CHAPTER - 4

REDEFINING THE ROLE OF THE STATE
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EXPANDING THE ROLE OF THE PUBLIC SECTOR TO ACCELERATE GROWTH (1956 TO 1990)

Soon after independence, there was a widespread belief that without increasing the role of the State, it was not possible either to accelerate the process of growth or to create an industrial base for sustained economic development of the country. The Second Five Year Plan stated in unequivocal terms: "The adoption of the socialist pattern of society as the national objective, as well as the need for planned and rapid development, require that all industries of basic and strategic importance, or in the nature of public utility services, should be in the public sector. Other industries which are essential and require investment on a scale which only the State, in the present circumstance, could provide, have also to be in the public sector.

The state has, therefore, to assume direct responsibility for the future development of industries over a wider area." The Second Plan further emphasised: 'The public sector has to expand rapidly. It has not only to initiate developments which the private sector is either unwilling or unable to undertake, it has to play the dominant role in shaping the entire pattern of investment in the economy, whether it makes the investment directly or whether these are made by the private sector.
The private sector has to play its part within the framework of the comprehensive plan accepted by the community." Outlining the strategy of development, the Second Plan further opined: "The use of modern technology requires large scale production and a unified control and allocation of resources in certain major lines of activity. These include exploitation of minerals and basic and capital goods industries which are major determinants of the rate of growth of the economy. The responsibility for new developments in these fields must be undertaken in the main by the State, and the existing units have to fall in line with the emerging pattern. In a growing economy which gets increasingly diversified there is scope for both the public and the private sectors to expand simultaneously, but it is inevitable, if development is to proceed at the pace envisaged and to contribute effectively to the attainment of the larger social ends in view, that the public sector must grow not only absolutely but also relatively to the private sector." From the above citations, certain issues stand out clearly:

- The consensus on the eve of the Second Plan was that all industries of basic and strategic importance should be in the public sector.
- The public sector was to act as a senior partner in the process of development and undertake investments in such areas in which the private sector was unwilling or unable to undertake such investments.
- In the exploration of minerals and basic and capital goods industries and infrastructure, public sector has to undertake direct responsibility.
- While accepting the framework of the mixed economy, public sector was expected to contribute effectively to the social ends
in view and grow at a fast rate so that the share of public sector grows both absolutely and relatively to the private sector.

This was a welcome decision because at that time, the Indian private industrial sector did not either possess the capability or the resources to undertake lumpy investments in the capital goods sector. Private sector was also not willing to undertake responsibility of the infrastructure. Thus, to initiate the process of building an industrial base and to reduce our dependence on industrialized nations, it was considered desirable that the state should develop the capital goods sector which was a totally neglected area during the British period.

In our over-enthusiasm for expanding the public sector, the Government nationalized the Imperial Bank of India and named it as State Bank of India. It went in for nationalization of Life Insurance and created the Life Insurance Corporation of India. A momentous decision which was hailed all over the country in 1969 was the nationalization of 14 major commercial banks of the country. The Government decided to takeover coal mines and created Coal India Ltd. At a later stage, 113 sick mills of the private textile sector were taken over in the orphanage of the public sector. The Government further expanded public sector in telecommunications and thus continued to enlarge the scope of the public sector. By 1992-93, total investment in the Central Government Enterprises shot up to Rs. 1, 46,971 crores. If we add to this investment in Railways, Posts and Telegraph and other departments and also take into account investment in State Level Public Enterprises, then total investment of a huge order of Rs. 2, 50,000 crores was made in the public sector. Besides this, the public sector provided 71 per cent of employment in the entire organized sector of the economy. It accounted for about 25 per cent of NDP.
Short Comings of the Public Sector

The operation of the public sector resulted in a number of state failures. These failures were highlighted by a number of Committees and economists. Principal failures were: Over manning and low work ethics leading to low capacity utilization, over-capitalization due to substantial time and cost overruns, political and bureaucratic interference stifling the ability to innovate, take quick and timely decisions, burden of taken-over private sector sick units, excessive social welfare expenditure, absence of a rational pricing policy based on economic calculus. All these factors resulted in a low rate of return which tarnished the image of the public sector. A serious charge against the operation of public enterprises is that they were used for private purposes deliberately ignoring the objectives for which they were established. Sudip Chaudhri has documented this charge by quoting a number of decisions and studies. One would have expected that when new plants are set up and existing plants are expanded in the public sector, the PEs would buy the available capital goods and technology from the sister PEs. In reality however imports of capital goods and technology continued despite the domestic availability.

Secondly, in cases when foreign companies are appointed as contractors for public sector projects, they often choose international suppliers of plants, equipment and technology ignoring domestic sources. Mr. Sudip Chaudhri emphasising the manipulation of Public Enterprises for Private Purposes concludes: "There are reasons to believe that some top level decision-makers in the government have also used the PEs to further their own interests. Imports provide one such opportunity Foreign manufacturers are naturally interested in pushing their products into India."
Reportedly it is quite common for them to bribe influential persons to secure the order. Once this is realised it may not be difficult to understand why the capabilities of PEs were often not recognised or further developed, why indigenous efforts were often opposed and imports were preferred. Among the glaring examples are the import of shipping vessels by Shipping Corporation of India, rather than buying them from Cochin Shipyards whose price was higher. In case of foreign aid agencies, power equipment was imported in the bilaterally aided projects, depriving BHEL the opportunity to supply it. Global tendering was resorted to either on the insistence of the World Bank or that of the financiers. Economic reasoning was not on many occasions the basis, but non-price factors such as delivery time, quality, and reliability were advanced as arguments to defend imports. The above analysis brings out that lack of autonomy in decision-making, use of PEs for furthering private interests, absence of a comprehensive policy public enterprise sector in decision-making, use of PEs by ministers and bureaucrats to siphon off funds, low work ethics resulting in low efficiency, all these factors conspired to create an environment of low or in some cases, negative rates of return for public enterprises. Consequently, the movement for liberalization got legitimacy and this prompted the late Prime Minister Rajiv Gandhi in his first broadcast to the nation in 1984 to declare in unambiguous terms: The public sector has spread into "too many areas where it should not be. We will be developing our public sector to undertake jobs that the private sector cannot do. But we will be opening up more to the private sector so that it can expand and the economy can grow more freely."
REDUCING THE ROLE OF THE PUBLIC SECTOR

The Government of India, therefore, thought of reducing the role of the public sector and started the process of opening more and areas for the private sector. The Industrial Policy of 1991 started the process of delicensing and but for a small number of 18 industries, industrial licensing was withdrawn. This process of deregulation was aimed at enlarging competition and allowing new firms to enter the market. The main aim was to abolish the license-permit Raj and establish the rule of the market. Not only the market was opened to domestic entrepreneurs/industrialists, even foreign capital was provided free entry upto 51 per cent equity in hi-tech areas. The area of the public sector was limited to the following in future:

- Essential manufactured goods
- Exploration and exploitation of oil and mineral resource
- Technology development and building of manufacturing capabilities in areas which are crucial in the long term development of the economy and where private enterprise is inadequate.
- Strategic areas — Defence equipment

AREAS OF MARKET FAILURE AND NEED FOR STATE INTERVENTION

While markets do act in a manner that they tend to competition and thus bring about efficiency and increase in productivity, the market failure has been following in future:

- In case of imperfect competition, markets generate situations in which state intervention becomes necessary to ensure competition.
• In case of monopoly, market failure is obvious and the state must intervene to break monopoly by anti-monopoly legislation or other measures.

• Market failure has also been noticed in public goods like education and health. In these areas, unless the state establishes schools, colleges, universities, primary health centres and hospitals, it would not be possible to take care of the weaker sections of the society.

• Market failure has also been noticed in areas of economic infrastructure like irrigation, roads, railways, telecommunications etc. Private sector loves to use infrastructure, but would not like to invest in infrastructure, more especially in remote areas, where the rate of return may be very small. Thus, it is generally expected that the public sector should create infrastructures and thus create an environment which facilitates direct investment by the private sector. The question arises: market failures necessitate state intervention so that the imperfections of the market mechanism can be corrected. For instance, market set prices on the basis of demand and supply force. But to quote Michael Lipton, setting prices right is quite different from letting prices come from state inaction. Obviously the function of the State is to set right price so that correct signals for allocation of resources can be made. State failures, however, do not justify the use of market in all situations. It is quite possible that there is a need to change policies or to take strong administrative measures to correct state failures.
This only underlines the fact that even if markets are to be used more extensively, this does not eliminate the role of the State. Rather than arguing for minimal state intervention, it would be more prudent to argue for effective state intervention. World Development Report (1999-2000) has also stated that in development thinking so far as the regulatory sphere is concerned, "the focus has shifted from deregulation to building an effective regulatory framework."

REDEFINING THE ROLE OF THE STATE

For the purpose of redefining the role of the State in the Indian society, it would be relevant to consider the structure of Indian economy and policy. It must be clarified at the very outset that Keynesian perceptions of state intervention are not so relevant to an under-developed mixed economy like India, because Indian society has in 1999-2000 about 26 per cent of its population living below the poverty line. As such this big segment of the Indian society comprising about 260 million persons is untouched by the market mechanism.

The State has, therefore, to play a positive role in employment generation for the poor and to promote their social welfare. Hanumantha Rao highlighting the point mentions: "It is often said that markets bypass the poor and the underprivileged and that they cannot participate in the market-driven development. This is not an accurate statement. The poor and the underprivileged are very much driven into the market. The child labour and bonded labour are all participating in the market but at very unequal or unfavorable terms. Therefore, it has rightly been said that the market can be a good servant when it is intelligently utilized but a bad master when it is allowed to have a free play." Obviously, markets cannot
be trusted to ameliorate the condition of the poor. The State has to play a positive role in providing education and health to the poor as well as to have special programmes of employment generation, more especially in the rural areas so that employment opportunities are enlarged for the poor and the underprivileged.

Another important factor responsible for poverty is the low resource base of the poor. For this purpose, even in capitalist societies land reforms were carried out in several countries. In India, the process of land reforms did help to arrest further concentration of land holdings by imposing ceiling on land, but it failed in its objective of providing land to the landless. Indian society would not be able to push land reform in the sense of transfer of ownership now, but can certainly provide secure tenancy rights so that the landless can benefit from the gains of increase in agricultural productivity. In view of the large size of our population, it would not be possible to provide land to all the landless labourers. Besides providing secure tenancy rights, the State has, therefore, to take up massive programmes of rural infrastructure development as also provide credit at highly subsidised rate so that the poor can create assets and earn income. In other words, the promotional role of the State in providing rural infrastructure and extend credit to the poor at low rates of interest can become an effective instrument in poverty removal.

The second role of the state is to provide infra structure — economic as well as social infrastructure. Economic infrastructure consists in the provision of roads and railways, hydro-electric works, irrigation dams, provision of drinking water etc. It has been observed that the private sector is not keen to invest in infrastructure. Some attempts are being made to involve the private sector in some areas of infrastructure as power genera
tion, road construction, building highways and telecom munications, but by and large, the responsibility for infrastructure development rests with the state. The role of the State in providing "hard infrastructure" in the form of power, transportation, irrigation is accepted by all, though private effort can also supplement state effort. Yet the state can also help in providing "soft infrastruc ture". This can take the form of organising market-outlets for the products of small scale sector and cottage industries. Since the small scale sector accounts for about 38 per cent of exports, the state can organise export promotion of small industry products. Such soft infra structure can cater to the supply of market information, encouraging modern designs and undertaking research and development for SSI sector, besides undertaking the marketing of their products.

The other part of the infrastructure — social infrastructure is in the form of health and education. Investment in education helps human beings to acquire human capital formation. The provision of basic educa tion to all has been accepted as the goal in all societies. For this purpose, the private sector will not be forthcoming to make investment in schools. At higher levels and specialized education in Medicine, Engineering, Technology, Electronics, the costs are beyond the reach of the lower middle and poor classes. Private schools, which go by the name of public schools-amisnomer-charge very heavy fees which the poor cannot afford. Yet to have vertical mobility in life, education is necessary State has to play the role. Similarly, provision of health facilities also re quires considerable investment which the public sector must undertake so as to improve the health status of the weaker sections of the society because it is not possible for the poor to pay for expensive health care by the private sector.
Both education and health have been considered as important for human capital formation, thereby raising levels of productivity. The third area which needs state intervention is macro-economic management of the economy. In this, the Government can intervene in a variety of ways, more especially for such sections of the population which are not covered by the market mechanism. In India, even in the year 1999-2000, as per the findings of the 55th Round of the National Sample Survey, nearly 26 per cent of the population is living below the poverty line. In other words, 260 million persons are not touched by the markets.

The state has to intervene in a variety of ways to promote industries where these persons can seek employment and earn a better living. State may take steps to promote certain industries which are labour absorbing. The World Bank Study "The East Asian Miracle" (1993) about eight highly performing economies of Asia states: "In most of these economies, in one form or another government intervened - systematically and through multiple channels — to foster development, and in some cases the development of specific industries. Policy interventions took many forms: targeting and subsidizing credit to selected industries, keeping deposit rates low and maintaining ceilings on borrowing rates to increase profits and retained earnings, protecting domestic import substitutes, subsidizing declining industries, establishing and financially supporting government banks, making public investments in applied research, establishing firm and industry-specific export targets, developing export marketing institutions, and sharing information widely between public and private sectors.

Some industries were promoted while others were not." In the Indian context, a number of other interventions such as providing financial
assistance to small scale industries and to individuals to create employment in the informal sector have also helped the process of growth and employment generation. The priority sector loans, supported by better information about emerging areas, can be a positive intervention which can become people friendly.

Another area which needs actives state intervention is the reform of the public sector. Many public sector enterprises have complained about absence of autonomy and quick decision-making as the principal factor responsible for their poor performance. Although Government has signed Memorandums of Understanding with several public sector enterprises, but still the chief executives complain that there is practically no change and they have still to obtain ministerial approval for every decision. The bureaucrats in the Government and the Ministers are not willing to part with their power and are treating the PEs as their colonies. Public sector reform can be certainly beneficial in improving their performance. The Government has intervened by signing MOUs, but has not intervened honestly and effectively. State intervention is needed in an honest manner.

There is a lot of wisdom in transferring some of the unimportant commercial enterprises to the private sector, but privatization in the nature of selling five, ten or twenty per cent of the shares to cover the deficit of the Central Government shall be of no avail to the economy. It would be better to shed the load of these enterprises to the private sector on the condition that labour employed in them will not be retrenched (or rationalized, to use a more sophisticated term). But the trade unions may resist this transfer and the Government of a democratic state like India may not be able to push the reform process which results in a backlash of labour.
The reform of the public sector, therefore, assumes greater relevance in this context. It may be pointed out that research has brought out the fact that ownership has nothing to do with the efficiency of an organization. There are public sector units which are running as efficiently as private sector units and even better in some cases. There are also public sector units which are incurring losses year after year. The same is true of private sector. It is thus the organization culture and the quality of management which determine efficiency of public sector units. The whole issue revolves round evolving a system of incentives and disincentives to improve work ethics of an organization. Such a system was evolved by Kautilya by building accountability in State enterprises and enforcing the rules laid down for the purpose. The State has to act decisively in this regard and innovate measures to link wages productivity.