CHAPTER II : INTRODUCTION

CENTRAL PUBLIC SECTOR ENTERPRISES

ROLE OF PUBLIC SECTOR ENTERPRISES

Role in the Economy

Public Sector Enterprises have the distinction of occupying the "commanding heights" in the development of developing economies. The connotation of occupying the commanding heights is the "desire of the Government to acquire the necessary means and power to change the pace and direction of economic activity by taking over key sectors of the economy. This can ensure a more effective translation into practice of national policies and priorities in the field of economic development. This can also increase the political and social authority of the State and prevent the acquisition of excessive and disproportionate power by any particular group or class in society, which may disturb the social and political balance". (1)

The Arjun Sengupta Committee in its recent Report has observed as under:

"Public enterprises have achieved a great deal in terms of their contribution to quantitative targets of production, to the establishment of a modern industrial structure, to balanced regional development and to the formation of technological skills. They have become principal instruments of economic planning in India, occupying commanding heights of the economy, controlling and directing in a large measure the whole course of development". (2)
Market imperfections of developing countries are not conducive to free operation of the market mechanism. The "policy of "Laissez - Faire" may fail to respond to the growing requirements of a developing economy". This may leave "wide and grievous gaps to be filled in meeting the basic needs of the community in the social and economic fields. Such gaps may relate to projects requiring large capital outlays, having long gestation periods or carrying a high degree of risk". (3) Some of the activities may require subsidization by the Government. Public sector has been used as a means to ensure equity and social justice - to bring about a more balanced and equitable distribution of income among different sections of society and regions of the country. It was pragmatic compulsion to deploy the Public Sector as an instrument of a self-reliant economy and so the sector expanded rapidly under successive Five Year Plans.

The most laudable contribution of CPEs is in respect of the following:

* exploration and exploitation of oil and natural gas and oil refining and marketing;
* ability to add substantially to the existing power generating capacity in the country and to manufacture plan and equipment for the purpose;
* substantial measure of self-sufficiency in the manufacture of plant and equipment needed by most major projects in diverse fields; and
* management of the food economy of the country through the production of necessary inputs and the operation of price support and buffer-stocking mechanisms.
The public sector has laid the foundation for the rapid industrialization of the country. It has helped the economy to develop an important capital goods structure; it has laid a solid base of heavy industry; it has made available industrial inputs for the vast and growing private sector in the country.

The role of public sector has since been increasing, commensurate with industrial progress. The growth has been either "through the establishment of state entrepreneurship or through the nationalisation and transfer of ownership from private to public hands". (4) The transfer of ownership is necessitated by strategic and ideological considerations. In several countries, "the expansion of the public sector arose from take-over of sick private units". (5) The Government took-over sick units to protect employment and productive capacity. In certain cases state intervention became necessary to discharge social goals. The broad framework for the role of public enterprises in the future economic development of India was provided by the Report of the Economic Programme Committee (also known as Pandit Jawaharlal Nehru Committee) of the Indian National Congress (1948). The Report observed as under:

'New Undertakings in defence, key and public utility industries should be started under public ownership. New Undertakings which are in the nature of monopolies or in view of their scale of operations serve the country as a whole...should be run on the basis of public ownership.'
Immediately after independence, the Government introduced the Industrial Policy Resolution in 1948 emphasizing continuous increase in production and ensuring its equitable distribution. After adoption of the Constitution and the socioeconomic goals, the revised Industrial Policy was adopted in 1956.

The Industrial Policy Resolution of 1956 classifies industries into three categories:

1. Industries which would be the exclusive responsibility of the state.
2. Industries which would be progressively state owned but in which private sector would be expected to supplement the efforts of the public sector.
3. Other industries.

Emphasis has been placed on complementarity of the public and private industrial sectors on the assumption that the private sector would accept the broad principles implied in the national development plans. The policy was modified from time to time meeting new challenges in 1973, 1977 and 1980. The Industrial Policy Statement of 1973 identifies high priority industries where investment from large industrial houses and foreign companies would be permitted.

The Industrial Policy Statement of 1977 laid emphasis on decentralization and on the role of small scale, tiny and cottage industries. The Policy refers to the role of the public industrial sector as follows:
"The public sector in India has today come of age. Apart from socialising the means of production in strategic areas, the public sector provides a countervailing power to the growth of large houses and large enterprises in the private sector. There will be an expanding role for the public sector in several fields. Not only will it be producer of important and strategic goods of basic nature but it will also be used effectively as a stabilising force for maintaining essential supplies for the consumer. The public sector will be charged with the responsibility of encouraging and developing of a wide range of ancillary industries, and contribute to the growth of decentralized production by making available its expertise in technology and management to small scale and cottage industries sectors. It will also be the endeavour of Government to operate public sector enterprises on profitable and efficient lines in order to ensure that investment in these industries pays an adequate return to society."

The Industrial Policy statement of 1980 aimed at promoting competition in the domestic market, technological upgradation and modernisation. Foreign investment in high technology areas was permitted. Emphasis on productivity was laid. A number of policy and procedural changes were introduced in 1985-86 to increase productivity, reduce cost and improve quality and thus promote competition. Public sector was given a larger measure of autonomy.

The Industrial Policy 1991 is a major deviation from the dominant role assigned to public sector hitherto. The Industrial Policy Resolution 1956 had given primacy to the role of public sector. By stating that the "state will progressively assume a predominant and direct responsibility for setting up new Industrial undertakings and for developing
transport facility". The policy also laid down that for rapid development, "all industries of basic and strategic importance, or in the nature of public utility services, should be in the public sector ........ The state has, therefore, to assume direct responsibility for the future development of industries over a wider area".

According to Industrial Policy Statement 1991 all monopolies of any sector or any individual enterprise in any field of manufacturer except on strategic or military consideration, will be abolished. All manufacturing activity will be open to competition. The role assigned to public sector is as under:

"The Government will ensure that the public sector plays its rightful role in the evolving socioeconomic scenario of the country. Government will ensure that the public sector is run on business lines as envisaged in the Industrial Policy Resolution of 1956 and would continue to innovate and lead in strategic areas of national importance. In the 1950s and 1960s, the principal instrument for controlling the commanding heights of the economy was investment in the capital of key industries. Today, the State has other instruments of intervention, particularly fiscal and monetary instruments. The State also commands the bulk of the nation's savings. Banks and financial institutions are under State control. Where State intervention is necessary, these instruments will prove more effective and decisive".

The New Policy, 1991 lays down the priority areas for growth of public enterprises in the future as under:-

* Essential infrastructure goods and services
* Exploration and exploitation of oil and mineral resources.
Technology development and building of manufacturing capabilities in areas which are crucial in the long-term development of the economy and where private sector investment is inadequate.

Manufacture of products where strategic considerations predominate such as defence equipment.

At the same time, the public sector will not be debarred from entering areas not specifically reserved for it.

The Government will also review portfolios of public investment in respect of industries based on low technology, non-strategic areas, inefficient and unproductive areas with low social consideration and where the private sector has developed sufficient expertise.

The Government will strengthen public enterprises in reserved areas of operation. In high priority areas where profit generation is reasonable, autonomy will be granted through memorandum of understanding. "There are a large number of chronically sick public enterprises incurring heavy losses, operating in a competitive market and serve little or no public purpose. These need to be attended to". The policy also lays down, "Public enterprises which are chronically sick and which are unlikely to be turned around will, for the formulation of revival/rehabilitation schemes, be referred to the Board for Industrial and Financial Reconstruction (BIFR), or other similar high level institutions"
created for the purpose. A social security mechanism will be created to protect the interests of workers likely to be affected by such rehabilitation packages".

The policy also proposes to offer a part of the Government's shareholding in the public sector to mutual funds, financial institutions, general public and workers. MOUs will be used as a weapon to ensure performance improvements. The MOU signed between the Government and public enterprise would be placed in Parliament. They will grant greater autonomy to managers who will also be held accountable. The Board of public sector companies would be made more professional and given greater powers.

This policy has diluted the role of the public sector. The Industrial Policy Resolution of 1956 had reserved 17 industries whose "future development will be the exclusive responsibility of the State". These industries included - atomic energy, iron and steel, coal and lignite, mineral oils, mining of ores of specific metals, air transport, railway, ship building, telephones and telecommunication cables and generation and distribution of energy.

The 1991 Industrial Policy Resolution has restricted the number of industries reserved for public sector to

a) Arms and ammunition and allied items of defence equipment defence aircraft and warships.

b) Atomic Energy
c) Coal and lignite

d) Mineral oils

e) Mining of iron ore, manganese ore, chrome ore, gypsum, sulphur, gold and diamond.

f) Mining of copper, lead, zinc tin, molybdenum and wolfram

g) Minerals specified in the Schedule to the Atomic Energy (Control of Production and Use) Order, 1953.

h) Railway transport.

Among the industries, excluded from the Resolution are generation and distribution of energy, aircraft, air transport, ship building, telephones and telecommunication cables, iron and steel, heavy casting and forging of iron and steel and heavy electrical plants, including large hydraulic and steam turbines.

The Government also stated while tabling the new Policy that there would be "no bar for areas of exclusivity to be opened up to the private sector selectively. Similarly, the public sector will also be allowed entry in areas not reserved for it". The Policy admits the central role played by the public sector in development in preventing the concentration of economic power and reducing regional disparities. The policy also takes into account a number of problems which have begun to manifest themselves in many of public enterprises. Such as "insufficient growth in productivity, poor project management, over-manning, lack of continuous technological upgradation, and inadequate attention to R&D and human resource development". They have shown a very low rate of return on the capital invested. The
return is less than 1% if the petroleum sector is excluded. The interest payable on loans to the PEs in 1989-90 was Rs.4245.39 crores on long-term loans of Rs.60,358.17 crores.* This has undermined their ability to regenerate resources in terms of new investment as well as in technology development. The result is that many of the public enterprises have become a burden rather than being an asset to the Government. The original concept of the public sector has also undergone considerable dilution. The most striking example is the takeover of sick units from the private sector.

However, the Government has not stated anything clearly about the "exit policy" and the retrenchment of surplus staff.

Resource allocation and resource generation:

Public industries require large capital resources for their establishment and expansion. The share of investment in developing countries is usually higher than their share in value added, output and employment. Il Sakong in his "Macro-economic Aspects of Public Enterprises in Asia" has observed that the public enterprises in general perform a relatively more important function as investment agents than as resource mobilizers.(6) Public enterprises in general do not mobilise sufficient resources for their own developmental needs and require external financial
resources. The surplus generated by these enterprises by way of taxes, dividends and retained earnings have, however, grown into a sizable magnitude. It would appear that in South Asia Enterprise has not realized its potential as a source of growth for the economy or as an instrument for distributing income towards the poor.\(^{(7)}\)

Seen in the context of the objective of economic growth, the failure of the public sector to generate an investible surplus has hampered the growth of the public sector and, therefore, the overall economy leading to an unwelcome call on the public finance. In India, budgetary support has been consistently extended to public sector to keep it operational. This implies a net inflow of financial resources from the rest of the economy, the proximate source being the Government treasury and the ultimate source being the general public.

There are large differences in financial performance of different public enterprises. These differences may be due to the nature of market, i.e. competitive or monopolistic, or due to different situations of enterprises operating in different industries. They may also arise due to differences in the degree of state protection. Nevertheless, one of the issues thrown up by the large differences in financial performance of public enterprises is the inefficient resource allocation. In drawing up a
national policy for investment, both the social objective and financial viability of an enterprise must be kept in view. The social cost benefit ratio and the financial viability must be critically analysed. The financial plans of public enterprises are either heavily tilted in favour of equity capital or concessional and soft term borrowings either directly by the Government out of the budget or the State-owned development banks. This is done with a view to offset the impact of a long gestation period of the projects and also to fulfill certain social objectives. Public enterprises also obtain funds through joint ventures with foreign firms. They have also attempted to raise funds through offering of shares and issue of debentures. In India, the Government has permitted a number of public enterprises to raise funds from the public to meet their working capital requirements. Generation of resources from the money market and self financing on the part of public enterprises should be encouraged as a means of economic self-reliance and self-regulation.

The public enterprises themselves should try to generate a high enough rate of return to be able to finance their investment requirement. A resort to self-financing will improve their viability and economic strength. Public enterprises in the Republic of Korea and Singapore have generated substantial results. But the experience in Argentina, Egypt, Panama and Nicaragua has not been very encouraging and
the net savings of the consolidated State Enterprises Sector was negative during the period 1970-73. (8) It has been observed:

"The absolute surplus generated by these enterprises, defined in the broader sense to include retained earnings and contributions to the budget by way of taxes and dividends, has grown into a sizable magnitude. However, the major part of it is in the form of taxes which form part of the government revenue pool. Since the bulk of the latter is spent on current operations rather than investment, and that too on non-developmental activities it follows that much of the surplus is in fact used for current consumption". (9)

The public sector thus may not be in a position to finance any of its new investment from its own resources and there may be an overall resource deficit. Government action may affect the cost adversely in various ways. One such way is inappropriate tariff/tax structure making domestic cost higher than that of import. A tax is part of the cost and it can erode surplus. A tax on output takes away part of surplus in another name. Any differential tax would have an effect on the surplus of the enterprise. Cost can be kept higher artificially by restricting total output. Cost can be raised in a number of ways such as by raising input costs, by retaining overmanning of enterprise or giving higher wages to employees or maintaining high inventory of inputs.

The 1966 Prime Ministers Round Table Conference on the public sector considered that the public undertakings should earn 20% gross on their total capital i.e. equity capital plus free reserves. The
Third Plan set forth a 11-12% rate of return for the public sector enterprises, the Fourth Plan raised it to 15%; the Fifth Plan raised it to 19% and the Sixth Plan to 22%. The Seventh Plan has had to rely for major part on the resources generated by the public sector because the tax instrument could not be used any further to raise more resources. As against this the actual surplus generation by the public sector has been disheartening and public sector has not given a good account of itself either as generator of surplus resources or as mobilizer of domestic savings. As a consequence, the idea of closing down unviable chronically sick PEs is gaining currency.

Thus it is politico-administrative arrangement which creates conditions for surplus generation or otherwise. Public enterprise in no way can influence these policies.

ISSUES

The problem of stimulating improved performance in public enterprises and raising the level of their efficiency is intimately connected with the question of specification of objectives. It is difficult to identify these objectives in the prevailing realities of the political and environmental situation. It is, therefore, highly desirable that a conscientious effort is made to promote the idea of management of public industrial enterprises by objectives. These objectives
should be predetermined and should not arise as a rationalisation of the actual reasons of working. The tendencies for public enterprises to resort to explaining their deficiencies by saying that they were contributing to social goals should be rejected. Very often there is a trade-off between economic and sociopolitical objectives. This makes the common Government practice of judging public enterprise performance by a simple profitability test unreasonable. This point has been highlighted in an official report on Ghana's state gold mines as under:

"The basic cause of the present weaknesses of the Corporation is political in nature. Since it was formed in 1961, no Government has provided the Corporation with the conditions necessary for its success. One reason for this is that Governments have tried to pursue contradictory objectives. Governments have tended to speak with two voices about the duties of the Corporation. With one voice they justify the necessity for the Corporation on social, non-commercial grounds... With the other voice, however, they talk of the Corporation in commercial terms, stressing the need to obtain profits and criticising the management for having to depend on budgetary subsidies."(10)

Public sector generally has shown negative resource balances i.e. the PEs are unable to generate the surpluses needed to meet their own investment requirement. In the absence of large Government subsidies or injections of funds from outside they cannot make any contribution to an on-going process of industrialisation. Subsidies have been frequently used as one of the way of resolving the dilemma posed by conflicting demands made on the pricing policies of
public enterprises. Such subsidies are justified on grounds of equity or keeping low the costs of production. The equity problem could be resolved by transferring additional income to poor families instead of subsidising the prices of individual commodities which may subsidise even the consumption of the rich along with the poor. Fertilizer subsidy in India is a case in point. The subsidies should be eliminated or reduced to the barest minimum extent permissible under the social and political constraints. They should be available only to the economically disadvantaged classes to distinguish between the targeted and others in order to retain the cost effectiveness of the subsidies.

There are other factors more specific to public enterprises which have more important bearing upon its economic efficiencies such as project planning, overmanning shortages of right type of managers etc. Deficiencies in the project planning contribute to substandard economic performance. Un-coordinated and un-planned projects will prove to be a burden on the economy of the State. Feasibility studies must be conducted by experts and such study must be based on reality. Once the project is finalised, adequate capital resources must be placed at the disposal of the chief executive to ensure proper implementation. Under capitalized projects will be badly affected by shortages of working capital and thus will result in
There is a tendency in public enterprises to engage larger labour force than is necessary to achieve given level of output. This weakens the economic viability of the enterprise. Overstaffing is one of the major problems of state corporations. There is hardly any enterprise which is not overloaded with redundant staff. The tendencies towards over-manning can be related to Government's employment creation objectives. Over-manning is an inefficient and inequitable way of providing employment.

The use of managerial appointments as a source of patronage represents one of the ways in which the political and economic motivations for the creation of public enterprises conflict with each other. When such a conflict becomes apparent, it is often resolved in favour of political advantages notwithstanding the economic costs. The politicisation of management will harm the economic interests of the public enterprise. The public enterprise managerial post should be filled on grounds of proven merit and not on considerations of political affiliation. Politicisation leads to a great deal of Governmental intervention in day to day operational decisions which is not desirable.

During the first 3 five year plans, the public sector did play a crucial role in the development of infrastructure and in laying down the foundation for a strong industrial base. Huge investments were made in
the field of infrastructure industries such as heavy engineering, steel and mining. After third Five Year Plan, due to indiscriminate expansion of the public sector and nationalisation of a large number of sick units, the initiative to develop infrastructure industries was lost. Plan priorities which were determined on the basis of national priorities till the third Plan, were influenced by political and other pressures thereafter.

Efficiency and profitability of public sector enterprises received a severe setback with the taking over of sick units from textile and other industries for protecting employment. Because of indiscriminate expansion about 50% of the Central Public Enterprises are incurring losses. As a consequence the public sector has become a target of attack in recent years from different quarters.

Critica

The poor performance of public sector enterprises is a factor behind the slow industrial growth of the country. This statement may look strange but it is true. Despite the solid industrial infrastructure, the industrial growth rate of economy has been around 4% to 5% during the last 40 years, against the 8-10%; needed for the economy to take-off. To what extent the public sector enterprises have contributed to industrial stagnation needs study and examination.
It has been recently observed by Dr. Bimal Jalan:

"The government’s role as an investor in and manager of public enterprises is probably the most crucial issue for the future. It is also the most controversial and difficult. However, not even the most ardent defender of public enterprises can ignore the substantial inefficiencies that afflict government’s management of these enterprises". (11)

It has been further observed that the future of these Enterprises and of those who run them, depends entirely and exclusively on outside forces, not on internal performance. It is in this context that the present study assumes importance.
References


