FOREWORD

On July 31, 1990 the Government of India decided to enter into Memorandum of Understanding (MOU) with 100 of the largest Central Government owned public enterprises in India. MOUs will now encompass approximately 90 percent of the total turnover of the Indian public sector. While this policy initiative is, indeed, dramatic in terms of the magnitudes involved, it is also equally significant in another respect.

All over the world Privatisation is the most frequently prescribed medicine for public sector problems. Yet, in India we seem to have defied this trend and opted for MOUs. The purpose of this article is to explore this fascinating dichotomy.

While both terms -- "privatisation" and "MOU" -- have been defined earlier by several authors and are fairly well known to most interested readers, yet let us recapitulate their meaning one more time for ready reference.

Memorandum of Understanding is a document in which the government (represented by the administrative ministry) and the public enterprise lay down their mutual obligations and responsibilities. The idea is to choose appropriate criteria, assign them mutually acceptable priorities and decide target values at the beginning of the year. After deciding on the enterprise objectives the enterprise is supposed to be left free to achieve them. Only at the end of the year the public enterprise is to be judged on the basis of a "composite score" that is derived by comparing achievements against the targets.

Privatisation, on the other hand, is not so well defined. In its broadest sense, privatisation encompasses any act of rolling back the role of government in the economy. However, the most common connotation of the term privatisation is taken to be the sale of public enterprise assets to private sector. This is the definition most people have in mind while discussing privatisation and, hence, we will adopt it as our working definition as well.

Both, privatisation and MOU, are a response to a general perception that public enterprises have not delivered what was expected of them. However, these two policy approaches represent two very different philosophies. Privatisation involves privatisation of "public assets." MOUs, on the other hand, imply privatisation of "public style of management."

Former believes that ownership *per se* is the problem. The latter finds fault with the "quality" of the control mechanism used by governments to manage their public enterprise portfolio. Privatisation generally represents an ideological response to the perceived problems in the public sector, whereas MOU is rooted in a more technocratic and pragmatic approach to the same problems.

Unfortunately, this kind of stark juxtaposition has done more harm to the cause of public enterprise policy formulation than good. It has forced the policy makers to treat these two policies as ***substitutes***. This has slowed the progress of public enterprise reforms in a large number of countries because choice of either extreme position has inevitably invited a deluge of criticism from the other camp.

Instead, if these policies had been treated as ***complementary*** strategies, both camps would have

supported public enterprise reform packages and thereby increased the probability of their eventual success. In the remainder of this article we examine both view points in depth.

MOU and Privatisation as Substitutes

The argument of people who treat these two policies as substitutes can be summarised as follows: whatever privatisation can do, MOU can do at least as well, if not better.

The privatisation protagonist argue that privatisation will make available extra-revenues to the hungry state coffers; increase the efficiency of the firms under private ownership; allow the state to focus on its essential functions; prevent interference in the day-to-day functioning of the enterprise; provide access to important markets and technologies when public enterprises are sold to multinationals.

For each of these arguments, however, the MOU enthusiasts have a counter argument. According to them, selling public enterprises does not mean extra revenues. It only means trading future revenues for present. That is, at the time of privatisation the government will basically get the net present worth of future stream of earnings. Colloquially, it means selling the family silver to pay for the grocery bills. By doing so government may squander the money more freely and pass the burden of paying the bills for their binges to future generations.

The argument that sale of equity shares in public enterprises will yield extra revenues is equally dubious. To start with, no real entrepreneur worth his salt is likely to buy a share in a losing public enterprise unless he or she can influence the management of that enterprise. That influence can only come about by owning a majority of shares. In which case the public enterprise will lose all its raison d'etre as a public enterprise and we might as well sell the entire stock.

All this is of course based on the assumption that losses are due to inefficiency alone and not because of controlled prices and social obligations imposed on the enterprise. In which case sale of shares may have the additional perverse consequence of altering public policy to suit private interest.

By the same token, selling shares in profitable enterprise is also a questionable way to raise resources. The profits of many of the profitable enterprises, such as those of ONGC are not pure profits they are conceptually equivalent to a tax revenues. By tinkering with prices, the Government can change the surplus generated by ONGC. Selling equity in ONGC would mean a license to share tax revenues. By creating a vested interest of this kind the potential for skewed pricing decisions with regard to enterprises like ONGC will be further enhanced.

The final point in this context relates to the issues of pricing the shares of ONGC. As far as I know, this area is almost like "Voodoo Economics." Even in highly advanced nations, the pricing of public enterprise shares was way out of line with the reality. In France and Britain, those with inside information regarding the date of sale of these equity shares made a killing when the shares they had bought quadrupled in prices overnight. I shudder to think the rents that will be collected by the entrenched vested interest if some shares of ONGC are sold in the present chaotic milieu of our country.

In contrast, the Bureau of Public Enterprises claims that an additional amount of Rs. 4,000 crores will be made available even if, a modest improvement of 5 percent is made in the efficiency of public enterprises through the instrumentality of MOU. This gain will be a real gain and will be available

every year and the net present worth of that gain is mind boggling.

Further, it is often found that privatisation is accompanied with so many concessions and special financial arrangements, that the real gain to the treasury is much less than the face-value.

As for the increase in efficiency, the MOU enthusiasts point out that the evidence from the large body of literature on comparative efficiency of public and private enterprises suggests that efficiency is related more to the degree of competition rather than ownership. And privatisation is not necessarily synonymous with competition. More often than not, in most LDCs, it is difficult to promote competition in most of the core and other key industries.

For example, most small LDCs do not have the markets to support two or more viable integrated steel plants or domestic airlines. Even if the markets could support two or more enterprises, say in the airlines business, that would be, at best, a duopoly or an oligopoly, not a competitive environment as privatisation enthusiasts suggest.

Taking the airlines example further, the real benefits of competition accrue when there is some excess capacity. Suppose you have three privately-owned airlines but all of them fly with 100% capacity utilisation, then there is no competition in the true sense. For competition, airlines must vie with each other for passengers by offering better service and rates. This means they must fly often with substantially empty planes or the threat of empty planes. In the US, on most of the fiercely competitive routes planes fly at a shockingly low level of capacity utilization. A poor country like ours, can hardly afford the multi-million dollar planes flying empty, whether in the public or private hands.

The MOU advocates argue that the MOU system promotes competition without breaking up the enterprise. Since each enterprise is rated on a scale of 1 to 5, there is a tendency among varied enterprises to compete with each other to get a better score. This is not just a theoretical argument. This competing zeal was evident in each country that has tried this system. In India also, one can already see it happening. The composite score in the MOU system provides us the public sector counterpart of a stock-market where the performance of diverse private enterprises is rated by the price of their shares. The pressure to look good on the stock market keeps the private enterprise on its feet. Similarly, the pressure to look good in terms of the "composite score" keeps the public enterprise from becoming complacent. There is absolutely no difference between the two stock markets except that on the "Dalal Street" profit is given a weight of 100% but MOUs distribute this weight to reflect their owner's wishes on the "Main" Street."

Privatisation advocates argue that privatisation will allow the state to get out of commercial business activities and focus on law and order, justice, national defence, etc. MOU protagonist argue that privatisation in most countries including U.K. has been accompanied by regulation. Thus the net administrative resources released by privatisation may not be substantial because effective regulation will absorb some of them.

Further, history of regulation in USA, which has had the longest experience in this regard, suggests that eventually regulators get regulated by the ones they are supposed to regulate. This danger is even greater in the case of poorer countries. Even without owning ONGC (Oil and Natural Gas Commission), Ambanis wield enormous influence over their regulators. One shudders to think what could happen if Ambanis or Birlas owned ONGC or the Indian Oil Corporation.

MOUs, on the other hand, by eliminating multiple evaluations and reducing frequency of evaluation have a better chance of releasing administrative resources. Without incurring potentially unacceptable risks of concentrating power in the hand of the few.

Evidence on reduction of day-to-day interference in the affairs of the enterprise as a result of privatisation is not clear. In some countries, minister many direct a public enterprise to employ his cousin, in others, nepotism is an accepted practice in the private sector but not in the public sector.

However, the MOU system is founded on the concept of eliminating day-to-day interference by holding enterprises accountable for results and not for procedures. Thus, if the Government is serious about reducing day-to-day interference, MOU can be as effective, if not more, than privatisation.

Argument of acquiring access to new markets and technology through multinationals is a theoretical one. Very few countries want to pass on the control of their enterprises to multinational corporations. Even Mrs. Thatcher, the Grand Old Lady of privatisation, refused General Motors from taking Jaguar in U.K.

In addition, lack of developed capital markets; lack of budgetary resources to finance contingent liabilities of privatised firms (such as domestic & foreign debt and severance pay for the laid off workers) and political constraints have prevented many a privatisation programmes from being implemented MOUs, on the other hand, do not face these constraints. No political party can oppose a quest for greater efficiency and accountability of public enterprises. MOUs take the constraints, over which managers have little control, as given and work with them to increase efficiency through eliciting better performance in those areas over which the management has some influence. In the process they highlight the cost of environmental constraints and help educate the Government about the desirable policy changes for improving the health of the public sector.

MOU and Privatisation as Complements

Unfortunately, the debate outlined in the previous section has deflected attention from a proper approach to the entire issue of public enterprise reforms. When viewed within the context of an appropriate policy framework, MOU and privatisation appear more of complementary options rather than substitutes.

Unless one adopts an ideological approach towards privatisation, there is consensus among economists that the case for privatisation can only be made after examining the merits of each case. For example, no reasonable person would argue that a loss making public enterprise that is operating in a competitive environment, with no social obligations, ought to be privatised. But as we go to other categories, the case becomes difficult. In those cases MOU may provide the answer.

MOU and privatisation are complementary to each other in other ways also. In South Korea performance improvement through a MOU like system was used to increase the value of public enterprises before selling them.

Finally, privatisation is a long-drawn and, often, a very contentious process. Even when the government has decided to privatise part of its portfolio, it should not wait and put its public enterprises under a MOU like system while the details of privatisation are being worked out.