Privatization in India

Renuka Sané

Using the privatization of public enterprises as a tool for improving economic efficiency began to gain traction in the 1980s in countries such as the United Kingdom and France. The next 20 years saw the large-scale exit of governments from most industries in Western Europe, Latin America, and the former USSR. In several cases, observers have raised concerns about how government equity was sold and who were the ultimate beneficiaries. While experts recognize that privatization's full benefits are only realized with well-designed reforms that create regulatory capacity,[1] the evidence suggests that, by and large, privatization has also been associated with better financial reporting and greater risk taking.[2]

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[1] Saul Estrin and Adeline Pelletier, "Privatization in Developing Countries: What Are the Lessons of Recent Experience?," *World Bank Research Observer* 33, no. 1 (February 2018): 65–102.

[2] Narjess Boubakri, Jean-Claude Cosset, and Walid Saffar, "The Constraints on Full Privatization: International Evidence," *Journal of Corporate Finance* 42 (February 2017): 392–407; Patricia Bachiller, "A Meta-analysis of the Impact of Privatization on Firm Performance," *Management Decision* 55, no. 1 (February 2017): 178–202; and Juliet D'Souza and William L. Megginson, "The Financial and Operating Performance of Privatized Firms during the 1990s," *Journal of Finance* 54, no. 4 (August 1999): 1397–438.

India adopted a gradual approach to privatization—so gradual that the process is actually referred to as "disinvestment" and not privatization. If the 1991 reforms were about embracing the market, one tool that has not been used to its full potential has been the privatization of public enterprises.

This paper argues that the privatization program in India is dominated by the absence of the philosophical foundations for private enterprise.[3] Policy has seen privatization as a way to meet imminent fiscal requirements. It has rarely expressed privatization as a means to improve productivity and efficiency. As a result, there has been no impetus to deal with the political economy issues that inevitably arise as a result of the decision to privatize. On the contrary, successive governments in India have continued to follow a policy of disinvestment or selling minority stakes on the one hand and making fresh investments in public-sector undertakings (PSUs) on the other. The status quo is likely to last until there is a shift in the perception of the role of private enterprise in the economy and society.

Disinvestment, Not Privatization

The story of privatization in India is one of minor equity sales and continued government control of PSUs. For example, between 1991 and 1999, an average of 8.87 percent of

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[3] See Tamanna Inamdar, "Don't Blame Bureaucrats for Stalling Privatisation: Subhash Chandra Garg," *Economic Times*, February 12, 2021.

shareholding was diluted in 39 central PSUs, with no transfer of control to private parties.[4] During the years of the United Progressive Alliance government (2004–2014), there was a conscious effort to move away from privatization—the National Common Minimum Programme stated that only loss-making companies would be sold and that privatization would be considered only on a case-by-case basis.[5] In recent years (2014–2020), the government sold its stake in 50 central PSUs; however, the average reduction in government equity was only 5.84 percent.[6] From 1991 to 2022, there have been only 13 strategic sales: 12 in the 2000–2004 period[7] and the sale of Air India in 2022.[8]

Even these limited instances of strategic sales have led to allegations of corruption, investigations of the process of valuation and sale, and labor unrest.[9] There have been

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[4] Sudipto Banerjee, Renuka Sané, Srishti Sharma, and Karthik Suresh, "History of Disinvestment in India: 1991–2020" (NIPFP Working Paper No. 373, National Institute of Public Finance and Policy, New Delhi, 2022).

[5] Department of Disinvestment, Ministry of Finance, "White Paper on Disinvestment of Central Public Enterprises," 2007.

[6] Sudipto Banerjee, Renuka Sané, and Srishti Sharma, "The Five Paths of Disinvestment in India," *Leap Blog*, July 7, 2020.

[7] Banerjee et al., "History of Disinvestment in India."

[8] Aditi Shah, "Tata Regains Air India Control in Privatisation Victory for Modi," *Reuters*, January 27, 2022.

[9] For details on each transaction and the problems that accompanied the transactions, see Banerjee et al., "History of Disinvestment in India."

instances where the bureaucracy has opposed the disinvestment of entities under its control.[10] One could argue that these hurdles of political economy have been the major reason behind the reluctance of governments to undertake large-scale sales of government enterprises. Although this argument has merit, these problems are neither unique to India nor insurmountable once there is consensus about the respective roles of the private sector and government in economic life.

The 1991 Reforms

In 1990, when the government was first discussing privatization, it resolved to keep the "public nature" of the firm. The Budget Speech of 1991–92, which heralded the liberalization of the Indian economy, continued to emphasize the role of the public sector. Manmohan Singh, while announcing his big-bang reforms, described what the process would be like:

> The thrust of the reform process would be to increase the efficiency and international competitiveness of industrial production, to utilise for this purpose foreign investment and foreign technology to a much greater degree than we have done in the past, to increase the productivity of investment, to

[10] For example, the Department of Pharmaceuticals did not support the decision for the strategic sale and disinvestment of Karnataka Antibiotics and Pharmaceuticals. The Parliamentary Standing Committee on Chemicals and Fertilizers (2019–2020) also strongly recommended that the decision be revisited by the government in the public interest.

> ensure that India's financial sector is rapidly modernised, and to improve the performance of the public sector so that the key sectors of our economy are enabled to attain an adequate technological and competitive edge in a fast changing global economy.[11]

The emphasis here is on improving the performance of the public sector, not dismantling the public sector. The budget speech went on:

> In particular, the public sector has not been able to generate internal surpluses on a large enough scale. At this critical juncture, it has therefore become necessary to take effective measures so as to make the public sector an engine of growth rather than an absorber of national savings without adequate return. . . . The portfolio of public sector investments would be reviewed so as to concentrate the future operations of the public sector in areas that are strategic for the nation, require high technology for the economy, and are essential for the infrastructure. In order to raise resources, encourage wider public participation, and promote greater accountability, up to 20 percent of government equity in selected public sector undertakings would be offered to mutual funds and investment institutions in the public sector, as also to workers in these firms.[12]

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[11] Shri Manmohan Singh, "Budget Speech of 1991–92," July 24, 1991, 9.

[12] Singh, "Budget Speech of 1991–92," 13.

There are three interesting points to note here. First, the diagnosis of the problem in the public sector was that the public sector was not able to "generate internal surpluses"; therefore, the solution was to find ways to make it an engine of growth. Second, the rationale for disinvestment was to raise resources, not to improve efficiency. Third, the limited disinvestment was to be made to other institutions in the public sector.[13]

The Reason for Disinvestment

It has been rare to find unequivocal support for the idea of privatization. For example, the Budget Speech of 1997–98 quotes the Disinvestment Commission, which was the expert body constituted to refer companies for disinvestment to the government:

> As the Commission has observed, "The essence of a long-term disinvestment strategy should be not only to enhance budgetary receipts, but also minimise budgetary support towards unprofitable units while ensuring their long-term viability and sustainable levels of employment in them." Government agrees with this view and I would appeal to Hon'ble Members to take a positive view of disinvestment.[14]

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[13] India did not have a vibrant private sector at the time, and so the choice of other institutions in the public sector may have been a result of the conditions of the time.

[14] Shri P. Chidambaram, "Budget Speech of 1997–98," February 28, 1997, 27.

The need to raise resources has been the overarching objective of all disinvestment announcements in India. The example of the Budget Speech of 1991–92 has been discussed earlier. Similar targets for raising resources have been repeated in every budget speech that has dealt with disinvestment. This is despite the fact that the Disinvestment Commission had argued for the de-linking of disinvestment and annual budgetary exercises.[15] To be fair, raising revenues for the state has been a goal of privatization in other countries as well. However, in those countries other goals, such as promoting economic efficiency, reducing government interference in the economy, and subjecting state-owned enterprises to market discipline also find a mention.[16] These are missing from the Indian discourse on privatization.

The one exception is the Budget Speech of 1999–2000, one of the few instances when the government acknowledged that privatization could lead to improvements in productivity:

> Government's strategy towards public sector enterprises will continue to encompass a judicious mix of strengthening strategic units, privatising non-strategic ones through gradual disinvestment or strategic sale and devising viable rehabilitation strategies for weak units. In 1999–2000, I propose to raise Rs.10,000 crore through the disinvestment programme. This will help the

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15 Disinvestment Commission, *Report V*, 1997.

16 William L. Megginson and Jeffry M. Netter, "From State to Market: A Survey of Empirical Studies on Privatization," *Journal of Economic Literature* 39, no. 2 (2001): 321–89.

> Government to fund the requirements of social and infrastructure sectors. Equally important, it will lead to improvements in productivity and profitability of these enterprises and also to the further development of domestic capital markets.[17]

In more recent years, the NITI Aayog was asked to classify firms into strategic and nonstrategic sectors,[18] such that nonstrategic-sector firms could be sold off.[19] However, it is unclear whether there is consensus within the government about this view of privatization.

The Diagnosis of Poor Public-Sector Performance

Public-sector enterprises[20] in India are a result of policy thinking in the 1950s, when policy makers argued that state control would lead India to build sufficient industrial capacity.[21] By the early 1980s, however, it was clear that the public sector's performance had been

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[17] Shri Yashwant Sinha, "Budget Speech of 1999–2000," February 27, 1999, 40–41.

[18] Strategic sectors included those where government had to play a role for reasons of national security, sovereign functions, market imperfections, or public purpose.

[19] Lok Sabha, "Unstarred Question No. 35: Disinvestment of PSUs," 2020, http://164.100.24.220/loksabhaquestions/annex/174/AU35.pdf.

[20] I use public-sector undertakings (PSUs) and public-sector enterprises (PSEs) interchangeably in this paper.

[21] Industrial Policy Resolution of 1956, Government of India.

poor.[22] One economic diagnosis of the failure would be that the very nature of the public sector is inimical to efficiency, and a drastic change in ownership or control will depoliticize the firms and change their incentives.[23] Such a diagnosis could then lay the foundations for a policy of privatization.

The diagnosis of the failure in India, however, was that the public sector did not have enough autonomy to undertake fresh investments and use cutting-edge technology; that there was nothing wrong with the public-sector character per se, and therefore if the frictions in the working of the PSUs were ironed out, India would see high growth.[24] This was spelled out in the Budget Speech of 1991–92: "Autonomy in management and corresponding accountability would be provided through a system of memorandums of understanding between the Government and public sector enterprises."[25]

This view was echoed by the Disinvestment Commission in 1997, which suggested that firms should be divided into three categories on the basis of performance—strong, moderate, and weak—and be given varying levels of autonomy. In fiscal year 1998, the common minimum program (CMP) of the government called for granting more autonomy to PSUs in order to support them to become global giants and introduced the "Ratna"

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22 See Singh, "Budget Speech of 1991–92."

23 Andrei Shleifer and Robert W. Vishny, "Politicians and Firms," *Quarterly Journal of Economics* 109, no. 4 (November 1994): 995–1025.

24 Department of Public Enterprises, "Monograph on the Performance Status of Central Public Sector Enterprises," 1991.

25 Singh, "Budget Speech of 1991–92," 13.

system, whereby the companies chosen by the government would be given increased autonomy with respect to incurring capital expenditures, obtaining technology without the prior approval of the administrative machinery, and raising debt from domestic and international capital markets. The Budget Speech of 1997–98 said,

> The CMP promised that “the United Front government will identify public sector companies that have comparative advantages and will support them in their drive to become global giants.” To begin with, nine well-performing public sector enterprises, the Navaratnas, have been identified. These are IOC, ONGC, HPCL, BPCL, IPCL, VSNL, BHEL, SAIL and NTPC. The Industry Minister will shortly unveil a package of measures that will help them achieve this objective. He will also make a full statement on managerial and commercial autonomy to all PSUs.
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> In the meanwhile, government has decided to delegate more monetary powers to the Boards of profit-making enterprises. For these PSUs, the existing limits for capital expenditure that can be incurred without the prior approval of the government is being doubled straight-away, and where the gross block is over Rs.500 crore, the limit will be Rs.100 crore.[26]

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[26] Chidambaram, “Budget Speech of 1997–98,” 25–26. The nine well-performing public-sector enterprises are as follows: Indian Oil Corporation (IOC), Oil and Natural Gas Corporation (ONGC), Hindustan Petroleum Corporation Limited (HPCL), Bharat Petroleum Corporation Limited (BPCL), Indian Petrochemicals Corporation Limited (IPCL), Videsh Sanchar Nigam Limited (VSNL), Bharat Heavy Electricals Limited (BHEL), Steel Authority of

The government also started a policy of encouraging oil-sector PSUs to buy stakes in each other to encourage vertical integration and improve performance. This policy of giving managerial and commercial autonomy to PSUs was further reiterated by the National Common Minimum Programme of the first United Progressive Alliance government.

There were high expectations that the new National Democratic Alliance government in 2014 would bring a different philosophy toward privatization. In some ways the government has been more effective at disinvestment than the previous United Progressive Alliance regime, especially given the sale of Air India.[27] However, as discussed earlier in this paper, the actual equity sold has been low. In addition, the government expanded the objectives of investment in PSUs. To accurately reflect this expanded mandate, the government renamed the Department of Disinvestment to the Department of Investment and Public Asset Management. The department was given a mandate of strategic disinvestment and privatization, minority stake sales, asset monetization, and

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India Limited (SAIL), and NTPC (NTPC Limited, formerly known as the National Thermal Power Corporation Limited).

[27] T. C. A. Sharad Raghavan, "NDA Govt. Divested Twice as Much as UPA, DIPAM Data Shows," *The Hindu*, November 18, 2018.

capital management.[28] This suggests a philosophical continuity of preference for government control of enterprises.

Conclusion

The privatization program in India has been slow despite the acceptance that PSUs have been economically inefficient. The response to public-sector inefficiency has been that removing frictions in the working of the public sector will improve the performance of PSUs and that there is nothing fundamentally problematic in the design of the public sector. While there has been a gradual shift in the narrative, including a recognition of the need to at least privatize “nonstrategic” industries, successive governments have been unwilling to give up control of the public sector. There isn’t a buy-in on the role of private enterprises. As a result, the will or the incentive to work through the political economy of privatization is missing.

About the Author

Renuka Sané is an associate professor at the National Institute of Public Finance and Policy in New Delhi.

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[28] “About DIPAM,” Department of Investment and Public Asset Management, accessed August 1, 2022, https://dipam.gov.in/#about-us.

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