Disinvestment Policy in India and DIPAM

In this article, you can read all about the disinvestment policy in India over the decades, how it has evolved from 1991 when it was initiated. You can also read about the different approaches towards disinvestment by the various governments in power. Also in focus is DIPAM, the acronym for the Department of Investment and Public Asset Management.

This topic is important for the IAS exam from both the economy and the polity perspectives.

DIPAM Meaning

1. The renaming and restructuring of the Department of Disinvestment were announced by the Finance Minister in his 2016-17 budget speech.
2. As a follow-up, the Dept of Disinvestment has been renamed as the **Department of Investment and Public Asset Management or 'DIPAM'** but it continues to function under the Ministry of Finance.
3. **Aim of DIPAM**: Efficient management of centre's investments in equity including its disinvestment in central public sector undertakings (CPSU).
4. **Mandate:**
    - Advice the government in matters of financial restructuring of CPSUs.
    - Attracting investment through capital markets.
    - Addressing issues such as capital restructuring, dividend, bonus shares, etc.

Disinvestment - Meaning

1. Disinvestment is defined as the action of a government aimed at selling or liquidating its shareholding in a public sector enterprise in order to get the government out of the business of production and increase its presence and performance in the provision of public goods and basic public services such as infrastructure, education, health, etc.
2. Disinvestment refers to the selling of the government's stake in public sector undertakings (PSUs) and other assets.
3. It is a process by which the government sells a part or whole of its shareholding in a public sector enterprise to private entities or the public.
4. The objective of disinvestment is to reduce the financial burden on the government, improve the management and performance of the public sector enterprise, and promote the growth of the private sector.
5. Disinvestment in India started in 1991 as part of economic liberalization and has since become an important policy tool for the government.

6. Funds from disinvestment would also help in reducing public debt and bring down the debt-to-GDP ratio while competitive public undertakings would be enabled to function effectively.

Disinvestment - Objectives

The main objectives of disinvestment in India are:

1. To reduce the financial burden of the sick, loss-making PSU's on the Government
2. To improve public finances
3. To introduce competition and market discipline
4. To fund growth, social sector welfare
5. To encourage a wider share of ownership
6. To depoliticize non-essential services

Disinvestment - Investment

The importance of disinvestment lies in the utilization of its proceeds for:

1. Financing the burgeoning fiscal deficit
2. Financing large-scale infrastructure development
3. For investing back in the economy to stimulate spending
4. For retiring government debt, because almost 40-45% of the Centre's revenue receipts are set aside for repayment of public debt/interest
5. For social sector welfare programs in health, education, MGNREGA, etc

Disinvestment in India: A Timeline

The following BYJU'S Infographic explains disinvestment in India through the years:

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Disinvestment TIMELINE

PRE 1990
- Socialistic pattern of management in PSU's
- License Raj era

1990
- Balance of Payment (BoP) Crisis

1991
- Era of Liberalization, Privatisation & Globalization
- Industrial Policy Statement

1991-92
- 20% disinvestment in Select PSU's
- Shares were sold to Mutual Funds & Financial Institutions

1992-93
- Investor base was expanded to include FII, PSU employees & banks

1993
- Rangarajan Committee:-
  - 49% disinvestment in PSU's reserved for public sector
  - 74% disinvestment in all other PSU's
- Govt did not implement these recommendations

1996
- Setting up of Disinvestment Commission

1998-00
- Vajpayee Govt classified PSU's into:
  - Strategic : Defence, Railways, Atomic (No disinvestment)
  - Non-Strategic : Disinvestment in a phased manner
- Department of Disinvestment was established

2001
- Dept of disinvestment renamed as Ministry of Disinvestment

2004
- UPA Govt adopted the Common Minimum Programme(CMP)
  - Revive Sick PSU's
  - No Disinvestment in profit making PSU's
  - PSU's to get commercial autonomy
- Ministry of Disinvestment scaled back to a department

2005
- Formation of National Investment Fund
  - 75% proceeds for social sector
  - 25% proceeds for Capitalization of PSU's

2005-09
- Disinvestment remained stagnant due to coalition pressure from Left parties

2009-10
- Revival of Disinvestment policy

2011-14
- Disinvestment process slowed down, targets could not be met due to-
  - Inter – ministerial disputes
  - Lukewarm response from investors
  - External & Internal market conditions

2014- PRESENT
- New Disinvestment Policy
- Setting up of DIPAM
- NITI Aayog vested with recommendation powers

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Disinvestment Policy - Background

1. Disinvestment of a percentage of shares owned by the Government in public enterprises emerged as a policy option in the wake of economic liberalization, globalization, and structural reforms launched in 1991.
2. Initially, it was not conceived as the privatization of existing public enterprises but as limited sales of equity/shares with the objective of raising some resources to reduce the budgetary deficit and ensuring market discipline to boost the performance of public enterprises.

Chandra Shekhar Government

1. In early November 1990, India faced a looming **balance of payments (BoP) crisis** and unprecedented risk of default on sovereign repayments. India needed to swiftly mobilize additional revenue, and reduce expenditure since the import cover had dropped to an alarming level of less than one month.
2. During this crisis, there was a proposal to mobilize resources by selling shares/equity in state-owned public sector companies. India entered into negotiations with the IMF for the **Compensatory and Contingency Financing Facility (CCFF)**, but the manner of usage of the funds raised from the sale of equity of state-owned companies was a sticking point.
3. The government intended to use the proceeds to reduce the budgetary deficit. But initially, the IMF opposed this because the proceeds which are classified in accounting jargon as **capital receipts**, wouldn't then be used to retire debt, or in other economically efficient ways.
4. India convinced the IMF that considering India's economic challenges, at this juncture, it would be better to allow fiscal managers to use it to bring down the deficit.
5. The interim budget of 1991 was the first to mention the sale of assets of Public Sector Enterprises. It used the word 'disinvestment' because 'privatization' was politically unpalatable. However, due to political instability, the plans remained unimplemented.

P V Narasimha Rao Government

1. The first sale of shares of public sector firms in small bundles to mutual funds and institutional investors happened in 1991-92 under P V Narasimha Rao-Manmohan Singh combine, who ushered in the 1991 economic reforms, but they too faced a difficult time in its implementation.
2. The World Bank, with which India was in negotiations for assistance, took the stance that proceeds raised through the sale of equity of public sector companies should be used only to reduce the government's debt. During negotiations in September 1991, Finance Ministry again managed to persuade the World Bank that given India's fiscal challenges, this couldn't be done under the current circumstances.

3. **Industrial Policy Statement of 1991** provided for a complete review of public sector investments to focus on strategic and essential infrastructure undertakings and new methods to tackle chronically sick and loss-making units.
4. In the latter half of the 90s, the range of disinvestment was gradually increased by the subsequent coalition governments to bring about a clear distinction between strategic and non-strategic enterprises so as to reduce government shareholding to 26% in non-core enterprises through **incremental disinvestment or strategic sale** while retaining majority shareholding (51%) in strategic enterprises.

I K Gujral Government

1. A **Disinvestment Commission** was established in 1996 by the government of India, to carefully evaluate the withdrawal of the public sector from non-core, non-strategic areas and assure workers of job security and opportunities for retraining and re-employment. It recommended the sale of equities or outright sale of several PSE's, including Air India.
2. That year's budget promised to make use of the revenue from these equity sales for education, health, and to set up a fund to strengthen Public Sector Undertakings. But for years, most of the money has been routed to the Consolidated Fund of India, to reduce the deficit.

Atal Bihari Vajpayee Government

1. In the 1998-99 Budget, the government announced that it would lower its shareholding in public sector firms to 26% while continuing to hold the majority shares in c that were considered strategic. It also contained a promise to protect the interests of employees and to set up a restructuring fund to provide compensation to employees.
2. It also introduced the **concept of strategic sales** in public sector companies some of which include the sales of Modern Bakeries, Hindustan Zinc, and Balco, and disinvestments in these fuelled major controversies as well.
3. Via strategic sales, privatization was envisaged only in non-strategic areas. The demarcation was redefined by the Government in 1999 to include only defense-related, atomic energy undertakings and railways among strategic enterprises and treat all other enterprises as non-strategic.
4. The government's determination to take the policy through was reflected in the setting up of a new **Department of Disinvestment** in 1999, which, in 2001, became a full-fledged Ministry.

Manmohan Singh Government

1. The government was not keen on treading the strategic sales route. The UPA manifesto in 2004 said it would take up privatization selectively. Unlike what the NDA had done, there

would be no disinvestment just to raise funds to meet short-term targets. Proceeds of disinvestment would be used for designated social welfare programs.
2. In pursuance of this, the government formed a **National Investment Fund (NIF)** in 2005, to which the funds raised from disinvestment were channelled. The purpose of the Fund, managed by professional investment managers, was to utilize 75% of the proceeds to fund social welfare schemes in education, health, and employment. But due to the financial crisis of 2008-09, and later a drought, this was put on hold for 3 years, and later in 2013, it was restructured to provide flexibility in using the Fund.

Narendra Modi Government - Present Status

1. Even though the moratorium that the UPA govt had placed on strategic sales in 2009 has been lifted, it is pretty evident that Prime Minister Modi is not planning to mimic British PM, Margaret Thatcher.
2. Thatcher was of the firm belief that the government had no business to be in business and had led the UK in the 1980s to privatize 670 of its public sector enterprises. This policy was in tune with the theory of **New Public Management (NPM)** which was gaining prominence.
3. If **Thatcherism** (privatization) was about exiting business via the transfer of state assets and companies to private ownership, the **new disinvestment policy** of Modi might lead to increased government control of public sector enterprises.
4. The intent of the new policy is not to downsize the public sector but to alter it so that assets, including land and cash balances of PSUs, can be hived off and utilized for investment in new projects. The renaming of the Department of Disinvestment as the "**Department of Investment and Public Asset Management" (DIPAM)** is a reflection of the new thinking.

The current government is pursuing disinvestment, not to vacate the public sector, but to enhance its efficiency. The new disinvestment mantra is to

i) Minimize interference

ii) Allow public sector undertakings to function along with commercial principles

iii) Grant managerial autonomy in decision-making, such as in appointments.

- The new policy clearly highlights the distinction between privatization and disinvestment. While sales of equity greater than 50%, maybe even 100%, is privatization, any tinkering here and there constitutes disinvestment.
- Previous efforts at large scale sale of shares have been frequently mired in controversies and as a result, bureaucrats have developed a sort of an aversion to strategic sales. In a course correction, the new disinvestment policy provides for land to be valued at market

price for inclusion in sales. This will help prevent any scope for rent-seeking and reduces discretionary powers and thus enables bureaucrats to do away with the status quo.

- **NITI Aayog** has been entrusted to come up with new recommendations about loss-making units that can be sold, their assets valued and disposed of, and to carry out possible strategic sales.
- Financial parameters of public sector companies, such as borrowings and operating profits, are being closely monitored to identify possibilities of share buybacks, a new kind of disinvestment the government has recently come up with.

Critique of India's Disinvestment Policy

1. Beginning in the early 1950s, with basic industries such as steel, the public sector helped lay strong economic foundations with a diversified industrial base. In the first 4 decades of Independence, there was a rapid expansion of the public sector into almost every area of economic activity and in a short time span became a mega-conglomerate of both basic and consumer goods production units and service enterprises.
2. Many of them would have delivered a better account of themselves had they been granted with maximum autonomy, freedom from bureaucratic controls, and made accountable. Their net profit to turnover has been very low despite the outstanding performance of a select group of PSE's, such as the oil majors.
3. Disinvestment was conceived in the context of not only the acute financial exigency of the Government of India, which was bound to continually provide budgetary support to loss-making public sector units but also of the failure of the public sector as a whole to provide a reasonable rate of return on the total investments in various public sector undertakings.
4. Disinvestment in India has progressed at a snail's pace, considering the rapid strides in privatization that developing countries in East and Southeast Asia, Latin America, Central, and Eastern Europe have made by transfer of ownership of productive assets to private investors, especially in the area of basic infrastructure (power, telecommunications, oil, and minerals) and financial services.
5. The below data from the Economic Survey clearly indicates that the government's plans to sell stake in state-owned enterprises have consistently missed the intended disinvestment target.

Challenges to Disinvestment:

- The COVID-19 pandemic and the Ukraine conflict have impacted the government's disinvestment efforts in recent years.
- These events have hurt minority stake sales and strategic sales as potential bidders' financial capacity and risk-reward options have turned worse.

- Additionally, strategic disinvestment transactions face several issues, including land title and lease issues with state government authorities, disposal of non-core assets, excess manpower, labour unions, and protection of process and functionaries.
- Moreover, multiple court cases filed by employees' unions and interest groups against the disinvestment policy and specific transactions are also hindering deals. Such issues may impact the transaction timeline.

Way Ahead:

- The government's primary focus in 2023-24 will be to complete ongoing transactions involving IDBI Bank, NMDC Steel, Concor, Shipping Corporation of India, and BEML.
- The issuance of ETFs has been on hold since 2020 because of the insufficient number of stocks available for sale.
- Additionally, there is a concern that the significant and repetitive tranches of equity ETFs may deter investors in public sector stocks due to a price overhang.
- To overcome these challenges, the government must address issues related to labour unions, land titles, leases, land use, and excess manpower.
- It also needs to develop a marketing strategy to attract investors to public sector stocks and revisit its ETF route for stake sales.

Conclusion:

- The Indian government's disinvestment policy faces several challenges that have impacted its efforts to privatize PSEs and raise funds.
- However, the government's focus in 2023-24 is to conclude transactions that are "work in progress" and overcome these challenges to meet its disinvestment targets

Frequently Asked Questions related to Disinvestment

Q. What are Disinvestment and Privatisation?

Privatization is the process of transfer of ownership of a public sector undertaking to the private sector. Disinvestment is a process in which an organization or government sells or liquidates the assets which it owns.

Q. What is disinvestment explain with example?

In business, disinvestment means to sell off certain assets such as a manufacturing plant, a division or subsidiary, or product line. Disinvestment is sometimes described as the opposite of capital expenditures. For example, an electric generator manufacturer might sell off its consumer generator product lines and manufacturing facilities in order to raise money that can be used to expand its industrial generator product line. Another example is a consumer products company

selling off a profitable division that no longer meets its long-range goals. The proceeds from this disinvestment are then used to improve the company's financial position by reducing its debt.

Q. Who started disinvestment in India?

The public sector in India overgrew itself and its shortcomings started manifesting in low capacity utilisation and low efficiency. Hence, a decision was taken in 1991 to follow the path of Disinvestment. The change process in India began in the year 1991-92, with 31 selected PSUs disinvested for Rs.3,038 crore. In August 1996, the Disinvestment Commission, chaired by G V Ramakrishna was set up to advice, supervise, monitor and publicize gradual disinvestment of Indian PSUs. It submitted 13 reports covering recommendations on the privatisation of 57 PSUs.

Q. What is the purpose of disinvestment?

Disinvestment is aimed at reducing the financial burden on the government due to inefficient PSUs and to improve public finances. It introduces competition and market discipline and helps to depoliticize non-essential services.