a system of Memorandum of Understanding (MOU). In addition, automatic approval of foreign investment up to 51% and foreign technology permitted for 35 priority industries, which account for about 50% value added in the manufacturing sector and so on. The Eighth Plan document also suggests the policy initiatives regarding restructuring, modernisation, rationalisation of capacity, product-mix changes, privatisation autonomy and performance accountability.32

Such policy shifts have generated a lively debate in India. Major works that broadly support the liberalisation policy prescription include Ahluwalia;33 Patel;34 Swaminathan;35 Srinivasan;36 Patibandla;37 and Desai;38 Critical reviews of the policy are given by

32/ibid.
33J.Ahluwalia (1985) op. cit.
Still the debate on liberalisation is going on. After five six years of policy implementation, assessment on the performance has started appearing. Now the stress is more on the market in association with the state, the latter being responsible for providing institutional and infrastructural set up.

In sum the earlier phase of heavy state spending, policy of protectionism, for example on setting up of financial institutions and investing in basic infrastructural sectors, was thought essential for providing a congenial atmosphere to indigenous capitalists and to facilitate the process of accelerated development of the economy. However, the fact that, in due course, the growing state investment and regulation of the economy resulted in increasing

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bureaucratisation, corruption, concentration of economic power in few hands, caused many analysts to think in new directions. It was natural that growing internal contradictions and consequently the rising complexity of the system strengthened the lobby seeking a more liberal economic environment in the country, especially when the international aid agencies and the mainstream economic view insisted on such opening-ups.

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

As explained earlier, the shifting government strands on the economy could not leave the public sector unaffected. In other words, this posture itself was rooted in insensitive assessment of public sector. Particularly after mid-80s, it has become a fashion in official circles to indulge in unrestricted disparagement of the public sector. The public sector is widely criticised as inefficient and the private sector is considered the hope for the future. Discontentment about the performance of the state-owned sector of Indian Industry has become the routine practice. Many studies evaluated the performance differences between state-owned and private sector industry. One school of thought\textsuperscript{46} found the public sector less efficient compared to its private sector counterparts. It was established that despite accounting for a major chunk of the capital investment, the state owned enterprises are systematically only two-thirds as efficient as private sector enterprises.\textsuperscript{47} Yet there is another school of thought that providing comparative evidence proves that public and private firms facing similar competitive environment do not display any


\textsuperscript{47}Inid.
efficiency differences\textsuperscript{48}. Still another school of thought\textsuperscript{49} is of the opinion that despite the fact that public enterprises, on the whole, has performed less than the potential and not up to the expectations, shortcomings of public enterprises have often been exaggerated.

The operations of public sector has resulted in a number of state failures such as overmanning and low work ethics, leading to low capacity utilisation, over-capitalisation, political and bureaucratic interference stifling the ability to innovate, take quick and timely decisions, burden of taken over sick units. Apart from this, a serious charge against the operations of public enterprise is that they were used for private purposes deliberately ignoring the objectives for which they were established.\textsuperscript{50}

However, many studies have proved that public sector enterprises are not inefficient. One such study is Dholakia (1978)\textsuperscript{51} which proved it in terms of total factor productivity. He constructed a


\textsuperscript{50}Chaudhuri (1994), \textit{op.cit.}

time series of overall factor productivity of the public sector and the private sector separately from 1960-61 to 1974-75. The results have revealed that state monopoly capitalist enterprises have performed far better than the private monopoly capitalist enterprises. A.Ghosh (1984)\textsuperscript{52} has proved it in terms of operating efficiency, physical norms of capacity utilisation and efficiency in the use of material and energy. Taking a few case studies, he found that Bhilai Steel Plant is as good as TISCO and Bokaro Steel Plant has a more efficient energy balance profile. He was of the view that if these plants are not making as much profit, as do the private sector plants, it is because of the exogenous policy constraints.

Despite such studies offered by many scholars, the recent policy shifts have changed the balance in favour of private sector. It is worth noting that for the first time in the planning history of India, the Seventh Plan (1985-90) proposed larger planned outlays for the

\begin{footnote}{A.Ghosh (1984) "Productivity and Efficiency in Manufacturing Industries: Some Case Studies", \textit{Economic and Political Weekly}, Annual Number, pp 1397-1453.}\end{footnote}
Table 2.1
Share of Public Sector in Total Investment

<table>
<thead>
<tr>
<th>Five Year Plans</th>
<th>Public Sector Investments (as % of total investment)</th>
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<tr>
<td></td>
<td>Projected</td>
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<tr>
<td>V Plan (1974-79)</td>
<td>57.6</td>
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<tr>
<td>VI Plan (1980-85)</td>
<td>52.9</td>
</tr>
<tr>
<td>VII Plan (1985-90)</td>
<td>47.8</td>
</tr>
<tr>
<td>VIII Plan (1992-97)</td>
<td>45.2</td>
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<tr>
<td>IX Plan (1997-02)</td>
<td>33.1(34.7)*</td>
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</tbody>
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Source: 1. Eighth Five-Year Plan, Planning Commission, Government of India, New Delhi, 1992, p.44.
* Accelerated at 7% growth scenario.

private sector as compared to the public sector. Table 2.1 shows that the share of public sector in total investment has continuously declined during the 1980s. The relative shares of the public and private sectors during this seventh, eighth and ninth plans clearly signal the rising importance of the latter at the cost of the former.

Apart from this, some of the enterprises in this sector are already open to the market to mobilise funds for their investment. National Thermal Power Corporation and Indian Telephone Industries Ltd. are examples of this trend, proving again that under the new economic dispensations, the superiority of the market is being taken
for granted. However, of late it has been observed that "notable decline in the public sector investment during reform period has made industrial growth both unstable and unsustainable." Infrastructure sector is the worst affected sector. All this has led to the deterioration of the industrial sector to a very bad shape, the symptoms for, which has started emerging particularly during 1996-97.