

Privatization, Regulation and Competition in the Indian Subcontinent

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Abstract

The talk will be in five parts. In the first and introductory part I will briefly review the development strategies of India and Pakistan since independence until the reforms of late eighties and nineties. The strategy assigned a dominant role to the state and emphasized import substituting industrialization. Under the strategy the state engaged in a wide variety of activities far beyond what conventional economic theory would consider appropriate, even though the state did not have the characteristics to enable it to perform many these activities efficiently, or equitably. Besides, far from being interventions in the economy of a benevolent social-welfare maximizing state, the political economy of state interventions in the economies of India and Pakistan led to widespread corruption and rent seeking. Of course, import substitution and the role of the state in the economy went much further in India than in Pakistan. Indian growth performance under the strategy was poor. Pakistan's performance though much better India's until the late eighties, did not match that of East Asia.

In both economies, the late eighties ushered in economic liberalization which emphasised both reintegration with the world economy through reduction of trade barriers, and also reduction of the extent of involvement of the state in the economy, through disinvestment and privatization. Liberalization followed from a rethinking of the state led inward-oriented development strategy in India following the macroeconomics cum balance of payments crisis in 1991. Pakistan had embarked on privatization even earlier.

The second section of the talk takes off from the premise that a convincing case is yet to be made in both countries, based on their own experience, that privatization has by and large achieved its objectives once the debilitating effects of still existing distortions are allowed for. It has to be deepened and accelerated further. This leads to me to discuss the analytics of privatization, in particular whether or not a change in ownership (partial or complete) from public to private hands would necessarily lead to beneficial outcomes. An important distinction emerges from this discussion between activities or sectors in which significant competition could be reasonably assured and those in which because of their being natural monopolies or their producing public goods, competition is less likely. In the former case, issues of privatization are relatively straight forward and boil down to essentially one issue: whether or not adequate competition exists or could be ensured for the privatized activity. It turns out that opening to import competition and to foreign direct investment are very effective means to ensure such competition for activities producing importable goods and services. For activities producing non-traded goods it is essential to eliminate entry barriers. In the case of second category of public goods and natural monopolies, if the production technology of production of public goods does not exhibit increasing scale economies, there are alternatives to public sector production and provision. For natural monopolies and quasi-monopolies,

creating an appropriate regulatory framework ahead of privatization would be appropriate. In this part of the talk I also touch upon modalities of privatisation and other practical policy issues.

In the third part of my talk, I briefly touch on the received theory of regulation, which largely assumes a closed market economy with few domestic distortions. I suggest that the economies of the sub-continent being rife with distortions and engaged in the process of globalization along with privatization, the received theory might need to be modified before being applied. In particular in some of the sectors being privatised such as telecommunications ongoing technical change is rapid and even in many industrialised countries these sectors were only recently privatised. Both analysis and practice of privatisation and regulation are still being experimented and tested. In our countries the situation is further complicated by our own political-economy. As such mistakes are expected but hopefully learning from them takes place. This said, in one area, namely telecommunication, privatisation and regulation has been far more successful than we had reasons to expect.

In the fourth part of the talk, I very briefly comment on the analyses of privatization in Pakistan by Parvez Hasan and A.R. Kemal and the policy implications emerging from them. A brief, fifth and final part of the talk will summarize and conclude.