SEMESTER IV
INDIAN ECONOMY (UG)
UNIT- III(B)
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<u>LECTURE 3</u>

In lecture session 1 and 2 we have already discussed the role of public sector; importance, genesis, and performance of public sector in India. Now, we are going to discuss problems of public sector enterprises, solutions of the public sector etc.

Problems of Public Sector Enterprises

It would be unreasonable to argue that all is well in the public undertakings. There is much scope for improving the efficiency and working of public sector enterprises. The main point which merits consideration are: -

1) **Mounting losses**

A review of the working of public sector enterprises reveals that either the profits in them have been deplorably low or that they have been making losses. As compared with the performance of the Central Govt., however, the State Govt. are having perennial low-makers like irrigation works, State road transport, and State Electricity Boards.

2) **Decision about location**

It has been noted that in many situations, political factors influence decisions about location of projects. Powerful ministers in the ruling party make promises about the future location of projects in a state irrespective of the results of the feasibility study about costs. This approach leads to a considerable wastage of capital resources.

3) **Delays in completion and increase in cost of construction**

Many reports on the working of the public sector projects have pointed out that many of the projects took longer time to complete than was initially envisaged. Not only that, the cost of the projects was also revised upwards. For instance, in the case of Trombay Fertiliser Project, it took 6.7 years to complete against the original estimate of 3 years. Similarly, the original estimate of cost was Rs. 27 crores (1959) and the final cost stood at about Rs. 40 crores (1965). It is very necessary to proper comprehensive construction plans, so that the avoidable delays & increase in costs should not put additional burden on the scarce resources.

4) **Over capitalisation**

Public sector projects are charged with over capitalisation. In other words, the input-output ratio obtaining in many projects was unfavourable. The causes leading to over capitalisation can be traced to inadequate planning, delay & avoidable expenditure during construction, surplus machine capacity, bad location of projects etc.

5) **Price policy**

The pricing policy of the public sector enterprises aren't guided solely by the profit maximisation principle, but are under the regulations & control of the Govt. Most of the public sectors produce products which serve as inputs for other sectors of the country. The public sector has to keep in mind the social implications of its price policy. In many cases, under public pressure, prices are kept low even when costs & prices have been rising. As regards the pricing policy of public sector enterprises we can find two different approaches- a) the public utility approach b) the rate of return approach.

6) **Poor manpower planning**

There is poor manpower planning & this is clearly reflected in the inadequate arrangement for training & education of workers. Labour indiscipline was one of the causes for the poor performance of the public sector enterprises. Indiscipline among the workforce & poor management-labour relationship plagued many of the large government enterprises.

7) **Inefficient management**

Managerial effectiveness & efficiency are crucial factors in improving the overall performance of the public sector enterprises. The successful operation of public sector enterprises is dependent upon the availability of experienced persons to fill up top positions. Government should employ professionalised management in the public sector enterprises.

8) **Under utilisation of capacity**

Under utilisation of installed capacity is another reason for the low levels of profits in the public sector enterprises. A large number of these enterprises have operated at less than 50 per cent of their capacity for a number of years. Some people have attributed this to the lack of foresightedness on the part of the government. However, the facts are somewhat different. Other factors such as inefficient operation, poor management, political interference in day-to-day working, labour disputes etc. accounted for under utilisation of capacity in public sector enterprises.

Solutions of the public sector:

The expansion of the public sector was based on the Industrial Policy Resolution of 1956, which assigned a strategic role of the public sector. Development of heavy & basic industries & the provision of infrastructure was the main task of the public sector. Many of these enterprises successfully expanded production,

opened up new areas of technology. There is no doubt that the public sector established an industrial base of the economy which enabled the private sector to undertake investments.

To improve the performance of the public sector the Government of India announced in July 1991 the new Industrial policy which contained the following decisions pertaining the public sector.

A) Portfolio of public sector investments will be reviewed with a view of focus the public sector on strategic & essential infrastructure.
B) Public sector enterprises which are chronically sick & which are unlikely to be turned around will, for the formulation of revival schemes, be referred to the Board for Industrial & Financial Reconstruction (BIFR). A social security mechanism will be created to protect the interests of workers.
C) In order to raise resources & encourage wider public participation, a part of the govt. share holding in the public sector would be offered to mutual funds, financial institutions general public, & workers.
D) Boards of public sector companies would be made more professional & given greater power.
E) There will be greater thrust on performance improvement through the Memoranda of understanding (MOU)system through which management would be held accountable.

Policy Regarding Sick Units

The 1991 Industrial policy brought the public sector at par with the private sector. As a result, public enterprises were also brought within the jurisdiction of the BIFR. The BIFR was given the responsibility to decide whether a sick public enterprise can be effectively restructured or whether it has to be closedown. Upto March, 2005, 294 cases of public sector enterprises were referred to the BIFR. Of

these, 211 were registered. Of the registered cases revival schemes were sanctioned for 44 cases, while winding up was recommended in 72 cases. Seventeen public enterprises were declared “no longer sick” on successful completion of the rehabilitation schemes.

The main elements of the present Government policy towards Public Sector enterprises as contained in the National Common Minimum Programme (NCMP) are reproduced below:

i)To devolve full managerial and commercial autonomy to successful, profit making companies operating in a competitive environment

ii) Generally, profit-making companies will not be privatized

iii) Every effort will be made to modernize and restructure sick public sector companies and revive sick industry

iv) Chronically loss making companies will either be sold off, or closed, after all workers have got their legitimate dues and compensation

v) Private industry will be inducted to turn-around companies that have potential for revival

vi) Privatization revenues will be used for designated social sector schemes

vii) Public sector companies and nationalized banks will be encouraged to enter the capital market to raise resources and offer new investment avenues to retail investors.

Disinvestment of shares

The government of India has decided to withdraw from some of the industrial sector & in accordance with this decision, it is privatising the public sector enterprises in a phased manner. The main approach of government in this regard is to bring down its equity in all non-strategic undertakings to 26 per cent & close down those public enterprises which can’t be revived. For purpose of privatisation, the government has adopted the route of disinvestment which

involves the sale of the public sector equity to the private sector & the public at large. Government have advocated the sale of public sector equity as a means of public sector reforms.

By disinvestment we mean the sale of shares of public sector undertakings by the government. The shares of government companies held by the government are earning assets at the disposal of the government. If these shares are sold to get cash, then earning assets are converted into cash. So it is referred to as disinvestment (Koner and Sarkhel, 2014).

There is a difference between disinvestment and privatization. Privatization implies a change in ownership resulting in a change in management. But disinvestment need not always imply change in management. Disinvestment is actually dilution of the stake of the government in a public enterprise. If the dilution is less than 50 per cent the government retains management even though disinvestment takes place. It is not privatized. But if the dilution is more than 50 percent there is transfer of ownership and management. It will be called privatization. Thus disinvestment is wider than privatization. Privatization implies disinvestment but disinvestment does not necessarily imply privatization. Only when disinvestment goes beyond 51 percent it implies privatization. The extent of dilution of the government`s stake is determined as part of the policy of disinvestment (Koner and Sarkhel, 2014).

There are two major reasons offered by the government for disinvestment. One is to provide fiscal support and the other is to improve the efficiency of the enterprise. The fiscal support argument runs as follows: Government`s resources are limited. These resources should be devoted to areas of social priority such as basic health, family welfare, primary education and social and economic infrastructure. More resources can be devoted to these priority areas by releasing

resources locked up in nonstrategic public sector enterprises. The demands on the governments both at the centre and in the states are increasing. There is need to expand the activities of the state in priority areas. It is, therefore, legitimate that a part of the additional resources needed for supporting these activities come out of the sale of shares built up earlier by the government out of its resources.

The second reason for disinvestment is that it will improve the efficiency of working of the enterprise. If the extent of disinvestment is such that the enterprise is privatized and management of the enterprise is taken over by the private sector it will be free from the control of the government and will be able to function more efficiently. It is here taken for granted that efficiency is higher for a private sector than for a public sector unit.

The Rangarajan Committee (1993) emphasised the need for substantial disinvestment. It stated that disinvestment could be up to 49 percent for industries explicitly reserved for the public sector. It recommended that in exceptional cases, such as the enterprises which had a dominant market share or where separate identity had to be maintained for strategic reason, the target public ownership level could be kept at 26 percent. In all other cases, it recommended 100 percent disinvestment of government stakes. In 1999 the government classified public sector enterprises into strategic and non-strategic units for the purpose of disinvestment. Strategic public sector enterprises would be those in the areas of defence production, atomic energy and railway transport. All other public sector enterprises were to be considered non-strategic. For non-strategic public sector undertakings, it was decided that the reduction of government's stake to 26 percent would not be automatic and the manner and pace of doing so would be worked out in case to case basis.