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## Overview of Privatization in South Asia

GOPAL JOSHI\*

### 1. Reasons for privatization

In an environment of increased globalization and liberalization, privatization of public sector enterprises has become an important agenda for the governments in South Asia. Although the process of privatization has taken varying paths in the subregion, and the pace has been different depending on the situation, there is an historical effort to alter the role of the state in economy and participation of the populations in the economic activities. The trend is towards reliance on private initiatives to spur economic growth and generate employment for rapidly growing populations. However, the reasons for privatization do not seem to be always clear in these countries. The reason why a state would wish to privatize has a great deal of bearing on the results of privatization, particularly in terms of social consequences.

While scanning through all the rationale advanced in planning documents in the subregion, it seems that there are three general reasons why privatization is being pursued.

- Greater economic democracy through increased private initiatives in economic activities.
- Achieving higher levels of economic growth and employment.
- Reducing budgetary deficits.

Expanding economic democracy through privatization needs to enhance the faith of the people in taking risks and investing in public enterprises being privatized. If the public sector enterprises being privatized happen to be the smaller ones, the goal of economic democracy may be better achieved. But transparency in the privatization process is most essential in pursuing such goal, particularly to avoid crony capitalism. Sale of profitable public sector undertakings would build the enthusiasm of the public in participating in the privatization process. India has divested shares of 39 public sector enterprises, many of which were profitable as well.<sup>1</sup> However, none of the equity issue to the public relinquished the majority ownership of the Government, thus making it more of an exercise to generate resources for bridging the budgetary deficit. Widely dispersed holding of the ownership through public sale of shares in the well-developed share markets could increase the number of people owning the newly privatized enterprises. Greater participation of the public through widened capital markets (as

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\* Senior Specialist on Small Enterprise and Management Development, ILO-SAAT New Delhi.

<sup>1</sup> Institute for Studies in Industrial Development, *Privatization in India: Social Effects and Restructuring*, a paper presented at Sub-regional Meeting on Privatization in South Asia, Kathmandu, 24-26 November 1999.

reported on the post privatization situations in Nepal and Sri Lanka)<sup>1</sup> also would have such effect. However, capital market has had negligible role in the overall economies in these two countries.

Achieving higher levels of economic growth and employment requires similar strategy as above. But the consideration for spreading economic ownership and increasing employment may be secondary to achieving economic efficiency, which can often be achieved through strategic sale or partnership. For instance, Indian Airlines is being sought to be privatized through strategic sale of 26 per cent of the equity to a strategic partner. However as a result of such strategic partnership, a few entrepreneurs or business houses may come to own privatized enterprises. In Nepal, a large majority of the shares of privatized units (51-72%) is being passed on to a small group of entrepreneurs while the public participation has been limited to 25 to 30 per cent.<sup>2</sup> The need for transparency and accountability becomes even greater in such a scenario.

Lastly, privatization is also undertaken under the economic compulsion of having to reduce budgetary deficit resulting from heavy losses of the public sector enterprises and subsidization by the government. The economic compulsion also is manifested by the conditionalities put forward by the Brettonwoods institutions. In such a scenario, loss-making organizations are first disposed off while retaining 'cash cow' enterprises with the government. By examining the pattern of privatization in South Asia (Table 1.1), it is quite evident that the governments are motivated to accelerate privatization largely due to fiscal deficits. Privatization of public sector enterprises accelerated in India and Pakistan initially as a result of the adverse balance

**Table 1.1: Budgetary deficit and privatization**

	<i>Deficit (% of GDP)<sup>a</sup></i>	<i>Privatization receipts</i>	<i>No. of units privatized</i>
Bangladesh	5.4	\$ 2.0 million <sup>c</sup>	1083
India	6.5	Rs. 126.38 billion	39
Nepal	6.4	Rs. 797 million	10
Pakistan	5.4 <sup>b</sup>	Rs. 59.6 billion	106
Sri Lanka	7.7	\$ 715 million	75

<sup>a</sup> for the year 1998. source: Asian Development Bank, *Asian Development Outlook 1999*, Oxford University Press, Hong Kong.

<sup>b</sup> with accumulated debt of Rs. 2,500 billion during 1990-97

<sup>c</sup> 3-4 small manufacturing plants over past three years

Sources: Country papers presented during the Sub-regional meeting on privatization in South Asia, Kathmandu, 24-26 November 1999.

<sup>1</sup> Narayan Manandhar and Pushkar Bajracharya, *Privatization in Nepal: Social Effects and Restructuring*, a paper presented at Sub-regional Meeting on Privatization in South Asia, Kathmandu, 24-26 November 1999 and Rozana Salih, *Privatization in Sri Lanka: Social Effects and Restructuring*, a paper presented at Sub-regional Meeting on Privatization in South Asia, Kathmandu, 24-26 November 1999.

<sup>2</sup> Narayan Manandhar and Pushkar Bajracharya, *Privatization in Nepal: Social Effects and Restructuring* Op. Cit.

of payments in the early nineties and as budgetary deficits have risen. Huge deficits in Nepal and Bangladesh also forced the governments to privatize the public sector enterprises (PSEs). However, proceeds from such privatization has been hardly adequate to bridge the deficit.

## 2. Social effects of privatization

When the public sector undertakings are privatized largely to reduce the fiscal deficit, there is bound to be a tendency to focus on off loading heavily loss making enterprises as quickly as possible without much regard to long term consequences to such privatized units. Studies<sup>1</sup> indicate that 40 to 50 per cent of the privatized units in Bangladesh closed down after privatization. Due to the closure of four units after privatization in Nepal, 3,200 jobs were lost.<sup>2</sup> Similarly, six public sector units closed subsequent to privatization in Sri Lanka.<sup>3</sup> When the employment in organized sector is limited and private initiatives are few in developing countries such as in South Asia, failure of such privatized units to continue to provide employment or even large scale worker redundancy can be catastrophic. Thus, the social effects of privatization have been presumably much greater than what would be the case, had the privatized public enterprises not been loss making. Therefore, the social effects of privatization in South Asia have been manifested by the following:

- Worker redundancy
- Retrenchment of workers
- Stagnation of employment in organized sector
- Growing casualization of labour

Often, loss-making public enterprises are presumed to be overstaffed regardless of the share of the wage bill. Therefore, both the government and the interested buyer of the public enterprise tend to focus on estimating worker redundancy and attempting to resolve such redundancy through worker retrenchment. From the standpoint of the buyer, quicker the redundancy is resolved, quicker would be the prospects of profitability. Plant upgradation and product innovation are expensive, time-consuming and uncertain for many buyers, who may not be very familiar with the subsector, which was previously protected. As a result of privatization, redundancies, whether in the form of retrenchment or voluntary retirement, have been evident in all South Asian countries (Table 1.2).

Since the employment in organized sector is stagnated or declining in the South Asian countries, growing trends of casualization and informalization of labour are evident. It has been estimated that 20,000 jobs have been contractualized in *Navratnas* (nine top performing enterprises) in India.<sup>4</sup> Even the retrenched workers are being recruited back in Nepal on

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<sup>1</sup> World Bank, *Bangladesh – Implementing Structural Reform*, 1993, Dhaka and Binayak Sen, *Whither Privatization: results of an Exploratory Survey of the Disinvested Industries in Bangladesh*, mimeo, 1997, BIDS, Dhaka.

<sup>2</sup> Manandhar and Bajracharya, *Privatisation in Nepal: Social Effects and Restructuring* Op. Cit.

<sup>3</sup> Rozana Salih, *Privatisation in Sri Lanka: Social Effects and Restructuring* Op. Cit.

<sup>4</sup> Rozana Salih, *Ibid*.

contractual basis, thus denying them the normal benefits available in regular employment. On the other hand, governments are seeking to promote self-employment, mostly in the informal sector to combat the situation of growing unemployment.

**Table 1.2: Redundancy resulting from privatization in South Asia**

	<i>PSE employment</i>	<i>Redundancy</i>	<i>Retrenchment costs</i>
Bangladesh	240 thousand	25%	TK 7 billion
India	9.8 million	23% <sup>a</sup>	Rs. 48,092 billion
Nepal	46.7 thousand	60%	Rs. 9,914 million <sup>b</sup>
Pakistan	34.6 thousand	63% <sup>a</sup>	Rs. 3,559 million
Sri Lanka	120 thousand	53% <sup>b</sup>	Up to 53 month salary

<sup>a</sup> voluntary retirement

<sup>b</sup> ILO estimate in 1992 for a scenario of 50% redundancy

Sources: Country papers presented during the Sub-regional meeting on privatization in South Asia, Kathmandu, 24-26 November 1999.

### 3. Compensation and safety net

In dealing with the redundant workers, several options are available. Not all are equally attractive in solving the problem of unemployment. Some of these have been tried in South Asia. These options are given below:

- Voluntary Retirement Scheme
- Cash Compensation or golden handshake
- Retraining of the workers
- Redeployment
- Creation of unemployment benefit and social security

At huge costs to the public exchequer, retrenched workers are being compensated through golden handshakes and voluntary retirement schemes. Almost a quarter of the bid value for privatization was utilized for payment on golden handshake in Pakistan.<sup>1</sup> While workers are being compensated on the short-term basis, it does not provide any long-term solution in regard to their employability.

Having relatively large amount of money does not necessarily guarantee that the retrenched workers would be economic contributors to the society in the long run. India has launched Voluntary Retirement Scheme for compensating redundant workers and has established National Renewable Fund for their retraining. Although over 129,000 public sector employees received benefits from such funds, National Renewal Fund was largely used for retirement benefits rather than retraining or redeployment.<sup>2</sup> Only 36,889 workers were retrained, and

<sup>1</sup> A.R. Kemal, *Privatization in Pakistan: Social Effects and Restructuring*, a paper presented at Sub-regional Meeting on Privatization in South Asia, Kathmandu, 24-26 November 1999.

<sup>2</sup> Institute for Studies in Industrial Development, *Privatization in India: Social Effects and Restructuring* Op. Cit.

11,623 were redeployed. Similarly, a Special Workers' Fund was created in Bangladesh with Tk 150 million (equivalent to \$3.0 million); however, there is yet no evidence that the fund has been used for retraining and redeployment.<sup>1</sup>

Thus, how workers are to be retrained and redeployed is less clear while workers continue to lose their jobs. On the other hand, the prospects of unemployment benefit and universal social security in populous countries of South Asia seem to be quite remote at the present time. References are made to establish and strengthen employment exchanges, which could make some impact if they prove more effective than other public service providing government agencies.

### 3.1 Restructuring of public enterprises

Rather than create large-scale redundancies and deal with the requirements of retrenched workers stretching the limit of the public resources, it would be more cost effective to restructure the public sector enterprises and attempt to turn them around before privatization. There may be restructuring before privatization, and additional restructuring may take place during and after privatization. Several approaches have been tried for restructuring public enterprises.

- Management Contract
- Performance Contract
- Unbundling of public sector undertaking
- Consolidation of activities

Professional managers from private sector could be contracted to turn around the public sector undertaking without divesting the equity. On the other hand, performance contract has been tried in many cases with the existing management of the public sector. Many times organizational restructuring in the form of either unbundling of the public sector undertaking or consolidation of activities may take place. Worker managed companies or outright buyout is another scenario.

However, the effectiveness of all these activities would ultimately rest on non-interference by the bureaucracy and politicians. Performance contracting and management contracting have not necessarily yielded intended desired results so far in South Asia, as attested by the experience in Nepal. The results of pre-privatization restructuring in Bangladesh were also at best mixed although some improvement in labour productivity in the enterprises placed under performance contract in the early nineties was reported.<sup>2</sup> Political instability has also added the complexity and difficulty in attempting to restructure the public enterprises.

Seemingly, the situation is hopeless. If the public enterprises are sold off in the loss-making state without turning them around, then the social consequences are high. If the attempt is first made to restructure them, then the bureaucratic and political interference derail such efforts. What is the solution available in such a seemingly no-win situation? There are certain

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<sup>1</sup> International Labour Office, *Retraining and Redeployment of Workers Affected by Privatization in Bangladesh*, 1999.

<sup>2</sup> Ibid.

steps that can be taken to restructure with less interference and then privatize the enterprises that have been turned around.

- Creation of a transparent, accountable and representative system of regulating the enterprises.
- Involvement of employers and workers even before the turnaround and privatization begin.
- Development of a system of independent monitoring of the public enterprises by people other than the bureaucrats and politicians during the time bound period of turnaround.
- Privatization of profitable enterprises so that all the concerned parties would have faith in the process.

Effective regulatory reform and social dialogue are needed for implementing above strategy with desirable results. Although both have been weak in South Asian countries, improvements in these mechanisms are not difficult.

#### 4. Regulatory reform

Privatizations have taken place without adequate reforms, which would have set the regulatory framework within which the private enterprises and public sector undertakings would participate. The reforms that have been half-hearted do not help either. Instead, such reforms create additional confusion since even after announcing them, governments continue to interfere. Such confusion has been evident in India in relation to the establishment of the Telecommunication Regulatory Authority of India (TRAI), wherein the reluctance to vest full powers to TRAI has not been helpful in carrying out full regulatory reform. Another sector suffering from such confusion has been air transport. However, the process of regulatory reform in the insurance sector in India seems to be so far well planned. Reforms should be transparent, accountable, complete and representative.

Regulatory reform should set the stage for the public sector to operate independently. When carried out properly, it would allow turning around of the public sector in a professional manner. Regulatory reform usually consists of three levels of actions:

- (a) Formulation of a policy for the subsector
- (b) Setting up of a Regulatory Body with its statutory mandate
- (c) Representation in the Regulatory Body

Each subsector often requires a policy that clarifies what would be the role of the government. The South Asian experience in setting regulatory policies has not been helpful for establishing independent, transparent and accountable regulatory body. If such policy still reserves the right of interference for the government, it would be a non-starter. Once, the policy is formulated, an independent regulatory body needs to be formed. The regulatory body packed with former or present bureaucrats would be inviting again interference in its work. It should have representation of the stakeholders, employers and workers. The procedure and tenure of their appointments would determine the extent to which the body will enjoy independence. The regulatory body should have similar status as a court without possibilities

of its decisions being overturned, except in very rare cases. Some of the issues that could be dealt by the body are the following:

- The terms and conditions of the private sector enterprises to enter and exit the subsector.
- Pricing mechanism, especially in view of the public investments already made.
- Dispute settling mechanism.
- Review of the policies.

Although the labour disputes are settled through separate mechanism of arbitration and mediation, there would be much more clarity of the issues if proper regulatory mechanism is established with clear policies. If a public sector undertaking does turn around as a result of the restructuring, the stake and ownership of the workers would enhance in such a situation.

On the other hand, the private sector and the employers would view favourably such clarity of policies and fair treatment as they participate in the privatization process. They would have less fear from the uncertain policy situation while taking risk of investing in public sector undertakings.

## 5. Social dialogue for privatization

The success of privatization would depend in the extent to which the mechanism for social dialogue effectively operates between workers and employers. The countries in South Asia need to promote and strengthen social dialogue so that the labour-management issues can be settled through negotiations. Many disputes arising from privatization would not have been as inflamed if the dispute settling machinery was in place even before the privatization process starts. In Pakistan, an agreement was reached between the workers' representatives and the Government for workers' protection against the loss of jobs. However, the agreement could not ameliorate the situation with a large percentage of employees opting for voluntary retirement.<sup>1</sup>

In many situations, labour unions have been weakened or abolished as a result of privatization. In Pakistan, the role of labour union has been greatly diminished as privatization of a public utility, WAPDA (Water and Power Development Authority) as well as some other public sector enterprises, has taken place. Some buyers may have preferred such situation for the short term reasons; however, in the long run, existence of a bargaining agent allows the labour disputes to be settled through negotiation.

## 6. Summary

This paper has attempted to emphasize that the rationale for privatization and preparations for the privatization are very important to minimize the social costs and dislocations causing from such initiative. Most South Asian countries have come to realize that privatization for the purpose of reducing fiscal deficit has caused them to off load those enterprises first, which

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<sup>1</sup> A.R. Kemal, *Privatisation in Pakistan: Social Effects and Restructuring*, Op. Cit.

are loss making. Such action has not inspired the private sector confidence and has resulted in large-scale worker retrenchment. On the other hand, the response to worker redundancy has not been very effective either.

Absence of a strategy whereby the enterprises are restructured and then privatized has also caused a great deal of loss in public investments when privatized. The restructuring experience has not been a very satisfactory one in South Asia due to the long-standing habit of interference of the government. Therefore, it is essential to first carry out the regulatory reform that would clarify the roles of government, workers and employers in the process of privatization. A transparent and accountable reform process would not only instill confidence among the private sector and the general public, it would also assure the workers about the fairness of the system. Additionally, effective social dialogue plays an important role in negotiating the disputes arising out of privatization. South Asian countries would need to further promote and strengthen the social dialogue mechanism in their respective countries.