Public Enterprises and Economic Reforms*

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My association with the Department of Commerce, Osmania University goes back to 1960 when I registered for Ph.D course under the guidance of Professor V.V.Ramanadham, the then Head of the Department. In 1963, I taught Public Enterprises as an optional subject for students of M.Com. which explains why I chose this topic for today. While Professor Satyanarayana was also one of my guides for Ph.D, Professor Ramakistayya, Vice Chancellor and I were colleagues in the late `eighties. Naturally, I jumped at the opportunity of coming back to Osmania University. Of course, as my friend Professor Raghuram of Economic Department once said, I "never really left Osmania University".

In 1964, Mr.S.S.Khera in his pioneering book on Public Enterprises says, "there is hardly any country today in which the Government is not engaged actively in the setting up and management of economic and industrial enterprises". Today, any book on the same theme will substitute the words 'setting up and management' of enterprises with the words "privatising and restructuring" of enterprises. It is necessary to understand why this dramatic change has occurred.

Almost fifty years ago, our country decided on a system of planning through a mixed economy model to achieve our developmental objectives. Public enterprises were important instruments of public policy in general and planning in particular. Since then, there were a number of occasions when there was disenchantment with the performance of public-enterprises. There were reviews of public enterprise policies by a host of Committees and we have been experimenting with holding-company structures, Memoranda of Understanding, etc. However, a review of the role and functioning of public enterprises in the 1990s has a qualitative difference, in that their relevance and scope are being analysed and changed in a more fundamental way, and this is being done as part of economic reforms that we have undertaken. Economic reforms reflect a review of the role of the Government, or more generally of the State vis-à-vis the market.

Dramatic Change and New Realities

It is true that market oriented economies and socialist countries or even "mixed economies" like India had been parties to expanding role of the State and public enterprises since Second World War upto 1980s. This happened as a reluctant concession to realities by market-economies, as a commitment to ideology by socialist systems, and as a pragmatic approach by mixed economies like ours. This period coincided with unprecedented growth in prosperity in most, if not all, of these economies. This policy was naturally in full recognition of the "market-failures". Yet, by early 'nineties, most, if not all economies have launched on a policy of redefining and reducing overall, the role of the State vis-à-vis the market. This phenomenon clearly signifies the new trade-off between 'State failures' and 'market failures' or what may be termed as the new realities in the relationship between the State and the market.

Institutions and Values

There are recent developments in the institutional dynamics in the relationship between the State and the market. The identification of the Government with the interest of public at large is being questioned because Government is often being made an instrument of sectional interest in the guise of serving poorer sections. As a corollary, the burden of proof of efficiency, compatible with public interest, has shifted from private to the public sector. There is an increasing perception that State failures on account of political factors and bureaucratisation may, in many cases, exceed market failures. Moreover, the importance of incentive-reward system in ensuring consistent improvement in efficiency has come to be recognised and it is observed that markets provide better incentive-framework. Finally, the concept of efficiency itself tends to be redefined in as much as the values prevalent in the society have undergone important changes asserting individualism in their relationship with the state and voluntarism among specific groups.

Competition as a Means

Closely related to the institutional factors is the belief that competitive environment tends to create a climate conducive to enhancing efficiency. In other words, while there could be some doubt as to the capacity of the competitive market structures to determine the ends, there is more confidence in competition as a means of achieving the desired ends. A differentiation is sometimes made between competition in the international markets and in domestic markets. Increasingly, the perception is that international competitiveness is a more effective instrument of competition and thus efficiency. Differentiation can also be made between competition in products and competition in capital markets. Here again, there is an increasing tendency to believe that competition in capital markets is essential to ensure allocative efficiency, though competition in product-market may bring about operational or technical efficiency to a limited extent. Further, it is argued that what has been perceived to be natural monopolies in the past need not necessarily be monopolies in as much as a number of components of these monopolies could be “unbundled”, hived off and subjected to competition. Even if it is established that some components of a system can be effective only on monopoly basis, competition can be introduced for operating such monopoly through franchising by means of competitive bidding procedure. More important, it has been empirically established that public ownership has a tendency of undermining competitive impulses and promoting monopoly. Hence, it can be argued that, even if monopoly appears natural it could as well be privately owned but regulated by State so that over a period, competition can be injected by Government. In a monopoly situation, an assessment of costs and benefits of publicly owned monopoly and regulated private monopoly are compared. No doubt, the costs of transferring an existing publicly owned monopoly into a private monopoly would have to be reckoned. The transfer costs would be both the direct costs of transferring ownership and the indirect costs of restructuring the enterprise and transferring the contractual obligations.

Regulation and Regulators

The approaches to regulation and control have also changed dramatically. The changes in technology, rapid obsolescence in products, and varied tastes of the consumers leading to a variety of products, have resulted in difficulties in defining a particular product or service. Thus, regulation becomes an increasingly complex legal and bureaucratic task. In any case, the regulated units supply most of the needed information to the regulator – a phenomenon resulting in what is described as "information asymmetry". This makes quality of regulation dependent on nature of information supplied by the regulated units. There is some empirical evidence of this "regulatory capture" viz., that the regulated tend to capture the regulatory. There is from behavioural angle, scope for "clientasis", i.e., constant exposure to the client's problems, making the principal or his agent identify more with the interest of the clients i.e., regulation units, than with public interest. Finally, of late, there is an emphasis on evaluation of the costs of regulation and the benefits on account of regulation. The costs of regulation are being reckoned to include not only the cost of administering the regulation by the state but also the costs of compliance incurred by the units which are subjected to such regulation.

Technology and Response

The most important impact of technologies is in regard to rapid obsolescence. The publicly owned Government institutions are reputed to have limited capacity to quickly respond to technological changes. Moreover, the globalisation of consumption patterns implies the need for quick interaction with changing consumption patterns – a matter in which the private sector seems to have an advantage. Further, the material component in industry is becoming less important due to technological advances as compared to knowledge-component and service-component. The public systems appear to be better suited towards mobilisation of material resources rather than towards enthusing people to innovate or respond promptly to them. Overall, the impact of technological development has, therefore, been to make public systems and bureaucratic systems less efficient compared to private systems in some areas. It is possible to argue that bureaucratic systems can be made equally flexible to respond to technological changes by providing the necessary autonomy, but experience has shown that Government institutions generally tend to be less flexible.

International Environment : Recent Developments

We should also recognise some new realities in the international economic and trading environment which are relevant to developing countries. The role of official flows. i.e., multilateral and bilateral flows which usually supported Government and public enterprise, has been reduced. Even at the reduced levels of these flows, they are now reversing the trend of support to public sector in favour of private sector. There is thus enormous privatisation of global financial flows. Further, with the demise of a large socialist block, the scope and need for investment flows or trade flows on public sector account such as, through Indo-USSR agreements gets reduced. The country obligations under World Trade Organisation (WTO) are also having a bearing on public private mix. With provisions of WTO favouring non-discriminatory treatment even for Government purchases, the special role or privileged role for public sector gets diminished. Also, the WTO agreement expands the coverage to services, recognising the fast growing service component of international trade. Be it tourism, banking or insurance, there is a strong bias in favour of private sector in international trade in services. We should also note the increasing importance of trade within and between multinational corporations (MNCs) in international corporations (MNCs) in international trade, even though some of the MNCs may not be giants. To the extent MNCs are mostly in private sector, any effort to expand one's share in international trade may require larger role for the private sector. It was widely believed in the past, that MNCs tend to have adverse impact on the goals of growth with social justice in developing countries. Empirical evidence in regard to most countries shows that MNCs have not hurt the cause of either growth or social justice – provided appropriate domestic policies of intervention were effected.

Wholesale Review and Not Retreat of State

These new realities do not imply that there is or that there should be a wholesale retreat by the State in favour of market. While, in fact, there is a wholesale review of the role of the State, the new realities are giving rise to new types of State intervention and of course, concerns. To start with, restructuring Government's share in ownership and dismantling of regulatory mechanisms in some areas and introducing regulating mechanisms in lieu of publicly owned monopolies are activities in the domain of the State, effected with the initiative of the State. While the State may reduce its role as a producer of goods and services, it could expand its role as a regulator and as provider of "public goods" or "social goods" like primary education and health. In the past, funding and provision of supply were considered indivisible and had to be solely the responsibility of Government or market. It is now recognised that there can be combinations of public and private sectors in funding and supply – say public funding with private supply. Both funding and supply can be partly public and partly private. In fact, new instruments of State control do provide what may be called reserve power rather than active involvement in direct supply of goods and services. Similarly, new combination of ownership are being attempted in which the State becomes one of the owners along with the workers and public. In fact, contrary to the rhetoric of privatisation, the pace has been slower than anticipated in most countries as the actual extent of privatisation of public enterprises has been less than what has been planned. It is inconceivable that public sector or public enterprise will disappear. They will still be significant, continue to be critical qualitatively but perhaps not in terms of magnitudes.

Our Response

We have reason to believe that, in our country, by early 'eighties, there was a clear recognition that there should be a fundamental review of India's economic policy. Reports of various committees on important policies such as Abid Hussain Committee on Trade Policies; Narasimham Committee on Physical Controls; Chakravarthy Committee on Monetary Policy; Arjun Sen Gupta Committee on Public Enterprises and Statement on Long Term Fiscal Policy testify to this. In reality, effective policy reform was stalled for a variety of reasons. Perhaps, the costs of reform are higher now because of our delayed response.

The Gulf crisis and consequent crisis in the external sector forced policy makers into action. Since the malaise expressed itself in the external sector, initial thrust of the early 'nineties was in exchange-rate management, trade-policy and balance of payment in general. To the extent, the reform of external sector demanded adjustment programme to correct macro-economic imbalances, fiscal correction and monetary-restraint were essential.

By now, broad directions of structural reform, reflecting the new realities have been identified and there is what can be termed as "national consensus" on the direction of change. No doubt, progress in reform has not been uniform and the sequencing is still somewhat unclear in some areas. In fact, there may be differing perceptions on the transitional costs, possible risks and in particular on the adverse consequences on some sections of the population. There is thus, the critical issue of gainers and losers in current and potential terms, as also in absolute and relative terms. Overall, it would be reasonable to claim that the direction and parameters of change are reasonably clear, and then set out the broad contours of this consensus.

a) A more dynamic mix of mixed economy i.e., changing mix of State and market or public and private sector;
b) Greater integration between domestic and international sectors at a sustainable pace consistent with our own interests;
c) Larger role for 'prices' and reduced role for licensing and other quantitative restrictions or discriminatory instruments or policies.
d) To the extent 'subsidies' distort prices across the board, gradual replacement of these by target oriented subsidies such as through Public Distribution System;
e) Greater transparency in the application of policies and procedures to enable economic agents both domestic and international to operate efficiently.
f) More effective rather than more pervasive regulation – taking cognisance of costs of regulation to the regulator (Government) as well as costs of compliance with regulation to the regulated (enterprises) vis-à-vis the benefits.
g) Special emphasis on emerging concerns, such as, environmental, health, price-level and consumer protection, many of which affect the poor more than the non-poor.
h) Reorienting the resources of Government to public goods (law and order or street lighting); merit goods (education and health) and economic infrastructure (roads) where there are substantial lags between investments and output adversely affecting both growth and social justice. If this reorientation demands, as it would since investible resources are not unlimited, some roll back of the Government especially

in provision of tradeable goods and yielding place to private sector, may be warranted.

Overall, the reform strategy asserts that medium to long-term solution to poverty lies in a combination of adequate public goods and reasonable level of "merit goods" to all through public sector; provisions of efficient infrastructure through combined efforts of public and private sector and economic growth through constant improvements in productivity. Work opportunities, incentives to work and reward for work are central to both growth and justice and not mere creation and protection of jobs.

Redefining the Role of Public Enterprises

The question then is, how does reform impact on public enterprises? There is no presumption now that investments in public enterprises necessarily generate benefits commensurate with the costs incurred by the Government through budgetary support or with alternative uses of such public funds. The instrumentalist view towards public enterprise i.e. as instruments of objectives of growth and social justice rather than an ideological view i.e. public enterprises are better merely because of public ownership, seems to be in order. Thus, public ownership is only one of the options of Government intervention towards defining and achieving social or economic objectives. It is, therefore, necessary to constantly identify ways of achieving the desired objective and view public ownership as one of such ways. Consequently, there is no reason to presume that the existing public enterprise would continue to be publicly owned. Today's public enterprise may be tomorrow's private enterprise; and vice-versa. Also, public ownership need not necessarily mean a 100 per cent ownership by the Government or other public sector bodies. It is possible that there are different mixes of public and private ownership or control.

Since competition is desirable under reform policy, market structure appears to be important as competition between public enterprises or between public and private enterprises will have to be induced and ensured. To ensure competition, independent regulatory bodies may be required. Such regulatory bodies may have to be seen to be independent of the Ministries that are also owners of pubic enterprises. After all, owners and regulators cannot be the same just as a player cannot be an umpire.

In the context of reform, central public enterprises have been classified in terms of market structure in which they operate, and profitability. In regard to market structure, they are often divided into those which operate in competitive and monopolistic markets. In terms of profitability, they are divided into profit-making and loss-making. This classification is static. The very purpose of economic reform is to change the market structures in favour of competitive element and any coping strategy will have to recognise this.

In regard to profitability also, many of the enterprises and indeed most of the profitable enterprises benefitted from administered price of some sort or the other, since both input costs and output price were either formally or informally regulated by Government or through other public enterprise in the network. Further, what is important is not the present profitability but the future profitability in the changed environment. Moreover, what is critical is the possible impact on profitability through diverse options such as partial or full divestiture or revised corporate strategies. In fact, even for Government's decision as owner on disinvestment, what is critical in purely fiscal terms is not present profit or loss but future stream of costs or benefits with continued public ownership vis-à-vis the one-time cost or yield of one time sale of its shares.

Public sector, at a conceptual level, includes Government sector and public enterprises sector. Public enterprises may be at the Union level or at the province/State level. The public enterprises may be financial public enterprises or non-financial public enterprises. Within the non-financial public enterprises, there may be departmental public enterprises and other autonomous bodies. The general practice in India is to equate the central non-financial autonomous public enterprises as "public sector", though departmental enterprises at the Union level (such as Ports, Railways and Telecommunications), and enterprises at State level (Power and Transport utilities), together have greater significance for the twin objectives of growth and social justice. Indeed, many of central autonomous non-financial public enterprises produce tradeable goods with little direct relevance to the welfare of poorer sections.

In view of the common understanding of the "public sector", and in order to limit the discussion to managebale elements, we may take public sector or public enterprise to mean Central non-financial public enterprises now. For convenience, it would be useful to adopt a five layer conceptual approach in analysing economic reform policies of the Government and their impact on public enterprises. The five layers are (a) the general macro-economic environment, (b) the policies of the Government in regard to the broadly defined public sector as such; (c) the relationship between the Government and the public enterprise as though between a principal and an agent; (d) the ownership structure of the public enterprise itself; and (e) the internal operations of the public enterprise.

The general macro-economic environment refers to the institutions and other macro-economic policies which affect the society institutions and the totality of the economic environment and not the public enterprises alone. The liberalising elements of reform may cover conditions of entry, operations and exit. The changes in the general macro-economic environment do affect all economic agents including the public enterprises.

At the second layer, there would be a follow-up in regard to the macro-policy but specifically dealing with public sector. These may include dereservation of activities of the public sector; corporatisation; creating institutions or procedures which emphasise commercial or enterprises elements; withdrawal of discriminatory treatment between public and private sector, etc. Steps in this direction include intended changes in regulatory framework and minimising budget support.

At a third layer, the relationship between Government and public enterprise as principal and agent may change. In fact, a large part of the liberalisation of the 'eighties in India was aimed in this direction and included the concept of MOUs; access to capital markets for loans; representation of private sector leaders in Boards, etc. The process of redefining the relationship has been strengthened as part of reform and includes minimising budgetary support, and disintermediation by Government in regard to external aid. There is admission of the possibility, however remote of 'exit of the unit' through Bureau of Industrial and Financial Reconstruction or exit of work force through Voluntary Retirement Scheme. Interface now is on an intensified 'arms-length' basis between principal and agent.

The fourth layer relates to the ownership structure. Liberalisation in this area, amounting to some sort of privatisation, involves sale of share by Government or in some cases through expanded equity base to private share holders, and limits on further equity-support by Government.

The fifth layer relates to internal operations of public enterprises, often induced by the Government as owner and sometimes as a response to changing environment brought about by the other four layers. These may relate to contracting out some activities to the private sector. There is a distinct, if not appreciable progress, in this area under the new policies.

Coping Strategies

Coping strategies will have to be evolved by both private and public sector enterprises due to changes in the macro-economic environment induced by our reform-policies. There has to be a greater focus in managing their own business than in managing the Government for success in their operations. To this extent, there is an advantage in public enterprises closely monitoring as to how the private enterprises are coping with the change in macro-economic environment.

It is, however, true that coping strategies will be different for the public enterprises compared to private enterprises because of a number of reasons.

First, there will be a new dynamism when the functions of the Government as sovereign-regulator and owner are differentiated.

Secondly, there will be changes in the approaches of Government as the principal owner and as lender since the objectives of the principal are under rapid change unlike in the private sector where the objectives remain the same, namely profitability.

Thirdly, changes in ownership pattern itself are being engineered by the owner and such changes in ownership may encompass changes in management control.

Fourthly, and as a consequence of the new economic environment, the attitude of workers and management may change. In the past, they owed their loyalty either to vaguely defined general public interest or at a more operational level to the Government, that is, political or bureaucratic expression of Government. The new reality is “enterprise” and not “public ownership”. Public ownership is being diluted, has admittedly become flexible and there is a threat of its exit under the reform programme. Hence, the attitudes of the management and workers will be oriented towards the survival and growth of each enterprise in order to maximise their own welfare.

Some enterprises in their response so far have been seeking funds for the enterprises from the receipts of the disinvestment. This also implies making available funds to an enterprise by the owner without regard to either the return to the owner or the requirement of funds to the enterprise concerned. There are also proposals from enterprises for mergers or restructuring, often with the intention of protecting their enterprises from immediate compulsions of coverage by BIFR. These measures, in some cases, may have potential for short-term relief or incentives but may result in medium-term collapse of the enterprise. If some of these are tactics to give time to respond, it would make good coping strategies for an enterprise.

Strengths of Public Enterprises

There are inherent strengths of public enterprises in many areas. These are often overlooked and more often inadequately exploited to the advantage of the enterprise.

First, most private corporate sector is family-oriented and surely Government as an owner cannot be less professional.

Second, public enterprises as compared to private enterprises have large very talented, qualified and experienced employees though they are often not adequately-motivated and poorly rewarded.

Third, the public enterprises usually have physical assets which may not contribute directly to the income stream now, yet command high market value. Large underutilised capacities do exist in some areas. Hiving off of non-income earning assets and using their resources for rationalising/modernising is possible.

Fourth, many public enterprises have reach and penetration in terms of technical collaborators, input-suppliers, markets etc. and they can be actively explored for coping strategies.

Fifth, the private enterprises that may try to come in now will have to bear the cost and time of entry and entrenched public enterprises could utilise this gestation period to enhance their competitive strengths.

Finally, public enterprises can take initiatives in foreign collaboration also.

In brief, timely coping on the part of public enterprises by exploiting opportunities is possible and perhaps desirable, irrespective of decisions on the extent of ownership by Government.

If structurally, the coping strategies by the enterprises require that they should have greater autonomy, it is quite possible that such an autonomy is more likely under conditions of diversified ownership. By the very nature of Government ownership. Government considers appointment to the Board or to the management as an incidental or minor aspect of its governance. Further, if a choice has to be made between political accountability and the interest of the enterprises clearly, it will be in favour of political accountability.

There is reason to believe that autonomy of an enterprise to cope up with reform is often difficult as long as Government owns an absolute majority of shareholding. The desirable level of Government holding and the manner of reaching such a level have been analysed by Dr.Rangarajan Committee on disinvestment in 1993. The report recommended that the target level of ownership could be zero; 26 per cent to ensure limited control over special resolutions brought in general body meeting of the enterprise; 51 per cent to have effective control and 100 per cent for full ownership. The report adds that while determining the final level of Government ownership, it must be recognised that there may be group specific or enterprise specific intermediate levels of disinvestment depending on the state of preparedness of each enterprises, stock market conditions and the requirements of Government, apart from the possibilities of expanding the equity base.

In brief, coping strategies are in order, for Government, public and private enterprises. For the intellectual community, a study of such strategies would be a rewarding experience. I look forward to such studies by the members of this august audience.

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