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# The Role of the Private Sector in the Indian Economy*

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In this paper I shall try to do three things. First of all I want to describe some often-overlooked aspects of the institutional setting of the private sector in the Indian economy. Secondly, I shall comment on some conceptual problems and, finally, I shall make a few policy recommendations.

## PUBLIC ATTITUDE AND PUBLIC POLICY

Let us begin by looking at the public attitude toward private business (commercial and industrial). In this connection it is worth pointing out that there seems to be in all societies, and most particularly in essentially agricultural societies, a latent suspicion of the businessman—especially the successful one who has been able to acquire some degree of wealth. This suspicion was present in the early days of *laissez-faire* when even Adam Smith, the early spokesman of free enterprise, pointed out in a famous passage:

> People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.[1]

Attitudes in the United States are no exception to this general observation, as evidenced by the popular appeal of the muckrakers at the turn of the century. This is worth mentioning because some writers have tried to find a connection between Hindu philosophy and this basic suspicion of businessmen, a relationship

*I am indebted to the editor of *Commerce* (Bombay) for permission to draw on an article I wrote recently for that journal.

which is questionable at best. In India's recent history there are, however, a number of specific factors which have accentuated this attitude. The personal experience of the Indian villager with "business" has been largely confined to small merchants, who frequently engage in questionable practices, and moneylenders, who all too often exercise an onerous control over the villager. Moreover, during the period of the British Empire much of "big business" was in the hands of the British or highly Westernized Indians. Thus the anti-British and anti-business feeling of the struggle for independence often became one. Similarly, certain communities, such as the Parsis and the Marwaris, tended to dominate the Indian business scene. This made it possible to give vent to anti-business feelings in communal terms. Finally, during the Second World War and the immediate postwar period there seems to have been a great deal of blackmarketing and profiteering, which has given further ammunition to the critics of the free enterprise system. While the importance of all of these factors can be overemphasized, it must be recognized that they exist in the background and influence public opinion. It is symptomatic of this problem that an organization which was formed in India a few years ago to present the free enterprise point of view to the Indian public, the Forum of Free Enterprise, has set as one of its major goals the adherence of the Indian businessman to a carefully worked-out code of ethics.

## GOVERNMENT POLICY

The Indian Congress, even though it obtained substantial financial support from prominent business groups, committed itself to economic planning when upon the urging and under the chairmanship of Nehru it organized a National Planning Commission in 1938. In 1954, the Indian Parliament officially accepted a "socialist pattern of society" as the goal of economic planning in India. While it is often misleading to quibble over the wording of such objectives, this phrase is highly significant in that most Indian leaders, in an effort to emphasize a non-dogmatic, highly pragmatic approach, carefully avoid the use of the term *socialism*. Broadly speaking their notion is essentially Fabian. The "socialist pattern of society" is based on the Directive Principles of the Constitution: "the State shall strive to promote the welfare of the people by securing and protecting, as effectively as it may, a social order in which justice, social, economic, and political, shall inform all the institutions of national life."[2] A recent official explanation of the meaning of the "socialist pattern of society" is contained in the Draft Outline of the Third Year Plan which reads in part as follows:

> The basic criterion in determining social policies and the lines of economic advance should be, not private profit or the interests of a few, but the good of the community as a whole. The existing social and economic institutions have, therefore, to be judged in relation to their role in national development. To the extent that they do not fulfill the social purposes in view, they have to be transformed or replaced. In reconstructing social and economic institutions, a large responsibility rests with the State on behalf of the entire community. The State has to plan its own investments and has to influence and regulate economic activity within the private sector so as to insure coordinated development to all the available resources; through the policies it pursues it has to safeguard the interests of the weaker sections of the community and enable them as speedily as possible to come up to the level of the rest. A socialist pattern of society has to be based on increased production realized through the use of modern science and technology and on equitable distribution of income and wealth. The problems of production cannot be viewed in isolation from wider social considerations, for the manner in which productive activity is organized itself determines to an extent the relative distribution of incomes and the benefits reaching different sections of the community. Programs of investment under public ownership or control, whether these relate to economic and social over-heads or to the development of agriculture and industry, are therefore of crucial significance not only for their direct effects, but also in determining the direction of future economic and social advance.[3]

This, of course, is not denying the fact that there is considerable difference of opinion within the Congress as to how to interpret this objective and there have been shifts in policy. Broadly speaking there was a shift in the direction limiting the scope of private enterprise from the first *Industrial Policy Statement* issued in 1948[4] to the second *Industrial Policy Statement* of 1956, while recently the government seems to have interpreted the *Industrial*

*Policy Statement* more liberally with regard to the private sector. This seems to be true notwithstanding the fact that the Third Five Year Plan for the first time speaks of "progress towards socialism."[5]

## THE POSITION OF THE PRIVATE SECTOR

In looking at the Indian economy one must recognize that the private sector plays a more important role than many outside observers seem to think. (This misinterpretation, of course, is largely the result of the emphasis that Indian leaders in their discussions place on the socialist pattern of society.) There are many ways in which one can look at this picture. At the present time (1959 to 1960) about 89.6 per cent of total national product is produced by the private sector, this percentage having fallen from about 92.6 per cent in 1948 to 1949.[6] Even omitting the agricultural sector, the proportion of goods produced in the private sector is about 80 per cent.[7] Another way of looking at this picture, which is more relevant to future trends, is the fact that very roughly half the new investment (in the Third Plan it is scheduled to be a little over 40 per cent) is undertaken by the private sector. Admittedly, this emphasizes the decline in the *relative* position of the private sector which can be expected in the future, even if one acknowledges fully that the private sector has consistently exceeded its goals. But these figures can still be misleading, since the public sector investments are heavily concentrated in certain limited segments of the economy: transport, communications, multipurpose river developments, the steel industry, and military procurement. This means that in large and important parts of the economy the private sector remains dominant.

Let us look at another area of comparison. There are substantial regulations over the economy in general: foreign exchange controls, control over new investments, allocation of raw materials, price regulation in a few basic industries, and so forth. The relative weight of these regulations is impossible to measure. One hears many complaints on the part of business men in India that these controls are administered to the detriment of the private sector. Such a charge is hard to substantiate, for it involves some difficult problems of evaluation. For instance, the public sector, at least in theory, has undertaken only very high priority projects, and, therefore, it receives what at times may seem like favored treatment. On the other hand, many managers of public sector enterprises complain that they must not only comply with all the regulations to which all of industry is subjected, but that in addition they must comply with all the regulations arising out of their public control and ultimate accountability to Parliament.

Regarding taxation I want to make only two observations. First, the common complaint of businessmen is that taxes are too high. This complaint is world-wide. Many assertions are made everywhere about the disincentive effect of high, especially progressive, income taxes. It is true that taxes have a disincentive effect for most people at some level, but we have far too little evidence on just how this effect operates to be dogmatic. My second point about taxation is particularly relevant to the Indian scene. It is important that taxation, regardless of the *level* of taxation, be fairly and expeditiously administered and that there be no undue changes in the *pattern* of taxation. With the great amount of fiscal experimentation in India during recent years and the cumbersome bureaucracy administering the tax law, these conditions are not fulfilled. It is this second set of tax problems which seems to me to have more serious repercussions on the incentives than the *level* of taxes.

One other observation is in order here. Some of the above comments may create the impression that the public and the private sector, public and private investment in particular, are in competition one with the other. While this may occur, it need not be the case. In fact, public investment frequently has created the framework which in turn facilitated additional private investment. This was recognized even by a spokesman for the private sector, M. R. Masani, M.P., when he said recently:

> I am not suggesting that, if there is a mixed economy where state enterprise supplements and complements the efforts of private enterprise to deliver the goods, there would be any question or challenge to the free enterprise of the joint stock system. That is the legitimate position to take in a country such as ours, that we need State enterprise, perhaps in certain fields of endeavor, to supplement private enterprise. If both

> work freely in free competition on equal terms without discrimination, without bias, then no one would be very much bothered.[8]

It is only fair to point out, however, that Masani then goes on to say:

> But it is not the mixed economy that is threatening free enterprise; it is the trend towards jettisoning the mixed economy increasingly in favor of what may be called monopoly State Capitalism of the Soviet-Chinese kind.[9]

## SOME CONCEPTUAL ISSUES

Even description is based implicitly on underlying theory in that at least the taxonomy used is the outgrowth of a theoretical system. This paper is no exception. The foregoing discussion uses, as typically occurs in such discussions, concepts derived from the analysis of industrial societies. These concepts may not be the most useful tools for discussing the Indian economy. I, therefore, want to raise some conceptual, theoretical if you must, issues which often befuddle the private-sector-public-sector controversy. Presumably we want to use that system of social organization which is most "efficient." Unfortunately, there is no commonly agreed-upon definition of efficiency which is amenable to even approximate measurement. In the first instance we need to differentiate between economic efficiency and other forms of efficiency; e.g., one type of organization may maximize output or minimize costs but may produce social, political, or other costs. For our purposes I want to confine myself primarily to economic efficiency. Even here, however, we have, at times, a conflict between private and social efficiency, i.e., differences in economic costs (or benefits) to the individual firm and to the nation as a whole. The smoke problem of the individual firm is the classic illustration of this problem. For the individual firm costs are minimized by just letting the smoke escape, whereas for the community as a whole costs are generally minimized if the firm is required to install equipment which will eliminate the smoke. These problems are, of course, highly relevant to the Indian scene. The imprecision of the efficiency concept makes it impossible to establish a clear-cut criterion in resolving the public-private-sector controversy on purely economic grounds.

In this connection I must comment on at least one other difficulty. Many efforts have been made to compare the "efficiency" of production either between firms in India and the West or different firms within India. Some very serious problems which arise here are often overlooked. The production costs depend, especially in a country like India, in part on the availability of external economies; for example, does the firm have to produce its own electricity and provide its own maintenance services, or can it buy such services from other firms? Man-hour costs of production are obviously greatly affected by such considerations. Money costs in turn are greatly affected, through depreciation charges, by the price levels which prevailed when the plant was constructed. These two obvious illustrations make it clear that simple comparisons of the cost of production in money terms or so many man-hours per final product can be misleading. Similarily, profits are not a good measure of efficiency particularly in a comparison of a private sector enterprise with a public sector enterprise. Profits depend not only on "efficiency" in production but also on "efficiency" of selling: i.e., a price policy. It may well be, for instance, that a public enterprise is "efficient" in some relevant sense on the cost-of-production side, but that as a matter of public policy the goods are sold at, say, cost and thus no profits are shown. Any number of variations are possible and profits are only relevant in regard to efficiency if the *total* adjustment to a market environment is to serve as a criterion. In public enterprises this clearly may not be the case.

An amplification of the above reference should be made in the problem of capital-intensive versus labor-intensive methods of production. It is, of course, not a foregone conclusion, as some writers seem to imply, that a country like India will find labor-intensive processes cheaper than capital-intensive methods. The basic reason is that while labor is abundant and receives low wages, it may not be cheap per unit of output because of the low level of skills which prevails. It is clear, that this is a perfect illustration of how the goal of economic efficiency (say lower money costs through advanced machinery) may conflict with other goals (e.g. create employment opportunities in the villages).[10] Without entering into this controversy in any detail I want to call attention to one special problem in India which, in my view, has tended to give new plants in India a strong capital-intensive bias. It is extremely difficult in India to fire workers once they have served a probationary period—one could almost say workers acquire tenure. This in economic terms has had the curious result that, in a sense, labor has become the fixed cost, while capital is at least more variable (with the shortage of capital it frequently has alternative uses and, therefore, can be sold more readily than labor can be dismissed). This is the reverse of the traditional thinking in economics. Another technical point that needs to be mentioned here is that insofar as firms can get import licenses to buy imported machinery, they obtain such machinery at world market prices, which do not reflect their "true" scarcity value in India, given the existence of very tight foreign exchange controls. This in turn leads to a more widespread use of capital-intensive methods than would be true if firms had to pay a price reflecting the "scarcity value" of the machinery.

## ENTREPRENEURSHIP

The last general topic I want to say something about is entrepreneurship in India. In distinguishing between the public and the private sector it is traditional to make this differentiation on the basis of the legal ownership; a firm whose shares are owned by private individuals is considered private enterprise, while a firm whose shares are owned by a public body is considered government enterprise. I want to suggest below some reasons why this may not be the most useful distinction. It has long been recognized that the whole character of the modern corporation (joint stock company in Indian usage) has changed. Increasingly the modern corporation is run by a professional management and not, except in the case of extreme crisis, by the stockholders.[11] The full implications of this corporate behavior are not yet fully understood. Related to this change is the fact that much economic thinking about these is—at least implicitly—in terms of Marshall's "representative firm," a relatively small, competitive, owner-run firm. It is in this context that it is not surprising to find that much discussion talks about *the* entrepreneur or *the* entrepreneurial function. In the Indian context I find it useful to distinguish between at least three aspects of the traditional entrepreneurial function, or three separate entrepreneurial functions: innovation, risk capital, and management. To the extent that this analysis is correct it has considerable bearing on the alleged shortage of entrepreneurs in underdeveloped countries and changes the focus of the private-sector-public-sector controversy.

First we have the entrepreneurial function in a Schumpeterian sense. Someone must conceive of the feasibility and desirability (in terms of profits or possibly other social criteria) of the enterprise and must organize it. He need not either finance it himself or run the enterprise after it is established, although the initial entrepreneur may, at least initially, do all these things. Nevertheless, a relatively small number of entrepreneurs in this sense can serve as catalysts in many different directions. The great influence which one man, the late Dr. M. Visvesvazaya, had in acting as a catalyst in the development of industrial enterprises, especially in Mysore, is a good illustration. I would also argue that, as regards this aspect of the entrepreneurial function, private initiative seems to have an advantage over public enterprise.

Second, we have the financing function, particularly the providing of equity financing, that is, risk capital. In India, where savings are inadequate to the task of achieving the rate of investment needed, government may have greater access to finance than the private entrepreneur, and, while this is often frowned upon, there is no inherent reason why government cannot provide risk capital as well as other types of financing. On balance it may be that in India government *may* have an easier time in raising capital, particularly when very large amounts are needed. I say this in spite of the boom in new issues markets in the last two years or so. The difficulties of TISCO (Tate Iron and Steel Co.) to raise the necessary funds for its expansion program from private sources are often cited as an illustration. This example, as is so often the case, is complicated by the special circumstances of the illustration. If there had been no price control on steel and if new steel plants had not been reserved to the public sector, would TISCO have been able to raise the necessary funds privately?

Third, there remains the function of actually running the enterprise after it is established; i.e. the management function of entrepreneurship. Here very briefly, I would argue that private or public sector enterprise clearly is not the relevant distinction. In India, typically the most efficient enterprises (measured in some intuitive sense) are beyond much question both privately owned corporations with a professional management and some of the quasi-independent public enterprises also with independent professional management. The less efficient enterprises generally are the family-dominated private or departmentally ("family" as it were) controlled public enterprises. Thus the distinction of private-versus-public enterprise becomes secondary to the more important question of the type of management involved, unless it can be shown (and I do not believe it can in India) that one type of legal ownership has an advantage over the other in the selection of management personnel. One last comment regarding management in India is called for. This is an observation which applies equally to business, public and private, and government and education. The personnel at the very top, be that in the Ministry in New Delhi or the general manager of a firm, generally are extremely high calibre, but the difficulty arises from the fact that the echelon right below the top is usually terribly weak. There are reasons for this that I cannot go into here. I would suggest, however, that this is perhaps the greatest structural weakness in the development of the Indian economy and little is being done to remedy this situation although considerable lipservice is being given to its importance.[12]

## POLICY

A concluding comment on policy is in order. The present Indian government is, of course, deeply committed to a highly pragmatic approach under the slogan of a socialist pattern of society. This emphasis on essentially a mixed economy seems appropriate for Indian conditions where on the one hand the private sector is playing and will continue to have to play an important role, while on the other hand government also has certain economic functions to perform. A pragmatic approach of this sort is always a difficult one to follow because on specific issues it does not give clear guide lines to a course of action.

Nevertheless it is useful for Indian policymakers to follow the rule of having government perform such economic activities which are not performed, or not adequately performed, by the private sector. There is no question about the fact that Indian policy has at times had dogmatic overtones in favor of the public sector. On economic grounds (as distinguished perhaps from political considerations), this should be avoided. Similarly, however, spokesmen for the private sector, to be most effective, must avoid dogmatism in the opposite direction. It is only in this way that the Indian economy can mobilize its latent resources, both in the public and in the private sector, without necessarily following either the American or the Soviet "model" of development, or taking any other imitative approach. If this is done, given the present industrial base in India, substantial progress is possible.

## NOTES

1. Adam Smith, *Wealth of Nations*, Modern Library edition (New York: Random House, 1937), p. 128.
2. As quoted by Government of India, Planning Commission, Third Five Year Plan, 1961, p. 3.
3. Government of India, Planning Commission, *Third Five Year Plan A Draft Outline* (New Delhi: 1960), pp. 1–2.
4. The Constitutional Amendment of 1955 barring a court review to determine a fair price for expropriated property also was viewed by some observers as a hardening of attitudes toward the private sector.
5. Government of India, Planning Commission, *Third Five Year Plan* (1961), p. 9.
6. Government of India, Central Statistical Organization, Cabinet Secretariat, *Estimates of National Income, 1948–49 to 1960–61* (New Delhi: 1961), p. 5.
7. Estimated from source cited in footnote 4.
8. M. R. Masani, *The Future of Free Enterprise in India* (Bombay: Forum of Free Enterprise, 1961), p. 2.
9. *Ibid.*
10. The government limitations in India on the establishment of mechanical looms and tax discrimination against mechanically woven textiles with all the resulting problems of the industry are a good illustration.
11. See James Burnham, *The Managerial Revolution* (New York: John Day, 1944), and the subsequent literature.
12. It is noteworthy that the Indian Government not only recognizes this problem but also points out that the basic managerial deficiencies in India are the same for the private and the public sectors. *Third Five Year Plan* op. cit., pp. 273, 283.