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## Phases of Disinvestment Policy in India

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### **Abstract:**

*Disinvestment policy in India has evolved over the years. The policy has changed in terms of objectives, choice of disinvestment method and targets- setting. The policy is directly related to political leadership in the country in that time. Also, it is crucial that the success and failure of the policy is not measured in terms of achieving the target for receipts mentioned in the budget.*

### **1. Introduction**

Disinvestment policy in India has evolved over the years. The policy has changed in terms of objectives, choice of disinvestment method and targets- setting. The policy is directly related to political leadership in the country in that time. The best way to understand the policy will be to study it in following phases:

- Phase I – 1991-92 to 1998-99
- Phase II – 1999-00 to 2003-04 (NDA)
- Phase III – 2004-05 to 2008-09 (UPA-I)
- Phase IV – 2009-10 to 2013-14 (UPA-II)
- Phase V – 2014 to current (NDA-II)

It is crucial that the success and failure of the policy is not measured in terms of achieving the target for receipts mentioned in the budget. A comparison between the third and first phase will illuminate why achievement of budget targets shouldn't serve as a parameter. The third phase of disinvestment had no fixed target except in its first year and this phase had the lowest record in terms of volume of disinvestment transactions. On other hand, in the year 1991-92 of the first phase, the government generated Rs. 3037.74 crore against a target of Rs. 2,500.00 crore. In first phase, government earned more than the stated target because minority shares were sold by auction method in 'Bundles'. And the average price obtained in bundling was extremely low and prime shares were highly undervalued. This practice fetched a bigger sum than expected or targeted but it was far from being perfect. It would be incorrect to conclude that the first phase was more successful than the third phase.

In fact, the practice of targets for receipts is inherently flawed because it pressurizes the department to sell shares to private players at throwaway prices. This happens, for instance, when shares are divested through Offer for Sale and the markets are weak. The government in its desire to achieve targets can pressurize the department to sell off shares at lower prices. Some might argue now that Strategic Sales is a better solution to the problem of 'fiscal compulsion' because it is not dependent on the markets. But in the next two chapters, I argue that the concessions given by the government and benefits received by the strategic partners were larger in the case of Strategic Sales. Selling off the national assets to reduce the fiscal burden has never been a good idea and selling them off at lower prices is even worse.

#### *1.1. Phases of Disinvestment Policy in India*

Before discussing Strategic Sales in detail, let's discuss the evolution of the government's disinvestment policy:

#### *1.2. Phase I – 1991-92 to 1998-99*

The disinvestment process was initiated in the year 1991 when the government's economic policy took a 180 degree turn. And even though the nature of disinvestment within this phase has changed over time, the tenures of three governments (Chandrasekhar Government, Narsimha Government and United Front Government) are clubbed together because in this period, disinvestment was mainly through Sale of Minority Shareholding in CPSEs. Mostly, the auction method was adopted for the sale of minority shareholding, though GDR issues have been resorted to as well in the last two years of that phase. There were no Strategic Sales in this period. Also there were no ideological differences on the method or scale of privatization between the parties in power and they agreed on gradual privatization.

In the interim budget 1991-92, the Chandrasekhar government capped the extent of divestment at 20% of equity in selected PSEs in favor of public sector institutional investors. The new coalition government, formed in 1991, reinstated the cap of 20% for disinvestment but the eligibility criteria for investors were relaxed. After that the process of establishing special committees to formulate disinvestment policy began. There were three committees established in this period: the Krishnamurthy Committee (1991), Rangarajan Committee (1993) and the five-member Disinvestment Commission under the chairmanship of G.K Ramakrishna (1996). There were significant differences in terms of objectives and recommendations between these committees. Whenever general recommendations or special recommendations for a PSU were made, how these recommendations will help achieve the set goals was not spelt out in all the committees.

The Krishnamurthy Committee and Rangarajan Committee aimed at modernization of PSUs, in order to increase their 'efficiency' while protecting the interests of employees. But, the main aim was to mitigate fiscal deficits of the government. Even if we accept the argument that disinvestment is a means to mobilize resources for the budget and ensure fiscal consolidation is correct, the recommendations suggested never focused on revenue maximization as an objective. Reviews of past failures to realize targets and measures to improve revenue generation have always been missing in the panels' reports. The focus had always been on increasing the limit on the proportion of equity divested and justifying the divestment of stakes in more and more PSUs. If the intention was to augment receipts they could have recommended measures to make the process more efficient instead of encouraging the sale of equity at throwaway prices.

The Rangarajan Committee was the first to suggest 100% divestment of government's stake. It made exceptions for two cases. First, for dominant or strategic firm the committee suggested that public ownership of 25% should be kept. Second, for six industries—coal and lignite, mineral oils, arms, ammunition and defence equipment, atomic energy, radioactive minerals and railway transport—the committee suggested the government hold 51% or more equity.

The new coalition government in 1996 came up with a Common Minimum Programme and decided to withdraw the public sector from 'Non-Core sectors'<sup>1</sup>. The government established a Disinvestment Commission in 1996 to advice on the long-term disinvestment policy. This commission submitted twelve reports and recommended disinvestment up to 49% in core sectors and 74% or more in non-core sectors. The commission classified the enterprises into core and non-core and made the special recommendations, offering only weak justifications. The recommendations suggested a shift from public offerings to strategic / trade sales. Out of 58 PSEs, 37 were recommended for disinvestment through strategic sale or trade sales<sup>2</sup>. The government doesn't necessarily adhere to the recommendations of the commissions and the acceptance is based on the current government's perceptions. The commission lapsed in 1999 and no disinvestments through Strategic/ Trade Sales took place in this period.

### 1.3. Phase II – 1999-00 to 2003-04 (NDA)

The ambit of disinvestment was widened the most during the second phase in our periodization. The NDA government's ideological commitment to privatize at any cost is illustrated in its disinvestment policy. Targets higher than ever before were set, a Department of Disinvestment was constituted on 10<sup>th</sup> December, 1999 and later a full-fledged ministry was set up<sup>3</sup>, an aggressive disinvestment policy was pursued and the government exited several PSUs completely.

Even then, the government failed to achieve the disinvestment targets in this phase. Setting up unreasonable targets does not increase the investor's appetite; and if the supply of PSUs' shares is increased in still-developing market, it will only lower the prices of equity sold and destroy the value of PSUs.

In this phase disinvestment commission was also constituted again and 41 units were examined. For 34 units, the commission had recommended Strategic Sale route. But Strategic Sales also failed to secure the right price for the PSUs and the loss to the exchequer was even larger<sup>4</sup>. In short, the NDA's crusade for privatization inflicted large losses upon the nation.

### 1.4. Phase III – 2004-05 to 2008-09 (UPA-I)

In the 2004 general elections, the Congress-led United Progressive Alliance came to power. The government was formed with the support of the Left Front and this had implications for the disinvestment policy in this phase. The government adopted the National Common Minimum Programme (NCMP) and following are the aspects of the programme that related to the public sector<sup>5</sup>:

- Government was to retain the existing "Navratna" companies.
- The programme stated that profit making PSUs will not be privatized and in line with this disinvestment through strategic sale of profit making CPSEs was called off.
- Public Sector companies and nationalized banks were encouraged to enter the capital market to raise resources and offer new investment avenues to retail investors.

<sup>1</sup> Core Group – Sectors which were capital or technology intensive, the most prevalent market structure may be an oligopoly

<sup>2</sup> In trade sales 100% of shareholding is sold with transfer of management and in strategic sales government might retain some percentage but transfer of management is done even if the strategic partner is not the major shareholder. Commission recommended strategic sale for 29 and trade sales for 9 PSEs.

<sup>3</sup> UPA- I reduced the ministry to a department.

<sup>4</sup> In detail in Chapter- 2 and 3

<sup>5</sup> Department of Disinvestment Publication (2007): "White Paper on Disinvestment of Central Public sector enterprises", Department of Disinvestment, Ministry of Finance, Government of India, Chapter-8 (The New Disinvestment Policy and Programme)

As discussed earlier, there were no targets fixed and the total receipts for the entire period was Rs 8515.94 crore<sup>6</sup>. Disinvestment was majorly done through the Offer for Sale or Sale route, though MUL shares were sold to Indian public sector financial institutions and banks and employees. It was in this phase that the National Investment Fund (NIF) was constituted. All the proceeds from disinvestment of central PSUs were transferred into this fund and 75% of the annual collections of the fund had to be invested in social sectors. The management of it was assigned to public sector mutual funds.

#### *1.5. Phase IV – 2009-10 to 2013-14 (UPA-II)*

In the 2009 general elections, the Congress-led United Progressive Alliance again came to power but the coalition was freed of Left pressures. The Congress went back to the path of privatization. High disinvestment targets were set and as expected they were never met. The disinvestment process restarted with full vigor but the government didn't resort to the Strategic Sale route. In most years, the sale of minority shares was done through offer for sale.

#### *1.6. Phase V – 2014 to current (NDA-II)*

The NDA government came back to power after ten years and brought back the phase of aggressive disinvestments. In the interim - budget 2014-15, Finance Minister P Chidambaram had planned to mobilize Rs 51,925 crore<sup>7</sup>. NDA Finance Minister ArunJaitley raised the disinvestment target for that fiscal year to Rs 58,425 crore, in expectation of receiving Rs 43,425 crore from selling stake in PSUs. But again the disinvestment targets were not achieved and total receipts were Rs. 24,328.93 crore<sup>8</sup>. From the day the NDA won the elections the stock markets were soaring but the PSUs' performance at stock markets has been lackluster. The expected increase of supply of PSU stocks and the constrained investor appetite had started affecting the prices. The trade-off between the political objective to privatize and revenue maximization was witnessed the most in this period. So the government decided to resort to Strategic Sales. The government has set a huge target of Rs 69,500 crore for receipts from privatization for fiscal year 2015-16. From this sum, Rs 28,500 crore is projected to come from Strategic Sale in both profit and loss-making companies.

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<sup>6</sup> Appendix 1 – Summary of Receipts from Disinvestment: 1991-92 to till date; Source – Department of Disinvestment Website.

<sup>7</sup> Pegged the proceeds at Rs 36,925 crore from selling stake in PSUs and another Rs 15,000 crore from sale of residual stake in the erstwhile government companies.

<sup>8</sup> Rs.3.60 cr from Employee OFS of NFL, Rs. 48.16 cr from Employee OFS of NTPC, Rs.1719.54 cr from SAIL, Rs.22557.63 cr from COAL INDIA.