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# PRIVATIZATION: CONCEPT, RATIONALE AND CRITICAL ASSESSMENT WITH SPECIAL REFERENCE TO INDIA

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**Abstract**

Privatization largely depends on the political ideology of any country. India is a mixed economy, where both public and private sectors are operating. Privatization is a way of altering the relationship between the government and private sector to build up its role in the functioning of nation's economy as a whole. This paper provides details about meaning, objectives, procedure, advantages and disadvantages of privatisation, challenges and suggestions with special reference to India.

## 1. Meaning of Privatisation

It means transfer of ownership, management and control of public sector enterprises to the private sector. A public sector enterprise is one in which direct holding of government is 51 per cent or more. The government ceases to be the owner of the entity or business. It simply means permitting the private sector to set up industries, which were previously reserved for the public sector. Under this policy, Public Sector Units (PSU's) are sold to private sector. The company starts using 'private limited' in its last name instead of 'limited'. In simple words, privatisation is the process of involving the private sector in the ownership of PSU's. After a company becomes private, its stock is no longer traded in the stock market and the general public is barred from holding stake in such a company.

## 2. Objectives of Privatisation

There are two major objectives behind privatisation: a) to attract inflow of Foreign Direct Investment (FDI) to improve financial strength of the economy. b) to improve efficiency of PSU's by giving them autonomy to make decisions; e.g. In India, some companies are given a special status of Navratna and Mini-Ratna.

## 3. Procedure of Privatisation

The government companies are transformed into private companies in two ways:

a) Transfer of Ownership: the government withdraws from ownership and management or by outright sale of public sector companies.

b) Disinvestment: the public sector undertakings are privatized by selling off part of the equity of PSUs to the private sector.

## 4. Advantages and Disadvantages of privatisation:

Privatisation involves selling government-owned assets to the private sector. It is argued that privatisation helps to build healthy competition in the market along with creating employment opportunities. It works for profit maximization by improving quality of goods & services and customer services. In simple words, profit motive keeps private sector run a business more efficiently. However, critics argue private firms tend to ignore social costs and exploit their monopoly power.

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**Arguments for and against privatisation**

| Aspect | Public Sector Undertakings | Private Enterprises |
|---|---|---|
| **Ownership** | owned and managed by government | owned by private sector |
| **Natural Monopolies** | prices are set based on social factors | prices are based on profit motive |
| **Externalities** | social benefit are put above profit motive | external costs (like pollution) and social benefits are often ignored |
| **Efficiency** | nationalised firms may find it hard to sack surplus workers | incentive to introduce new technology and increase labour productivity |
| **Incentives** | sense of belongingness to company makes them motivated | profit motive act as incentive for owners |
| **Knowledge** | politicians may interfere based on political motives | private firms employ managers with expertise |
| **Depends on Industry** | for essential services like water, health | can work well for telecom |

Source: https://www.economicshelp.org/blog/501/economics/advantages-of-privatisation/

**Advantages of privatisation**

1. Private firms are profit oriented; they are more likely to cut costs and be efficient. However, managers working in government do not have share in any profits, thus they are motivated to increase efficiency.
2. There is a general trend that managers in public sector are influenced by political pressures rather than economic principles e.g. a public sector undertaking may employ surplus workers which becomes inefficient. Moreover, government may be reluctant to cut down human resource because of political reasons.
3. The government generally brings or invests in those projects, which gets completed within their election term. For instance it is easier to cut down investment on important infrastructural projects and put them hold for next election.
4. It is argued that a public sector firm tends to perform inefficiently because of lack of pressure from shareholders, whereas private firms often tend to perform efficiently because of pressure from shareholders.
5. Generally, privatisation of public sector monopolies occurs alongside deregulation i.e. policies to allow more firms to enter the industry, which increases competition in the market leading to increased efficiency; e.g. increased competition in telecom industry.
6. The revenue of government significantly increases by selling off public owned assets to the private sector. However, there is loss on future dividends from the profits of public companies.

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**Disadvantages of privatisation**

1. There are areas where public monopoly becomes essential for example: supply of tap-water. For instance in such industry, if many players are allowed, it will only exploit consumers by higher prices. Thus, in such a situation only one industry that is government; which is considered efficient.
2. There are many essential services, e.g., health care, education and public transport, which become important for masses. The primary objective of firms or industry in providing such services is not profit motive rather welfare of the citizens.
3. selling out public units to private companies provide only one time benefit to government, whereas government loses out on potential dividends. There is a general trend that, when these companies are sold, privatised companies becomes quite profitable.
4. Privatisation tends to develop tendency of creating monopolies, which needs government regulation. For instance, water and rail companies cannot be completely left to become monopoly.
5. There is one important consideration of fragmentation. For example, if railways are made privatized, it will create confusion of rail infrastructure and train operating companies. Furthermore, different railways companies may charge different railway tickets.
6. There is tendency for private firms to continue operations with existing plants instead of investing in new ones. Because private entrepreneurs are keener to increase short-term profits and avoid investing in long term projects.

**5. Privatization in India**

India went for privatization with 'New Economic Policy (NEP) or LPG (Liberalization, Privatization and Globalization policy' or 'The new Industrial Policy of 1991'in the historic budget of 1991. Former Prime Minister Manmohan Singh is considered to be the father of New Economic Policy (NEP) of India. It was introduced on July 24,1991. NEP was launched under the leadership of P.V. Narasimha Rao, wherein government opened reserved sector for the private players, reduced the import duties and devalued Indian currency to increase the export. This is also known as the LPG Model of growth.

**Steps taken for Privatisation in India**

Before independence, Indian industry was largely private. There was not a single industry except railways and post office in the public sector. The main idea behind new economic policy was to open Indian economy for the global investment. This is the impact of the NEP that as of now just two sectors of national importance are reserved for the public enterprises and rest are opened for the private players. These sectors are atomic energy and railway operations. Private investment in rail infrastructure has also been permitted since 2014. The following steps are taken for privatisation in India:

1. **Sale of shares of PSUs:** The government of India started selling shares of PSU's to private sector e.g. government sold shares of Maruti Udyog Limited. The share of private sector has increased from 45% to 55%.

2. **Disinvestment in PSU's:** The government 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. The government sold enterprises worth Rs. 30,000 crores to the private sector.

**3. Minimisation of Public Sector:** The policy of contraction of PSU's was followed under new economic reforms, because PSU's could not achieve objective of industrialisation with removal of poverty. Therefore, a number of industries reserved for public sector were reduced from 17 to 2 as mentioned earlier that is (a) Railway operations (b) Atomic energy.

**Challenges for Privatisation in India:**

1. The public opinion about privatization in the country is not much favourable as it is against the interest of marginalized and disadvantaged sections of the society.
2. The move to privatize railways is not much appreciated in general, as railways in public domain provide low-cost travel at cross-subsidized rates. This is evident from the experience with the Metro train rates.
3. The proposed privatization and consequent high-end services is expected to cater to wealthy sections of society; whether, it will be beneficial to the ordinary is not sure.
4. In some cases, there are dubious issues with the process itself. For instance Air India. Private players are not very enthusiastic about buying loss-making entities.
5. The privatization of profit-making PSUs is unreasonable because it only leads to loss of regular continuing income to the government. There are very little long-term structural changes after this process.
6. In case of natural resources such as oil, its ownership in foreign hands is not compatible with our nation's strategic stand.

**6. Suggestions:**

1. Privatization or disinvestment in loss-making assets is a common wisdom now; but PSUs should not be sold just for the sake of privatization at lesser prices than expected. A proper evaluation of the value of the PSU is necessary; for example in Railways and BPCL; as these sectors have the potential for future growth.
2. The process of privatization must be transparent.
3. A third-party evaluation of assets and a minimum number of bidders should be necessary pre-conditions to ahead with each sale.
4. The private firms should be made accountable even after getting assets purchased from government, so that socio-economic benefits of the asset should continue and not to be wiped out for profit motive.
5. The regulatory mechanism also needs to change if the all-around privatization takes shape.
6. There is an issue with how do we utilize the proceeds of disinvestment. Using it for bridging the revenue deficit and neglecting dire needs of modernization of existing strategic sectors and asset creation will be a huge misstep.

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7. This is a critical process as we must balance the socio-economic needs with market requirements of freedom of operation. The new policy must take into account all these issues and come up with a fool-proof policy to regulate the Privatization and after.

## 7. Conclusion

Privatization means any process that reduces the state's dominant role in directly owning and running the economic activities of a nation. Private firms are driven by profit motive. The profit is distributed among the shareholders of the company, who are owners of the company. However, in case of Public Sector enterprises profit goes to the government. The government then uses it for their citizens. The motto of a government company is to provide welfare to its people. On the flip side, in private companies, workers or employees work effectively to gain share in profits. Also, in private companies, management usually focuses on improving customer service with improved decision making at all levels, which is more or less absent in public enterprises. There arises a state of competition among private firms in providing quality services at lower prices as well as maximise profits. Therefore, it is a win-win situation on both hands. However, it depends on the industry in question; e.g. healthcare or transport sector are not driven by profit motive as regard to telecom sector, which is driven by profit motive resulting in increased efficiency. It also depends on quality of regulation such as whether privatised firms meet certain standards of service. Further, it depends upon on market competitiveness.

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