UNIT IV
INDUSTRIAL POLICY SINCE 1991

New Economic Policy of 1991: Objectives, Features and Impacts

New Economic Policy of India was launched in the year 1991 under the leadership of P. V. Narasimha Rao. This policy opened the door of the India Economy for the global exposure for the first time. In this New Economic Policy P. V. Narasimha Rao government reduced the import duties, opened reserved sector for the private players, and devalued the Indian currency to increase the export. This is also known as the LPG Model of growth. (Liberalization, Privatisation and Globalisation).

New Economic Policy refers to economic liberalisation or relaxation in the import tariffs, deregulation of markets or opening the markets for private and foreign players, and reduction of taxes to expand the economic wings of the country.

Manmohan Singh is considered to be the father of New Economic Policy (NEP) of India. Manmohan Singh introduced the NEP on July 24, 1991.

The main objectives behind the launching of the New Economic policy (NEP) in 1991 by the union Finance Minister Dr. Manmohan Singh are stated as follows:

a. The main objective was to plunge Indian Economy in to the arena of ‘Globalization and to give it a new thrust on market orientation.

b. The NEP intended to bring down the rate of inflation.

c. It intended to move towards higher economic growth rate and to build sufficient foreign exchange reserves.

d. It wanted to achieve economic stabilization and to convert the economy into a market economy by removing all kinds of un-necessary restrictions.

e. It wanted to permit the international flow of goods, services, capital, human resources and technology, without many restrictions.

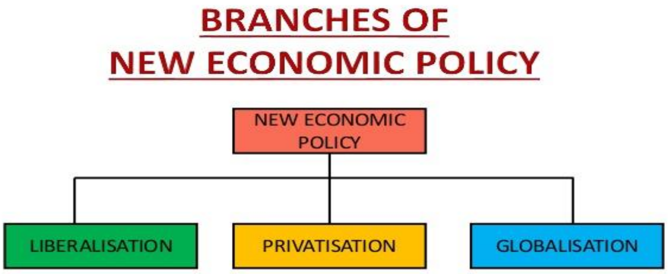
f. It wanted to increase the participation of private players in the all sectors of the economy. That is why the reserved numbers of sectors for government were reduced. As of now this number is just 2.

Beginning with mid-1991, the govt. has made some radical changes in its policies related to foreign trade, Foreign Direct Investment, exchange rate, industry, fiscal discipline etc. The various elements, when put together, constitute an economic policy which marks a big departure from what has gone before.

The thrust of the New Economic Policy has been towards creating a more competitive environment in the economy as a means to improving the productivity and efficiency of the system. This was to be achieved by removing the barriers to entry and the restrictions on the growth of firms.

Main Measures Adopted in the New Economic Policy

Due to various controls, the economy became defective. The entrepreneurs were unwilling to establish new industries (because laws like MRTP ACT 1969 de-motivated entrepreneurs). Corruption, undue delays and inefficiency risen due to these controls. Rate of economic growth of the economy came down. So in such a scenario economic reforms were introduced to reduce the restrictions imposed on the economy.



Following steps were taken under the Liberalization measure:

a. Free determination of interest rate by the Commercial Banks:

Under the policy of liberalisation interest rate of the banking system will not be determined by RBI rather all commercial Banks are independent to determine the rate of interest.

b. Increase in the investment limit for the Small Scale Industries:

Investment limit of the small scale industries has been raised to Rs. 1 crore. So these companies can upgrade their machinery and improve their efficiency

c. Freedom to import capital goods:

Indian industries will be free to buy machines and raw materials from foreign countries to do their holistic development.

d. Freedom for expansion and production to Industries:

In this new liberalized era now the Industries are free to diversify their production capacities and reduce the cost of production. Earlier government used to fix the maximum limit of production capacity. No industry could produce beyond that limit. Now the industries are free to decide their production by their own on the basis of the requirement of the markets.

e. Abolition of Restrictive Trade Practices:

According to MRTP ACT 1969**,** all those companies having assets worth Rs. 100 crore or more were called MRTP firms and were subjected to several restrictions. Now these firms have not to obtain prior approval of the Govt. for taking investment decision. Now MRTP Act is replaced by the competition Act, 2002.

1. Liberalisation

Removal of Industrial Licensing and Registration:

Previously private sector had to obtain license from Govt. for starting a new venture. In this policy private sector has been freed from licensing and other restrictions.

Industries licensing is necessary for following industries:

(i) Liquor
(ii) Cigarette
(iii) Defence equipment
(iv) Industrial explosives
(v) Drugs
(vi) Hazardous chemicals

Privatisation

Simply speaking, privatisation means permitting the private sector to set up industries which were previously reserved for the public sector. Under this policy many PSU's were sold to private sector. Literally speaking, privatisation is the process of involving the private sector-in the ownership of Public Sector Units (PSU's).

The main reason for privatisation was in currency of PSU's are running in losses due to political interference. The managers cannot work independently. Production capacity remained under-utilized. To increase competition and efficiency privatisation of PSUs was inevitable.

Step taken for Privatisation

The following steps are taken for privatisation

1. Sale of shares of PSUs

Indian Govt. started selling shares of PSU's to public and financial institution e.g. Government sold shares of Maruti Udyog Ltd. Now the private sector will acquire ownership of these PSU's. The share of private sector has increased from 45 per cent to per cent.

2. Disinvestment in PSU's

The Govt. has started the process of disinvestment in those PSU's which had been running into loss. It means that Govt. has been selling out these industries to private sector. Govt. has sold enterprises worth Rs. 30,000 crores to the private sector.

3. Minimisation of Public Sector

Previously Public sector was given the importance with a view to help in industrialisation and removal of poverty. But these PSU's could not able to achieve this objective and policy of contraction of PSU's was followed under new economic reforms. Number of industries reserved for public sector was reduces from 17 to 2.

(a) Railway operations

(b) Atomic energy.

Globalization

Literally speaking Globalisation means to make Global or worldwide, otherwise taking into consideration the whole world. Broadly speaking, Globalisation means the interaction of the domestic economy with the rest of the world with regard to foreign investment, trade, production and financial matters.

Steps taken for Globalisation

Following steps are taken for Globalisation

(i) Reduction in tariffs

Custom duties and tariffs imposed on imports and exports are reduced gradually just to make India economy attractive to the global investors.

(ii) Long term Trade Policy

Forcing trade policy was enforced for longer duration. Main features of the policy are:

(a) Liberal policy

(b) All controls on foreign trade have been removed

(c) Open competition has been encouraged.

(iii) Partial Convertibility of Indian currency

Partial convertibility can be defined as to convert Indian currency (up to specific extent) in the currency of other countries. So that the flow of foreign investment in terms of Foreign Institutional Investment (FII) and foreign Direct Investment (FDI).

This convertibility stood valid for following transaction:

(a) Remittances to meet family expenses.
(b) Payment of interest.
(c) Import and export of goods and services.

(iv) Increase in Equity Limit of Foreign Investment

Equity limit of foreign capital investment has been raised from 40% to 100% percent. In 47 high priority industries foreign direct investment (FDI) to the extent of 100% will be allowed without any restriction. In this regard Foreign Exchange Management Act (FEMA) will be enforced.

If the Indian economy is shining at the world map currently, its sole attribution goes to the implementation of the New Economic Policy in 1991.

PRIVATISATION -- MEANING

Privatisation means the transfer of ownership and management of an enterprise from the public sector to private sector. It also means the withdrawal of the state from an industry or sector, partially or fully. It as an economic policy has been gathering momentum throughout the world since 1980. This trend is gathering ground even in socialist and communist countries to make the economy market oriented.

Privatisation can suggest several things, including migrating something from the public sector into the private sector. It is also seldom used as a metonym for deregulation when a massively regulated private firm or industry becomes less organised. Government services and operations may also be (denationalised) privatised; in this circumstance, private entities are tasked with the application of government plans or execution of government assistance that had earlier been the vision of state-run companies. Some instances involve law enforcement, revenue collection, and prison management.

Privatisation of the public sector companies by selling off part of the equity of PSEs to the public is known as disinvestment.

OBJECTIVES OF PRIVATISATION

- Providing strong momentum to the inflow of FDI.
- Privatisation aims at providing a strong base to the inflow of FDI.
- Increased inflow of FDI improves the financial strength of the economy.

Improving the efficiency of public sector undertaking (PSU's).

- The efficiency of PSU's was improved by giving them the autonomy to make decisions.
- Some companies were given a special category of Navratna and Mini-Ratna.

WAYS OF PRIVATISATION

Government companies are transformed into private companies in 2 ways,

Transfer of Ownership

- Government companies can be converted into private companies in two ways :
- By withdrawal of the government from ownership and management of public sector companies.
- By outright sale of public sector companies.

Disinvestment

- Privatisation of the public sector undertakings by selling off part of the equity of PSUs to the private sector is known as disinvestment.
- The purpose of the sale is mainly to improve financial discipline and facilitate modernization.

However, there are six methods of Privatisation:

- The public sale of shares
- Public auction
- Public tender
- Direct negotiations
- Transfer of control of State or municipally controlled enterprises
- Lease with a right to purchase

ADVANTAGES AND DISADVANTAGES OF PRIVATISATION

1. Improved efficiency

The main argument for privatisation is that private companies have a profit incentive to cut costs and be more efficient. If you work for a government run industry managers do not usually share in any profits. However, a private firm is interested in making a profit, and so it is more likely to cut costs and be efficient. Since privatisation, companies such as BT, and British Airways have shown degrees of improved efficiency and higher profitability.

2. Lack of political interference

It is argued governments make poor economic managers. They are motivated by political pressures rather than sound economic and business sense. For example, a state enterprise may employ surplus workers which is inefficient. The government may be reluctant to get rid of the workers because of the negative publicity involved in job losses. Therefore, state-owned enterprises often employ too many workers increasing inefficiency.

3. Short term view

A government many think only in terms of the next election. Therefore, they may be unwilling to invest in infrastructure improvements which will benefit the firm in the long term because they are more concerned about projects that give a benefit before the election. It is easier to cut public sector investment than frontline services like healthcare.

4. Shareholders

It is argued that a private firm has pressure from shareholders to perform efficiently. If the firm is inefficient then the firm could be subject to a takeover. A state-owned firm doesn’t have this pressure and so it is easier for them to be inefficient.

5. Increased competition

Often privatisation of state-owned monopolies occurs alongside deregulation – i.e. policies to allow more firms to enter the industry and increase the competitiveness of the market. It is this increase in competition that can be the greatest spur to improvements in efficiency. For example, there is now more competition in telecoms and distribution of gas and electricity.

6. Government will raise revenue from the sale

Selling state-owned assets to the private sector raised significant sums for the UK government in the 1980s. However, this is a one-off benefit. It also means we lose out on future dividends from the profits of public companies.

DISADVANTAGES OF PRIVATISATION

1. Natural monopoly

A natural monopoly occurs when the most efficient number of firms in an industry is one. For example, tap water has very significant fixed costs. Therefore there is no scope for having competition amongst several firms. Therefore, in this case, privatisation would just create a private monopoly which might seek to set higher prices which exploit consumers. Therefore it is better to have a public monopoly rather than a private monopoly which can exploit the consumer.

2. Public interest

There are many industries which perform an important public service, e.g., health care, education and public transport. In these industries, the profit motive shouldn't be the primary objective of firms and the industry. For example, in the case of health care, it is feared privatising health care would mean a greater priority is given to profit rather than patient care. Also, in an industry like health care, arguably we don't need a profit motive to improve standards. When doctors treat patients, they are unlikely to try harder if they get a bonus.

3. Government loses out on potential dividends

Many of the privatised companies in the UK are quite profitable. This means the government misses out on their dividends, instead going to wealthy shareholders.

4. Problem of regulating private monopolies

Privatisation creates private monopolies, such as the water companies and rail companies. These need regulating to prevent abuse of monopoly power. Therefore, there is still need for government regulation, similar to under state ownership.

5. Fragmentation of industries

In the UK, rail privatisation led to breaking up the rail network into infrastructure and train operating companies. This led to areas where it was unclear who had responsibility. For example, the Hatfield rail crash was blamed on no one taking responsibility for safety. Different rail companies has increased the complexity of rail tickets.

6. Short-termism of firms

As well as the government being motivated by short term pressures, this is something private firms may do as well. To please shareholders they may seek to increase short term profits and avoid investing in long term projects. For example, the UK is suffering from a lack of investment in new energy sources; the privatised companies are trying to make use of existing plants rather than invest in new ones.

EVALUATION OF PRIVATISATION

- It depends on the industry in question. An industry like telecoms is a typical industry where the incentive of profit can help increase efficiency. However, if you apply it to industries like health care or public transport the profit motive is less important.
- It depends on the quality of regulation. Do regulators make the privatised firms meet certain standards of service and keep prices low?
- Is the market contestable and competitive? Creating a private monopoly may harm consumer interests, but if the market is highly competitive, there is greater scope for efficiency savings.
- Can you create incentives in a nationalised firm? For example, performance related pay could replace the profit incentive.

RATIONALE FOR PUBLIC SECTOR ENTERPRISE IN INDIA

The ten rationales for setting up the public enterprises are:

1. Need for a Planned Economy.
2. Building Industrial Infrastructure.
3. Basic and Heavy Industries.
4. Public Utilities.
5. Defence Production.
6. Development of Backward Regions.
7. Fuller Employment.
8. Surplus for Economic Growth.
9. Preventing Concentration of Economic Power.
10. Socialistic Pattern of Society.

1. Need for a Planned Economy:

For speeding up the process of economic growth, there is need for economic planning through Five-Year Plans. Through public sector enterprises, the Government can ensure planned development of the economy according to plan priorities – a task which cannot be expected to be performed by the private sector.

2. Building Industrial Infrastructure:

Industrial infrastructure is necessary for rapid industrialisation and economic growth of the nation. This infrastructure consists of very basic facilities like transport, communication, power, irrigation, electricity, oil and gas, construction of roads, bridges etc.

Projects of building infrastructure have a long gestation period with lesser return on investment and are not at all attractive to private sector businessmen. Hence the need for public sector to take up the task of building industrial infrastructure.

3. Basic and Heavy Industries:

Basic and heavy industries include – iron and steel, coal, power, cement, fertilizers, petroleum etc. These industries are necessary for industrial development. These require huge capital investment, which is beyond the capacity of private entrepreneurs.

4. Public Utilities:

Public utilities consisting of services like water supply, electricity, gas, public transportation etc. are necessary for people to lead a worth living life. The Government has to assume responsibility for providing such services to the public, at most reasonable prices, in the interest of public welfare.

5. Defence Production:

Defence production consisting of goods and services needed for the defence forces of the country cannot be left to the whims (i.e. desires) of the private sector. Hence, public sector is needed to take care of defence items production in the most responsible way in the interest of national defence.

6. Development of Backward Regions:

Private individuals are least willing to start industries in backward areas e.g. rural areas, hilly areas or otherwise neglected areas; because location of industries in such areas is not profitable at all, in initial stages. In view of the balanced regional development of the economy, Government itself starts setting up industries in such backward areas on its own initiative, cost and convenience.

7. Fuller Employment:

One of the biggest aims of public section enterprises is to generate maximum employment opportunities in society, to help solve the serious and grave unemployment situation of the economy. Private enterprises also provide employment; but these do not emphasize on generating employment opportunities at the cost of their profit-earning techniques.

8. Surplus for Economic Growth:

The surplus generated by public enterprises is available to the Government for investment in programmes of economic growth. In fact, taxation alone cannot provide huge funds for developmental purposes.

9. Preventing Concentration of Economic Power:

Public sector enterprises keep a check on the monopolistic tendencies of the private sector; and prevent concentration of income and wealth in the hands of private individuals. In fact, good public enterprises are the biggest competitor for the private sector.

10. Socialistic Pattern of Society:

Under the Constitution of India, the Government is committed to achieving the goal of a socialistic pattern of society. For this objective, there is a need to assign a significant role to the public sector.

PUBLIC SECTOR

The public sector in India owes its origin to the 1956 Industrial Policy Resolution of the GOI. This resolution provided for direct assumptions of responsibility by the state in relation to certain vital sectors of the economy. Example: State managed departments like Posts and Telegrams, Port Trusts, Salt and Quinine factories.

FORMS OF ORGANISATION

The public sector in India comprises of three of organization.

a. Administration by the Government department.
b. The Joint-Stock Company governed by Company Law and controlled by the Government as the principal major share; and
c. Public Co-operation proper.

PROBLEMS OF PUBLIC SECTOR

a. Pricing policy.
b. Under-Utilization of capacity.
c. Over Capitalisation.
d. Inefficient control over inventory
e. Delays in the completion of the projects and cost escalation.
f. Political interference and bureaucratic way of functioning.

MERITS AND DEMERITS OF PUBLIC SECTOR

a. Strengthened the Industrial structure of the Economy.
b. Modernized the technological Base.
c. Changed the structure of foreign trade.
d. Promotion of social interest.

DEMERITS

a. Public sector units cannot stand on their own legs.

b. Gross inefficiency.

REMEDIAL MEASURES

a. Privatisation.
b. Marketing.
c. Improving efficiency of working in public sectors.
d. Balancing control and autonomy.

DISINVESTMENT POLICIES AND CAUSES OF FAILURE

MEANING OF DISINVESTMEN

Disinvestment means sale or liquidation of assets by the government, usually Central and state public sector enterprises, projects, or other fixed assets. The government undertakes disinvestment to reduce the fiscal burden on the exchequer, or to raise money for meeting specific needs, such as to bridge the revenue shortfall from other regular sources. In some cases, disinvestment may be done to privatise assets. However, not all disinvestment is privatisation. Some of the benefits of disinvestment are that it can be helpful in the long-term growth of the country; it allows the government and even the company to reduce debt. Disinvestment allows a larger share of PSU ownership in the open market, which in turn allows for the development of a strong capital market in India.

OBJECTIVES OF INVESTMENT

a. Disinvestments are primarily motivated by the optimization of resources to deliver maximum returns.
b. Disinvestment in India is aimed at reducing the financial burden on the government due to the inefficient and poorly functioning PSUs (called sick units) and to improve public finance.
c. It introduces competition and market discipline and helps to depoliticize non- essential services.
d. Sometimes, disinvestments can also be called upon for political or legal reasons.

IMPORTANCE OF DISINVESTMENT IN INDIA

Currently, the government of India has around Rs. 2 lakh crores locked up in PSUs. Disinvestment of the government stakes in these companies, thus, it far too significant in the Indian economy. The disinvested money can be used for:

a. Financing India's increasing fiscal deficit.
b. Financing large-scale infrastructure projects across the country.
c. Increasing consumption and demand.
d. Minimizing government debt – Almost 40-45% of the Centre's revenue receipts go towards repaying public debt or interest in the same.
e. Implementing social programs in health and education sectors.

On the other hand, private entities or companies buy these disinvested stakes in PSUs for a cheap price and the skills, discipline, and talent brought in by such private entities helps in improving the overall performance of such Sick Units.

TYPES OF DISINVESTMENT METHODS IN INDIA

The method of disinvestment in India changes from time to time, mostly depending on the party at the centre. But there are primarily 3 different approaches to disinvestments (Government's perspective).

1. Minority Disinvestment.
2. Majority Disinvestment.
3. Complete Disinvestment.

1. Minority Disinvestment

Minority disinvestment in PSUs is such that, at the end of it, if the government of India retains a majority stake (typically more than 51%) in the company, it ensures management control. Historically, minority stakes have been either auctioned off to financial institutions or offloaded to the public by way of an offer for sale. The present government has made a policy statement for FY 2018-19 that all disinvestments would only be minority disinvestments through public offerings. Minority disinvestment via auctioning to institutions go back into the early and mid-90s and is no longer the preferred method in India.

Some examples of minority disinvestment via Offer for Sale include recent issues of Power Grid Corporation of India Ltd., Rural Electrification Corporation Ltd., NTPC Ltd., NHPC Ltd., etc.

2. Majority Disinvestment

Majority disinvestment in PSUs is such that, at the end of it, the government of India retains a minority stake in the company i.e. it sells off a majority stake. It is also called Strategic Disinvestment.

If look into the disinvestment history, majority disinvestments have been typically made to strategic partners of the government of India. These strategic partners could be other Central Public Sector Enterprises (CPSEs) themselves, a few examples being BRPL/MRL to Indian Oil Corporation Ltd. (IOC) and KRL to BPCL. Alternatively, these strategic partners can be private entities, like the sale of Modern Foods to Hindustan Lever Ltd., CMC to Tata Consultancy Services Ltd. (TCS). Also, same as in the case of minority disinvestment, in majority disinvestment case the stake can also be offloaded by way of an Offer for Sale, separately or in conjunction with a sale to a strategic partner.

3. Complete Disinvestment

Complete disinvestment or privatization is a form of majority disinvestment wherein 100% control of the company is passed on to a buyer i.e government of India completely disinvests from that PSU. Example of this includes 18 hotel properties of India Tourism Development Corporation (ITDC).

History of Disinvestment in India

In India, the new economic policy has given rise to significant focus for the privatization of public enterprises in the year 1992. Disinvestment is a method of privatization for public enterprises.

It is a major step towards privatization and liberalization of the Indian economy.

The Indian economy was adversely affected by bankruptcy during the period 1981-91.

The public sector which was supposed to achieve new heights and was taught to be the perfect path for India's economic growth, right from independence was characterized by poor and sick performance.

In the year 1991, there were 236 operating PSUs, of which only 123 were profit making.

The top 20 profit making PSU's counted for 80% of the profits, implying that less than 10% of the PSU's were responsible for 80% of profits. The return on PSUs investment for the year 1990-91 was just around 2%.

Allowing the private sector to pump capital into these ailing PSUs would, of course, go some way in turning around these entities even as it provides the government with funds to bankroll welfare programs.

Hence, the process of disinvestment in India was started in the year 1992.

Major divestment steps were taken in the past by BJP led NDA government in the tenure between1999-2004, made four strategic disinvestments –

Bharat Aluminium Company (BALCO) and Hindustan Zinc, both to Sterlite Industries Ltd.

Indian Petrochemicals Corporation Limited (IPCL) to Reliance Industries Ltd. and

VSNL to the Tata group.

Again, in starting from 2014 to 2018, BJP led NDA government divested total Rs. 1,94,646 crore, which also includes minority and majority stake sale of most profitable Public sector undertaking companies, like ONGC-HPCL deal worth Rs. 36,915 crores.

In the budgetary announcement of the financial year 2017-18, The Finance Minister noted that the government initiated strategic disinvestment in 24 PSUs, including Air India, this fiscal. Since the financial year,1991-92 to 2017-18 government led by political parties sold total public assets of Rs.3,47.439 crore.

<u>THE CURRENT DISINVESTMENT TARGET IN INDIA</u>

The government in its interim budget 2019, set the disinvestment target for FY 2019-20 at Rs. 90,000 crores, higher than the Rs. 80,000 crore budgeted for the ongoing year that it said would be exceeded.

The government had raised Rs 35,532 crore from disinvestment till December of 2018.

Interim finance minister Piyush Goyal said in the budget speech that the government had pursued a public enterprises asset management agenda to make these entities accountable to the people.

As the new government takes a charge for the second term, the Prime Minister Narendra Modi led National Democratic Alliance (NDA), is expected to take up immediate and swift disinvestment of at least a dozen state-owned companies.

Some of the key disinvestments that were announced but couldn't proceed due to market conditions.

- Offer for Sale of General Insurance Corporation of India Ltd. and New India Assurance Company Ltd.

- Divestment in MSTC Ltd. through Initial Public Openings (IPO).
- Strategic disinvestment of 100% government holding in Central Electronics Ltd.
- Strategic disinvestment of Bridge and Roof Ltd.
- Disinvestment in North Eastern Electric Power Corporation Ltd. through IPO.
- Divestment in Bharat Electronics Ltd. through offer for sale.
- Disinvestment in NBCC (India) Ltd. and HUDCO through offer-for-sale.
- Sale of Air India and five of its subsidiaries: The strategic disinvestment process will begin once again in national carrier Air India, which is neck deep in debt, and it is likely to commence during August-September 2019.

CAUSES FOR FAILURE OF DISINVESMENT STRATEGY

The reasons for such low proportion of disinvestment proceeds as against the target set were identified and have been presented below:

(1) The unfavourable market conditions are the main reason responsible for this downward trend of disinvestment.

(2) The proceeds realised through disinvestment were not paid to the enterprise concerned for its expansion and improving efficiency but the government has been using such disinvestment proceeds to bridge the budget deficit.

(3) The offers made by the Government for disinvestment of PSUs are not attractive and stringent bureaucratic procedures causing discouragement to the private sector investors.

(4) Undervaluation of assets leading to 'under-pricing' of public sector enterprises shares resulting in considerable loss to the Government.

(5) The Government does not have a comprehensive policy on disinvestment of its PSU's. The procedures adopted for disinvestment suffered from adhocism. It narrowly focused only on disinvestment of shareholdings.

(6) The Government is not transparent about its approach towards sequencing the restructuring and the methods of privatisation of PSE's.

Thus, the disinvestment process of the Government has not really been successful both in terms of realisation of proceeds from disinvestments and achieving the targets for that purpose.

As disinvestment and privatisation process gains momentum, there is need for a comprehensive strategy for disinvestment. Such a policy should treat each case for disinvestment on its own merits. Moreover, public sector enterprises must be allowed to compete on par with the private sector in the market.

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