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REFORMS IN STATE PUBLIC ENTERPRISES IN KARNATAKA: A REVIEW

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REFORMS IN STATE PUBLIC ENTERPRISES IN KARNATAKA: A REVIEW

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Abstract

The beginning of the year 2002 has seen some concrete reform measures concerning the state- level public sector enterprises (PSEs) in Karnataka. One of the interesting features of this new initiative is to identify enterprises for privatisation not through the measurement of profit but on the basis of the kind of activity that the unit is engaged in (commercial/non-commercial etc.).This paper reviews the status of the PSEs in the State of Karnataka, the recent restructuring measures initiated by the State Government and the issues emerged thereby.

Introduction

Many of the pro-reform economists base their views on the proposition that the market makes the best allocative decisions. However, one can arrive at a (competitive) market equilibrium, which is Pareto efficient only if several stringent conditions on the functioning of the markets are satisfied, including the existence of all markets with large numbers of buyers and sellers having complete information. "We need a sufficient variety of commodity and financial instruments traded in the market to allow the market mechanism to do the job. Usually it requires many more active markets than are actually in use in real economies. The message of this family of models is that a rich enough array of active markets can result in a successful allocation over time and uncertainty" (Starr, (1997)). "Thus if the market structure is not complete in the sense of Arrow-Debreu, there is scope for government intervention (Srinivasan (1992))." Public intervention is justified in situations where markets may not function efficiently for a variety of reasons. For example, there are certain goods for which there is a situation of natural monopoly. There are others that are by definition public goods and private provision of which may involve a free riders' problem. Because of lack of information

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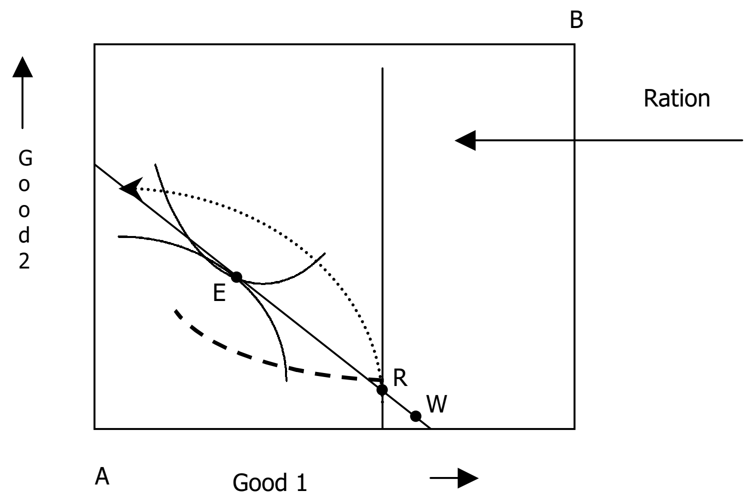
sometimes there is a need for social insurance (Hemming (1991))[1]. In other words, presence of transaction costs can distort the equilibrium outcome. It is well-known that even when conditions of perfect competition are satisfied, the resulting equilibrium arrived at though efficient, may not be socially desirable. While in all these cases there can be an argument for government intervention, one can debate the extent and the form of such interventions. It has been theoretically proved by Benassy (1975), Malinvaud (1977) and Dreze (1975), that intervention in one market can have far-reaching effects on other markets. This can be easily demonstrated through a simple two-good, two-agent Edgeworth box diagram[2].

Figure 1



Thus a ration in the good 1 market can change demand and supply in the good 2 market. Thus, government intervention in one market can have impacts on other markets some of which may be beneficial, while others may even reduce welfare at large. Further, there is always a chance of government failure and hence there is a need to do a careful cost benefit analysis of government failure vs market failure. The proponents of privatization often argue that the cost of government failure outweighs the cost of market failure.

Concentrating on the issue of privatization, there are two broad ways in which it may occur[3].

i) Divestment: transfer of shares of the state-owned asset to private entities by various means.

ii) Delegation: by transfer of management and control of state assets or activities to agents operating in accordance with market incentives. Operational autonomy is entrusted to the private owner with the state still retaining the ownership.

These measures are usually taken up with a view to [Bennett (1997)]

1. Enhance efficiency: If one looks at overall efficiency of production in the private sector, it is generally found to be more efficient. There are several reasons for this. However, in India, sick private units are also common. While a sick public enterprise can continue to exist even with loss, it is not possible for a private unit to do so. They have to wind up much faster.

2. Bring about fiscal stabilization: Many of the developing countries including India have been facing severe fiscal deficit problems. Loss-making public enterprise adds to this problem. Privatization is thought of as a means to reduce a government's financial burden.

3. Follow IMF /World Bank mandates: Many of the developing nations need to depend on the above two organizations for financial resources. As a result countries need to go through their mandates.

While emphasizing on efficiency in this debate one often tends to ignore the equity aspect. As Bos (1993) said, 'Economists believe that efficiency aspects of privatization are more important than the distributional aspects'. Ramanadhan (1995) differentiates between various equity-related goals. Notable amongst them are reduction of poverty, maintenance of income of disadvantaged groups, hill tribes, backward regions, etc. 'However, to reconcile efficiency with equity remains a leading issue in transitional economies', Bennet (1997).

Moving on to the public sector enterprises in India, we observe that at the time of independence investment capacity in the country by the private sector was inadequate. Thus, bringing efficiency through private sector was not feasible. As a result, the industrial development in the country during the post-independence era was initiated through substantial domestic investment by the state. The large public sector in

our country has its origin in such state investments. Fiscal deficit at that time was not envisaged as a major problem. As Bimal Jalan writes[4], "In line with our socialistic traditions, a commitment to the expansion of the public sector was viewed as being synonymous with a commitment to the welfare of the poor. ….As a means of distancing India from the colonial powers, these views had some merit at the time of independence in 1947." However, any planning process has to evolve over time accommodating changes for the changed economic environment. Questions have to be asked continuously whether a policy adopted in the past is still relevant in the present context and this debate has to be based on a careful cost- benefit analysis in the macroeconomic sense rather than on ideological grounds.

Public sector enterprises in India, which may be either centrally owned or owned by the state governments, cover a wide range of products. Apart from heavy machinery and infrastructure- related goods they include consumer goods, medium and light engineering goods, textiles etc. In fact, according to the statistics of 2000-01, one-third of the central public sector manufacturing enterprises are operating in the light consumer goods sector where there is already a strong presence of private entrepreneurs. On the other hand, tourist services (hotels) and contract and construction services account for a quarter of the enterprises in the services sector. Should these enterprises still remain in the public sector and, if so, why? It is important to ask this question since the central government's total internal debt has reached almost Rs.500,000 crore (even in '94-'95) and one third of this loan was due to assets held in the public sector (Jalan(1996)). In fact, the interest burden that arises (from PSEs) in turn (about Rs 16,000-17,000 crores, Jalan (1996)), is enough to destabilize the fiscal situation of the government. Even though there have been continuous promises from the government to disinvest and allow for more private participation, because of pressures, from the labour unions and other related political pressures government is unable to bring forth substantial changes. While arguing on these lines there is however no denying the fact that because of the government's vision and endeavour during the post-colonial period to develop the industrial sector through the Public Sector Enterprises (PSEs), India has been able to have a sizeable industrial base today as compared to many developing nations. However, any policy needs critical review over time. As is well known, over time the post-independence vision became blurred, we went somewhat overboard with our PSEs and the policy on PSEs became unsustainable. This is true for central public sector (Ganesh, 2001) enterprises but more so for the state-level public sector units.

A very similar situation prevails among state-level public sector enterprises, in particular in the state of Karnataka. The erstwhile state of Mysore, which forms a major part of present Karnataka, was quite rich in natural resources and, in order to utilise the same, industrialization in the state had began in early 1800 (Mendon, 1964). Sir M Visvesvaraya (then Dewan of Mysore) who started the slogan "Industrialize or Perish" was a pioneer in establishing a good number of basic and consumer goods industries, as private investment was not forthcoming. It is however sad to note that a number of these once flourishing enterprises are in a sick state at present. Given the current state of the economy marked by IT boom etc. where private firms are flourishing , the state Government is firm in its view that 'It is no business of the Government to do business'[5] . Consequently, the Public Sector Restructuring Commission was formed with the specific object of deciding exactly what has to be done with a set of selected PSEs. A detailed report has been submitted and the High Power Committee is further scrutinizing it and taking decisions about closure or privatisation.

Given this background and our interest in the state public enterprises in Karnataka, this paper begins with an analysis of the state enterprises. New policy initiatives for public sector reform are taken up in the next section. Further, implementation aspects of these policies are discussed in the section that follows. Issues concerning the workers and some observations relating to Mysore Lamps (an enterprise marked for closure) are then taken up. Some of the important issues emerging from this reform drive have been considered in the penultimate section. A concluding section follows thereafter.

State Public Enterprises in Karnataka

Historical Background

Erstwhile Mysore State began its industrial activities well before Independence (of our country) through the directed efforts of the state. Given the availability of natural resources, mining in particular became an important industrial activity. The Kolar Gold Fields turned into a town bustling with industrial activities with about 10,000 labourers engaged in the production of gold that touched the figure of 16,325 ounces in 1886-87[6] . The starting of the flow of electricity from Sivasamudram in 1902 marked the beginning of a new era in the State's industrial development[7] . Further, to enhance infrastructure facilities, the postal

system was also modernized and education received priority. As part of infrastructure development railway lines were constructed and the early 1900s saw further expansion of railways in Mysore. In 1917 Government decided to install a distillation plant to manufacture coal and a blast furnace for smelting iron. It was in August 1905 that the electric lighting scheme for Bangalore City was completed and Bangalore became the first city to be lighted by electricity. During the same year, it was finally decided that the Tata Institute –now known as the Indian Institute of Science –was to be established in Bangalore[8] .

Any account of the industrial history of Karnataka would remain incomplete unless one mentions the contribution of Sri Mokshagundam Visvesvaraya who propagated the motto 'industrialize or perish'. After his retirement from service he became the Dewan of Mysore in 1912. One of the noteworthy initiatives of Sir M Visvesvaraya was to carry out a survey of natural resources, a report of which was published in 1913. In 1922 the Department of Industries and Commerce was reorganized in order to give a greater emphasis to the development of industries in the State. The decade 1931–41 witnessed the highest degree of industrial activity in the State [9] . Apart from gold mining, Mysore Iron and Steel Works , the Aircraft Factory, the Mysore Chemicals and Fertilizers , Mysore Sugar Company and Mysore Paper Mills were *directly owned or aided by the government*. 'In the absence of a coordinated policy Mysore has had to evolve an individual policy of her own, in order to encourage and help private effort and direct government enterprise in fields beyond the capacity of private effort. As a result of this policy there were 29 major industrial concerns (not including the hydro electric works, the textile mills and the gold mining companies) during the 1920s with a total investment of about Rs 500 lakhs and employing 16, 500 persons. The number of large industrial establishments during the year 1944 was 605 employing about 77,518 persons[10] . Since power was made available to all parts of the State, even cottage industries which were developed through proper policy initiatives, were encouraged to develop further into small-scale and minor industries.

Further, with the advent of the Second World War some new production activities were initiated in the State which included manufacture of starch for textile purposes, vegetable dyes, potash salts from molasses, caustic soda, radio sets, cement, etc. Thus, through government initiatives there was substantial growth of large and small industries in the State.

The Current State

Over time public sector enterprises have developed gradually. However, the early zeal and motivation with which Government developed the public sector enterprises lost its direction in the subsequent period. Because of political interventions leading to bad managerial decisions and excessive employment, these organizations no longer remain profitable. Many of these giant organizations degenerated into chronic loss-making enterprises and, given the fiscal situation of the Government, it no longer remained feasible to aid these enterprises. This forced the Government to re-think its policies regarding public sector enterprises.

Subsequently, various committees were formed to look into the reform measures. However, nothing much has been achieved in the decade of the 1990s. As of 31.03.2000 there were 80 state public sector enterprises under the purview of the Karnataka State Bureau of Public Enterprises (Public Enterprises Survey, '99-'00) . On the basis of the commodities and services they deal with, they are classified into 7 groups as follows.

1. Public utilities: 5 enterprises
2. Financial institution: 2 enterprises
3. Development enterprises (non commercial): 5 enterprises
4. Development enterprises (commercial): 12 enterprises
5. Service enterprises: 18 enterprises
6. Manufacturing enterprises: 30 enterprises
7. Marketing and advertising enterprises: 8 enterprises

The table below (Table 1) shows some of the indicators relating to these sectors.

Table 1: Sectorwise Performance of the PSEs

Year 2001-2002		Rs. in Lakhs	
Sectors	Net worth	Capital Employed	Profit*
Public utilities	383126.44	1014627.89	37844.79
Financial institutions	-39358.80	265555.05	-25747.58
Development enterprises (non commercial)	22369.54	46651.58	-119.20
Development enterprises (commercial)	-2085.73	17242.76	-2799.78
Service enterprises	355885.53	1322843.79	7317.12
Manufacturing enterprises	-4748.84	73811.97	-12831.93
Marketing and advertising enterprises	16274.08	36850.12	1404.3

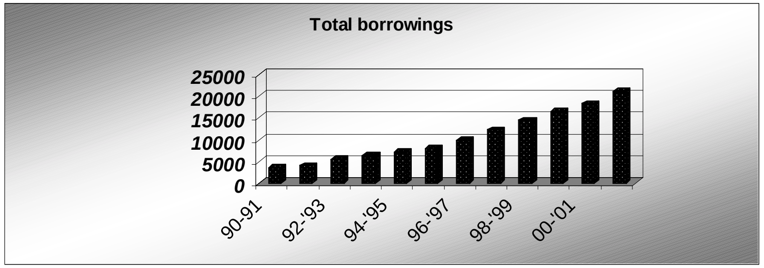
Source : Public Enterprises Survey 2001-02

Notes: * Profit after income tax and prior period adjustments

Thus we observe that both development (commercial) enterprises and manufacturing enterprises are loss-making sectors in the aggregate sense. Therefore, pressure is mounting on the ground that from a revenue point of view also, Government should try to reduce its share from these sectors. Furthermore, the financial institution sector and the development (non commercial) sector are also incurring net losses.

Further the total borrowings show an increasing trend (Figure 2). This is a matter of concern because usually the borrowings of the PSEs are from the State Government and when they are unable to repay the loan Government has no other way but to convert the loan to an 'investment'. Thus, the total loss shown by an enterprise may be much less than what it actually amounts to.

Figure 2 : Total Borrowings of State Public Enterprises in Crores of Rupees

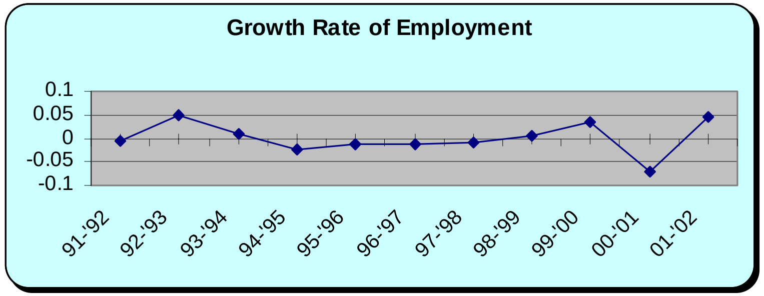


Source: Public Enterprise Survey, 2001-2002.

As for employment, even after the initiation of big-bang reform we observe positive growth rates of employment in PSEs till '94 which however has started falling (negative growth rate). While the growth rate of decline of total employment was falling over the years till '97-'98, we observe further increase in employment from '98-'99 to '99-'00 and again in 2001-02 (Figure 3).

This forces one to re-think about Government's commitment to reform measures with respect to the PSEs.

Figure 3 : Growth Rate of Employment in State PSEs



Source : Public Enterprise Survey, 2001-02

Most interestingly, however, over-employment seems to be the major impediment for the profitability of the PSEs from our *regression analysis*. In a cross section analysis for the year 2000 we began with all the 80 state-level PSEs and after omitting the missing values we are left with 65 enterprises. These enterprises are classified according to manufacturing enterprises, public utilities, developmental enterprises (clubbing both commercial and non-commercial enterprises) and services

enterprises (financial services and marketing services). We have accordingly run a dummy variable regression to explain *net profit* by using age of the enterprise, capital employed (= net fixed asset+ net working capital + capital related to the work in progress), employment size and average annual wage (as a proxy for average skill level). Thus, Net profit = f (age of the enterprise, capital employed, employment size, average annual wage rate)......(1)

The first and the last explanatory variables we felt may be proxies for experience in business and skill level of labour respectively. Dummy variables relate to the type of enterprises (manufacturing, public utilities etc.).Details of the regression results are presented in table 2.

Table 2 : Regression Results Based on (1)

Model	Degrees of freedom	F
Regression	7	5.687
Residual	58	
Total	65	

Independent variables	Beta coefficients	t-values	Significance level
Constant		0.419	0.677
Age	-0.047	-0.404	0.688
Capital employed	0.792	**5.966****	0.000
Average annual wage	-0.024	-0.227	0.821
Total employment	-0.466	**-2.117***	0.039
Public utilities dummy	-0.007	-0.031	0.975
Service related enterprises dummy	0.021	0.173	0.864
Developmental enterprises dummy	0.022	0-.178	0.859

R-square = 0.407, Adjusted R-square = 0.335.
* significant at 5% level, ** significant at 1% level.

The regression result shows that employment is a significant factor (at 5% level) in determining profit and, as is expected, affects profit negatively. Keeping all other variables constant, a unit -level increase in employment reduces profit by 0.466. Capital employed, on the other hand, is significant at 1% level and positively affects the profit. Another interesting feature is that none of the dummy variables is significant (base dummy relates to the manufacturing enterprises). In other words profitability of public utility – related enterprises or development enterprises is in no way less than that of the manufacturing enterprises which are supposed to be engaged in the commercial activities of the Government. This reemphasizes the need for reform in the commercial sector[11].

Discussions with the concerned Government officials reveal that at the beginning of the year 2002, Government showed determined commitment in this direction. The vigour however received a set back during the latter half of the year 2002, because of several internal problems of the state the prominent ones being the sharing of Cauvery Waters issue and the abduction of the former minister, Mr Nagappa, by the forest brigand, Veerappan.

Policy on Public Sector Enterprises Reform

Even at the State level, the recognition of the problems of PSEs and the idea of refrm are not new. In fact, during the 1980s the State Government had taken steps to improve the performance of state-level PSEs. A commitee was formed in August 1988 to evaluate State Government policies relating to PSEs.

To examine these recommendations another cabinet sub committee was formed in 1990. The sub-committee expressed the view that loss-making PSEs that do not serve any useful purpose should be closed or privatised. The cabinet agreed with these recommendations but authorized the Chief Minister to take the final decision. However, when it came to the implementation stage, nothing actually happened. PSEs continued functioning with their inherent inefficiencies and government support.

New Policy Initiatives

As the financial situation of the Government deteriorated, it became clear that it is no longer viable for Government to inject more resources into the loss making PSEs. This situation, however, is not unique to the State of Karnataka. While most other states are yet to start their drive for reform and privatisation, Karnataka is taking some concrete measures in this direction.

The State Government again began the process of formation of another commission, **Public Sector Restructuring Commission,** in March 2000, but this time with a very specific objective, viz., what exactly needs to be done in the case of a few specified PSEs. The terms of reference of the Commission are as follows[12]

1) To evaluate the State PSEs and suggest measures which would promote greater productivity and profitability within the next 5 years.

2) Suggest measures, which could promote autonomy and reduce or preferably remove budgetary support.

3) Evolve a long-term reform programme, which would enable Government to identify PSEs that need alternative forms of management such as complete privatization or disinvestment or merger etc. If any PSE needs Government support to enhance its long-term profitability, strategies should be evolved to identify them.

4) Labour interests should be safeguarded and appropriate voluntary retirement schemes (VRS) should be formulated.

The Commission has given a detailed report concerning each of the units. The details of the Report are not known as it is not a public document. However, following the recommendations of the Commission, some enterprises are selected for closure and disinvestment. While certain enterprises are selected for 100% disinvestments, others are intended for 74% disinvestments, whereby Government would have a share of 26% and hence some say in the management of the unit.

High Power Committee

A high power committee headed by the Chief Secretary was set-up in order to examine the recommendations of the Public Sector Restructuring Commission[13]. The commission would ensure that on receipt of the cabinet decision, the concerned administrative department in close collaboration with the Department of Disinvestment (see the following section) takes timely action to implement the decision. The Committee is also entrusted with the task of periodically reviewing the process of restructuring, privatisation and closure.

The Department of Disinvestment

Earlier, matters relating to the public sector enterprises in the State were mainly looked after by the Karnataka State Bureau of Public Enterprises

(KSBPE). However, in order to monitor and expedite the process of PSE reform, in August 2002, sanction was given for creation of a separate department viz.,"*The Department of Disinvestment and State Public Sector Enterprises Reforms'.*[14] We have a similar department at the Centre and Karnataka State is one of the pioneering states in the creation of such a department for carrying out its reform process. The "Proceedings of the Government of Karnataka" mentions that the process of reform suggested by the Restructuring Commission and handled by the High Power Committee involves a number of stages. The process of closure or disinvestment involves the Administrative, Law and Finance departments amongst others. Therefore the idea of a separate department was conceived and formed, and the earlier KSBPE was merged with this department. The new department is expected to deal with the following subjects

1. All matters relating to disinvestment of State Government equity from PSEs.

2. Decision regarding setting up of a committee / commission to make recommendations about disinvestment.

3. Implementation of disinvestment decisions, including appointment of advisers, pricing of shares and other terms and conditions of disinvestments.

4. Winding up, amalgamation or such other major schemes of structural reorganization of state public sector enterprises.

Policy Prescriptions

Based on its renewed conviction on Public Sector Reforms, the Government of Karnataka has brought out a policy prescription on Public Sector Reforms and Privatisation in Karnataka in consultation with the Public Sector Restructuring Commission in 2001 and the process of reform gained momentum from early 2002. The policies includes (Public Enterprise Survey, 1999-00):

(i) PSEs whose activities are commercial in nature or which produce consumer goods, and where there exists a strong private sector presence, would be restructured through privatisation or closure. No further infusion of funds from state budgetary resources would be made in such PSEs for the purpose of modernization, expansion and taking up of new initiatives. Thus one observes some difference from the earlier policies conceived during the initiation of liberalization i.e., in 1988-90. *Emphasis on loss making has been removed; rather a generalised policy on all commercial enterprises has been taken*. Later we will see that while implementing the reform measures, Government is indeed going ahead with privatization of some of the profit-making PSEs.

(ii) Duplication of activities, if any, between PSEs, Government agencies and cooperatives would be minimized by suitable rationalization.

(iii) No new PSEs will be established with the rare exception of appropriate institutional mechanisms for the expeditious execution of specific major projects that relate to development of infrastructure.

(iv) Rationalization of employment in the PSEs would be ensured through implementation of schemes relating to voluntary retirement and possible redeployment among PSEs. In this process the interest of labour would be adequately protected and a suitable mechanism of social safety net will be developed.

(v) The net proceeds realised from privatisation or closure will be used on infrastructure development, rural development and welfare activities.

Implementation of the Policies

As is clear from the policies of the State Government 'profit making' is not the criterion for selecting units for reform. Enterprises, which deal with commercial goods and that have the presence of the private sector, are selected for privatisation/ disinvestment or closure. Table 3 shows the list of PSEs slated for privatisation or closure during the next five years. The performance of the companies is also listed.

Table 3: Performance of the Enterprises for which privatization / closure is done or planned

PHASE 1

Sl. No.	Name	Year of esta-blish-ment	Net Worth*	Net profit*	Fixed assets*	Capital Emplo yed*	Number of Workers in 2001-02
1	Chamundi Machine Tools Ltd.	1975	-727.54	-35.76	9.18	-160.75	0
2	Karnataka Agro Proteins Ltd.	1975	-331.66	0	0.13	-75.24	0
3	Karnataka Small Industries Marketing Corp.Ltd.	1960	677.1	0	100.92	689.58	0
4	Karnataka Soaps and Detergents Ltd.	1980	2321.95	122.33	633.23	5764.86	1140
5	Karnataka State Construction corp. Ltd.	1968	2345.1	202.59	226.72	3669.52	323
6	Karnataka State Textiles Ltd.	1984	-1030.37	-61.81	259.99	412.71	3
7	Karnataka State Veneers Ltd.	1974	-435.34	-143.1	45.65	-145.69	0
8	Karnataka Telecom Ltd.	1985	-4282.53	-753.15	486.29	-829.63	0
9	KAVIKA	1976	1067.67	56.45	502.08	1784.39	348
10	Mysore Acetate & Chemicals Ltd.	1963	-1216.37	-16.15	128.45	94.96	79
11	Mysore Cosmetics Ltd.	1966	-83.23	0	15.54	22.52	0
12	Mysore Electrical Industries Ltd.	1945	2516.5	-258.87	3969.37	4963.26	575
13	Mysore Lamp Works Ltd.	1936	-7073.44	-2360.46	1256.37	-898.22	131
14	Mysore Match Company Ltd.	1940	-18.27	-4.27	1	-18.27	2
15	Mysore Paper Mills Ltd.	1936	13293.32	-2954.22	17409.42	33618.61	2976
16	NGEF Ltd.	1961	-4845.69	-4942.42	10013.35	10164.14	2939
17	Sree Kanteerava Studios Ltd.	1966	-18.2	0.24	19.67	13.31	32
18	Karnataka Fisheries Development Corporation	1971	-205.33	-127.4	144.51	103	231
19	Karnataka Film Industries Dev. Corporation	1968	-177.29	-26.17	14.66	34.22	42
20	Karnataka Electronics Development Corp. Ltd.	1976	-657.07	161.28	143.5	7228.05	209

PHASE 2

Sl. No.	Name	Year of esta-blish-ment	Net Worth*	Net profit*	Fixed assets*	Capital Emplo yed*	Number of Workers in 2001-02
1	Devraj Urs Truck Terminals Ltd.	1980	64.64	11.33	3.81	89.64	6
2	Hutti Gold Mines Company Ltd.	1947	-1796.18	-1062.2	5305.29	4046.38	4113
3	Karnataka Agro Industries Corp.Ltd.	1967	-4833.78	-1077.25	1528.71	-2464.15	708
4	Karnataka Diary Dev. Corp.Ltd.	Not in existence					
5	Karnataka Implements and Machineries Co. Ltd.	Merged with KSRTC					
6	Karnataka Meat and Poultry Marketing Corporation.	1974	167.36	-3.91	27.97	167.36	46
7	Karnataka Pulpwood Ltd.	1985	-1895.06	222.89	1.29	-94.29	190
8	Karnataka Silk Industries Corp. Ltd.	1980	203.89	-638.93	329.05	1535.4	2003
9	Karnataka State Agro Corn Products Ltd.	1973	1001.04	637.84	328.73	2214.86	416
10	Karnataka State Forest Industries Corporation	1973	0.25	13.84	179.58	41.83	339
11	Karnataka Tungsten Molly Ltd.	1986	-0.08	-0.02	303.69	-0.08	0
12	Mysore Chrome Tanning Co. Ltd.	1940	-1133.83	21.28	2.87	-672.59	52
13	Mysore Minerals Ltd.	1966	-3214.74	-622.28	359.06	396.39	2418
14	Mysore Sugar Company Ltd.	1966	1414.22	-61.66	2480.98	8801.3	1292
15	Mysore Tobacco Company Ltd.	1937	-893.01	-3760	1.98	51.46	1
16	Vijayanagar Steel Ltd.	1982	1267.44	0	12.77	1328.79	11

Source : Public Enterprise Survey, 2001-02

Note: * in lakhs of rupees in 2001-02

As is evident from the above table this first phase of the reform drive is going to effect over 10,000 employees working in PSEs and 30% of these enterprises are currently profit-making. Our discussion with several Government officials dealing in this area reveal that the current idea of the Department is to sell an enterprise while it is functioning satisfactorily (as it is then easier to privatise) rather than waiting for it to become sick over time and then opt for closure. This is indeed a welcome decision. Thus, after identifying an enterprise for privatisation, the strategy is to ask the management to identify and shed the extra manpower as it has been generally observed that it is difficult to sell even a profit-making enterprise which has excess labour. The Government in turn would finance the VRS for the retrenched workers. Excess labour is often seen as a burden by the private entrepreneur as s/he is not sure whether s/he would be able to curtail the workforce later and at what cost. Unless these uncertainties are adequately reduced, private bidders will not come forward.

As of October 2002, the progress report on reform of the 20 units mentioned in Table 3 is shown in Table 4.

Table 4 : Progress Report on PSE Reform

Sl. No.	Name	Administrative Dept.	Status	HPC Decision (G.O. Issued)
1	Chamundi Machine Tools Ltd	C & I	Closed	Closure (GO issued)
2	Mysore Cosmetics	C & I	Closed	Closure(GO issued)
3	Karnataka Telecom Ltd	C & I	Closed	Closure (GO issued)
4	Mysore Match Company	F E E	Closed	Closure (GO issued)
5	Mysore Acetate & Chemicals Company Ltd.	C & I	Closed	Closure (GO to be issued)
6	Mysore Electrical Industries Ltd.	C& I	Operating	Privatisation (GO issued)
7	NGEF Ltd.	C & I	Closed	Closure (GO issued)
8	Karnataka State Textile Ltd.	C & I	Closed	Closure(GO to be issued)
9	Karnataka State Construction corporation Ltd.	P W D	Operating	Closure (GO to be issued)
10	KAVIKA	C & I	Operating	Privatisation (GO to be issued)
11	Mysore Paper Mills Ltd.	C & I	Operating	Privatisation (GO to be issued)
12	Mysore Lamp Works Ltd.	C & I	Closed	Closure (GO issued)
13	Karnataka Agro Proteins Ltd.	Agriculture & Horti-culture	Closed	Closure (letter issued)
14	KEONICS	I T	Operating	Yet to be discussed
15	Karnataka Soaps and Detergents Ltd.	C & I	Operating	Privatisation (GO to be issued)
16	Karnataka Fisheries Development Corporation	A H & F	Operating	Yet to be discussed
17	Karnataka State Veneers Ltd.	F E E	Closed	Yet to be discussed
18	Karnataka Film Industries Development Corp	I T Y	Operating	Yet to be discussed
19	Sri Kanteerava Studios Ltd.	I T Y	Operating	Yet to be discussed
20	Karnataka Small Industries Marketing Corp Ltd.	C & I	Closed	Closure (GO issued)

Source : Department of Disinvestment Record

Note : GO: Government Order, H P C : High Powered Committee

Thus we observe that concrete decisions have been taken for many of the enterprises except for 5 units which are yet to be discussed. Nine units have already got Government orders (GO) and decisions have been taken about the rest (six units) where the GO will be issued soon.

Disinvestment

During the present drive for disinvestments, the exact process of disinvestment is yet to be developed. No disinvestment and privatization has been taken place so far except for Vikrant Tires which was privatized sometime back. The recent effort at privatizing NGEF Ltd. has been a failure. Government is yet to formalize proper methodologies for carrying out the privatization or disinvestment process. The Disinvestment Department is still quite young and, as an official puts it, the Department is still trying to crawl!

With regard to the duplication of activities and having full fledged corporations for similar activities, a rationalization of the same may be economical. From our discussions with various officials, the idea emerged that corporations relating to weaker sections e.g. Karnataka SC/ST Development Corporation Ltd., Karnataka Backward Classes Development Corporation Ltd., Karnataka Minorities Development Corporation Ltd. may be merged into one. This does not necessarily imply that benefits to these sections of society will diminish. However, how far such actions would be feasible depends on the political will.

Workers at the Receiving End

Investment in Public Sector Enterprises by the Government at a crucial juncture has helped formation of an industrial base, which led to future industrial development both in India and also in the State of Karnataka. There is no denying the fact that at a particular point of time this was necessary. However the industrial policy of the Government, which needed critical scrutiny over time and bold political decision-making on autonomy/ privatisation etc., much earlier has never taken place till the time when Government is compelled to do the same due to severe resource constraints. As the right decision was not taken at the right time many of these enterprises today find no takers. Closure of an enterprise means loss of jobs for the workers who have got used to some standard of living over time and taken decisions for the future on the basis of the expectation that they have a permanent job. In a highly labour surplus economy, a sudden loss of job due to a closure is traumatic for the workers especially for those who are at the lower end. Many of the highly skilled workers

(high level officers etc.) with better prospects of securing an alternative employment in the private sector (given their experience), sometime even welcome a VRS provision (as it also ensures that all their dues will have to be paid by the Government within 90 days without any hassles). Once these people leave the organisation, the rest of the lower level workers have no alternative but to accept VRS, and leave. Also if a worker is not ready to accept VRS under the Industrial Dispute Act his/her employment may be automatically terminated. Thus, accepting VRS remains to be the only feasible alternative for a worker. Our interview with several workers reveal that they consider this scheme not as Voluntary Retirement Scheme (VRS) but rather as Compulsory Retirement Scheme (CRS).

Safety Net

Recognizing the psychological trauma that an employee may go through at the sudden loss of a job, especially if he is young, Government provides counseling services through experts. It may be mentioned in this context that Karnataka is a state with one of the highest incidences of suicides in the country. VRS provides workers with financial resources at one time and the management this resource becomes important. Further training to enhance and sharpen ones skill is also required. So far (as of Feb 2003) there have been four such meetings held. We were present at some of these training programmes, where it is observed that the participation rate is rather low. Later, our interviews with the people going through such training programmes revealed mixed feelings. First, the program is so general that it does not give any specific solution, which is the need of the hour for people in distress and frustration. Specialized training involves expenses, which these workers are unable to bear at this juncture. Adding to this problem is the continuous downturn of bank interest rates which makes life miserable. People expected some counseling on how to profitably invest their money, which however was missing in the training.

Mysore Lamps: A Company Marked for Closure

While carrying out this study, we had the opportunity to discuss various issues with the workers and officials of the Mysore Lamp Company. We discuss here some aspects of the discontentment of the employees of the company as disclosed to us in our interviews. Mysore Lamps, a well-known name in South India as a manufacturer of light bulbs was established as early as 1936 as a private enterprise. The company produced mercury vapour lamps using indigenous technology for the first time in the country in 1969 and thereafter initiated its production of florescent tubes in 1970. Sodium vapour lamps for which the company is famous, were first manufactured in 1981. Glass shells for the manufacture of bulbs were earlier ordered from outside. However, as the transaction costs were mounting[15], in-house manufacture of glass shells was started through vertical integration of the production process in 1983. The company was bought by General Electric, USA and managed as a profit-making enterprise. Controversies relating to FERA regulations brought the company under the control of the Government of Karnataka in 1983. As of December, 2002 the holdings of the companies are as follows:

Government	91%
NGEF	3%
Others	6%

From 1983 to 1993 it ran as a profit making company. However, during this period with the introduction of in-house glass shell production, over employment took place which slowly and silently ruined the efficiency of the company. By 1994, with the worsening market conditions, the company showed losses for the first time and since then though the company was brought under BIFR, it has been unable to recover. Thus a good profit-making private company became a perennial loss maker in the hands of the Government. While the Government of Karnataka (GOK) provided financial assistance, it actually did very little to cure the root causes of inefficiency. The Managing Director of the company has been changing every year and has been given very little autonomy to take independent decisions. Our interviews with many of the officials revealed this as the major impediment to recovery. The GOK has decided to close the company and VRS has been offered to its 1569 employees. Till date (January 2004) 1046 employees have applied for VRS and 970 have been relieved. One of the problems that arose with VRS relates to the provision of the scheme itself. Earlier the VRS scheme was based on both number of completed years and number of years left till retirement . Of late, however, this has been changed to depend only on number of completed years in service[16]. In this later provision, a younger worker loses. As mentioned earlier, Mysore Lamps expanded its activity around 1983 and hence a large proportion of its workers are of the younger generation. These workers are protesting against the current VRS, but with the given weak fiscal situation of the State Government, the problem is not resolved.

Another problem relates to the disinvestments process that was attempted before the closure order. Though the Government tried for strategic sale, the advertisement was an anonymous one (the name of the company was not made public) and never went for a global tender.

The timing of this attempt to sell was also not appropriate since the company was in its worstever state. Most officials feel that if one is really interested in reviving this old and renowned company, granting some financial support by the Government and, most importantly, autonomy in management, could help a lot. Once the company recovers, one can go for a global tender. However, so far not only has this not happened, but the Government kept on changing the Managing Director every year, so that no long-term planning could take place. Surprisingly, our interviews reveal that after the company was marked for closure, Government recently appointed five unofficial directors and one (political) chairman. Where is the need for such additional appointments at a time when production in the company has been stopped and workers are forced to take VRS. One wonders …

Emerging Issues and Policy Implications

The PSE reform process and in particular the case of Mysore Lamps raise several issues.

- The most important one is the *time of disinvestment*. The case of Mysore Lamps reveals that when Government tried to sell the company it was in its worst ever state. There was no attempt on the part of Government to make the company attractive to buyers. Closure of a large production unit has far more implications than the loss of jobs of its employees. Such units usually have forward and backward linkages with the small scale sector of the economy. Furthermore, it provides an industrial culture in the economy. If we had depended on foreign investment from the beginning we would not have seen such industrial development in the country today. Therefore, caution must be taken when declaring that a company is 'closed'. On the other hand, if in order to make the company attractive to a buyer it is necessary to put in substantial resources, then careful cost benefit analysis is needed to examine whether or not to go for such expenditure. Several aspects come to the fore in this context.

  i) Probability 'p' of being successful after inserting fresh funds.

  ii) Amount of funds necessary, say, 'F'.

  iii) Gestation period 'T' for the company to come to at least a 'no loss' situation

  iv) Changing market scenario in this gestation period which in turn effects 'p'.

Given such uncertainties, together with the financial weakening of the Government it is not clear whether or not to go for further investment in some of these companies. Scarce resources have competing uses. Resource saved on this count can be used for other sectors like the social sector. Thus opportunity costs need to be taken into account as well. This shows that serious cost benefit analysis is needed even to decide when to disinvest and this would differ from enterprise to enterprise. For example, consider the case of Chamundi Machines. This enterprise is in a sector where technology is changing rapidly and the factory indeed has outdated technology. There is declining demand for its product and the revival of the factory would be rather expensive. This makes *F* pretty high and '*p*' rather small. Since it involves a smaller workforce, potential cost may outweigh benefits. There may be other factories where technology is not the constraint, while autonomy to the management could solve many of the problems. Thus, one needs to take decisions case by case, taking (i) - (iv) into consideration.

To give an idea of the macro scenario, we present the following table (table 5) which shows the total loss incurred by loss making State PSEs. This loss finally is a financial burden on Government. In addition, Government supports these units through various subsidies, loans converted to equities etc. It is not possible to estimate these additional burdens from the secondary data available. The ever increasing loss adds to the fiscal deficit of Government which touched the figure of Rs 4219 crore in 2000-'01.

Table 5 : Total Loss Incurred by Loss-Making PSEs

Year	Loss (Rs Crores)
1990-91	35.17
1991-92	55.28
1992-93	155.18
1993-94	167.14
1994-95	142.18
1995-96	142.66
1996-97	206.4
1997-98	208.56
1998-99	274.5
1999-2000	289.83

Source: Public Enterprises Survey, Various Issues

Table 6 below shows the total loss of the enterprises which are marked for closure.

Table 6 : Total Loss of the Enterprises marked for Closure

Year	Loss (Rs crores)
'94-'95	45.49
'95-'96	60.76
'96-'97	43.84
'97-'98	39.8
'98-'99	64.39
'99-'00	40

Source: Computed from Public Enterprises Survey, Various Issues

Thus total accumulated loss of these factories in last 6 years is above 290 crores (table 6) which is around 7% of our fiscal deficit of '99-'00.

- The second important aspect is the *autonomy.* The Managing Director of an enterprise is usually an IAS officer without any background of industrial management. Our interviews with several employees across different enterprises reveal that this has affected most of the units adversely. If Government plans to run business on a regular basis, it should have a management pool from which it can draw expertise. Alternatively, management personnel for these companies can be recruited from the open market. Secondly, these officers are transferred frequently. Hence it is meaningless to expect a long term vision from them. Thirdly, there is a chairman who is a political appointee and can interfere in the management of the company. Thus the autonomy of the management is highly limited. Though theoretically there appears to be no problem in allowing autonomy, in practice it never happens. Our discussions with several management personnel in the PSEs reveal that autonomy could have solved a number of problems dogging these PSEs. Like a private corporate, in the public sector also the largest share holder (which is the Government) wants to optimize its objective function, while the objectives of the politicians may be quite different.

- Another important issue in the process of reform is the *process of closure.* When a company is marked for closure, one of the major concerns is that of the employees. Undoubtedly provision of VRS in the aggregate sense involves huge amounts of financial resources and it is not sure whether privatization or sale of the fixed assets of these enterprises would cover this cost or not. However, from the individual employee's point of view this amount appears to be meagre and in the face of the declining rates of interest, this fetches less than 40% of the earlier income to the employees. Our interviews with several employees show that they are struggling to come to terms with this unexpected loss of income. The safety net programme therefore should start while a person is working. Concerned department should collect information from private units about the job requirements and tailor their training accordingly. Whether the employees can start business through a cooperative venture should also be explored in the training programme. Otherwise a general training programme as is provided now is of no help. One can also consider the possibility of providing preferential employment to younger employees who lose their job, at least for a period of time, to allow them to adjust to the new situation.

- The *process of disinvestments* is another important aspect in this entire exercise of PSE reform. Given the national level experience with respect to companies like BALCO , it is absolutely necessary that disinvestment processes should be transparent. Even in Karnataka, when Government tried to look for a strategic partner for Mysore Lamp there was an anonymous advertisement. Why this hesitance to publish the name of the company or to go for global tenders? This naturally caused dissatisfaction amongst the workers, who felt that Government had only tried half-heartedly to sell the company without giving any thought to the plight of the workers. Many of these companies like NGEF, Mysore Lamps etc have prime properties in the city of Bangalore. Five political appointments in Mysore Lamps recently have raised the eye brows of many. Given the rent-seeking possibilities, the sales of these properties should be done through established consultants like SBI Capitals or other such well-known agencies, who should be held responsible for any mismanagement of the sale process.

Conclusion

The beginning of the year 2002 has seen a commitment on the part of the Karnataka Government to restructure the (State level) PSEs. With the motto that 'it is not the business of the Government to run business', Government is slowly distancing itself from commercial activities. One of the distinctive policy initiatives in this regard is to restructure and privatise even the profit-making enterprises, provided there is strong private sector presence in the sector concerned, and thus there is no question of market failure. Government has realized that it does not have the best of managerial skills and if it waits till a factory becomes sick, there is no other alternative but to opt for closure whereby the workers suffer the most. By retaining 26% of the share of a company Government will have some say in the functioning of the enterprise. As revealed by Government officials, possibly in the next 5 years almost 50% of the PSEs will be privatised (if possible) or closed. The enterprises that are related to public utilities or developmental (non-commercial) activities are probably going to remain. Given the diverse interests of politicians and the resulting state of the PSEs, such a step is possibly necessary at this juncture. However, at the same time, Government has to regulate working conditions and norms for workers in the private sector, so that the private sector cannot go to the other extreme of exploiting the labour force.

While the privatization drive is a most welcome one, before declaring the closure of some of the oldest large companies which apart from employment generation have forward and backward linkages with other small and large enterprises in the economy, proper measures for their revival may be tried. The most important aspect here is autonomy. The time of disinvestment for many of these enterprises has not been appropriate. Some thought and action in this regard could save a number of old large production houses.

Notes

[1] Public Expenditure Handbook, Edited by Ke-Young Chu and Richard Hemming, IMF, Washington D.C., 1991.

[2] In this diagram we are measuring utility of two persons A and B having to consume 2 goods: 1 and 2. The point E represents the point of tangency between A and B's indifference curves and W the initial endowment. In a competitive set-up a Pareto efficient equilibrium allocation would look like E. Suppose now a ration on good 1 is introduced. The new rationed equilibrium would now be at R. This would not only effect the consumption of good 1 , but also effect that of good 2.

[3] For a detailed discussion see Bennet, Anthony ,1997, How Does Privatization Work?, Routledge, London, NY

[4] Jalan, Bimal (1996), India's Economic Policy, Viking Penguine Books India Ltd.

[5]From interviews with different Government officials.

[6] Mysore Gazetteer, Vol II, part IV, Edited by G Hayavadana Rao.

[7] Taken from Economic Development of Mysore 1956-69, Govt. of Mysore, 1970.

[8] Mysore Gazetteer, Vol II, Part IV, Edited by G Hayavadana Rao.

[9] Development of Mysore 1956-69, Govt. of Mysore, 1970.

[10] Development of Mysore 1956-69, Govt. of Mysore, 1970.

[11] We have run similar regressions for other years also and arrived at exactly similar results.

[12] For details refer to the Policy on Public Sector Reforms and Privatisation in Karnataka: Karnataka State Bureau of Public Enterprises, 2001.

[13] Policy on Public Sector Reforms and Privatisation in Karnataka, Karnataka State Bureau of Public Enterprises, 2001.

[14] Proceeding of the Government of Karnataka.

[15] This includes breakage, transport cost etc.

[16] One scheme is salary for 35 days of each completed year and 25 days for each year remaining till retirement and the other one is 60 days for each completed year.

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