CHAPTER - IV
The previous chapter has explained the techniques of evaluating capital expenditure. This chapter narrates the origin of public sector enterprises in India and their present position.

Before independence, Indian economy was basically an agrarian economy with a very weak industrial base, low level of savings and investments. It also lacked infrastructural facilities. Majority of the population was poor and unemployed.

During the colonial rule the Indian Industrial Commission (1916) had recommended that in future the Government should play an active part in the industrialisation of the country. The Government of India took over the management of Indian Railways in 1922, which is considered to be the origin of Public Sector in India.

Later the second world war provided a great impetus to the expansion of war industries, when India's economy was placed on a war footing and a period of controls and regulations began. Earlier in August 1937, the Indian National Congress in power in some states, thought of

formulating a tentative policy of industrialisation for the country. A National Policy Committee was set up by the Indian National Congress in 1938 under the Chairmanship of Pandit Jawaharlal Nehru. The committee prepared blue prints for a planned economic development in various states, laying an informal basis for the emergence of the Public Sector on a large scale. In 1942 The Hindustan Aircraft Ltd., was taken over by the Central Government. A year later, Telephone Companies of Bombay and Calcutta were taken over. The Overseas Communication system was also taken over for public operation.

In 1944, the Government of India set up a Planning and Development Department. A statement on Industrial Policy was made by Lord Warell in 1945 prescribing that all ordinance factories, public utilities, railways and basic industries of key importance should be nationalised. The overall aim was to take positive steps to encourage and promote industrialisation of the country to the fullest extent possible.

After independence, it was felt that direct participation of the public sector in the national economy was a necessity, especially in the capital intensive areas. It was, as experts now explain, a pragmatic compulsion to deploy the public sector as an instrument of self reliant economic growth. This was necessary to develop the agricultural and industrial base, diversify the public economy and to overcome economic and social backwardness. Over the years, public sector industries in India have proliferated into various fields as evident from the
growth, expansion and diversification of the public activities and the increase in the shares of the public sector in the total plan outlays.

In the post independence period the Industrial Policy Resolution of 1948 recorded a radical departure from the "LAISSEZ-FAIRE" economic policy followed by the British and envisaged Government controls of twenty big industries. The logic of this was stated as under:

"When the mass of the people are below the subsistence level, the emphasis should be on the expansion of production. There can be no doubt that the state must play a progressively active role in the development of industries."(2)

The Constitution of India adopted on 26 January 1950, directed the state to secure that the ownership and control of material resources of the community were so distributed as best to resolve the common good and that the operation of the economic system did not result in the concentration of wealth and means of production to the common detriment of the people.

Table 4.1 shows the share of Public and Private Sector Enterprises under the various Five Year Plans.(3)

(2) ibid. p.2
(3) A N Agrawal, H O Varma and R C Gupta; India - Economic Year Book - 1995; op cit. p.319
Table 4.1

<table>
<thead>
<tr>
<th>Plan</th>
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<td></td>
<td>Public Sector</td>
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<tr>
<td>First Five Year Plan</td>
<td>46.4</td>
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<tr>
<td>(1951-56)</td>
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<tr>
<td>Second Five Year Plan</td>
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<td>(1956-61)</td>
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<tr>
<td>Third Five Year Plan</td>
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<td>(1961-66)</td>
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<td>(1966-69)</td>
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<tr>
<td>Fourth Five Year Plan</td>
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<td>(1969-74)</td>
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<td>Fifth Five Year Plan</td>
<td>43.3</td>
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<td>(1974-79)</td>
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<td>Sixth Five Year Plan</td>
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<td>(1980-85)</td>
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<td>Seventh Five Year Plan</td>
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<td>(1985-90)</td>
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<td>Eighth Five Year Plan</td>
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</tr>
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<td>(1992-97)</td>
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Source: Plan Documents
The Industrial Policy resolution of April 1948 classified industries into the following four categories:

Category I - Strategic industries like arms and ammunitions, atomic energy, river valley projects, and railways.

Category II - Coal, iron and steel, aircraft ship building, communication equipment and mineral oil.

Category III - Fertilizers, chemicals, road transport and machine tool.

Category IV - Private sector - all the remaining industries.

The first three categories were the responsibilities of the state and the rest of the industries were left to the private sector. Five public sector enterprises with an investment of 29 crores of Rupees in 1951 was the beginning.

The first Five Year Plan indicated the need for a rapid expansion of the economic and social responsibilities of the state which did not need to involve complete nationalisation of the means of production or elimination of private agencies in agriculture, business and industry.
Only a progressive widening of the public sector and a reorientation of the private trader to the needs of planned economy was envisaged. The plan stated that "the distinction between public and private sectors was only of relative emphasis and private enterprise should have a public purpose and major expansion of private enterprise could rarely be undertaken except through the assistance of the state in one form or another - the private functioning of enterprises only on the basis of unregulated profits was already an anachronism - the private and public sectors can not be looked upon anything like two separate entities; they are and must function as parts of a single organism"

On 21 December 1954, the Lok Sabha resolved after a debate that the objectives of India's economic policy should be to establish a "Socialistic Pattern of Society". The second Five Year Plan elaborated that the benefits of economic development must accrue more and more to the relatively less privileged classes of society and there should be progressive reduction of the concentration of income, wealth and economic power. For creating the appropriate conditions the state has to take on heavy responsibilities as the principal agency speaking for and acting on behalf of the community as a whole. The public sector has to expand rapidly to initiate the development which the private sector was either unwilling or unable to undertake; it has to play the dominant role in shaping the entire pattern of investments in the economy.
The second Industrial Policy Resolution of 1956 realigned the industrial policy of the country by broadly enunciating the philosophy underlying public operation of industries and services. It says; "In order to realise the objective, it is estimated to accelerate the rate of economic growth and to speed up industrialisation and in particular to develop heavy industries and machine making industries to expand public sector and to build up a large and growing co-operative sector. This will provide the economic foundations for increasing opportunities of gainful employment and improving living standards and working conditions of the mass of the people. The adoption of the socialist pattern of society as the natural 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 public sector. Other industries which are essential and require investments on a scale which only the state in present circumstances could provide have also to be in the public sector.

Like in 1948 resolution, industries were classified into 3 categories:-

1) Industries where further development was to be exclusively in the public sector - 17 such industries were named.

2) Industries which were progressively to be state owned and in which the state will generally take the initiative in establishing new undertakings but in which private enterprise will also be expected to
supplement the efforts of the state - 12 such were named.

3) Comprising all the remaining industries, the further development of which was left to the initiative of the private sector though it was open to the state to start any industry in this category.

The Government of Independent India under the leadership of Pandit Jawaharlal Nehru had taken policy decisions to

a) improve agriculture
b) to develop the country's basic and capital goods industry through establishment of large and heavy industries.
c) enlarge manufacture of mass consumption goods and create opportunities for employment and
d) develop infrastructure for rapid industrial development.

Planned development through the medium of five year plans was adopted as an instrument of policy. Jawaharlal Nehru took another basic decision viz., that at the initial stage of development of Indian economy would have to be structured on the mixed economy pattern, which means that while there would necessarily be a massive and progressively dominant share of the Government in economic development, the private sector would still have a significant place for initiative in entrepreneurship.

The Second Five Year Plan emphasised the interdependence of the public and private sectors and
referred to investment in the public sector - like in power, irrigation and transport which would increase the production potential of the private sector. By the middle of 1961, the Third Five Year Plan laid down that the public sector was to grow relatively, as well as absolutely and the private sector had to develop in terms of Government Policies and was not to be impeded in any way in its contribution to the growth of the economy. The public sector was intended to prevent concentration of economic power and growth of monopolistic tendencies.

The subsequent plans also reiterated the above policy. There was continuous emphasis on making the private sector imbued with public purpose. The Fourth Plan however envisaged the emergence of the public sector as "the dominant and effective area of the economy, to take charge more and more of the commanding heights in the production and distribution of basic and consumer goods."

The Industrial Policy announced on 23 December 1977 envisaged the public sector as a means of socialising the means of production in strategic areas and for providing counter acting force to the growth of large houses and large scale enterprises in the private sector. The Government was also to operate it on profitable and efficient lines to ensure an adequate return on investment made.

Though not defined so clearly, the expectation under Articles 39 to 43 of the Constitution of India was that Government participation in industry and trade would imply
a speedy conduct and management of economic activity, with the simplification of decision making at all levels and the willingness of the top echelons to assume responsibility, coupled with decentralisation of authority. With efficiency and quick despatch of business, production would improve in government hands throwing up large revenues in the shape of profits in the overall available for further investment.

A public sector enterprise is by definition, an enterprise where there is no private ownership, where its functions are not merely confined to the maximisation of profits or the promotion of the private interest of the enterprise but are governed by the public or social interest and where the management is responsible to the Government either directly as in departmental undertakings or indirectly as in Government companies and corporations.

The public sector in India was instituted to enable the economy to achieve "Commanding heights" (4) The role of the public sector was quite clearly envisaged to be in areas where either the private sector was unable to venture because of large size of investment required or where the social welfare objectives were very different from private objectives.

The general objectives of public sector enterprises are:

- Promote critical development in terms of social change and strategic value rather than primarily on considerations of profit;
- and, provide commercial surpluses with which to finance economy development.

The macro objectives\(^{(5)}\) that form the framework within which public enterprises have to function, have been laid down as:

1) To promote the rapid economic development by filling the gaps in the industrial sector.
2) To provide the basic infrastructure for the growth of the economy.
3) To undertake economic activity strategically important for the growth of the country, which, if left to the private initiative would distort the national objectives.
4) Balanced regional development and dispersal of economic activity through the growth and diversification of economic activity in less developed areas by providing an adequate infrastructure and undertaking programmes on conservation and development to national resources.

\(^{(5)}\) Besant C Raj; *Public Enterprise Investment Decisions in India - A Managerial Analysis*; op cit. p.110
5) To reduce disparities in income.

6) To avoid concentration of economic power.

7) To have social control and regulation of long term finances through public financial institutions.

8) Control over sensitive areas allocation of scarce imported commodities, wholesale trade in agricultural commodities, especially food grains, control over the distribution of essential goods in order to reduce the margin between the prices obtained by the producers and those paid by the consumers.

9) Self reliance in different technologies through the development of capability for design and development of machinery, equipment and instruments and the elimination of dependence on foreign agencies for their services.

10) To create employment opportunities on an increasing scale.

11) To increase exports.

It is often heard that in Public Sector Enterprises there is no "goal congruence", and there is neither goal specificity or role clarity. Moreover, everybody feels that somebody will take the decision, may be due to lack of role clarity or due to fear of failure and ultimately nobody takes the decision.
From 1951 onwards till 1989-90 financial outlay totalling Rs.787,591 crore has been invested in development projects, Rs.368,876 crore in the public sector and Rs.418,715 crore in the private sector\(^{(6)}\) The annual development plans for 1990-91 and 1991-92 were of the order of Rs.107,993 crore and Rs.118,501 respectively. These huge sums have been distributed among the heads of development like Agricultural and Allied activities, Energy, Industry and Minerals, Transport, Communications, Science and Technology and Environment, Irrigation and Flood Control, Rural development, Special Area programmes, Housing and General Economic Services etc. In the Eight Plan (1992-97), out of a total outlay of Rs.798,000 crore, investment in public sector will be Rs.434,100 crore, while the private and household sectors' investment in various projects will account for the balance.

The Government of India announced a new Industrial Policy in July 1991 which contains the following four major decisions in respect of the public sector.

1) Reduction in the list of industries reserved for the public sector from 17 to 8 and introducing selective competition in the reserved areas.

2) Disinvestment of shares in Public Sector enterprises to raise resources and encourage wider participation of general public and workers in the ownership of public Sector enterprises.

\(^{(6)}\) P K Joy; *Total Project Management - The Indian Context*; op cit. p.1
3) Policy for sick public enterprises to be same as that for the private sector and
4) Improving performance through contract or Memorandum of Understanding (MOU) system by which managements are to be granted greater autonomy and held accountable for results.

The Industrial Policy Statement opened up nine of 17 industries hitherto reserved for the public sector for private investment and participation. This step is expected to augment the flow of investible resources to priority sectors and at the same time enhance competitiveness and efficiency in these sectors. While the mixed character of our economy will remain, public sector units will focus more on strategic areas in keeping with the original intention.

The Eighth Plan visualises an important role for an autonomous and effective public sector in providing essential infrastructural and strategic support for achieving the targeted rate of economic growth during the plan period (1992-97).

The plan document enumerates the following policy initiatives in this regard:
1) Restructuring involving modernisation, rationalisation of capacity, product mix changes and selective exit and privatisation.
2) Increase in autonomy and performance accountability through an effective system of MOU's between
administrative ministries and public enterprises launched since the Seventh Five Year Plan.

3) Changes in management in specific enterprises to promote leadership, resourcefulness and innovation.

4) A major effort by the State Governments to streamline the working of their public sector enterprises which are beset with interference and adhoc investment and employment decisions.

5) Technological upgradation through an integrated R & D effort and import of technology.

6) Re-orientation of approach in Ministries and other Government agencies corresponding to liberalisation and dismantling of regulations (Price, distribution, investment and import controls) to develop a new institutional capability to facilitate operations of market forces, orchestrisation of integrated R & D effort and evolution of consenses and partnership among various stake holders.

Public Sector Enterprises constitute a major national capability in terms of their scale of operations, coverage of the national economy, technological capabilities and stock of human capital. There are over a thousand public enterprises, about 700 of which are owned by the states. The rest are in the Central Sector. These include deparmental undertakings (eg. Railways, Post and Telecommunications), financial institutions (eg. The State Bank of India, The Industrial Finance Corporation of India, The Unit Trust of India and The Industrial Development Bank of India) and non-deparmental enterprises or Government Companies or corporations which are either incorporated
under the company law (eg. Steel Authority of India and The Indian Petrochemical Corporation ltd.) or statutorily created by Acts of Parliament (eg. Coal India, Air India, Indian Airlines and the National Thermal Power Corporation) Non departmental enterprises account for 25 percent of value addition, more than 50 percent of gross investment and about a third of the total employment on PSE's. PSE's contribute the entire output in the case of petroleum, lignite, copper and primary lead; about 98 percent of zinc; well over 90 percent of coal; more than half of steel and aluminium and about one third of fertilisers.

Non departmental PSE's have thus been an important sector of our economy and have dominated infrastructure and basic industries. Over the decade, their production activity has been perhaps over diversified and extends from steel making and oil refining to manufacture of bread and footwear. This has been the result of a number of circumstances and has diluted the original strategic and commanding heights of objectives of PSE activity. Infrastructural or producer services are dominated by public sector corporations in transport, energy and communications. PSE's also operate in diverse service sectors such as international trade, consultancy, contract and construction services, hotels and tourist facilities etc,
As on 31 March 1992(7) there were 246 central public sector enterprises (excluding 8 companies with central Government investment but with out direct responsibility, for management, 6 insurance companies and 3 financial institutions) Of these, 9 were in the construction sector, 72 in services and 165 were engaged in manufacture.

The number of enterprises increased from 179 in 1980 to 246 in 1992 and the investment increased from Rs.181 billion to Rs.993 billion. They produced goods and services worth Rs.995 billion. Their net profits were low, about Rs.38 billion. The net profits to capital employed ratio was as low as 5.8 per cent in the manufacturing sector and barely 1.5 per cent in the service sector.

The central public sector enterprises operate in 21 cognate groups(8) These cognate groups include areas of national importance and high social returns. These enterprises can be categorised as enterprises set up by the Central Government and those taken over from the private sector. Out of 187 enterprises set up by the Government 64 are loss making units, 29 of which are chronically sick.

(7) Government of India; Economic Survey of India - 1992 - 93, p.146
(8) S P Gupta; Liberalisation - It's Impact on the Indian Economy; op. cit. p.98
The minimum required rate of return in Private sector projects are generally assessed using three criteria(9) namely (a) the return obtained by the firm from the present investment (b) the average return obtained by other companies in the same industry and (c) the cost of capital to the company. These criteria can not be used for determining the discount rate for the public sector projects. The present rate of return can not be used as most of the public sector units in India report very meagre profits, and in many cases only losses, from year to year. The average rate of return in the industry can not be used, as in a number of cases, there are no corresponding projects either in the public sector or private sector enterprises. Finally the Manual on Feasibility Studies points out that the interest rate on loans to a project can not be used as they do not measure the true cost of capital in a developing country like India. In view of this the Manual suggests the use of alternative estimates of cost of capital or desired rate of return established elsewhere. A reference is made by the Manual to the Reserve Bank of India study wherein the cost of capital to the Government has been estimated at 12 percent. It also invites attention to the Parliamentary memorandum of the Fourth Five Year Plan wherein a 12 percent return is suggested as a desirable rate for the public sector industries. The Manual observes that this figure could be used as a discount rate in present worth calculations, although there seems to

(9) Besant C Raj; Public Enterprise Investment Decisions in India - A Managerial Analysis; op. cit. p.117
be a need to establish different rates for different industries.

Over the last 48 years the growth of the public sector enterprises has been phenomenal in terms of investment, production and range of activities. The public sector enterprises now number 1166, 246 in the central list and 920 in the state list. In 1989-90, the public sector accounted for 36 per cent of employment and owned 49 per cent of the capital employed in the corporate sector and it contributed 18.7 per cent to national income.

Exhibit 4.1 shows the increase in employment in public sector in comparison with private sector.

Lord Morrison, the father of the concept of public enterprises in U.K., has said that public corporation "Must have autonomy and freedom of business management."

Pandit Jawaharlal Nehru, the first Prime Minister of India and the father of the concept of the public sector in India has once said in our Parliament that "We have to evolve a system of working public enterprises, where, on one hand there are adequate checks and protections and on the other, enough freedom for the public enterprise to work

(10) S P Gupta; *Liberalisation - It's Impact on the Indian Economy*; op. cit. p.98.

(11) *The Economic Times*  
27 September 1996
EXHIBIT 4.1
INCREASE IN EMPLOYMENT IN PRIVATE SECTOR & PUBLIC SECTOR COMPANIES

IN LAKHS

<table>
<thead>
<tr>
<th>Year</th>
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<th>PUBLIC SECTOR</th>
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<td>1990</td>
<td>75.82</td>
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</tr>
<tr>
<td>1995</td>
<td>81.14</td>
<td>192.94</td>
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Source: Ministry of Labour
quickly and with out delay Ultimately it has to be judged by the results" Unfortunately, the result was exhorbitantly poor. The core sectors as Jawaharlal Nehru conceived during the first and second five year plans, became liabilities to the nation. The poor exchequer has to bear the consequences in terms of increased taxes and duties.

The committee on Public Undertakings has expressed the view that unless the public sector enterprises contribute to the rapid growth of GDP and generate substantial internal resources for future investment the country cannot move forward quickly. Most of the public sector undertakings have unusually long gestation period, very low level of production or under utilisation of assets and the consequential escalation of cost of projects and their processes.

Public sector in India has grown in a haphazard manner. Except for some vague statements about its objectives, the philosophy of public sector has never been properly defined or strictly followed. What all things have been done, it is a reality that most of the public sector enterprises are a burden rather than a support to the poor Indians.