G.D. GOENKA MODEL UNITED NATIONS'22

LOK SABHA

BACKGROUND GUIDE

LETTER FROM THE EXECUTIVE BOARD

Greetings Members!

With intense felicity we welcome you all to GD Goenka MUN’s Lok Sabha deliberating upon:

Privatization of public sector undertakings.

Intricate deliberation and contemplative diplomacy are what we aspire from all the upcoming leaders who’ve become a part of this committee along with creating a memorable learning experience that will aid you forever, and the executive board is here to help you with the same , the Committee hopes to have a dynamic deliberation to elucidate upon the national agenda at hand. The groundwork of research has been laid out for you in this Background Guide. This Guide is just a compilation of simple facts and this would act as a good starting point for your research. From here on, you can cover topics more deeply and cover other aspects of the Debate. Delegates are suggested to not limit their research to just the background guide. New facts, figures and arguments would be highly acknowledged by the board.

Mindful researching!

Wishing you Godspeed, glory.

The Executive board

Lok Sabha

AGENDA: PRIVATIZATION OF PUBLIC SECTOR UNDERTAKINGS

INTRODUCTION TO THE AGENDA

Post-independence India had adopted a very conservative economy that was practically shut to the outside world. But as time went by, Indian leaders and economists recognized the need to merge with the global economy. So, in 1991, India went through some very major economic reforms. In 1991 India made some major policy changes in their economic ideologies. There were stagnation and slow growth in the economy. To tackle these problems the, then Finance Minister Dr Manmohan Singh introduced some major economic reforms.

In India, the privatization strategy has been adopted in the form of disinvestment of governments' equity in public sector undertaking and also through the opening up of hitherto reserved areas for the participation of private enterprises. With the growing problem of large-scale fiscal deficits faced by the government in recent years, the issue of privatization has been brought to the forefront. In 1990-91, the huge fiscal imbalance and growing balance of payments crisis have forced the country to approach the IMP for huge repurchase facilities and also to the World Bank for structural adjustment loan. While giving such assistance, both the IMP and the World Bank had linked it with certain 'conditionalities' covering different sectors of the economy for their gradual opening up and liberalization.

Accordingly, the new Industrial Policy, 1991 was formulated to meet some of these conditionalities. This new policy has emphasized the increasing role and importance of the private sector in developing the industrial health of the economy and thereby adopted various measures. Some of these important measures included the abolition of licensing in all industries excepting 18 industries (subsequently reduced to 15 industries), reducing the number of industries reserved for the public sector from 17 to 8, scrapping of the MRTP limit, free entry of foreign investment and technology transfer etc.

In recent years, the most specific step that has been identified and adopted by the Government in the issue of privatization is the divestiture, i.e., through the selling of equity of public sector enterprises to mutual funds, financial institutions and finally to the private sector. India is expected to go ahead with its disinvestment and privatization programme in a more ambitious manner.

Public sector undertakings will go in for a massive dose of disinvestment and more infrastructural projects will be handed over to the private sector. In respect to the infrastructural sector, privatization will be carried over from power to telecommunications to roads, ports, railways and airways. Privatization will be needed because the government has been lacking the required resources to build such infrastructure on the required scale. What is being assumed, however, is that privatization is going to create more efficient infrastructural projects than when operated by the public sector. It is assumed that privatization will lead to cheaper and better-quality output through competition.

EVOLUTION OF PUBLIC SECTOR UNDERTAKINGS

At the time of independence in 1947, the Indian industry was ill-developed and required considerable policy thrust. The Second Five Year Plan (1956-61) and the Industrial Policy Resolution of 1956 provided the framework for public sector undertakings/enterprises in India, which were expected to play a substantial role in preventing the concentration of economic power, reducing regional disparities and ensuring that planned development serves the common good. A list of 17 industrial sectors were reserved for the public sector in Schedule A of the 1956 Resolution and no new units in the private sector in these categories would be permitted. Another list of industries was included in Schedule B where the Government actively encouraged public ownership. The Union Government and various sub-national governments made a considerable investment in setting up and running public sector undertakings/enterprises.

Initially, the public sector was confined to core and strategic industries such as irrigation projects (e.g. the Damodar Valley Corporation), Fertilizers and Chemicals (e.g. Fertilizers and Chemicals, Travancore Limited) Communication Infrastructure (e.g. Indian Telephone Industries), Heavy Industries (e.g. Bhilai Steel Plant, Hindustan Machine Tools, Bharat Heavy Electricals, Oil and Natural Gas Commission etc.). Subsequently, however, the Government nationalized several banks (starting with nationalization of the Imperial Bank of India which was renamed State Bank of India in 1955) and foreign companies (Jessop & Co, Braithwaite & Co, Burn & Co.). Later Public Sector companies started manufacturing consumer goods (e.g. Modern Foods, National Textile Corporation etc.) and providing consultancy, contracting, and transportation services.

The internal (profits) and extra-budgetary resources (borrowed funds) of public sector undertakings are factored into the preparation of the Annual Financial Statement (Budget) of the Government. However, poor productivity, poor project management, over-manning, lack of continuous technological up-gradation, and inadequate attention to R&D and human resource development resulted in a large number of public enterprises showing a very low rate of return on the capital invested and the need for budgetary support for day to day running. Several of them accumulated huge losses and ran up huge debts which had to be written off /settled from time to time by the Government.

Reviewing the role of the public sector, the Industrial Policy Resolution 1991 reduced the number of industrial undertakings exclusively reduced to the public sector to just six areas which included strategic industries like atomic energy, defence, coal, mineral oils etc. as well as railway transport. Efforts were made to divest non-strategic public sector industries and to increase private participation in the equity of profitable public sector industries. At the same time, a Board for Reconstruction of Public Sector Enterprises has been set up to suggest ways to turn around sick and loss-making public sector enterprises.

WHAT IS A PUBLIC SECTOR UNDERTAKING?

The term public sector undertaking or Enterprise refers to a Government Company. “Government Company” is defined under Section 2 (45) of the Companies Act, 2013 as ‘any company in which not less than fifty-one per cent of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company. The term is not intended to mean a public company. Public Sector undertakings refer to commercial ventures of the Government where user fees are charged for services rendered. The tariff/fees may be market-based or subsidized. They are usually fully owned and managed by the Government such as Railways, Posts, Defence Undertakings, Banks etc.

Investment decisions of Public Sector Undertakings are passed by the respective boards and then appraised and approved by the administrative ministry to which they are accountable (e.g. Shipping Corporation of India is under the Department of Shipping in the Union Ministry of Surface Transport) or the Public Investment Board under the Department of Expenditure, Union Ministry of Finance and if the investment is beyond a certain threshold level or if a new public sector company is being created, then the proposal has to be approved by Cabinet. Central Public Sector Enterprises are classified as “maha-ratnas” “mini-ratnas” and other enterprises depending on their track record based on guidelines approved by the Government from time to time. Subnational governments also own and manage public sector undertakings and, in most cases, they are loss-making and require considerable budgetary support. The audit of public sector undertakings is done by the Comptroller and Auditor General of India while that of public sector enterprises is done first by Chartered Accountants and the supplementary audit is done by the Comptroller and Auditor General of India.

MEANING OF PRIVATIZATION

Privatization occurs when a government-owned business, operation, or property becomes owned by a private, non- government party. Privatization of specific government operations happens in several ways, though generally, the government transfers ownership of specific facilities or business processes to a private, for-profit company. Privatization generally helps governments save money and increase efficiency.

OBSTACLES IN THE GROWTH OF PSUs

(1) Under-utilization of Capacity: A large number of public enterprises function at a capacity far below the rated capacity. Because of the underutilization of the plant capacity, there is wastage of material and manpower resources which leads to the escalation of the cost of production.

(2) Administrative Inefficiency: Public enterprises lack the strong cadre of professional managers. In most of the public enterprises the common practice is to use bureaucrats as chairman, managing directors and managers, no matter how much inefficient or incompetent they may be to
manage these enterprises.

(3) Price Policy: The pricing policy of the public enterprises is not guided solely by the profit motive but social consideration as well. Public enterprises have to keep the prices of their products low even when costs and prices have been rising. Now, it is being gradually realized that profit should be recognized as an index of efficiency.

(4) The takeover of Sick Units: Public sector has taken over the management and control of several units declared sick in the private sector. Most of the loss-making units in the public sector are the sick enterprises taken over by the government from the private sector.

(5) Less Remunerative Enterprises: Most of the public sector enterprises are set up in those areas of production which have a very low rate of return on investment. These enterprises employ large capital and the gestation period is also too large. These enterprises are generally established in relatively backward areas, and this adversely affects their profitability.

(6) Ministerial Interference: The Parliamentary Committees and the Government do not allow the public enterprises to function independently. Purely political considerations have sometimes led to overstaffing, mismanagement and other inefficiencies, political interference also leads to the unbalanced regional development of industries.

ADVANTAGES OF PRIVATIZATION

(1) DISMAL PERFORMANCES OF PSU'S:
One of the strongest arguments in favor of privatization aired by its supporters is the dismal performance of the PSEs and, thus, its inefficiency can be removed if these enterprises are privatized. PSEs in India are over-controlled and overregulated causing inefficiency to grow upwards. Accountability of these enterprises is minimal and no one is held responsible for the ineffective functioning of these enterprises. Political interference also has a telling effect on the performance of the PSEs. Most PSEs operate with the manager having less or no expertise in the affairs of the concern. Decision-making again is a lengthy process. Managerial inefficiency is one of the greatest banes of the PSEs. As a result of all these, PSEs chronically suffer from losses leading to drainage of state resources. Most of the public sector undertakings fail to generate revenues.

(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. The government is maybe 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) ACCOUNTABILITY OF PRIVATE SECTOR RAISES EFFICIENCY:
Privatization will usher in an improvement in efficiency and as improved performance is concerned with 'profit-oriented' decision-making strategy, accountability is strictly ensured in private sector enterprises and some people are held responsible for any failure. Accountability and responsibility will tone up the efficiency and greater output of the private sector.

(4) DEVELOPMENT OF SOCIAL AND ECONOMIC INFRASTRUCTURES BY THE GOVERNMENT:
Government resources for keeping up PSEs may be utilized for social sector development as this sector is starved of financial resources. Modern governments should spend more on this sector as well as economic infrastructures as these are the two essential pillars of growth.

(5) LPG AGAINST ANTI-COMPETITIVE BEHAVIOR:
Hitherto, Indian private industrialists performed in a sheltered market and remained insulated from any kind of external competition. This made the Indian private sector an inefficient one. Goods produced by this sector were far below international standards. Private industrialists kept themselves busy competing among themselves domestically. Privatization will promote private sector culture by introducing competition so that Indian industrialists can compete with their foreign counterparts and, hence, generate greater output and improved efficiency. All these triggers a chain of favorable movements in many direct and indirect directions.

(6) ABSENCE OF GOVERNMENTAL INTERFERENCE:
Indian PSEs are subject to too much governmental and political interference thereby making them operationally inefficient. The private sector is free from such unavoidable interference.

DISADVANTAGES OF PRIVATIZATION

(1) PRIVATE SECTOR IS INEFFICIENT TOO:
There is some good number of PSEs that are not loss-making enterprises; instead, some of them generate revenues. If PSEs are allowed to grow independently, managers of these enterprises are expected to respond according to the changed requirements. Further, no evidence can suggest that the Indian private sector performs satisfactorily. The private sector is inefficient too. During 1950-1990, India's private industrialists functioned under the protective umbrella without putting much effort into increasing factor productivity. These industrialists felt no urgency in modernizing their industries; they used old and obsolete technology which made this sector an inefficient one. There is no statistical evidence that can show a positive relationship between ownership and performance. Performance is not to be related to the ownership of industries. What is needed is the competitive environment in which any sector public sector and the private sector can grow.

(2) FINANCIAL BURDEN:
There are so many private industries that are lying sick. Sometimes, private industrialists deliberately make their organizations ‘sick’—so that they can receive financial help from public sector institutions to tide over the crisis.

(3) INFRASTRUCTURES MAY NOT GROW IN ABUNDANCE:
Economic growth crucially depends on the growth of infrastructures. Infrastructures both economic and social and economic growth are positively linked to each other. Since infrastructure investments are lumpy, private capital shies away from such investments and thrives on state- support infrastructures. Therefore, move towards greater and greater privatization means the country’s slow and haphazard growth of infrastructural facilities.

(4) 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 privatizing health care would mean a greater priority is given to profit rather than patient care.

(5) PROBLEM OF REGULATING PRIVATE MONOPOLIES:
Privatization creates private monopolies, such as water companies and rail companies. This need regulating to prevent abuse of monopoly power. Therefore, there is still a need for government regulation, similar to under state ownership.

(6) PERIPHERAL SOCIAL RESPONSIBILITY:
The private sector is completely guided by the profit motive. This sector will invest in those areas that yield a quick return to the low priority industries. Above all, social responsibility or welfare objective of the business is side-lined by the private industrialists

(7) DANGER OF EMPLOYMENT LOSS:
Employment loss seems to be another argument against privatization as far as present employment scenario is concerned. In the name of more and more profit, private industrialists have adopted ‘hire and fire’ policy of employment as well as labor-saving technologies. Further, private businessmen exploit workers in many forms (like extending working hours or increasing workload, sabotaging the power of the workers to negotiate with the employers, etc.). All these impacts on wages. Income inequality, thus, gets widened.

ANALYSIS OF PRIVATE SECTOR WITH REFERENCE TO THE INDIAN ECONOMY

Government of India chose for a mixed economy in which both public and private sectors were permitted to operate. The private sector had to operate within the provisions of the Industries (Development and Regulation) Act. 1951 and other relevant legislation. In this framework, the Industrial Policy Resolution 1956 stated, Industrial undertakings in the private sector have necessarily to fit into the framework of the social and economic policy of the State and will subject to control and guideline in terms of the Industries (Development and Regulation) Act and other relevant legislation.

The Government of India recognizes that it would be desirable to allow such undertakings to develop with as much freedom as possible, consistent with the targets and objectives of the national plan. Reports indicated that despite speedy progress of the public sector in the period of planning, the private sector is the principal sector in the Indian economy.

Since many decades, numerous modern industries have been established in the private sector. Important consumer goods industries were set up in the pre-Independence period itself. Examples include cotton textile industry, sugar industry, paper industry and the edible oil industry. These industries were set up in response to the opportunities offered by the market forces. They were highly suitable for the private sector since they ensured good returns and required less capital for establishment. Though the engineering industries were not established in the pre- Independence period, yet Tata had initiated in the field of iron and steel industry at Jamshedpur. After Independence, several consumer goods industries were set up in the private sector. Presently, India is practically self-reliant in its requirements for consumer goods. According to the 1956 resolution, "industries producing intermediate goods and machines can be set up in the private sector." As a result, chemical industries like paints, varnishes, plastics etc. and industries manufacturing machine tools, machinery and plants, ferrous and non-ferrous metals, rubber, paper, etc. have been set up in the private sector.

In India, there is a need for privatization of companies to enhance economic status. Though the PSUs have contributed a lot to develop the industrial base of the country, they continue to suffer from several inadequacies such as; Many PSUs have been incurring and reporting losses continually. Consequently, a large number of PSUs have already been referred suto as loss giving units. The multiplicity of authorities to whom the PSUs are accountable. Delay in implementation of projects leading to cost escalation and other consequences. There is Ineffective and extensive inefficiency on management. Many PSUs are over-staffed resulting in lower labor productivity, bad industrial relations. There are many examples of privatization of companies in India such as:

- Lagan Jute Machinery Company Limited (LJMC)
- Videsh Sanchar Nigam Limited (VSNL)
- Hindustan Zinc Limited (HZL)
- Hotel Corporation Limited of India (HCL)
- Bharat Aluminum Company Limited (BALCO)

Privatization in infrastructure sector started with the modification of relevant legislation to permit private enterprises to enter power generation in October 1991. Reforms have been much successful in the telecommunications sector. Value-added services were opened to the private sector in 1992, followed by the enunciation of the National Telecom Policy in 1994-95 which opened up basic telecom services to competition. Foreign equity participation up to 49% was permitted in case of a joint venture between an Indian and a foreign firm.

The Telecom Regulatory Authority of India (TRAI) was established in 1997. To separate the service- providing the function of publicly owned telecom enterprises and policy-making function, both of which were initiated with the Department of Telecommunications, a separate Department of Telecom Services was set up in 1999- 2000. The two public sector service providers were corporatized in 2000-01. International long-distance business, which was a public sector monopoly, was opened to unrestricted entry in 2002-03. In the roads sector, there are also infrastructure reforms. A major reform was the creation of a major new source of funding for national, state and rural road construction, called the Central Road Fund (CRF) under the Central Road Fund Act of2000. The National Highway Development Project funded by the CRF is one of the largest single highway projects in the world. It includes the nearly 6,000 km of Golden Quadrilateral (GQ) connecting the four metropolitan cities of Chennai, Delhi, Kolkata and Mumbai and 7,300 km of North-South and East-West Corridor.

MAJOR IMPACT OF PRIVATISATION ON INDIAN ECONOMY

(1) It frees the resources for a more productive utilization. Private concerns tend to be profit-oriented and transparent in their functioning as private owners are always oriented towards making profits and get rid of sacred cows and hitches in conventional bureaucratic management

(2) Since the system becomes more transparent all fundamental corruption is minimized and owners have a free reign and incentive for profit maximization so they tend to get rid of all freeloaders and vices that are inherent in government functions.

(3) Gets rid of employment inconsistencies like freeloaders or over-employed departments reducing the strain on resources.

(4) Lessen the government's financial and administrative load.

(5) Effectively minimizes corruption and optimizes output and functions.

(6) Private firms are less tolerant towards capitulation and appendages in government departments and hence tend to right-size the human resource potential befitting the organizations' needs and may cause resistance and disgruntled employees who are accustomed to the benefits as government functionaries.

(7) Permit the private sector to contribute to economic development.

(8) Development of the general budget resources and diversifying sources of income.

In short, privatization is the process of transfer of ownership, can be of both permanent or long-term lease in nature, of a once upon a time state-owned or public owned property to individuals or groups that intend to utilize it for private benefits and run the entity to generate revenues. Privatization is an overriding process to enhance productivity and competitiveness, as well as attracting foreign direct investment.

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CURRENT STATE OF PRIVATISATION REFORMS IN INDIA

Introduction

In order to understand the privatisation reforms in current times, it is necessary to be familiar with the following terms:

Delegation: The government administers an enterprise's ownership and accountability.
However, while the state actively engages in this process, private firms can supply the products or services. Delegation can take place through a contract, franchise, lease, or grant.

Divestment: Divestment occurs when the government sells a majority ownership in a company to one or more private companies. As a result, the government manages partial ownership and a minority investor.

Displacement: Deregulation is the first step toward displacement. This procedure permits private players to enter the market, and then private corporations gradually supplant public enterprises.

Disinvestment: In this case, the government sells a partial or entire public enterprise directly to private parties.

NEW DISINVESTMENT POLICY

The new public sector policy for 2021 was unveiled as part of the Union Budget 2021-2022 changes. The new policy was significant for India since it now outlines the industries that have been designated and spells out the strategy that India wants to pursue for disinvestment.

The Policy has the following goals:
(1) To reduce the involvement of the Central Government in Public Sector Enterprises while creating new opportunities for the private sector.
(2) In order to kick-start economic growth among PSUs and financial institutions, private financing, technology, and management methods will be infused.
(3) That the earnings of the disinvestment would be used to fund numerous social sector development projects.
It categorises sectors as 'strategic' or 'non-strategic.' Strategic industries have been selected based on factors such as national security, energy security, infrastructure, mineral availability, and so on.

The following industries have been designated as "strategic":
Atomic energy, space, and defence.
• Transport and tele-communication.
• Power, petroleum, coal, and other minerals.
• Banking, insurance, and financial services.

NATIONAL MONETIZATION PIPELINE (NMP)

Over a four-year period, the National Monetisation Pipeline (NMP) envisions an aggregate monetisation potential of 6 lakh crore by leasing of fundamental assets of the Central government in sectors like as highways, trains, power, oil and gas pipelines, telecom, civil aviation, and so on (FY 2022-25).
NMP Required - Failure of Public Sector Enterprises:

Cost Overruns: In certain circumstances, project completion time is surpassed, resulting in increased project costs to the point where the project becomes unviable at the time of launch.

Overcapitalisation: The bulk of government infrastructure projects do not have an optimal input-output ratio, resulting in overcapitalisation. Other Causes of PSE Failure: Other factors for the failure of public infrastructure assets include a reluctance to adopt labour reforms, a lack of Inter-ministerial/departmental collaboration, poor decision-making, weak governance, and excessive government control.

NMP-Challenges

Taxpayers' Money: Since taxpayers have already paid for these public assets, why should they have to pay again to a private company to use them? Cycle of Creating and Monetising Assets: The NMP is quite likely to put in motion a vicious cycle of producing new assets and then monetising them when they become liabilities for the government at a later time. Asset-Specific Difficulties: Low capacity utilisation in gas and petroleum pipeline networks, regulated prices in power sector assets, investor interest in national roads with fewer than four lanes, and various stakeholders with stakes in the business.
Monopolisation: A major critique of the NMP is that the transfer would result in monopolies, causing prices to rise. Monopolization of roads and railway lines is unavoidable.
Out of Sync with Current Pressures: Existential threats, global warming, pandemics, geopolitical upheaval, and fanaticism are all threatening the globe. India must also address persistent poverty, unmet expectations, societal polarisation, and the deterioration of democratic institutions.