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FOREIGN BUSINESS INVESTMENTS
IN INDIA

FOREIGN BUSINESS INVESTMENTS
IN INDIA SINCE 1948

by

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PREFACE

A radical change has occurred since 1948 in the volume and pattern of foreign business investments in India, as shown in Figure 1, resulting in both favourable and unfavourable effects on the economy. This change and the consequent effects constitute the substance of this study.

I owe deep gratitude to my research director, Professor Irving Brecher for his constant guidance and counsel in the preparation of this study.

My sincere thanks are due to Dr. K.S. Gill, Director, Planning Commission, Government of India, who very kindly discussed with me many aspects of the problem of private foreign investments in India.

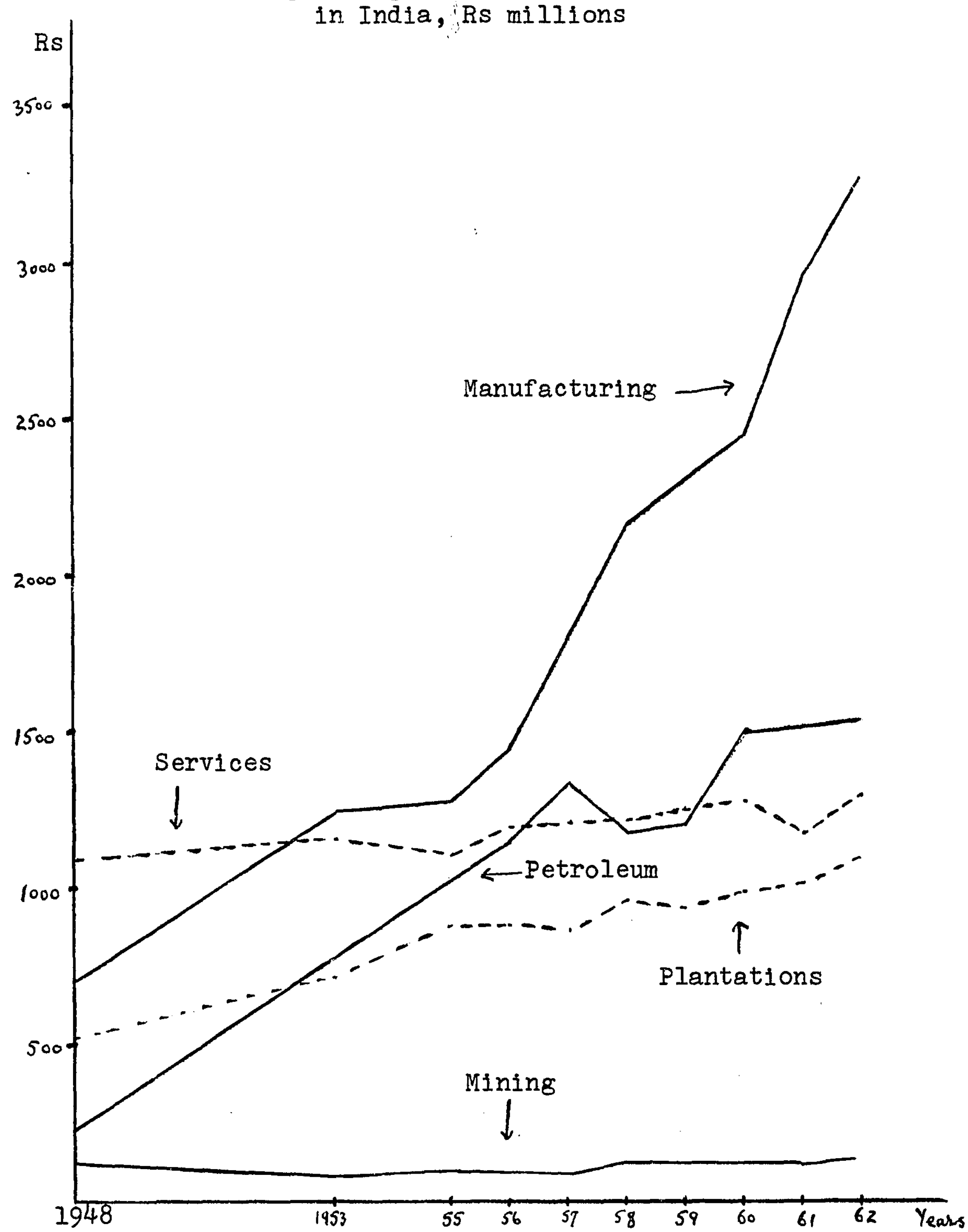
I must also thank Mr. G.S. Lall, senior research officer, Planning Commission, Government of India and Mr. Namboodripad, Assistant Secretary, Federation of Indian Chamber of Commerce and Industry for their help in the collection of data.

Office of the Company Law Administration, Ministry of Law, Government of India and the Indian Investment Centre, New Delhi, were very helpful in allowing me access to certain useful documents.

Thanks are due to the staffs of the Commerce Library and Redpath Library, McGill University, Montreal; Royal Bank of Canada Library Montreal, and Library of Panjab University, Chandigarh.

Figure I

Outstanding Foreign Business Investments
in India, Rs millions



Source: Reserve Bank of India Bulletin (April, 1966), p.378.

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CHAPTER I

THE PLACE OF CAPITAL IN ECONOMIC DEVELOPMENT

In this introductory chapter, we plan to discuss the roles of the different forms of capital - first, capital in general, then foreign capital and, lastly, private foreign capital - in the economic development of a developing economy such as India. As economic development has different meanings for different people, it becomes necessary to explicitly state the meaning which we will use in this study.

I. Economic Development

Of the many ways of defining the level of economic development of a country, one useful, though by no means perfect, way, is to express this level in terms of per capita income.[1] Bearing this in mind, we may look at the national income statistics of the various countries in the world to establish their relative positions, and for this we may refer to Table 1.

The figures[2] in Table 1 show that in 1958, the per

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1. Benjamin Higgins, Economic Development (New York, 1959), pp.6-10.

2. We have used the figures converted in U.S. $ on the basis of purchasing power parity rather than

Table 1

Estimates of Per Capita G.N.P. U.S.$ *

(1)	1958 (2)	1969-71 Low (3)	1969-71 High (4)
United States	2235	2593	3017
Canada	1720	1995	2322
Australia	1575	1780	2000
New Zealand	1560	1763	1982
United Kingdom	1515	1924	2166
West Germany	1490	2399	2622
Switzerland	1480	2116	2368
Sweden	1475	1991	2227
Norway	1460	1854	2088
Denmark	1410	1791	2016
France	1405	2164	2360
Belgium and Luxembourg	1395	1772	2009
Netherlands	1260	2054	2230
Austria	1235	1976	2223
Finland	1200	1716	1920
Italy	925	1554	1702
Japan	910	1693	1893
Soviet Union	900	N.A.	N.A.
South Africa	835	1002	1194
Argentina and Uruguay	825	965	1048
Ireland	770	978	1101
Yugoslavia	730	1234	1467
Central America(Excl.Mexico)	555	666	727

Table 1 (continued)

(1)	(2)	(3)	(4)
Mexico	535	701	781
Spain	525	840	945
Greece	520	832	934
Portugal	490	662	740
Turkey	425	502	570
North Africa(Algeria, Egypt,Libya, Morocco, Tunisia	315	378	450
Philippines	270	316	373
Thailand	270	308	346
Ceylon	240	259	290
Burma	210	254	284
Vietnam	210	212	239
Taiwan	190	228	270
South Korea	190	220	249
Indonesia	175	194	229
India	150	181	212
Pakistan	145	147	171

* G.N.P. converted in U.S.$ on the basis of purchasing power parity according to U.S. prices in 1955.

Source: F.A.O., Agricultural Commodities Projections for 1970 (Rome, 1962), Table M2, pp. A3 and A4 with one further assumption that 1958=1957-59.

capita income of the majority of the countries in Asia was about $200 whereas that of the majority of the countries in Western Europe was greater than $1,000. In North America, per capita income was greater than $2,000. According to the projections for 1969-71, the gap between the per capita income in the high income countries and low income countries will widen. The per capita income of the high income countries is projected to increase by 37% to 56% during 1957-59 to 1969-71, against an increase of only 22% to 38% for the low income countries during the comparable period.[3] After observing these wide and growing differences in per capita income, one would like to ask why countries in Asia, Africa and Latin America have remained under-developed; what elements are missing in the underdeveloped countries which would explain their failure to achieve the living standards of the developed countries?

II. The Role of Capital

Until quite recently, most of the economic experts on problems of underdeveloped countries have been putting all these countries under one rug and

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official exchange rate as the latter method undervalues a low income country's output by a greater degree, the greater the disparity in per capita income between the two countries being compared.

3. F.A.O. Agricultural Commodities Projections for 1970 (Rome, 1962), Table M2, pp. A3 and A4.

suggesting that only if they have capital would development be easy; in other words, economic underdevelopment was exclusively identified with capital scarcity.[4] How has the notion developed that only if you have capital, would development be easy? This may be due, among other things, to the following reasons:[5]

a) That the countries where investment has been highest have enjoyed also the most rapid advance in production and income.

b) That capital is something that lends itself to Government action; if you have not enough you can borrow; if investment is not taking the right direction you can control it.

c) That capital is equally manageable from the point of view of the theoretical economist; he can build it into models and watch how the growth of capital and income respond to each other.

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4. A.K. Cairncross makes a similar observation in his article "The Place of Capital in Economic Progress", in L.H. Dupriez (ed.), Economic Progress (Louvain, 1955), reprinted in his book Factors in Economic Development (London, 1962), pp. 75-88. He notes that "in most of the recent writings of economists whether they approach the subject historically (e.g. in an attempt to explain how the industrial revolution started) or analytically (e.g. in models of an expanding economy) or from the side of policy (e.g. in the hope of accelerating the development of backward countries) it is the process of capital accumulation that occupies the front of the stage". (p. 75).

5. Cairncross, "Investment and Growth", in Factors in Economic Development, p.89. Throughout this

The above reasons, along with the apparent constancy of the capital-output ratio during the course of the last couple of decades in the developed countries, seem to have influenced some economists to identify economic underdevelopment with capital shortage. This view, however, is increasingly challenged now in the economic literature; it is suggested that the contribution of investment would be very small if it is unaccompanied by other changes.[6] It can be objected that other changes are bound to occur as investment rises; a higher rate of investment may introduce a more dynamic atmosphere and force people to re-examine established ideas and techniques so that innovation proceeds more rapidly. Cairncross does not offer an answer to this objection, his only comment being that "we know too little about the forces governing innovation to be dogmatic about an issue of this kind. It seems

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section on the Role of capital we will be referring extensively to the writings of Professor Cairncross as he has been a leading economist on this subject for the last two decades.

6. Ibid., p. 90. Cairncross notes here that "net investment in the United Kingdom has in recent years averaged about 10% of the national income while the increase in output has averaged about 3% per annum. Given an average social return on the additional capital invested of, say, 10% - and it is unlikely that it would be higher in current conditions - the increase in output attributable to investment comes to 1% or one-third of the recorded increase; and an increase in the rate of investment by one-half, unaccompanied by other changes, would at most bring about a change in the rate of growth of output from 3% to 3½%."

likely that high investment <u>expresses</u> a change in ideas and techniques rather than provokes them; but the sequence may well be of the hen and egg type and start with one or the other."[7]

As far as the role of capital in the underdeveloped countries is concerned, Professor Cairncross earlier held the following views:

> It is by no means obvious that additional capital whether borrowed from abroad or accumulated through the exertions of surplus labour in the countryside, would by itself suffice to start off a cycle of industrialization. The problem is often one of organization quite as much as of capital creation; of training managements and men; of creating new attitudes towards industrial employment; of taking advantage of innovations that need little capital and using the resulting gains to finance investment elsewhere.[8]

Cairncross now thinks that "if I set out again to discuss the causes of economic growth I should certainly say different things and say them in a different way. In dealing with capital investment, I should probably concede more willingly the importance of its role, particularly in underdeveloped countries."[9]

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7. Ibid., p. 92.

8. Cairncross, "The Place of Capital in Economic Progress", op. cit., pp. 87-88.

9. Factors in Economic Development, p. 8.

He further observes "if a country is in course of industrialization, and can draw an almost unlimited manpower into urban factories from the countryside, as in U.S.S.R., capital may be the controlling element in the growth of industrial capacity and output, and additional investment may permit a more rapid mobilization of otherwise idle or underutilized resources."[10]

Cairncross has now not only conceded the importance of the role of capital in underdeveloped countries but also has enriched the theory of economic development by suggesting that capital has different roles to play in different stages of development even of the same country. He notes that "whatever one may think of investment as a fast breeder, we need have no reservations about the scale on which investment becomes necessary as development proceeds. The switch from an agricultural, village economy to an industrialized, urban economy probably involves heavier capital expenditure in relation to income available during the process of transformation than in the subsequent period of growing productivity."[11]

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10. "Investment and Growth", op.cit., p.93.

11. "Capital Formation in the Take-off", paper presented to the Conference on the Economics of Take-off into Sustained Growth, at Konstaz, September 1960 and published in Factors in Economic Development (p.115). This paper seems to be one of the first attempts to incorporate Rostowian stage analysis in the problem of the relation of capital and economic development. For Rostowian stage analysis, refer to W.W. Rostow, "The Take-off into Self-Sustained Growth", The Economic Journal (March, 1956); The Stages of Economic Growth

As for India, the U.N. Economic Commission for Asia and the Far East has recently emphasized the role of capital in the economic development as follows:

> Many conditions are needed before economic growth can be realized, but India could meet several of them even before it launched its first plan. It had experimented with industrialization for almost seventy years. It possessed a railway network (although overloaded and badly in need of repair and replacement), a banking structure and associated money markets, port facilities and other infrastructure. The major shortcomings were roads and road vehicles, shipping and power resources. It had some experienced entrepreneurs and a modicum of high level technicians besides almost unlimited reserves of unskilled labour. There was, however, an inadequate supply of middle level technicians and skilled workers. A large measure of political and social stability had also been attained. Finally, India had inherited a competent administration even if it operated a complicated bureacratic machinery. The country, accordingly, was adequately, if not ideally, endowed with the political, social and economic requisites of growth. The most serious handicap was the lack of modern techniques and productive capital.[12]

Applying Rostowian stage analysis to the problems of economic development of India, Professor

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(Cambridge, 1960) and International Economic Association, <u>The Economics of Take-off Into Sustained Growth</u> (London, 1963) edited by Rostow.

One may or may not agree with Rostow's demarcation of the different stages of development, but his approach has made a signal contribution to the literature on the problems of economic development. Now economic development is not studied under one garb; rather it is looked at as a process. It is rightly suggested now that to look for a general sort of diagnosis for the problems of economic underdevelopment is extremely naive as different countries need different factor combinations at different stages of development.

12. U.N. <u>Economic Survey of Asia and the Far East, 1961</u> (Bangkok, 1962), p.83.

Galbraith holds the view that the stress on capital fits her stage of development not too badly:

> India has an effective government; there is a substantial measure of literacy; she has a backlog of administrative and entrepreneurial talent; there is a solid commitment to the goals of social justice and social progress. At the same time, the propensity to consume is high and the problem of capital supply is especially serious for that part which must be obtained from abroad. Under these circumstances, attention has naturally been focused on the question of financial support to investment.[13]

The lesson which we may draw from the above analysis is that capital is not a limiting factor in every underdeveloped country or even in every stage of development of the same country. In countries socially and politically as developed as, say, India, capital (along with the techniques to handle it) is the limiting factor; and in countries which are socially and politically less developed than India, as many countries in Asia, Africa and Latin America, popular education and enlightenment may take precedence over capital.

III. The Role of Foreign Capital

Since shortage of capital is the most important

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13. J.K. Galbraith, Economic Development (Cambridge, Mass.,1964), pp.43-44.

element contributing to economic underdevelopment of a country such as India, the prescription for development is obvious; the rate of investment must be increased.

The rate of investment can be increased by raising the rate of domestic savings and/or by encouraging an inflow of foreign capital. Unfortunately, the rate of domestic savings, if left alone, will inevitably be low because of the extremely low level of income. Here we encounter the so-called "vicious circle of poverty". It was in relation to such an economy that the late Professor Nurkse once observed, "a country is poor because it is poor".[14] How can we break this vicious circle? If the circle has to be broken without any significant help of foreign capital, it may involve a revolutionary reorganization of the economic, social and political institutions so that the "potential" surplus[15] is mobilised and channelled into productive lines. However, for a country like India, which is bound by tradition and an anti-developmental caste system, and whose present leadership does not seem to be prepared to reorganise the

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14. Ragnar Nurkse, Problems of Capital Formation in Underdeveloped Countries (Oxford, 1955), p.4.

15. Paul A. Baran, The Political Economy of Growth (New York, 1957), pp.22-43.

society, to make social reforms, this approach does not seem to be available at the present time. In such circumstances the choice left is to have an inflow of foreign capital, supplementing the domestic savings. This is one role which foreign capital can play in a developing country such as India.

Another very important role of foreign capital is improving the balance of payments. It can be convincingly argued that even if a country such as India increases the rate of domestic savings to the required rate of investment, the need for the imports of capital equipment still remains very important at her present stage of development. This is so because the domestic resources are not enough for the manufacture of capital equipment needed for development projects. Unless the economy can pay for these imports through an expansion in exports or a cut in imports, foreign capital must be made available.

In the case of India, the chances of cutting the imports of the non-capital goods are very limited as most of such imports are either industrial raw materials or food.[16] Imports of luxury and semi-luxury

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16. Reserve Bank of India, India's Balance of Payments 1948-49 to 1961-62 (Bombay, 1963).

type consumer goods are already almost banned. In such a situation, the only hope, if any, is to expand exports. Before we analyse the prospects of the expansion of India's exports, it might be useful first to look at the pattern of exports for the last decade. This is given in Table 2.

Two main trends may be observed in the pattern of export trade over the past decade:

> Firstly, among commodities which are directly or largely based on agricultural production (which still account for the bulk of India's exports) such as tea, cotton textiles, jute manufactures, hides and skins, spices and tobacco, on the whole, export did not improve. However, significant increases were achieved in the exports of new manufactures and of products like iron ore, but these were not sufficient to offset the decline in the traditional exports.[17]

Receipts from exports during the 1950's stagnated at around Rs 6 billion. Will India be able to expand her exports sufficiently by the end of the 1960's to be in a position to balance the foreign exchange budget without an inflow of foreign capital? To achieve this objective, say by 1970-71, import requirements of the Indian economy, and the repayment obligations on account of loans previously contracted, would be such as to require annual exports worth Rs 13-14 billion.[18] Having assessed the requirements, we may now analyse the prospects of

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17. India, Planning Commission, Third Five Year Plan (New Delhi, 1961), p.135.

18. Ibid., p.138.

Table 2.

Pattern of Exports, 1951-60

(Rs millions)

	1950-51	1955-56	1958-59	1959-60
1. Agricultural commodities & related manufactures	4,965	4,893	4,535	4,736
Cotton & Jute Manufactures (included in item 1)	2,505	1,817	1,537	1,805
2. Other manufactures	584	610	533	1,050
New manufactured products (included in item 2)	89	86	125	250
3. Minerals	234	344	462	530
TOTAL:	5,783	5,847	5,530	6,316

Source: India, Planning Commission, Third Five Year Plan (New Delhi, 1961), Table 3, p. 135.

Indian exports, first by looking at the traditional exports and then the so-called "new manufactures".

Traditional exports. Dr. Patel[19] estimated that exports of certain items - tea; jute yarns and manufactures; cotton yarns and manufactures; hides, skins and leather; cotton, raw and waste; coal and coke; chemicals, drugs and medicines - would be only Rs 3.75 to 3.95 billion in 1975, while these items contributed Rs 3.84 billion in the average year of India's Second Five Year Plan (1956-61). He further estimated that exports of vegetable oils and tobacco could be expected to increase from Rs 370 million in the average year of the Second Plan to Rs 700 million in 1975. Total traditional exports, according to him, would not increase beyond Rs 6.2 to 6.4 billion in 1975. In 1970-71, receipts from traditional exports would thus be even less than that for 1975.

Recently, Dr. Manmohan Singh[20] made a study of export prospects for 1970. His estimate is that exports of jute manufactures, tea, cotton textiles, vegetable oils and cakes, spices, coffee, leather, cashew kernels, raw

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19. S.J. Patel, "Export Prospects and Economic Growth: India", Economic Journal (September, 1959), Table IV, p.498.

20. Manmohan Singh, India's Export Trends and the Prospects of Self Sustained Growth (Oxford, 1964), pp.177-246.

cotton, iron ore, manganese, coir goods, tobacco, fish, woollen textiles, art silk, fabrics etc., would increase by Rs 1.66-2.18 billion between 1960 and 1970; as a rough order one may put the figure at Rs 2 billion. This means that exports of these items would be Rs 8.5 billion in 1970 compared with Rs 6.5 billion in the last two years of the Second Plan. Manmohan Singh's projections, however, are based on the following assumptions:

(1) That agricultural targets in the Third Plan will be fully realised and that satisfactory progress in agriculture during the Fourth Plan will ensure adequate export surpluses. The estimates for vegetable oils, oil cakes, raw cotton, coffee and tobacco, are naturally dependent on the assumption being proved right. Similarly, progress in agriculture will influence the export performance of such industries as jute and cotton textiles.

(2) That in those commodities of which India in a major exporter in the world, her relative share of world exports will not fall, while for those commodities of which she is only a marginal supplier in the world, sustained efforts will be made to enlarge her relative share. In the first category are jute manufactures; tea, cotton textiles, virginia flue-cured tobacco, black pepper, manganese ore, mica and lac; in the latter are vegetable oils, raw cotton, coffee and iron ore.

The studies by both Patel and Singh rightly conclude that the prospects of India's traditional exports are very limited. This is so because India's traditional exports face (a) inelastic world demand, (b) increasing competition from synthetics and other substitutes, (c) restrictive and discriminating commercial and excise policies, specially followed by Western Europe (excluding Britain) and particularly towards cotton textiles and tea, and (d) the inflationary situation in the country.

Exports of new manufactures. As for "new manufactures" - steel, cutlery, hardware, vehicles, electrical goods, sewing machines, bicycles, machinery etc. - it is strongly suggested that India is capable of selling these products at competitive prices and receipts from such exports may reach Rs 5-6 billion by 1970. This is the view of Sir Donald Macdougall. He works out India's comparative advantage in the following fashion:

> (a) With very high grade iron ore, India should be able to produce cheap steel...
>
> (b) Indian wages per worker are a very small fraction of wages in the main exporting countries of Western Europe and North America (and probably less than half of wages in Japan.) Even if output per worker in manufacturing as a whole were a still smaller fraction, so that labour costs per unit of output were in general higher in India, one would expect to find a fair number of industries in which Indian labour costs were lower....
>
> ....
>
> (c) The reports of the Tariff Commission suggest that, while the ratio between costs at home and abroad varies greatly, a significant

proportion of India's industries may, in fact, be competitive...

....

(d) A wide range of manufactured products (in addition to cotton and jute manufactures) is in fact already being exported, though usually in very small quantities...

(e) India's manufacturing cost should progressively decline and the quality of her products improve as the scale of production is increased, as managements acquire greater experience, as labour is trained and as better equipment is installed.[21]

For these reasons, Sir Donald thinks that Indian industry is capable of competing in export markets over a significant range of products and that the range will widen. Even where industries are not yet competitive, the margin of disadvantage is often not very large. India is thus more favourably placed than a good many underdeveloped countries where the great bulk of manufacturing industries is sometimes still hopelessly uncompetitive.

Sir Donald does not seem to have taken note of the difficulties which would prevent the expansion of exports of the new manufactures in the world market. The difficulties are:[22]

(1) To the extent that consumer goods pre-

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21. Sir Donald (G.D.A.) Macdougall, "India's Balance of Payments", Bulletin of the Oxford University Institute of Statistics, Vol. 23 (May, 1961), pp.167-169.

22. Manmohan Singh, "Self-Sustained Growth by 1971?", The Economic Weekly, Special Number (July, 1962), p.1221.

dominate in the new manufactures, and they are directed to the underdeveloped countries, there is the risk that importing countries may restrict their imports for balance of payments reasons.

(2) Because a large number of items can be manufactured on a small scale, they are bound to be an early victim of import substitution by other developing economies.

The above two difficulties would be considerably reduced if the new manufactures exports consisted of goods which were vital to the development of other countries and which they could not manufacture locally; as, for instance, industrial machinery, intermediate products like iron and steel, chemicals, drugs, etc.

Unfortunately, no mention is made in the Indian plan documents of the export demand for these goods and hence no investment has been allocated for additional capacity for exports.

In the discussion of the exports of new manufactures, the issue of repayments to the specific countries seems to have been neglected in the literature. Even if the above two difficulties in the way of expanding exports to the developing economies of Asia, Africa and Latin America, do not operate, and India gets an export surplus vis-à-vis these countries, such export surplus may not help to pay back loans and interest to the United States, United

Kingdom, Germany, Japan, etc. unless there is free convertibility of the currencies of these developing economies or they get an export surplus with India's creditor countries.

Bearing in mind the above two obstacles in the way of the expansion of export of new manufactures, Dr. Singh estimated that exports of both traditional goods and new manufactures will not be more than Rs 10 billion in 1970.[23]

What about invisible exports? In this connection, two hopeful cases often mentioned are tourism and shipping. As for shipping, it is limited by foreign exchange difficulties, since the import content of a merchant fleet is very high. Tourism has increased significantly over the last few years, but it is still less than Rs 200 million; any foreseeable expansion in this item would not greatly alleviate India's payment difficulties. India's external imbalance thus will have to be corrected by the import of foreign capital (public and private) and official donations. This proves the role of foreign capital in improving the balance of payments in a developing country like India.[24] This role,

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23. Ibid., p.1222.

24. The two main roles of the foreign capital - supplementing domestic savings and improving the balance of payments - were explicitly identified by Professor W.B. Reddaway in "The Role of External Aid" published in his book The Development of the Indian Economy (London, 1962), Appendix D, pp.213-216.

however, may not be important in the export-oriented underdeveloped countries, particularly those which produce petroleum.

IV. The Role of Private Foreign Capital

In our discussion so far we have not distinguished the role of private foreign capital from public foreign capital. Both add to domestic savings and improve the balance of payments. If this is so, then why has so much emphasis been placed on the role of private foreign capital in economic development? One finds that the United States, the most important capital exporter at present, has placed a high priority upon private foreign investment. The reports of many advisory committees[25] have strongly emphasized the role of private foreign investment. All these reports justify the emphasis on the role of private foreign investment in the following fashion:

(1) The human and financial resources which the government can devote directly to foreign economic objectives are limited. Their effectiveness will be

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25. See particularly Gordon Gray, Report to the President on Foreign Economic Policies (Washington, 1950); Ralph I. Straus, Expanding Private Investment for Free World Economic Growth (Washington, 1959) and Proposals to Improve the Flow of U.S. Private Investment to Latin America, Report of the Commerce Committee for the Alliance for Progress (Washington, 1963).

greatly enhanced by complementary private activity abroad.

(2) Private enterprise offers a unique advantage in the development effort - adaptability. The underdeveloped world is one only in its intense desire for economic growth. In every other respect it is highly diverse. The peoples demanding development range from the nearly primitive to the very advanced, from the nearly destitute to the nearly developed. No single formula, either of governmental or of private assistance, will assure success. In the history of development in the West, private enterprise has had to adapt itself to almost every kind of economic and political situation. Where it has been allowed to work, it has generally succeeded.

(3) It is crucial to generate the resourcefulness, organizational talent and technical skill without which capital cannot achieve economic expansion. It is especially in these skills that the developmental potential of private enterprise lies. Each business enterprise sets in motion a chain reaction of constructive economic activity and broadens the base of local technical competence which will determine, in the end, the degree of success of any development program.

(4) Since private enterprise cannot be expected to abandon the profit motive as the normal basis for its decisions, it seeks sound investments,

If the risks appear to be high, it demands a rate of return commensurate with the possibilities of loss.

(5) Private foreign business can have a dynamic and beneficial effect on the economies of other countries which cannot be created by government-to-government activities alone. In supplying capital, providing new production facilities and creating employment, private foreign investment often broadens local capital markets and induces local capital to embark on complementary investments. It encourages modern marketing techniques and low-margin high-volume production enabling a larger number of people to have more goods at lower prices. Also it is sometimes easier to mobilize domestic capital for an industry if the domestic capitalist can rely on the association of foreign entrepreneurs experienced in the industry since the participation of such entrepreneurs suggests that the industry has a fair prospect of profitability. Association with foreign enterprise may also prove helpful if the domestic enterprise needs to be represented, say, for selling purposes in the country from which the foreign capital is coming, or in other markets where the foreign entrepreneur already has connections.

It is well argued that private foreign investment seeks sound investments and (if it is direct) carries with it important collateral benefits - technical know-how, entrepreneurial and managerial skills; by example and through training, it can encourage the growth of a local business class. With all these apparent advantages, still the underdeveloped countries do not appear to follow an open-door policy towards private foreign investment. Some element of politics may enter in such a choice, but is there some economics too which may cast doubts on the benefits of private foreign investment. It is this sort of analysis which is the subject matter of the next chapter.

CHAPTER II

THE BENEFITS AND COSTS OF PRIVATE FOREIGN INVESTMENT IN A DEVELOPING ECONOMY

In the last chapter we noted that in an underdeveloped economy private foreign investment adds to the domestic savings, improves the balance of payments, assumes entrepreneurial risks and (if it is direct) brings technical know-how. This, however, is only a part of the full or long-term[1] impact of private foreign investment. To determine the long-term impact of such investment on the economic development of a country like India, we must weigh its long-term direct and indirect benefits and costs.[2] Since most of the benefits and costs, particularly the indirect ones, do not lend themselves to quantitative assessment, the discussion, accordingly, will have to remain highly abstract. However, we will make every possible effort to relate the discussion to the situation prevailing in a developing economy.

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1. By long-term we mean a period in which economic forces involved have had time to work themselves out.

2. Benefits and costs refer here to the effects on the real income of the country.

I. Direct Benefits

The direct benefits of foreign investment can accrue to local factors of production in the form of increased employment, to consumers by way of lower prices and to the government through higher tax revenues.

Local factors of production. Foreign investment raises the real income of a given amount of labour[3] and allows a larger labour force to be employed. It is the latter which is most relevant for India where the population pressures are taken out through unemployment in the rural sector. Since shortage of capital limits the employment of labour from the rural sector to the industrial sector where wages are higher, an inflow of foreign capital would make possible more employment in the advanced sector, and to this extent, would serve as an alternative to the migration of labour.[4] In such a situation, the social benefit from the foreign investment in the advanced sector would be greater than the

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3. Sir Donald (G.D.A.) Macdougall, "The Benefits and Costs of Private Investment from Abroad: A Theoretical Approach", Bulletin of the Oxford University Institute of Statistics, Vol 22 (August, 1960), p.192.

4. When outlets for the emigration of surplus labour from the densely populated underdeveloped country are restricted, the substitution of domestic migration of labour into the advanced sector seems to be the most feasible solution.

profits on this investment, for the wages received by the newly employed exceed their marginal productivity in the rural sector and this excess should be added as a national gain.[5]

Local consumers. When the foreign investment is cost-reducing in a particular industry, there may be a gain not only to the suppliers of factors in this industry through higher factor prices, but also to the local consumers of the product through lower product prices. If the investment is product-improving or product-innovating, consumers then enjoy an additional benefit from the "better quality" or the "novelty" of the product.

Government taxes. Apart from the benefits enjoyed by the local factors of production and consumers, owing to the inflow of foreign capital, an additional benefit accrues in the form of taxation of foreign profits.

II. Indirect Benefits

Foreign investment not only generates direct benefits but also indirect benefits essentially in terms

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5. G.M. Meier, International Trade and Development (New York, 1963), p.94.

of external economies.

A technique of mobilizing domestic capital. It is rightly suggested that foreign capital sometimes becomes a technique of mobilizing some of the dormant and less usefully employed capital into useful economic activities.[6] A good part of the domestic capital in the underdeveloped countries remains concentrated in a relatively few and overcrowded activities, notably agriculture, trade and real estate owing, among other things, to lack of infrastructure and social capital and lack of big and specific capital. Some enterprises require more capital than domestic entrepreneurs can command. This capital or some part of it may be required specifically in the form of foreign exchange to purchase machinery or raw materials. Or it may be merely that the enterprise needs to be on a large scale if it is to succeed. Foreign capital, either on its own, or in association with the domestic capital, helps to overcome these difficulties.

Technical know-how and personnel. Foreign capital (if it is direct) brings to the recipient country not only capital but also technical personnel, technological knowledge and innovations in products and production techniques.

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6. U.N., ECAFE Secretariat, "Relation between Foreign Capital and Mobilization of Domestic Capital" in *Mobilization of Domestic Capital: Report and Documents of the Second Working Party of Experts* (Bangkok, 1953), pp. 270-288.

By the example they set, foreign firms may then promote the diffusion of technological advances to the rest of the economy. This benefit may be significant in so far as through imitation, domestic firms might make up for their own lack of innovations. In addition, foreign investment may result in the training of labour in new skills and the knowledge gained by these workers may spread to other parts of the labour force or this labour may be later employed by local firms.

III. Indirect Costs

To determine the net effect of foreign investment we have to compare the direct and indirect benefits with the possible direct and indirect costs. Direct costs are represented by the foreign debt service as interest and repayment of principal and remittance of profits and dividends. The indirect costs, unfortunately, remain less obvious and sometimes are not even suspected. In this section, we shall attempt to bring to light some of the important indirect costs of private foreign investment.

Effect on the growth mechanism.[7] The effect of

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7. This section has borrowed heavily from H.W. Singer, "The Distribution of Gains between Investing and Borrowing Countries", American Economic Review, Papers and Proceedings (May, 1950), pp.475-477.

foreign investment on the growth mechanism of the recipient country depends on the purpose of such investments. Where the purpose is to open up new sources of food and raw materials for the industrialized countries, the import of capital might have been not merely ineffective in giving them the normal benefits of investment and trade, but may have been positively harmful. The tea plantations of Ceylon, the oil wells of Iran, the copper mines of Chile, and the cocoa industry of Ghana may all be more productive than domestic agriculture in these countries; but they may well be less productive than the domestic industries in those countries which might have developed if they had not become so highly specialized in the export of food and raw materials, thus providing the means of producing manufactured goods elsewhere with superior efficiency. Admittedly, it is a matter of speculation whether in the absence of such highly specialized export development, any other kind of development would have taken its place. But the possibility cannot be dismissed.

It is further observed that the principle of specialization along the lines of static comparative advantage leaves a good deal to be desired in underdeveloped countries. In the economic life of a country and in its economic history, a most important element is the mechanism by which one thing leads to another. Thus the immediate product and social benefits, and the effect on other industries, are not the most important contribution of an investment. More important than these, is the influence on the general level of education, skill, inventiveness, store of technology, way of life and creation of new demand, etc. And this is one of the reasons why manufacturing industries are so universally desired by underdeveloped countries; namely, that they provide the growing points for increased technical knowledge, urban education, the dynamism and resilience that goes with urban civilization as well as the direct Marshallian external economies. No doubt, under different circumstances, commerce, farming and plantation agriculture have proved capable of being such growing points, but manufacturing industry is unmatched in our present age.

To conclude, the specialization of underdeveloped countries in export of food and raw materials to industrialized countries, largely as a result of investment by the latter, has been unfortunate for the underdeveloped countries for these reasons: (1) It removed most of the secondary and cumulative effects of investment from the country in which the investment took place to the investing country. (2) It diverted the underdeveloped countries into types of activity offering less scope for technical progress, and withheld from the course of their economic history, a central factor of dynamic radiation which has revolutionized society in the industrialized countries.

The above analysis suggests that one should be careful about inviting foreign capital indiscriminately, since different forms of investment have different effects on the growth mechanisms. Also, this analysis offers a justification for some sort of screening of foreign investment, now popular in all underdeveloped countries.

Effect on the terms of trade. The possible effects of foreign investment on the terms of trade are that the latter **usually** tend to improve with an inflow of capital from the borrowing country. Aside from this, foreign investment may also affect the terms of trade through structural changes associated with the pattern of development that results from the capital inflow. Whether the terms of trade improve or worsen depends on "such factors as the pattern of changes, at home and abroad, in supply of, and demand for, different types of goods".[8]

If the pattern of development associated with foreign investment involves deterioration in the borrowing country's commodity terms of trade,[9] then the net

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8. Sir Donald Macdougall, op. cit., p. 204.

9. For different concepts of the terms of trade, refer to C.P. Kindleberger, International Economics (3rd ed; Homewood, Illinois, 1963), pp. 168-172.

gain from the foreign capital will be diminished. It is, however, improbable that foreign investment would cause any substantial deterioration in the context of commercial and exchange control policies being followed by most of the underdeveloped countries:

> If an unfavourable shift resulted from a rising demand for imports on the side of consumption, it would probably be controlled through import restriction. And if it resulted, on the side of production, from a rising supply of exports due to private direct investment in the export sector, the inflow of foreign capital would diminish as export prices fall, thereby limiting the deterioration in the terms of trade. Moreover if the deterioration comes through an export bias in production, it is still possible that the factoral and the income terms of trade might improve even though the commodity terms worsen, since the capital inflow may result in a sufficiently large increase in productivity in the export sector.10

Effect on the Transfer Problem. Servicing of foreign investment may give rise to some long-term economic and social costs of balance of payment adjustment. An important indirect cost in relation to long-term external balances arises from the need to find foreign exchange for the remittance of interest and profits accruing to foreign investors. In this connection, we will go along with the observation of Professor Arndt:

> For a developing national economy to remain in long-term external balance, in the absence of international capital movements, it is necessary

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10. G.M. Meier, Leading Issues in Development Economics (New York, 1964), p.155.

> that exports...rise in step with imports.... Domestic investment must be distributed between the various sectors of the economy in such a way that the value of exports keeps in step with national income or if not, that enough import replacement takes place to fill the gap.
>
> Overseas investment must do more; it must have a sufficient bias towards increased export production or import replacement to ensure the long-term improvement in the balance of payments necessary to finance the transfer of dividend remittances abroad. The emergence of the problem may be postponed in two ways: either by retention and reinvestment of profits by the overseas companies themselves, or by a steady increase in new capital inflow which keeps pace with the growth in remitted profits on past investments. The former is intrinsically unlikely for any length of time; individual overseas investors will sooner rather than later want to see a return for their money. The latter is, in principle, conceivable. But for various reasons, it would be foolish to rely on it. Sooner or later the chickens will come home to roost.[11]

If the bias is not sufficient and a long-term balance of payments problem arises, it is reasonable to regard this as an indirect cost of overseas investment, since it will sooner or later require socially and economically costly measures of balance of payment adjustment. When exchange rates are fixed and foreign exchange reserves inadequate, balance of payments adjustment will probably involve (a) deflationary measures that will interrupt growth and cause unemployment of resources, and (b) possibly, intensified import restrictions that may

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11. H.W. Arndt, "Overseas Borrowing - The New Model", The Economic Record, Vol. 33 (1957), p.256.

cause shortages, disrupt production and investment plans, create rigidities in the economy and involve more than optimum protection.[12] If the currency is devalued, there will be a weakening of trust in the national currency. Moreover, devaluation may not quickly remove the deficit because though trade may be quite highly responsive to relative price changes in the long run, it is much less so in the short run; deflationary measures and restrictions may thus have to be maintained for some time.

The further question arises as to how to eliminate, or at least minimize, these indirect costs of balance of payments adjustment; for this the development programme should take into account the debt-servicing capacity of the country. To provide for adequate servicing of foreign investment, the pattern of investment in a developing economy must be planned so as to raise productivity sufficiently to yield an increase in real income greater than the interest and amortization charges. If this is done, the economy will have the capacity to raise the necessary funds, either through a direct commercial return or an increase in taxable capacity. Also the capital should be utilised in such a way as to generate a surplus in the other items of the balance of pay-

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12. Sir Donald Macdougall, op.cit., p.205.

ments equal to the transfer payments abroad. However, the capacity to service foreign capital can be determined only after taking into account a country's development programme as a whole. This "is necessary for an appraisal of the conditions under which the competing claims on total resources, on saving, and on foreign exchange can be adjusted so as to release the amount required for debt service".13

The suggestion to take into account the entire investment pattern rather than the pattern of foreign investment alone is extremely important because the development of one sector may influence the development of other sectors. The balance of payments effects of any given investment will then be determined by the spatial and temporal interdependence of other investments along with the mobility of the factors and the flexibility with which the investment resources can be reallocated into export and import competing sectors.

> Once we appreciate the relationship between total resource availabilities and uses, the interdependence of investments, and the transforming capacity of the economy, we can perceive that the transfer problem can still be solved without stipulating that the investment of foreign capital should create its own means of payment by directly expanding exports or replacing imports. If it is realized that the ability to create a sufficiently large export surplus depends on the

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13. Meier, International Trade and Development, p.109.

> operation of all industries together, not simply on the use made of foreign investment alone, it is then apparent that a project financed from foreign borrowing need not itself make a direct contribution to the balance of payments.[14]

<u>Effect on the stability of the economy</u>. In the literature referring to the effects of capital imports on the internal and external stability of an advanced borrowing economy - Australia and Canada are good studies in this respect - it is strongly held that foreign investment, particularly the direct foreign investment, tends to make a substantial net addition to the level of domestic spending.[15] However, the addition to domestic spending may be greater, equal or smaller than the capital imported, depending upon the way the capital import is financed and the repercussions of such an import on the domestic investments:

> In the most favourable case, where the capital imported by an overseas company pays for the whole of its investment expenditure and this replaces an equal amount of domestic investment that would otherwise have been undertaken...total domestic spending remains unchanged....If the capital import finances the whole of the overseas company's investment but this represents a net addition to domestic investment spending, the effects of the capital import on supply and demand cancel out, leaving internal and external balance unaffected at a higher level of investment and imports.... If, however, the import of capital causes the level of domestic spending to rise by a <u>larger amount</u> - whether because the overseas company tries to

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14. <u>Ibid</u>., p.110.

15. Arndt, <u>op.cit</u>., p.253.

> finance part of its investment by raising additional domestic capital or because the overseas investment stimulates more domestic investment (in complementary industries) than it replaces, then the net effect of the capital inflow...is almost certain to [generate] ...inflationary pressure on resources.[16]

In the case of a developing economy, it is probably realistic to assume that the foreign investment would stimulate more domestic investment (in complementary industries) and channel some of the dormant capital into economic activities. And this is indeed a desirable development.

Another facet of the stability argument is that a massive withdrawal, or a suddently halted inflow of foreign capital, would have serious effects on domestic levels of income and employment and balance of payments. In the Great Depression, the sudden cessation of American overseas investment was as serious a cause of balance of payment trouble in the rest of the world as the slump in American imports. However, the chances of such a massive withdrawal of capital occurring are remote.[17] It is further suggested that even if such a sudden cessation or massive withdrawal occurs, a country like Canada would not be without defences. "Built into the capital decline

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16. Ibid., pp.253-254.

17. Irving Brecher, "The Flow of United States Investment Funds into Canada since World War II" in Hugh. G. H. Aitken et al., The American Economic Impact on Canada (Durham, N.C., 1959), p.115.

would be a drop in Canada's merchandise imports from the United States. In addition, there would be... a drawing down of Canada's foreign exchange reserves and domestic government policy designed to counteract the effects of capital outflow".[18] In the case of India, apart from the built-in defences against a sudden withdrawal of foreign investments, such a withdrawal, if at all, will have a small effect on the economy simply because foreign investments represent a small proportion of total investment (see Chapter III, section IV).

Effect on domestic infant industries. It is feared that competition by large-size foreign firms may squeeze out and inflict losses on existing domestic firms and thus may achieve monopolistic positions. In advanced countries like Canada, it is suggested, however, that to infer monopolistic effects from the fact of large-size foreign firms is to adopt an over-simplified view of the modern competitive process; foreign companies may promote competition through such means as new technology, improved product quality and aggressive merchandising.[19] It can also be expected that foreign investment, instead of fostering monopoly, may break down local monopolies, and, by accelerating the growth of the domestic economy and market, may widen the scope

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18. Ibid., p.115.

19. Ibid., p.116.

for competition by increasing the number of firms of reasonable size possible within existing industries.[20]

In an underdeveloped country like India, the situation is different. The domestic industries are still infant and need protection. Also, the Indian economic history bears witness to the fact that India's domestic industries were ruthlessly crushed by the foreign investments. Two important examples are the Indian shipping and Indian match industries. These two industries were thoroughly ruined by the foreign shipping and match interests.[21]

Foreign companies' policies and practices. Foreign companies may discriminate against employing domestic technical and professional personnel; may discriminate in purchasing and marketing policies; may take decisions on political grounds which may be harmful to the domestic economy; may contribute only stingily to the development of infrastructure. All these alleged charges against foreign companies must be analysed in the context of the situation of a particular country. However, since World War II, most of the underdeveloped countries have achieved political independence and this has probably

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20. Sir Donald Macdougall, op.cit., p.203.

21. Nurul Islam, Foreign Capital and Economic Development: Japan, India and Canada (Tokyo, 1960), pp.186-88.

helped to reduce the large-scale discrimination by the foreign companies against local interests.

Non-economic considerations. Apart from the economic costs, there are certain non-economic costs which sometimes become even more decisive in the formulation of foreign investment policy. This is particularly true of newly independent nations in Asia and Africa who sometimes look upon private foreign investment as a form of "neo-colonialism". If the extent of foreign ownership becomes very large, then even in an advanced country like Canada - a close ally of the United States - there develops "a deep, though intangible, sense of disquiet over the social and political implications of large-scale and continuing United States ownership and control of Canadian industry".[22]

IV. Conclusion

Having, perhaps, said enough on the long-term economic benefits and costs - direct and indirect - and non-economic considerations, it is time to question whether the benefits of private foreign investment outweigh the costs or vice versa. Theoretically speaking,

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22. Irving Brecher and S.S. Reisman, Canada - United States Economic Relations, Royal Commission on Canada's Economic Prospects (Ottawa, 1957), p.152.

there does not appear to be any clear-cut answer to this question.[23] This, however, does not prevent the economist advising the policy-maker, particularly in an underdeveloped economy like India (whose stage of development is identified essentially with the shortage of capital and modern techniques) to seek a compromise solution. The policy-maker should seek ways to (i) attract foreign investment in its most desired forms and (ii) achieve the most effective utilization of international financing.

The policy of attracting foreign investment in its most desired forms must be interpreted very carefully since its content would be different for different countries. However, in any country, it must be examined "not simply in the narrow context of debt servicing but more broadly in terms of the various effects on the country's entire development program".[24]

In formulating its investment policy, an underdeveloped country should encourage such joint international technical agreements and management contracts as would permit a suitable technology to develop in the underdeveloped countries. Also the arrangements should be made which encourage joint partnerships between domestic

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23 Arndt, op.cit., p.260.

24. Meier, International Trade and Development, p.113.

capital and private foreign capital so that the dormant and less usefully engaged domestic capital is mobilized into productive economic activities.

The most effective utilization of the foreign investment can be achieved if its allocation is planned or encouraged in a way that the country's <u>growth potentiality</u> is raised. In other words, a program approach, not a project approach must determine the criteria of productive use of foreign capital.[25] The recipient country may formulate certain investment incentives which can attract private foreign investment into those sectors of the economy "where it will have the maximum catalytic effect of mobilising additional national effort".[26]

After convincing the foreign investment policy-maker of the usefulness of the program approach for allocating the investment, the economist must also warn his client that there is no simple equivalence between the amount of the country's foreign investment and its rate of development. A country's development, in the last analysis, depends on its own efforts. Whatever the amount of foreign capital and whichever form it takes, it will be simply washed away if the recipient country shirks its responsibility to adopt appropriate complementary domestic policies.

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25. P.N. Rosenstein-Rodan, "International Aid for Underdeveloped Countries", <u>Review of Economics and Statistics</u> (May, 1961), pp.107-108.

26. <u>Ibid</u>., p.107.

CHAPTER III

FOREIGN BUSINESS INVESTMENTS IN INDIA, 1948-62

In the last chapter we discussed the long-term benefits and costs of private foreign investments and concluded that a country like India should seek ways to attract such investments in the most desired forms and achieve the most effective utilisation. Keeping this discussion in mind, we shall now study long-term foreign investments in the private sector, or so-called foreign business investments in India during 1948-62. Unfortunately, no comprehensive statistics on foreign business investments in India are available before the year 1948. The Census of India's Foreign Liabilities and Assets as on 30th June, 1948[1] was the first in India, and in Asia too.

I. Statistical Framework

On 30th June, 1948 foreign business investments in India were of the order of Rs 3200 million - Rs 2540 million were direct investments and Rs 660 million portfolio investments.[2] As the terms direct

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1. Reserve Bank of India, Report on the Census of India's Foreign Liabilities and Assets as on 30th June 1948 (Bombay, 1950); hereafter it is cited as the Census.

2. Census. p.39.

investments and portfolio investments, particularly the former, permit wide flexibility in their meaning, it will be useful to know the meanings given to these terms by the Census.

Direct investments. According to the Census, all the obligations in regard to which the "control" was in the hands of non-Indians, were to be treated as foreign direct investments; the following obligations were specifically mentioned:[3]

(i) All branches of foreign firms and companies (including banks and insurance companies).

(ii) Any joint stock company

(a) where 40% or more of the ordinary shares were owned by the residents of any one country outside India; or

(b) which was a subsidiary to a company registered abroad; or

(c) where 25% or more of the shares were held by another joint stock company which itself was foreign controlled (but not a managing agent of the former); or

(d) which was managed by a foreign controlled managing agency company.

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3. Ibid., pp. 37-38.

(iii) All partnerships, registered in India, in which the proportion of the proprietory interest of a partner or partners resident abroad exceeds 40% and which were controlled from abroad.

The above statistical concept of control is necessarily a formal one indicating the existence of potential control of the firm by the non-residents, rather than the extent to which managerial control is in fact exercised. At the same time the concept is an arbitrary one; there is no proof that only if 40% or more of the ordinary shares of a joint stock company are owned by non-residents, the control changes hands from residents to non-residents. In the case of Canada, the category of foreign direct investments includes all concerns which are known to have 50% (rather than 40%) or more of their voting stock held in a country outside Canada.[4]

Portfolio investments. The Census treated all the obligations - equity or creditor - as portfolio investments by the foreigners, if their control remained in India. In those cases where the shares of a company were distributed in a number of countries, the procedure

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4. Canada, Dominion Bureau of Statistics, Canada's International Investment Position 1926-54 (Ottawa, 1956), p. 24 and The Canadian Balance of Payments 1961 and 1962 (Ottawa, 1964), pp. 95-97.

adopted was as follows: The country in which the proportion of shares held was large enough or alternatively was known to exercise control was considered as a country from which direct investment in the company had taken place; the holdings in other countries were taken as portfolio investments.

Definitional and methodological changes, 1953: In the next collection of statistics of foreign business investments as on 31st December, 1953, one of the direct investment criteria - that a joint stock company be treated as a form of direct investment if the ownership of 40% or more of its ordinary shares were located in any one country outside India - was changed. The change was made in regard to a few companies incorporated after 30th June, 1948:

> In the last three or four years, a number of companies had been started by Indians in collaboration with foreign interests. The foreigners usually provided the technical services (or know-how) for the projects and were alloted shares by way of compensation for these services. Control over these companies rested entirely with Indians, even though 40% or more of their shares was owned outside India. The foreign investment in these companies was treated as an exception to the general criterion and classified as portfolio.[5]

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5. Reserve Bank of India, Report on the Survey of India's Foreign Liabilities and Assets as on 31st December 1953 (Bombay, 1955), p. 12; hereafter it is cited as the First Survey.

Apart from revising the trade classification of companies, the First Survey excluded the investment figures relating to partnerships and made a departure from the practice of treating shares owned by foreign controlled "resident" managing agencies as part of foreign investment.[6]

If we apply these changes to the Census data so that a correct comparison can be made with the First Survey data and if the Census figures are revised in the light of more information available for the year 1948, the Census figures should be scaled down from Rs 3200 million to Rs 2875 million.[7]

Another survey[8] of foreign business investments relating to the year 1955 was made on the same pattern as the First Survey.

The latest survey[9] was made relating to the year 1961. This was on the same pattern as the First Survey and the Second Survey except that it included statutory corporations, excluded insurance companies and

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6. Ibid., p.74.

7. Ibid., Table V-1, p.75.

8. Reserve Bank of India, Report on the Survey of India's Foreign Liabilities and Assets as on 31st December, 1955 (Bombay, 1957); hereafter cited as the Second Survey.

9. Reserve Bank of India, India's Foreign Liabilities and Assets 1961 - Survey Report (Bombay, 1964); hereafter cited as the Third Survey.

incorporated certain changes in the manner in which foreign loans and credits were allocated to diferent sectors.[10]

<u>New arrangement</u>. For the years 1956-60 and 1962, the Reserve Bank of India collected data under a new arrangement. Unlike the Census and Surveys data which were based exclusively on information obtained from individual companies,the data under the new arrangement are obtained, to a large extent, from the records of the Reserve Bank's Exchange Control Department (E.C.D.) except for reinvestment of profits and investment in kind for which the information has to be obtained from individual companies. The data collected under the new arrangement differ in one important respect from the Census and Surveys data; the latter give the <u>levels</u> of foreign investment and permit an assessment of the capital inflow only indirectly by means of comparison of the levels of investment on different dates, the former permits a direct measurement of capital flows under various categories like foreign investments in cash and in kind, reinvestment of profits and repatriation of foreign investment.[11]

We have mentioned above that foreign business

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10. <u>Ibid</u>., p.33.

11. <u>Reserve Bank of India Bulletin</u> (September, 1958), p. 1008.

investments on 30th June 1948 amounted to Rs 2875 million, of which banking investments were Rs 317 million and non-banking investments Rs 2558 million. The figure of non-banking foreign investments of Rs 2558 million has been further revised to Rs 2646 million.[12]

In the following pages we shall make a detailed study of the sources of the inflow of non-banking foreign business investments - that is, whether they come through cash transfers, retained earnings or investment in kind - and the pattern of such investments - that is, whether they are direct or portfolio, in foreign branches or subsidiaries. From now onwards in this study, whenever we refer to foreign business investments, it will always mean non-banking foreign business investments unless otherwise specified.

II. Sources of Inflow

During the period 1948-62, there was a net increase of Rs 4709 million in the foreign business investments. Of this, Rs 3609 million were contributed by the private foreign sources and Rs 1100 million by the official foreign sources. The breakdown in the various years is given in Table 3.

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12. Reserve Bank of India, The Third Survey, p.16.

Table 3

Foreign Business Investments, 1948-62

(Rs millions)

	Private Sources Abroad	Official Sources Abroad	Total
Mid-1948	2646	-	2646
End 1953	3971	-	3971
" 1955	4397	27	4424
" 1956	4635	148	4783
" 1957	4843	477	5320
" 1958	4886	739	5625
" 1959	4989	839	5828
" 1960	5522	825	6347
" 1961	5805	993	6798
" 1962	6255	1100	7355

Source: Reserve Bank of India Bulletin (April, 1966), Table 1, p. 363.

Sources of inflow, 1948-55: During July 1948 to December 1955, foreign business investments increased by Rs 2007 million,[13] of which Rs 470 million[14] were due to revaluation. Thus net inflow (excluding revaluation) was Rs 1537 million (see Table 4). During this period Rs 820 million worth of foreign investments were repatriated. Adding the amount repatriated to the net inflow (excluding revaluation), we get the gross inflow equal to Rs 2357 million. There were two sources which subscribed to this inflow: Retained profits and fresh capital inflow; the latter was either in cash or in kind.

Investment in kind received particularly by the branches of foreign companies and Indian subsidiaries is not recorded in India's balance of payments statistics and has been a source of considerable confusion in the estimation of capital inflows and outflows:

> Some of this was accounted for by companies which import goods on a consignment basis but do not fully remit the proceeds of the sale of these goods to the consignor companies. It is believed that a large part of the investment in the oil refineries was received in this manner. Similarly some companies registered in India instead of bringing funds

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13. According to the revised figures given in the Reserve Bank of India Bulletin (April, 1966), business investments had increased by Rs 1778 million and not Rs 2007 million. However, we are using the figure of 2007 million because the details we require are available only for this figure.

14. U.N. ECAFE, "Postwar Foreign Investment in India", Economic Bulletin for Asia and the Far East (June, 1962), Table 6, p. 6.

Table 4

Sources of Inflow of Foreign Business Investments
(Excluding Revaluation) 1948-62

(Rs millions)

	1948-53	1954-55	1956-60	1961-62
A. Private Sources				
1. Net Inflow	1210	300	1090	578
2. Gross Inflow	1710	620	1745	743
(a) Retained Earnings	700	460	665	236
(b) Cash Inflow	350	30	232	90
(c) Non Cash Inflow	660	130	848	417
3. Outflow	500	320	655	165
B. Official Sources				
1. Net Inflow	-	27	798	275
2. Gross Inflow	-	27	892	479
3. Outflow	-	-	94	204
C. Total Net Inflow	1210	327	1888	853
D. Total Gross Inflow	1710	647	2637	1222

Sources: 1948-55: Economic Bulletin for Asia and theFar East (June, 1962), Table 6, p.6.

1956-62: Reserve Bank of India Bulletin (April, 1966), p.364.

Note: Figures for 1948-55 do not tally with the ones given in Table 3. Table 3 has been worked out from the revised figures which are not amenable to the processing done in this table.

from abroad bring equipment and issue to the foreigners in lieu thereof shares in the companies against the import of goods. A substantial part of the fresh investment in goods and machinery was not probably reflected in the published payments figures - based on E.C.D. data - since concerns which import goods as part oftheir working capital, are not required to approach the Reserve Bank in so far as the imports are covered by valid licenses. They have to secure approval of the Bank, whenever shares are to be issued to the non-residents in lieu of goods and equipment exported by them previously and even when approval is accorded, the value of the shares is not included in the existing payments statistics. Similarly they are not required under the present regulations to report these imports to the E.C.D., until such time as they have to seek repatriation of their invested funds for which purpose production of import licenses would be adequate proof and which can be done without any restrictions of time limit.[15]

Up to 1956, no data were available regarding investment in kind. The estimates that have been made for the period 1948-55 are in the nature of residuals (i.e., are calculated by deducting the figures of retained profits, cash inflow, etc., from the total increase in foreign business investments as reported by the enterprises having such investments).

We have noted above that the gross increase (excluding revaluation) in foreign business investments during 1948-55 was Rs 2357 million. Of this, Rs 1160 million were financed through retained earnings and Rs 1170 million through fresh capital inflow of which Rs

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15. First Survey. p. 84.

790 million were in kind and Rs 380 million in cash. Another Rs 27 million came from the official sources abroad - in this case from the World Bank.

Sources of Inflow, 1956-62. During January 1956 to December 1962, there was a net increase of foreign business investments amounting to Rs 2931 million. Rs 190 million of this amount was due to revaluation.[16] Thus net inflow (excluding revaluation) during 1956-62 was Rs 2741 million.

Up to the end of 1958, the World Bank was the only official organization participating in the business sector of India. During 1959-62, other official organizations such as the Development Loan Fund (D.L.F.) and Export Import Bank (Eximbank) of the United States, the British Government (Loan for the Oil-Pipe Line Project) and the Japanese Government (Yen credit) also participated.

During the entire period 1948-62, there was a

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16. There was a revaluation of Rs 20 million in 1958 (see U.N. Economic Bulletin for Asia and the Far East, June, 1962, p.6); another revaluation of Rs 20 million occurred in 1960 (see Reserve Bank of India Bulletin, October, 1962, pp.1531-44). In 1962, a revaluation of Rs 150 million occurred, which included Rs 37 million in the plantation sector and Rs 87 million in the petroleum sector (see Reserve Bank of India Bulletin, April, 1966, pp.366-67).

net increase of foreign business investments amounting to Rs 4938 million[17] - Rs 2007 million during 1948-55 and Rs 2931 million during 1956-62. There was a revaluation of foreign investment amounting to Rs 660 million. Net increase (excluding revaluation) was thus Rs 4278 million. There was an outflow of foreign investments during this period equal to Rs 1938 million - Rs 1640 million of investments from the private sources and Rs 298 million of investments from official sources. Gross inflow was thus Rs 6216 million.

Of Rs 6216 million, Rs 1398 million were provided by official organizations and Rs 4818 million by private sources.

Of Rs 4818 million, retained earnings contributed Rs 2061 million, cash inflow Rs 702 million, and non-cash inflow Rs 2055.

III. Pattern of Investment

We noted in Table 3 that foreign business investments increased by Rs 4709 million (including revaluation) during 1948-62. Of this Rs 1100 million were

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17. This figure of Rs 4938 million is different from the investment figure of Rs 4709 million used in the beginning of this section. The difference of Rs 229 million is there because we had to use the figure of Rs 2007 million for 1948-55 instead of the revised one of Rs 1778.

contributed by official sources abroad and Rs 3609 million by private sources abroad.

Foreign business investments by official sources abroad. Official organizations, particularly the World Bank, Development Loan Fund and Eximbank, are increasingly participating in the business sector of India. Whereas such participation was non-existent before 1955, it contributed about 15% of the total foreign business investments in 1962. Detailed figures are given in Table 5. One may mention here that all the investments of the official sources abroad are portfolio investments.

Up to the end of 1958, the World Bank was the only official organization participating in India's private sector. During this period, the World Bank concentrated exclusively in the metals and metal products sector and construction, utilities and transport.

By 1959, except for Rs 11 million invested by the Japanese government, the entire amount was contributed by the World Bank. It still continued to monopolize the metals and metal products sector and construction, utilities and transport except Rs 23 million in the non-banking financial sector of India.

By1960, there was a nominal amount of Rs 3 million invested by the United States Government; another nominal contribution of Rs 7 million was made by the Czechoslovakia government; Japanese government still had her Rs 11 million and the remaining Rs 804 million were

Table 5

Outstanding Foreign Official Investments in the Private Sector of India

(Rs millions)

	1955	1956	1957	1958	1959	1960	1961	1962
Petroleum*	-	-	-	-	-	-	39	18
Manufacturing	20	102	401	637	686	658	749	825
of which								
Textile Products	-	-	-	-	-	-	7	4
Machinery and machine tools	-	-	-	-	-	10	26	61
Metals and metal products	20	102	401	637	686	648	630	566
Chemicals and allied products	-	-	-	-	-	-	30	86
Miscellaneous	-	-	-	-	-	-	56	108
Services	7	46	76	102	153	167	205	257
of which								
Construction, utilities and transport	7	46	76	100	130	132	144	142
Financial	-	-	-	2	23	35	61	115
TOTAL	27	148	477	739	839	825	993	1100

* Petroleum includes petroleum manufacturing and trading.

Source: Reserve Bank of India Bulletin (April, 1966), p.377.

contributed by the World Bank.

By 1961, the share of the United States government had increased to Rs 163 million and that of the World Bank had fallen (because of the outflow) to Rs 757 million. The World Bank continued to concentrate in metals and services. However, the United States investments were widespread over the entire manufacturing sector.

In 1961, Rumania made an investment of Rs 39 million in the petroleum sector. This was the first time that any official organization had made investments in the petroleum industry.

By 1962, the share of the United States had increased to Rs 295 million while that of the World Bank had fallen further to Rs 719 million. The share of Czechoslovakia had increased to Rs 58 million and the whole of it was in machinery and machine tools.

Foreign business investments by private sources abroad. Foreign business investments made by private sources abroad more than doubled during the fourteen and a half year period, 1948-62; investment pattern also changed a great deal during the same period. The figures are given in Table 6.

By the end of June 1948, private foreign investments were Rs 2646 million; during the next five and a half years these investments increased by Rs 1325 million; during the next two years, the increase was of Rs 426 million; during 1956, 1957, 1958, 1959, 1960, 1961 and 1962 these investments increased by Rs 238, 208, 43, 103, 533, 283

Table 6

Outstanding Foreign Private Investments
in the Private Sector of India

(Rs millions)

	Mid-1948	End 1953	End 1955	End 1956	End 1957
Plantations	522	715	872	878	865
Mining	115	84	93	106	95
Petroleum(a)	223	771	1040	1164	1341
Manufacturing of which	707	1241	1271	1340	1406
Foods, beverages etc.	101	313	290	297	301
Textile products	280	252	218	219	211
Transport equipment	10	54	36	45	49
Machinery & machine tools	12	27	50	54	56
Metals & products	80	85	91	102	114
Electrical goods & machinery	48	120	146	158	165
Chemicals & allied products	80	189	203	221	229
Other manufactures	96	201	237	244	281
Services of which	1079	1160	1121	1147	1136
Trading(b)	430	277	268	290	270
Const'n, utilities & transport	315	408	420	444	458
Financial	157	198	174	168	164
Other services	177	277	259	246	244
TOTAL	2646	3971	4397	4635	4843

Table 6 (continued)

	End 1958	End 1959	Ebd 1960	End 1961	End 1962
Plantations	951	942	990	1024	1103
Mining	118	124	127	124	130
Petroleum(a)	1184	1195	1492	1486	1522
Manufacturing of which	1512	1617	1802	2201	2449
Foods, beverages etc.	304	313	340	361	395
Textile products	211	219	221	207	224
Transport equipment	57	71	79	130	155
Machinery & machine tools	59	71	91	114	177
Metals & products	123	136	178	321	350
Electrical goods & machinery	171	178	185	148	169
Chemicals & allied products	259	301	345	511	564
Other manufactures	328	327	363	409	414
Services of which	1121	1110	1111	970	1051
Trading(b)	296	278	294	293	327
Const'n, utilities & transport	418	414	396	421	461
Financial	164	166	167	63	63
Other services	243	251	254	193	200
TOTAL	4886	4989	5522	5805	6255

(a) Petroleum includes both petroleum manufacturing and petroleum trading.

(b) Trading does not include petroleum trading.

Source: Reserve Bank of India Bulletin (April, 1966), pp. 377-378.

Note: Totals may not add up because of rounding.

and 450 millions respectively. On the average, the private foreign investments increased annually by about Rs 249 million.

Over the fourteen and a half year period under study the pattern of private foreign investments shifted drastically in favour of petroleum and manufacturing sectors; in petroleum the investment increased from Rs 223 million in June 1948 to Rs 1522 million in 1962 and in manufacturing the investment increased from Rs 707 million to 2449 million during the same period. During 1948-62, the proportionate share of petroleum increased from 8% to 26% and of manufacturing from 27% to 39%; the relative share of plantations, mining and services decreased.

If we combine the business investments made by both private and official sources abroad, the investment pattern changes markedly in favour of manufacturing. This is so because most of the official organizations invested only in the manufacturing sector. The combined investment pattern in absolute figures is given in Table 7 and in percentages in Table 8 and Figure 2.

Combined investments in manufacturing of Rs 707 million in 1948 more than quadrupled by 1962. Investments in petroleum in 1962 were seven times those of 1948. Investments in plantations doubled during 1948-62; in services, investments increased by a third and in mining there was only a small increase.

Table 7

Outstanding Foreign Business Investments in India

(Rs millions)

	Mid-1948	End 1953	End 1955	End 1956	End 1957
Plantations	522	715	872	878	865
Mining	115	84	93	106	95
Petroleum(a)	223	771	1040	1164	1341
Manufacturing of which	707	1241	1291	1442	1807
Foods, beverages etc.	101	313	290	297	301
Textile products	280	252	218	219	211
Transport equipment	10	54	36	45	49
Machinery & machine tools	12	27	50	54	56
Metals & products	80	85	111	204	515
Electrical goods & machinery	48	120	146	158	165
Chemicals & allied products	80	189	203	221	229
Other manufactures	96	201	237	244	281
Services of which	1079	1160	1128	1193	1212
Trading(b)	430	277	268	290	270
Const'n, utilities & transport	315	408	427	490	534
Financial	157	198	174	168	164
Other Services	177	277	259	246	244
TOTAL	2646	3971	4424	4783	5320

Table 7 (continued)

	End 1958	End 1959	End 1960	End 1961	End 1962
Plantations	951	942	990	1024	1103
Mining	118	124	127	124	130
Petroleum(a)	1184	1195	1492	1525	1540
Manufacturing of which	2149	2303	2460	2950	3274
Foods, beverages etc.	304	313	340	361	395
Textile products	211	219	221	214	228
Transport equipment	57	71	79	130	155
Machinery & machine tools	59	71	101	140	238
Metals & products	760	822	826	951	916
Electrical goods & machinery	171	178	185	148	169
Chemicals & allied products	259	301	345	541	650
Other manufactures	328	327	363	465	522
Services of which	1223	1263	1278	1175	1308
Trading(b)	296	278	294	293	327
Const'n, utilities & transport	518	544	528	565	603
Financial	166	189	202	124	178
Other services	243	251	254	193	200
TOTAL	5625	5828	6347	6798	7355

(a) Petroleum includes both petroleum manufacturing and petroleum trading.

(b) Trading does not include petroleum trading.

Source: Reserve Bank of India Bulletin (April, 1966), p.378.

Table 8

Pattern of Foreign Business Investments in Percentages

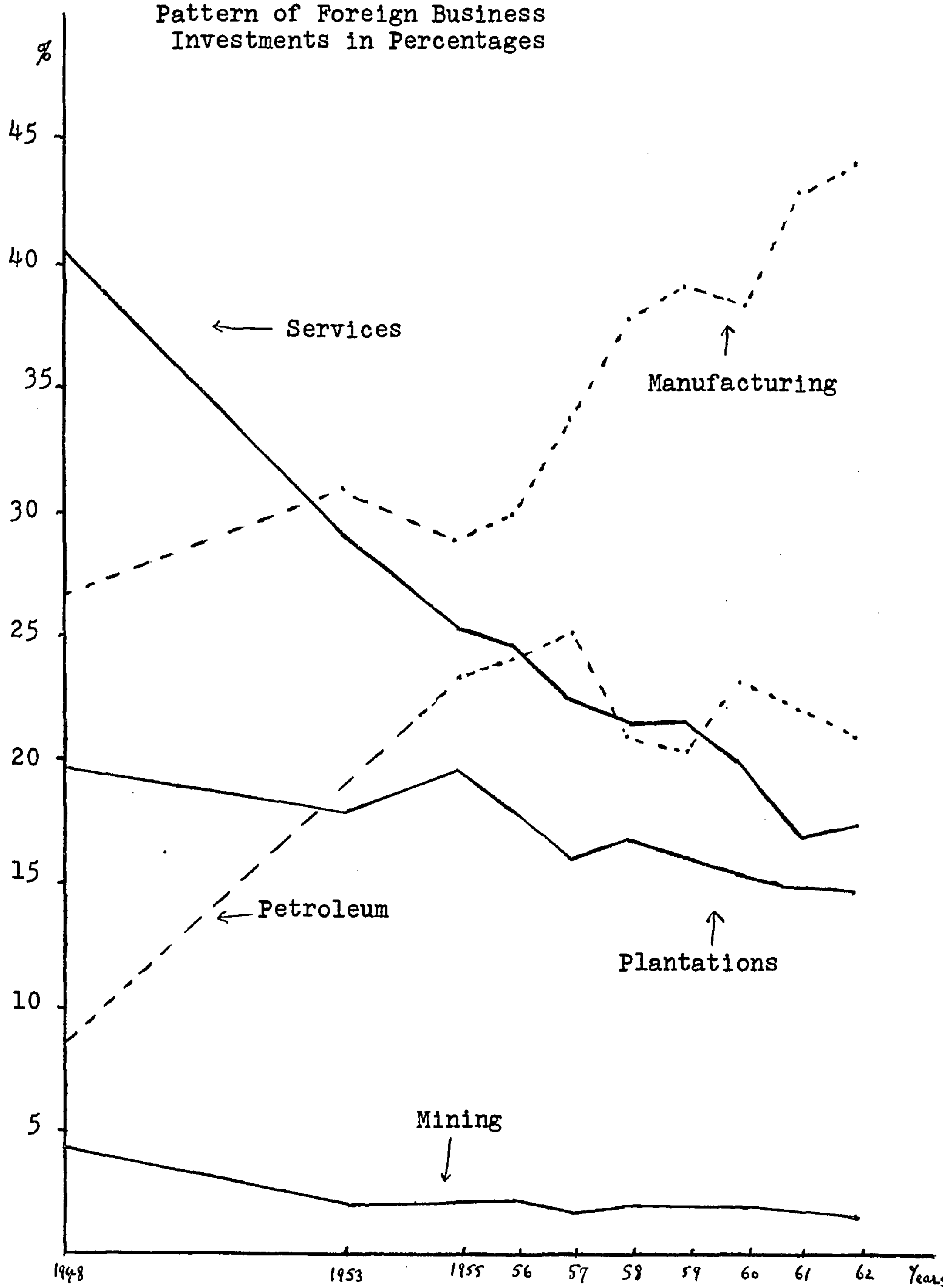
	Plant-ations	Mining	Petro-leum	Manufact-uring	Services	Total
Mid-1948	19.7	4.3	8.4	26.7	40.8	100
End 1953	18.0	2.1	19.4	31.2	29.2	100
" 1955	19.7	2.1	23.5	29.2	25.5	100
" 1956	18.3	2.2	24.3	30.2	25.0	100
" 1957	16.2	1.8	25.2	34.0	22.8	100
" 1958	16.9	2.1	21.1	38.2	21.7	100
" 1959	16.2	2.1	20.5	39.5	21.7	100
" 1960	15.6	2.0	23.5	38.8	20.1	100
" 1961	15.1	1.8	22.4	43.4	17.3	100
" 1962	15.0	1.8	20.9	44.5	17.8	100

Source: As in Table 7

Note: Totals may not add up because of rounding.

Figure 2

Pattern of Foreign Business Investments in Percentages



Source: Table 8.

Direct and portfolio investments: Investments in India made by the official foreign sources were all portfolio and those made by private foreign sources were predominantly direct. The pattern of foreign business investments in terms of direct and portfolio investments is given in Table 9. Of the total foreign business investments of Rs 7355 million in 1962, 5676 million were direct and 1679 million were portfolio while in 1948, 2112 million were direct investments and 447 million portfolio investments. The share of direct investments in 1948 was 83% and of portfolio investments 17%; in 1962, the share of direct investments decreased to 77% and that of portfolio investments increased to 23%. This, however, was due to official organizations' participation in the business sector of India. Since official organizations' investments are portfolio and since by 1962, official organizations contributed about one-seventh of the total foreign business investments, this decline in the direct investments share is understandable.

Investments in plantations have been predominantly and increasingly of the direct category: Of the total of 523 million in 1948, 451 million were direct and of the total 1103 million in 1962, 1071 million were direct; in other words, the share of direct investments in plantations increased from 86% in 1948 to 97% in 1962.

In manufacturing, of the total foreign business investments of Rs 710 million in 1948, the direct invest-

Table 9

Direct and Portfolio Foreign Investments in India

(Rs millions)

	Mid-1948	End 1953	End 1955	End 1956	End 1957
Plantations					
Direct	451	641	808	815	803
Portfolio	72	74	64	63	62
Mining					
Direct	89	62	78	90	81
Portfolio	25	22	15	15	14
Petroleum					
Direct	220	768	1036	1161	1338
Portfolio	3	3	4	3	3
Manufacturing					
Direct	486	950	1007	1064	1125
Portfolio	224	291	284	378	682
Services					
Direct	866	842	936	967	959
Portfolio	123	267	192	226	253
Total					
Direct	2112	3263	3865	4097	4306
Portfolio	447	657	559	685	1014
Grand Total	2558	3920	4424	4783	5320

Note: Figures for the years 1948 and 1953 are different from those in Table 7. Table 7 contains revised figures which are not amenable to processing done in this table.

Table 9 (continued)

	End 1958	End 1959	End 1960	End 1961	End 1962
Plantations					
Direct	896	890	945	991	1071
Portfolio	55	52	46	33	32
Mining					
Direct	105	111	114	109	106
Portfolio	13	13	13	15	24
Petroleum					
Direct	1181	1192	1490	1481	1518
Portfolio	3	3	2	44	22
Manufacturing					
Direct	1214	1310	1472	1868	2089
Portfolio	935	993	988	1082	1185
Services					
Direct	945	935	937	823	892
Portfolio	278	328	341	352	416
Total					
Direct	4341	4437	4957	5272	5676
Portfolio	1284	1390	1389	1526	1679
Grand Total	5625	5828	6347	6798	7355

Sources: 1948: Reserve Bank of India, Second Survey (Bombay, 1957), Statements 8 and 13.

1953-62: Reserve Bank of India Bulletin (April, 1966), Statement 3, pp.374-376.

Totals may not add up because of rounding.

ments were 486 million and of the total of 3274 million in 1962, such investments were Rs 2089; proportionately the share of direct investments declined from about 68% in 1948 to about 64% in 1962.

In petroleum, investments have all along been direct; of the total of Rs 223 million investments in 1948, Rs 220 million were direct and of the total of Rs 1540 million in 1962, direct investments were 1518 million.

In mining, the share of direct investments has been continuously increasing over the period; in 1962, of the total of 130 million, 106 million were direct. As regards services, the share of direct investments was more than 88% in 1948; after 1955, because of the participation by official organizations abroad, the share of the direct investments declined; in 1962, this share was about 68%.

Of the various countries which participated in the business sector of India during 1948-62, the United Kingdom made the biggest contribution. The investment figures from various countries are given in Table 10. Of the total foreign business investments of Rs 7355 million by the end of 1962, Britain's share was 4828 million or about 66%. Next comes the United States whose contribution by 1962 was 1089 million or about 15%. Switzerland, West Germany, Canada and others had only a small share of business investments in India.

Of the two most important contributors, the United Kingdom's investments have been predominantly

Table 10

Foreign Business Investments in India
(Countrywise Classification)

(Rs millions)

	Mid-1948	End 1953	End 1955	End 1956	End 1957
U.K.					
Direct	1796	2793	3308	3468	3564
Portfolio	264	471	351	344	342
U.S.A.					
Direct	102	276	367	439	542
Portfolio	10	25	29	29	30
Switzerland					
Direct	46	46	42	56	41
Portfolio	7	14	15	17	17
West Germany					
Direct	1	1	6	3	9
Portfolio	-	-	18	20	22
Canada					
Direct	-	-	-	-	-
Portfolio	-	-	-	-	-
Japan					
Direct	-	-	-	-	-
Portfolio	-	-	-	-	-
Italy					
Direct	-	-	-	-	-
Portfolio	-	-	-	-	-
Sweden					
Direct	-	-	-	-	-
Portfolio	-	-	-	-	-
Others					
Direct	166	147	143	131	151
Portfolio	166	147	145	275	602
Total	2558	3920	4424	4783	5320
Direct	2111	3263	3865	4097	4306
Portfolio	447	657	559	685	1014

Note: Figures for 1948 and 1953 in this table agree with those in Table 9 but not with those in Table 7. For this difference, see footnote of Table 9.

Table 10 (continued)

	End 1958	End 1959	End 1960	End 1961	End 1962
U.K.					
Direct	3566	3565	3998	4176	4507
Portfolio	337	331	325	286	321
U.S.A.					
Direct	569	643	685	760	755
Portfolio	33	34	45	199	334
Switzerland					
Direct	40	49	61	76	91
Portfolio	18	17	18	17	17
West Germany					
Direct	11	16	30	44	56
Portfolio	22	34	34	63	64
Canada					
Direct	-	-	-	63	71
Portfolio	-	-	-	2	2
Japan					
Direct	-	-	-	9	11
Portfolio	-	-	-	23	22
Italy					
Direct	-	-	-	24	30
Portfolio	-	-	-	17	22
Sweden					
Direct	-	-	-	44	74
Portfolio	-	-	-	-	-
Others					
Direct	155	165	184	76	80
Portfolio	875	974	969	919	897
Total	5625	5828	6347	6798	7355
Direct	4341	4437	4957	5272	5676
Portfolio	1284	1390	1389	1526	1679

Source: Reserve Bank of India Bulletin (April, 1966), pp. 374-376.

Totals may not add up because of rounding.

direct; to be precise, 93% of her investments in India by 1962 were direct. The share of the direct investments in the United States total investments in India by 1962 was about 69%.

Direct investments during 1948-62 were made either in foreign branches or in foreign subsidiaries - the latter are known as controlled rupee companies in India. In portfolio investments, equity capital predominates; creditor capital makes a small share. Detailed figures are given in Table 11. It may be noted that the share of direct investments made in foreign branches has been declining since 1956. Remaining at about 64% during 1948-56, the share came down to 63% in 1957, 59% in 1958, 55% in 1959 and 1960, 51% in 1961, and 52% in 1962. The decline in the share of investments in foreign branches may be due, among other things, to the Indian government policy to encourage Indo-foreign business collaboration.

IV. Share of Foreign Business Investments

We noted earlier (Table 3) that foreign business investments in India increased by Rs 1325 million during July 1948 to December 1953, that is the annual increase in such investments was Rs 241 million. During January 1954 to December 1960, foreign investments increased by Rs 2376 million. For the ten year period January 1951 to

Table 11

Foreign Business Investments in India

(Rs millions)

	Direct		Portfolio			
	Foreign Branches	Controlled Rupee Companies	Private Equity	Private Creditor	Official	Total
Mid-1948	1360	751	449*		-	2558
End 1953	2193	1182	538	121	-	4033
" 1955	2523	1436	506	114	27	4604
" 1956	2764	1526	516	109	148	5063
" 1957	2817	1644	518	108	469	5556
" 1958	2591	1766	521	107	722	5706
" 1959	2470	2009	527	106	995	6107
" 1960	2758	2259	533	114	1241	6905
" 1961	2715	2569	443	90	993	6810
" 1962	2931	2745	474	105	1100	7355

* Includes creditor capital

Sources: 1948-53: First Survey, Table 11-20, pp.35-37, 75; and Second Survey, Statement 13, pp. XIX-XX.

1955: Second Survey, Table 1, p.12.

1956: Reserve Bank of India Bulletin (September, 1958), Table 1, p. 1008 and Statement III, p. 1018.

1957: Reserve Bank of India Bulletin (June, 1959), Table 1, p. 660 and Statement III, p. 669.

1958: Reserve Bank of India Bulletin (April, 1960), Table 1, p. 466 and Statement II, p. 474.

1959: Reserve Bank of India Bulletin (May, 1961), Table 1, p. 674.and Statement II, p. 683.

1960: Reserve Bank of India Bulletin (October, 1962), Statement II, p. 1540.

1961: Third Survey, Statement 10, pp. 72-73

1962: Reserve Bank of India Bulletin (April, 1966), Statement 2, p. 373.

Note: Figures in this table differ from those in other tables since the breakdown in the above form is available only for the original figures.

Totals my not add up because of rounding

December 1960, foreign business investments increased by Rs 3099 million.

During April 1951 to March 1961, total investments in India increased by Rs 101 billions, of which private investments accounted for Rs 49 billion.[18] The amount of foreign business investments during almost the same period was Rs 3099 million. Thus, the share of foreign business investments was only about 3% of the total investments and 6.3% of total private investments during the period covered by the First and Second Five Year Plans of India.

During the Second Plan period, 1956-61, total private investments were Rs 31 billion of which investments in organised industry and minerals were Rs 6.75 billion.[19] No such breakdown of the private investments of Rs 18 billion during the First Plan period, 1951-56, is available. So we assume that the proportionate share of organised industry and minerals in total private investments during 1951-56 was the same as during 1956-61. This would mean that investments in organised industry and minerals were Rs 3.92 billion during 1951-56 and Rs 10.67 billion during 1951-61. In India, organised industry

18. India, Planning Commission, Third Five Year Plan (New Delhi, 1961), p. 32.

19. Ibid., p. 59.

and minerals sector is virtually synonymous with the corporate sector.

About 60% of foreign business investments in India were in the corporate sector.[20] In other words, Rs 1859 million of Rs 3099 million of foreign investments were in the corporate sector.

We mentioned above that total private investments in the corporate sector of India were Rs 10.67 billion. Of this, Rs 1859 million were contributed by the foreign investments. In other words, the share of foreign investments in the corporate sector of India was 17.4%

V. India's Overall International Investment Position

On June 30th, 1948, India had foreign assets totalling Rs 20087 million (refer to Table 12). On the same date, the foreign liabilities amounted to Rs 5042 million. Thus, she was enjoying a creditor position of Rs 15045 million. By the end of 1962, the assets had declined to Rs 6100 million and the liabilities had grown to Rs 26950 million. Considered from the angle of obligations owed and owned abroad, the country's investment

20. Outstanding foreign business investments by the end of 1961 were Rs 6.8 billion of which Rs 4.1 billion were in the corporate sector (see Reserve Bank of India, Third Survey, Statements 13 and 15, pp. 80-83). This means that 60% of foreign investments were in the corporate sector. No such breakdown is available for other years. We assume that for other years too, the share of the corporate sector is 60%.

Table 12

India's International Investment Position
1948-62

(Rs millions)

	Mid-1948	End 1953	End 1955	End 1961	End 1962
Assets					
Official	19396	12066	11760	5840	5050
Private	691	774	890	920	1050
Total	20087	12840	12650	6760	6100
Liabilities					
Official	1781	2496	2060	16260	18920
Private	3261	4768	5100	7390	8030
Total	5042	7264	7160	23650	26950
Net Position	15045	5576	5490	-16890	-20850

Sources: 1948-53: Second Survey, Table 1, p. 5.

1955-62: Reserve Bank of India Bulletin (April, 1966), Table 11, p. 371.

Note: The figures include both short-term and long-term assets and liabilities.

position had changed by as much as Rs 35895 million between mid-1948 and the end of 1962.

The pronounced changes in the country's international investment position over the fourteen and a half years were due, by and large, to the aftermath of the war and of partition and the impact of planned economic development.

The sizeable reduction in the net creditor position between mid-1948 and end of 1955, was mainly the result of certain extraordinary payments, such as transfers to Pakistan of its share of foreign assets of the undivided Reserve Bank, currency settlement with Aden following the withdrawal of the rupee from that territory, payment of pensions to former British employees out of the Pension Annuity and repayment of the Railway annuities and the liquidation of the Burmese debt following the arrangements reached with Burma in 1954.

Besides these extraordinary capital transactions, this period also witnessed inflationary pressures and domestic shortages of food and raw materials, which were in the main the legacy of the Second World War and the aftermath of partition and the Korean War. There were heavy deficits on current account.

India's international investment position in the period after 1955 changed rapidly as a result of payments for a sharp step-up in investment activity. A much larger outlay in the Second Plan compared to that in the First Plan, and a shift in emphasis from agriculture to the development of heavy industry were responsible for heavy imports of steel, machinery and chemicals. These imports had to be financed, in the initial years of the Second Plan, largely out of the country's own foreign exchange resources. After 1958, there was little scope for recourse to this source of financing. External assistance on a much larger scale than hitherto, started pouring in to finance developmental outlays.

CHAPTER IV

INDO-FOREIGN BUSINESS COLLABORATION

Since the second half of the fifties, the Indian government has insisted on Indo-foreign collaboration in new business ventures. There are a number of reasons for this insistence. One is that collaboration seems to give immediate relief to the balance of payments providing foreign exchange or its equivalent in imported machinery. Another is the desire to graft foreign managerial and technical skills on to Indian industry. These reasons have so affected Indian official thinking that it is now virtually impossible for an Indian firm to start up or expand without presenting a scheme for foreign collaboration.[1]

Apart from the government pressure, many foreign firms have their own reasons for seeking local collaboration or local intermediaries. The local intermediaries understand the way of persuading the government authority to make favourable decisions. Sometimes an opening ceremony of a factory by a minister or other high official can earn good dividends. This is an important factor of production which may not be fully emphasized and exploited by a foreigner without the help

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1. Michael Kidron, Foreign Investments in India (London, 1965), pp. 261-262.

of local intermediaries.

The importance of this factor may be illustrated by reference to Atul Products Ltd. - a major dyestuffs, chemicals and pharmaceutical producer, with Indian, British, American and Swiss capital involved:

> The factory construction, machinery installation and commencement of production proceeded without delay due to the promptness with which the Indian government issued the licences for importation of the requisite machinery and raw materials. The government showed its good-will and particular concern towards the company when the Prime Minister performed the inauguration ceremony in March 1952.[2]

I. Extent of Collaboration

During the last decade or so, there have been two types of collaboration; one technical and the other financial. Technical collaboration[3] is a partnership between an Indian party and a foreign party in which the latter agrees to supply (i) technical know-how by way of patents, process of manufacture, surveys, charts, blueprints, etc., and/or (ii) machinery and/or (iii) technical personnel to erect the factory and maintain it for some time during which the Indian personnel is trained.

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2. W.G. Friedmann and G. Kalmanoff (eds.), Joint International Business Ventures (New York, 1961), p. 390.

3. P.K. Srivastava, "Problems of Technical Collaboration", a paper submitted to the All India Seminar on Foreign Collaboration (Bombay, Feb. 1965).

For technical assistance, the foreign party receives a royalty of some fixed percentage of profits or a lump-sum payment, in addition to reimbursement for expenses incurred.

Financial collaboration will most often involve technical collaboration plus investment.

Technical-collaboration agreements. During the period 1957-65, there were 2340 collaboration agreements.[4] For the period prior to 1957, there are no published data on such agreements. Detailed figures for 1957-65 are given in Tables 13 and 14.

Of the total of 2340, about 70% of the agreements were made by four countries as follows: The United Kingdom, 639; the United States, 417; West Germany, 381; Japan, 206. Switzerland and France each made about 100 agreements, Italy 71 and East Germany 50, while each of the other participating countries made less than 50. Canadian firms[5] made only 16 agreements during the nine years from 1957 to 1965.

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4. An unknown, but large, number of these agreements were never used. This was affirmed by an officer in the Indian Investment Centre, New Delhi.

5. Canadian firms having technical collaboration agreements with Indian firms are: Parson and Whitemore, Canada; Massey Ferguson Ltd., Toronto; Structo System of Canada Ltd., Ottawa; Wireco Eng. Co. Ltd., Vancouver; Sheldan's Eng. Co. Ltd., Galt, Ontario; Air Coils Mfg. Ltd., Oakville; Canada-Wide Air Conditioning and Refrigeration Services, Toronto; Abitibi Power and Paper Co. Ltd.; Shaver Poultry Breeding Farms Ltd., Galt, Ontario; Consolidated Mining and Smelting Co. of Canada Ltd., Montreal; Aluminum Laboratories Ltd. Montreal; Foundation Overseas Ltd., Toronto; M/S Sandwell International Ltd., Canada and Caristrap Corporation of Canada.

Table 13

Indo-Foreign Technical-Collaboration Agreements, 1957-65

	1957	1958	1959	1960	1961	1962	1963	1964	1965	1957/65
United Kingdom	21	39	84	86	116	73	63	98	59	639
United States	7	5	6	70	77	62	64	78	48	417
West Germany	6	7	44	62	67	40	47	64	44	381
Japan	1	3	9	38	38	24	32	35	26	206
Switzerland	1	3	8	8	19	18	19	17	18	111
France	2	1	2	11	25	15	17	18	12	103
Italy	5	4	4	8	18	11	6	8	7	71
East Germany	-	-	-	3	5	6	13	19	4	50
Sweden	1	-	6	12	3	5	1	5	3	36
Netherlands	1	-	2	4	8	7	2	4	2	30
Denmark	-	-	3	6	4	2	3	8	1	27
Belgium	-	-	5	4	2	4	3	5	-	23
Czechoslovakia	-	-	-	7	2	1	3	4	3	20
Austria	-	-	1	2	4	3	2	5	1	18
Poland	-	-	-	2	6	-	3	4	2	17
Canada	-	1	-	-	5	6	-	3	1	16
Australia	-	-	-	6	2	2	-	2	3	15
Hungary	-	-	-	1	4	2	-	3	1	11
Yugoslavia	-	-	-	-	1	1	3	2	1	8
Norway	-	-	-	1	-	2	1	2	-	6
Others	36	40	35	3	3	5	5	5	3	135
Total	81	103	209	334	409	289	287	389	239	2340

Source: Office of the Indian Investment Centre, New Delhi.

Table 14

Industrial Classification of Indo-Foreign Technical-Collaboration Agreements, 1957-65

	1957	1958	1959	1960	1961	1962	1963	1964	1965	1957/65
Plantations	3	5	4	-	-	-	-	-	-	12
Food & Beverages	6	5	10	4	1	9	5	2	4	46
Cotton textiles	4	3	1	-	-	-	-	1	-	9
Jute textiles	-	-	1	-	-	-	-	-	-	1
Other textiles	7	2	7	11	4	4	8	8	7	58
Transport equipment	5	5	22	19	24	17	20	13	14	139
Iron & steel & products	2	-	4	7	13	11	19	29	13	98
Other metals & products	2	6	7	14	14	12	9	12	6	82
Electrical machinery	9	12	16	54	69	41	37	58	23	319
Machinery other than electrical & transport	7	8	44	104	131	80	96	139	86	695
Consumer durables*	1	5	3	13	14	11	2	6	7	62
Chemicals & allied products	11	8	25	45	53	42	35	48	33	300
Pharmaceuticals & allied products	3	9	12	9	7	14	6	10	3	73
Rubber & products	2	2	2	5	5	-	3	5	3	27
Leather & products	-	2	1	2	3	1	-	2	-	12
Pulp & paper & products	1	2	3	5	10	7	1	4	3	36
Cement	3	3	2	1	2	-	1	1	1	14
Building & construction	3	-	5	11	18	13	11	16	7	84
Glass & ceramics	-	2	3	4	5	2	3	6	5	30
Wood industry	1	-	1	1	3	2	2	2	4	16
Other manufactures	6	8	22	16	31	17	19	20	17	156
Trading services	1	3	3	9	1	2	-	-	1	20
Construction utilities & transport svcs.	1	7	7	-	1	4	9	6	1	36
Financial svcs.	3	5	3	-	-	-	-	-	-	11
Other services	-	1	1	-	-	-	1	1	-	4
Total:	81	103	209	334	409	289	287	389	239	2340

* Watches, cameras, radios, bicycles and sewing machines.

Source: Office of the Indian Investment Centre, New Delhi.

British firms have all along been active in seeking technical-collaboration agreements with Indian firms. Prior to 1960, United States firms were not very active, but since then their share is not much less than that of Britain.

During the period of 1957-65, 319 agreements were made in the electrical machinery sector, 139 in transport equipment and 695 in non-electrical non-transport machinery.

Thus, of the total 2,340 agreements, 1153 or about 49% were distributed among machinery of one kind or another. United Kingdom firms had 348 agreements - i.e., 54% of their total - in the machinery sector. The corresponding figures for the United States, West Germany and Japan were 42%, 57% and 46% respectively.

Chemicals and pharmaceuticals attracted 373 agreements, or about 16% of the total. United Kingdom firms had 82 agreements in this sector; in other words, 13% of all United Kingdom agreements were in the chemicals and pharmaceutical sector; the corresponding figures for the United States, West Germany and Japan were 20%, 15% and 16% respectively.

In the metals sector, there were 180 agreements of which iron and steel attracted 98 and other metals 82. Of this, 58 were with the United Kingdom, 26 with West Germany and 14 with Japan.

Financial Agreements. During 1951-65, the

Controller of Capital Issues in the Indian Ministry of Finance, granted a total of 1042 consents of new capital issues for the entire corporate sector of India. These issues totalled Rs 8908 million. For details we may refer to Table 15.

Of the total amount of Rs 8908 million for the entire corporate sector, foreign-associated issues accounted for Rs 4019.6 million or 45.1 percent.

During 1951-55, only 66 foreign-associated consents were granted, accounting for Rs 779 million. This was the period in which India had not experienced any foreign-exchange crisis and was not in a mood to welcome foreign collaboration with open arms.

During the next ten years, 303 foreign-associated consents were granted, accounting for Rs 3240.6 million. This was the period in which there was a serious foreign-exchange crisis and a strong shift to the "right" both in the economic field and foreign policy.

Non-resident contribution during the first two plan periods, 1951-60, was Rs 812 million. Capital issues for the entire corporate sector totalled Rs 4879 million during the same period. Thus, the share of non-residents in the total corporate sector was about one-sixth of the total[6] during the fifties.

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6. We arrived at a similar figure in section IV, Chapter III. There we had studied the share of actual foreign investment in the actual total investment in the corporate sector. Actual foreign investment was Rs 1859 million compared to Rs 812 million of new issues to non-

Table 15

Consents of Foreign- Associated New Capital
Issues in the Corporate Sector of India

(Amount in Rs millions)

Year	Consents for Total Corporate Sector		Consents for Foreign-Associated Corporate Sector		
	No.	Amount	No.	Amount	Foreign Amount
1951	46	216	19	96.4	39.8
1952	23	127	7	9.0	1.8
1953	31	183	11	92.3	36.0
1954	74	662	20	482.0	274.1
1955	76	479	9	99.3	57.4
1956	79	803	15	87.2	31.6
1957	54	433	12	81.6	35.3
1958	38	208	18	127.9	54.4
1959	51	768	25	415.2	207.4
1960	97	1000	26	225.4	74.3
1961	109	780	38	295.3	102.9
1962	122	736	59	471.0	143.4
1963	130	1269	54	627.6	211.6
1964	61	708	27	391.4	121.2
1965	51	536	29	518.0	147.4
Total	1042	8908	369	4019.6	1538.6

Source: (i) Office of the Controller of Capital Issues, Ministry of Finance, Govt. of India, New Delhi.

(ii) Office of the Company Law Administration, Ministry of Law, Govt. of India, New Delhi.

Contribution of non-residents was Rs 1539 million of the total of Rs 4020 million or 38.3 percent of the foreign-associated corporate sector during 1951-65. Only in two years - 1955 and 1959 - was the non-resident share 50 percent or more. And in both these years it is petroleum investments which explain the high non-resident share in the foreign-associated investment projects.

In 1955, the share of non-residents in total foreign-associated new capital issue was 57.8 percent. This was mainly the result of an issue of Rs 65 million in the Caltex Oil Refining India Ltd., of which Rs 45 million were provided by a foreign company, California Texas Corporation, U.S.A. In 1959, the share of non-residents was about 50 percent. This is primarily attributable to an issue of Rs 210 million in the Oil India (P) Ltd. Bombay, of which Rs 140 million or 66.6 percent were contributed by Burmah Oil Company Ltd., England.

II. Foreign Control of Indian Industry

A total of 369 foreign-associated consents for

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residents.

It may be mentioned here that granting of consent of new capital issue need not always be followed by actual investment. Also, new capital issue is only a part of the total investment. Total investment includes not only new-capital issues but also consents for further issues, debenture issues, loans etc.(see India, Controller of Capital Issues, Quarterly Statistics of the Working of Capital Issues Control: Annual Review, 1965, New Delhi, 1966, Table 14, p. 17).

new issues were granted during 1951-65. Of these, only five were granted full foreign ownership (see Table 16), accounting for less than 2 percent of the total foreign contribution of Rs 1539 million. These five consents naturally had full control over the investments authorized. Another category in which foreign control is as effective is the one where foreign participation is 75 percent or more. A holding of 75% or more ensures passage of the special resolutions required by law to change the administration and capital structure of a company. In this category there were 13 consents, accounting for about 6 percent of all authorized foreign investments. There were another 88 having a share of 50 percent or more but less than 75 percent; these accounted for more than 42 percent of the total foreign stake.

In 79 of the consents, the non-resident share was between 40 percent and 50 percent and these accounted for about 19 percent of new capital issues for non-residents.

There were thus 185 foreign companies authorized to hold shares of 40% or more, accounting for 69% of the total foreign investment in the foreign-associated consents of new capital issue. According to the definition of the Reserve Bank of India, all these were direct investments controlling the operations of Indian firms.

Another category in which the non-resident share was between 25 percent and 40 percent, had 74 companies, accounting for 21 percent of the total authorized foreign

Table 16

Foreign Participation in the Foreign-Associated Consents of New Capital Issues

(Amount in Rs millions)

Foreign Partici-pation		1951	1952	1953	1954	1955	1956	1957	1958
Less than 25%	No.	6	4	2	8	3	2	4	1
	Amt.	2.2	0.3	3.0	12.4	1.2	6.0	1.9	6.7
25% to less than 40%	No.	1	2	3	2	1	4	3	2
	Amt.	6.3	1.2	1.3	15.1	0.9	7.6	10.4	6.4
40% to less than 50%	No.	7	-	3	6	4	6	1	7
	Amt.	8.3	-	12.9	12.8	10.3	10.1	0.4	13.6
50% to less than 75%	No.	3	1	2	4	1	2	1	6
	Amt.	11.3	0.3	2.8	233.8	45.0	3.9	0.8	22.2
75% to less than 100%	No.	1	-	1	-	-	-	3	2
	Amt.	11.4	-	16.0	-	-	-	21.8	5.5
100%	No.	1	-	-	-	-	1	-	-
	Amt.	0.3	-	-	-	-	4.0	-	-
Total	No.	19	7	11	20	9	15	12	18
	Amt.	39.8	1.8	36.0	274.1	57.4	31.6	35.3	54.4

Table 16 (continued)

Foreign Partici- pation		1959	* 1960	** 1961	1962	1963	1964	1965	1951/65
Less than 25%	No.	3	9	13	22	12	9	12	110
	Amt.	4.1	28.2	19.5	24.0	13.4	9.7	19.4	152.0
25% to less than 40%	No.	8	4	8	6	16	9	5	74
	Amt.	17.5	4.9	21.1	18.8	74.7	64.0	73.2	323.4
40% to less than 50%	No.	4	3	5	11	9	4	9	79
	Amt.	29.5	7.8	9.0	49.8	74.0	10.3	46.0	294.8
50% to less than 75%	No.	7	8	11	19	15	5	3	88
	Amt.	144.7	14.5	38.3	48.8	39.5	37.2	8.8	651.9
75% to less than 100%	No.	2	2	-	1	1	-	-	13
	Amt.	8.0	18.9	-	2.0	4.5	-	-	88.1
100%	No.	1	-	1	-	1	-	-	5
	Amt.	3.6	-	15.0	-	5.5	-	-	28.4
Total	No.	25	26	38	59	54	27	29	369
	Amt.	207.4	74.3	102.9	143.4	211.6	121.2	147.4	1538.6

* Information in this form available for only 26 consents, although there were 33.

** Information in this form available for only 38 consents, although there were 39.

Source: As in Table 15.

capital. Under Indian conditions, where local ownership is often very dispersed, it can be assumed that much of the 25%-40% category is also foreign-controlled. Adding this to the controlled category of 40% or more, we get about 90% of the total foreign investment under foreign "control".

In the category of less than 25% foreign share, chances of control by non-residents are very limited. In this category were 110 companies accounting for less than 10% of the foreign investments.

During the period 1951-65, no new-capital-issue consent was granted for plantations (see Table 17). In mining only one consent was granted, with a minority share of less than 25% by non-residents.

About two-thirds of the capital authorized in the petroleum sector was by non-residents. This is despite the government's industrial policy which declared that the state would be exclusively responsible for new undertakings in mineral oils.[7] Involved in the oil sector were such giants as Burmah Oil Co., Ltd., London; Anglo Saxon Petroleum Co. Ltd., U.K.: California Texas Corporation, U.S.A.; and Philips Petroleum Co., U.S.A.

In food and beverages, the foreign share in foreign-associated capital was about 55%. In transport

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7. The Indian government issued an Industrial Policy Statement in 1948 and then in 1956. Both of these statements are reprinted in U.S. Dept. of Commerce, Investment In India (Washington, 1961), p. 148.

Table 17

Industrial Classification of Foreign-Associated Capital Issues, 1951-65

(Rs millions)

	Less than 25% foreign share			25% to less than 40% foreign share		
	No.	Total amount	Foreign amount	No.	Total amount	Foreign amount
1.Plantations	-	-	-	-	-	-
2.Mining	1	2.5	0.6	-	-	-
3.Petroleum	-	-	-	1	70.0	17.5
4.Food & beverages	1	1.5	0.3	4	12.0	4.0
5.Còtton textiles	1	2.9	0.5	-	-	-
6.Jute textiles	-	-	-	-	-	-
7.Other textiles	4	106.5	15.5	2	27.8	10.1
8.Transport equip.	6	86.0	11.6	6	60.2	18.9
9.Iron & steel & products	12	220.3	15.9	5	96.0	29.6
10.Other metals & products	3	64.5	12.4	4	16.6	5.2
11.Electrical machinery	13	86.1	14.3	7	46.5	13.4
12Machinery other than electrical & transport	22	170.1	18.8	7	35.9	12.3
13.Consumer durables*	1	1.9	0.2	1	2.4	0.7
14.Chemicals & allied products	13	106.0	16.5	15	437.6	141.8
15.Pharmaceuticals & allied products	1	3.5	0.8	2	2.0	0.7
16.Rubber & products	2	45.0	4.1	2	70.0	17.5
17.Leather & products	-	-	-	-	-	-
18.Pulp & paper & products	5	130.1	18.4	2	19.2	6.6
19.Cement	2	17.5	2.4	2	25.0	8.1
20.Building & construction	3	3.3	0.4	4	27.0	9.1
21.Glass & ceramics	3	13.2	2.4	3	11.0	3.3
22.Wood industry	1	3.0	0.3	1	1.7	0.6
23.Other mfrs.	11	71.1	9.0	2	5.5	1.9
24.Trading svcs.	1	2.0	0.1	1	0.5	0.2
25.Construction, utilities & transport svcs.	2	21.0	2.5	2	15.0	6.9
26.Financial svcs.	2	25.5	5.0	1	50.0	15.0
Total	110	1183.5	152.0	74	1031.9	323.4

Table 17 (continued)

	40% to less than 50% foreign share			50% to less than 75% foreign share			75% to less than 100% foreign share		
	No.	Total amt.	Foreign amt.	No.	Total amt.	Foreign amt.	No.	Total amt.	Foreign amt.
1.	-	-	-	-	-	-	-	-	-
2.	-	-	-	-	-	-	-	-	-
3.	-	-	-	5	590.5	417.7	-	-	-
4.	2	7.5	3.2	2	5.5	2.8	3	19.2	15.0
5.	-	-	-	-	-	-	-	-	-
6.	-	-	-	-	-	-	-	-	-
7.	3	24.2	10.1	2	27.8	16.4	-	-	-
8.	8	46.4	22.3	3	8.9	4.5	2	7.0	6.5
9.	5	56.7	24.7	3	10.6	7.1	-	-	-
10.	3	46.5	19.2	4	13.5	7.3	-	-	-
11.	11	31.5	14.5	11	39.9	21.1	-	-	-
12.	12	108.2	50.6	23	116.4	60.7	1	12.5	9.4
13.*	2	5.0	2.2	1	3.5	2.0	-	-	-
14.	14	222.1	100.2	7	33.0	16.8	2	35.0	27.4
15.	3	15.7	7.3	6	33.6	20.9	4	27.9	24.5
16.	-	-	-	2	15.0	8.7	-	-	-
17.	-	-	-	-	-	-	-	-	-
18.	1	3.0	1.5	1	1.3	0.8	-	-	-
19.	-	-	-	-	-	-	-	-	-
20.	2	20.0	8.9	1	2.5	1.4	-	-	-
21.	3	23.3	11.4	4	24.0	12.5	-	-	-
22.	-	-	-	-	-	-	-	-	-
23.	10	40.9	18.7	9	43.7	24.0	1	7.0	5.3
24.	-	-	-	1	0.5	0.3	-	-	-
25.	-	-	-	3	46.0	26.9	-	-	-
26.	-	-	-	-	-	-	-	-	-
Total	79	651.0	294.8	88	1016.2	651.9	13	108.6	88.1

Table 17 (continued)

	100% Foreign Share			Total		
	No.	Total amt.	Foreign amt.	No.	Total amt.	Foreign amt.
1.	-	-	-	-	-	-
2.	-	-	-	1	2.5	0.6
3.	-	-	-	6	660.5	435.2
4.	-	-	-	12	45.7	25.3
5.	-	-	-	1	2.9	0.5
6.	-	-	-	-	-	-
7.	1	0.3	0.3	12	186.6	52.4
8.	-	-	-	25	208.5	63.8
9.	-	-	-	25	383.6	77.3
10.	-	-	-	14	141.1	44.1
11.	2	9.5	9.5	44	213.5	72.8
12.	1	3.6	3.6	66	446.7	155.4
13.*	-	-	-	5	12.8	5.1
14.	-	-	-	51	833.7	302.7
15.	-	-	-	16	82.7	54.2
16.	-	-	-	6	130.0	30.3
17.	-	-	-	-	-	-
18.	-	-	-	9	153.6	27.3
19.	-	-	-	4	42.5	10.5
20.	-	-	-	10	52.8	19.8
21.	-	-	-	13	71.5	29.6
22.	-	-	-	2	4.7	0.9
23.	-	-	-	33	168.2	58.9
24.	-	-	-	3	3.0	0.6
25.	1	15.0	15.0	8	97.0	51.3
26.	-	-	-	3	75.5	20.0
Total	5	28.4	28.4	369	4019.6	1538.6

* Watches, cameras, radios, bicycles and sewing machines.

Source: As in Table 15.

equipment the foreign share was 30%; in iron and steel about 20%; in electrical machinery 34%; in non-electrical non-transport machinery about 35%; in consumer durables about 40%; in chemicals (including fertilizers) about 37%; in pharmaceuticals more than 65%;in rubber less than 25% and in pulp and paper less than 20%. In services, the foreign share in foreign-associated new capital issues was 41%.

Ownership by non-residents is one indicator of "control" of the operations of firms. This was strengthened by the terms and conditions of collaboration agreements in India. Following are some of the terms and conditions of collaboration agreements to illustrate this point:[8]

(1) The Indian firm is usually required to keep secret, all information supplied within the terms of the agreement, even after it has expired. With the expiry of the agreement, the Indian firm must stop the manufacture of products produced according to the patterns and designs of the foreign collaborator and return all drawings and documents.

(2) There is strict control over production. In some cases modifications made abroad must be incorporated into the Indian product whether justified by

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8. Kidron, op. cit., pp. 281-85; and Indo-Foreign Publication and Publicity, Survey of Indo-Foreign Collaboration (Bombay, 1963), pp. 78-80.

Indian conditions or not.

(3) The foreign firm frequently insists on appointing some of its own directors and engineers in the collaborated firms.

(4) The agreement usually limits the freedom of the Indian firm to sell abroad (although, quite often, the foreign firm is not precluded from continuing to sell in India). In some cases, the right to export is conditional on the use of the foreign firm's sales organization abroad.

(5) It is usually stipulated that, in case of a dispute which cannot be settled through a common understanding, the decision made by, say, the International Chamber of Commerce (Paris) will be binding.

In recent years, collaboration agreements have been subject to severe criticism, particularly in regard to their effects on India's technical know-how and balance of payments. These aspects will be studied in Chapter VI.

CHAPTER V

FACTORS DETERMINING THE INFLOW OF FOREIGN BUSINESS INVESTMENTS

We now possess a useful statistical picture of foreign business investments in India since 1948. We noted in section IV, Chapter III, that the share of foreign investments was about 3 percent of total investments and 6.3 percent of total private investments in India during the 1950's. India, however, is not the only country which could not attract foreign investments in large amounts. Many other Afro-Asian countries had a similar fate. A large share of the international flow of private capital during the fifties moved either among the industrially advanced countries themselves or to countries which had a substantial industrial sector; then came the low income countries which possessed natural resources, mostly in the form of oil and non-ferrous metals and permitted private foreign companies to exploit these resources; other low-income countries (and India is included in this group) could attract little capital.[1] In the present

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1. U.N. International Flow of Private Capital 1956-58 (New York, 1959), p. 11 and International Flow of Long-Term Capital and Official Donations, 1951-59 (New York, 1961), pp. 12-32.

chapter, we shall discuss some of the factors often reported to be responsible for determining the inflow of foreign investments in a developing country such as India.

Government participation in business. After about 150 years of colonial government, India achieved independence in 1947. The privileged position of private foreign investors who were compatriots of the colonial rule and thus were a target of criticism during the independence movement, naturally weakened. They repatriated their capital on a very large scale. The value of private foreign investments immediately before the Second World was unofficially reported to be around Rs 8500 to 9500 million;[2] it fell to a mere Rs 2646 million by mid-1948.

On April 6, 1948, the Indian Government issued a statement of national policy in the industrial field. This statement pleaded, on the one hand, for the mixed economy, and on the other hand, suggested that the State, as a matter of principle, must play a progressively active role in the development of industries. The statement further noted that in the case of coal, iron and steel, aircraft manufacture, shipbuilding, manufacture of telephone, telegraph and wireless apparatus (excluding radio receiving sets) and mineral oils, the existing undertakings

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2. U.N. Economic Bulletin for Asia and the Far East (June, 1962), p. 1.

would be permitted to develop for a period of ten years during which they would be allowed all facilities for efficient working and reasonable expansion; at the end of this period the whole matter would be reviewed and a decision taken in the light of the circumstances obtaining at that time. This part of the statement put a brake on the expansion of these industries without suggesting an alternative. Who would like to expand his industry if he fears that it might be nationalized in ten years? The fear of nationalization and the half-hearted welcome of the private sector were recorded as having adverse effects on private foreign investments.[3]

In December 1954, the Parliament of India adopted "socialist pattern of society" as the objective of social and economic policy. This objective created further doubts in the minds of private investors as to their role in the Indian economy.

In April 1956, another Industrial Policy Statement was issued which superseded that of 1948. This statement noted that the future development of Schedule A industries - such as the following - would be the exclusive responsibility of the State:

> Arms, amunition and allied items of defence equipment; atomic energy; iron and steel; heavy castings and forgings of iron and steel; heavy plant and machinery required for iron and steel

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3. U.S. Department of Commerce, Factors Limiting U.S. Investment Abroad (Washington, 1953), p. 108.

> production, for mining, for machine tool manufacture and for such other basic industries as may be specified by the Central Government; heavy electrical plant including large hydraulic and steam turbines; coal and lignite; mineral oils; mining of iron ore, manganese ore, chrome ore, gypsum, sulphur, gold and diamond; mining and processing of copper, lead, zinc, tin molybdenum wolfram;minerals specified in the Schedule to the Atomic Energy Order 1953; aircraft; air transport, railway transport; shipbuilding; telephones and telephone cables, telegraph and wireless apparatus (excluding radio receiving sets); and generation and distribution of electricity.

It was further stated that Schedule B industries - as following - would be progressively State-owned and that in such industries, the State would generally take the initiative in establishing new undertakings:

> Other minerals; aluminum and other non-ferous metals; machine tools; ferro alloys and tool steels; basic and intermediate products required by chemical industries such as the manufacture of drugs, dye-stuffs and plastics; antibiotics and other essential drugs; fertilizers; synthetic rubber; carbonisation of coal; chemical pulp; road transport and sea transport.

All other industries were left to the initiative and enterprise of the private sector.

The growing participation of the government in the economic life of India may be a source of concern to some prospective investors. However, private Indian entrepreneurs, for the most part believe that there is ample opportunity for private industry to participate in India's economic development. India is essentially a private enterprise economy.[4] Important foreign-exchange-earning

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4. J.K. Galbraith, "Rival Economic Theories in India", Foreign Affairs (April, 1958).

industries, such as jute, tea, cotton textiles, and mining are almost entirely privately owned. The same is true of agriculture and many important manufacturing industries. Although the Industrial Policy Statement of 1956 apparently assigns a major role in India's economic development to the government, it does not close the door completely to private enterprise in any of the delineated categories:

> In fact, in the past year or two the government has inclined toward encouraging private investment in new industries hitherto marked for development primarily by government initiative. Among these industries are machine tools, antibiotics, fertilizers and synthetic rubber. A private synthetic rubber plant is already under way. The government is also now actively seeking the cooperation of private foreign companies for oil exploration in India, an activity formerly reserved for the public sector.[5]

To assure even the casual observer that India is essentially a free enterprise economy, the present government of the country should honestly admit that the phrase "socialist pattern of society" was adopted in 1954 "partly because it sounded good...but largely to steal the thunder from the then powerful left wing opposition."[6]

Screening policy: The Indian Government has consistently adhered to the practice of screening the entrance of foreign investment. It judges each case on its own merits, and establishes the terms upon which the particular

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5. U.S. Department of Commerce, Investment in India (Washington, 1961), p. 4.

6. Jagdish Bhagwati, "The Socialist Pattern of Society and Foreign Trade", Economic Weekly (July, 1962), p. 1211.

investment may be approved, if at all. This is necessary because some types of investments produce more benefits and involve less costs than other types.

Even from the point of view of foreign investors, the screening policy may be desirable:

> Considering the attitudes and policies of foreign governments, and the fact that most of them employ a complex of controls over domestic as well as foreign enterprise, the screening of foreign investments and official approval of entry is probably desirable from the stand-point of the foreign investor. Official approval or registration frequently carries with it special safeguards and exemptions. The foreign investor knows that he has met certain tests of public policy and that he is officially welcome.[7]

While screening policy is justifiable on grounds of principle, the complicated bureacracy it involves in most of the countries including India is extremely discouraging. In the case of India, the U.S. Dept. of Commerce study correctly remarks:

> The tedious screening procedure has been a source of annoyance for many potential foreign investors. Processing of investment proposals has been time-consuming and, along with the need to negotiate with the government on various aspects of investment, has hindered consummation of the proposal. The screening procedure has been known to drag out for a year or more. Over such a period some companies may lose interest or be unable to afford waiting for a decision.[8]

The Government of India is trying hard to reduce the delay in the processing of applications and, in view

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7. R.F. Mikesell, Promoting U.S. Private Investment Abroad, National Planning Association Pamphlet No. 101 (October, 1957), p. 45.

8. U.S. Department of Commerce, Investment in India, p. 3.

of this, it has drawn up a list of industries in which foreign capital would ordinarily be welcome;[9] this list includes the following industries:

> Iron and steel structurals; iron and steel castings and forgings; iron and steel pipes; special steels; non-ferrous metals and alloys; boilers and steam generating plants; equipment for transmission and distribution of electricity; furnaces; marine diesel engines; industrial machinery including major items of specialized equipment used in specific industries and general items of machinery used in several industries such as equipment required for various unit processes; ball, roller and taper bearings; speed reduction units; machine tools; tractors, earth moving and construction machinery; plastics; industrial and scientific instruments; fertilizers; organic chemicals; fine chemicals and intermediates; industrial explosives; industrial gases; agricultural chemicals such as insecticides; dyestuffs and drugs, including the production of basic intermediates; newsprint; pulp; and hotels.

The fields in which foreign capital is ordinarily not welcome have also been listed. This list includes banking, insurance, trading and commercial activities and plantations.

To avoid the delay resulting from separate and successive consideration by different authorities of various aspects of investment projects, the Government of India has established a unified agency in a position to undertake co-ordinated consideration of all aspects at the same time, in consultation with the authorities concerned.[10]

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9. Government of India, <u>Press Note</u> (May 8, 1961), reprinted in Indian Investment Centre, <u>Objects and Functions</u> (New Delhi, 1962), Appendix IV, pp. 87-90.

10. <u>Ibid</u>., p. 87.

Inadequate information: Another factor responsible for the low level of the inflow of foreign capital could be the ignorance of foreign investors about investment opportunities and business ways in India.[11] It was primarily to fill this gap that an Indian Investment Centre[12] was established in New Delhi in 1961, with two branches added later - one at New York and the other at Dusseldorf.

Taxation. High tax rates on personal and corporate incomes and no double taxation agreements, are often reported as hindering the inflow of private foreign capital in India. The studies made by the National Council of Applied Economic Research (NCAER)[13] of the problem of Indian taxation and foreign investment, revealed that in India the rates of the personal income tax are higher than that in important capital exporting countries such as the United States; the United Kingdom; Canada; West Germany in the range of incomes in which most of the salaries of foreign technicians and management lie. The rates are also higher than those in many countries which compete with India in the world's capital

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11. H. Venkatasubbiah, "Fewer Foreign Investors", Hindu Weekly Review (Madras, January 21, 1963).

12. Indian Investment Centre is an autonomous agency to advise on various aspects of investment and attempts to bring together Indian entrepreneurs wth investment proposals and foreign companies seeking Indian collaborators.

13. NCAER, Taxation and Foreign Investment (New Delhi, 1957) and Foreign Investor and Tax Reforms (New Delhi, 1964).

market. India's rates of corporate income taxes too remain among the highest in the world as shown in Table 18.

Before 1958 India had not signed any double-taxation avoidance agreements with any country. The first tax agreement was signed with Sweden in 1958. Others followed with Switzerland (1958), Norway (1960), Denmark (1960), Japan (1960), and West Germany (1960). A treaty was negotiated and signed with the United States in 1959.[14]

Indian tax rates are no doubt very high, but India also gives some special tax incentives to new industrial undertakings - both domestic and foreign - which make the tax liability extremely small during the first five years of operation. Following are some of the important tax incentives.[15]

Liberal depreciation allowances. The Indian Income Tax Act provides liberal depreciation allowances. There is first the "normal depreciation" of buildings, plant, machinery and furniture. In addition, extra shift allowances of 50% and 100% respectively, of the normal depreciation are granted on plant and machinery worked for two or three eight-hour shifts a day.

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14. For full texts of the agreements, one may refer to U.N. International Tax Agreements.

15. Mathew J. Kust, Foreign Enterprise in India (Chapel Hill, North Carolina, 1964), pp. 386-396.

Table 18

Corporation Income Tax Rates:
Foreign Branches and Subsidiaries

Country	Foreign Branches (% rate)	Foreign Subsidiaries (% rate)
Japan	49.00	67.50
Australia	40.00	44.00
United Kingdom	53.75	53.75
France	50.00	57.50
Canada	51.50	51.50
Philippines	30.00	35.25
Malaysia	40.00	40.00
Peru	37.00	49.50
Columbia	40.00	43.60
Venezuela	45.00	45.00
India	63.00	67.50

Source: National Council of Applied Economic Research, Foreign Investor and Tax Reforms (New Delhi, 1964), pp. 28 and 33.

A tax holiday for new industrial undertakings. This feature provides an exemption from income and super tax for a period of five years to the extent of 6% per annum on the capital employed in new industrial undertakings established after April 1, 1948 and going into production within a period of eighteen years thereafter. Dividends from such exempt profits are tax free to the shareholders.

Exemption of interest on foreign loans and credits. Interest payable by an industrial undertaking in India on (1) a loan obtained from a financial institution abroad, or (2) a loan incurred abroad for the purchase of raw materials or capital plant and machinery, is wholly exempt from Indian income tax.

Rebate for high priority industries. The Finance Act of 1964 introduced a 10% rebate of the corporation tax on profits from the following industries:

> Iron and steel; aluminum, copper, lead and zinc; coal; industrial machinery; boilers and steam generating plants, steam engines and turbines and internal combustion engines; equipment for the generation, transmission and distribution of electricity, including transformers; machine tools; tractors and earth-moving machinery; steel castings and forgings; cement and refractories; fertilizers; pulp and paper and tea, coffee and rubber.

Development rebate. This tax feature, unique in India, is an allowance of 20% of the actual cost of new machinery or plant installed after March 1954 and is over and above depreciation allowances. It enables companies to recoup 120% of the actual capital expenditure, thereby constituting a bonus or special allowance. This rebate may be carried forward for a maximum period of eight years.

Export incentive tax. An incentive for export promotion is now provided for all Indian companies (including foreign subsidiaries) in the form of a rebate of one-tenth of their income tax and super tax attributable to income from exports.

Apart from these incentives to private foreign enterprises, foreign technicians are exempted from Indian taxes. Foreign technicians whose service contracts are approved in advance by the Indian Government, are now exempt from Indian personal income taxes for a period of 36 months from the time of their arrival for work in India, provided that they have not been resident in India in any of the four financial years immediately preceding the year of arrival.

Also, persons having specialized knowledge and experience in industrial or business management techniques, are eligible for a tax holiday, provided they are employed in India in a capacity in which such knowledge and experience are actually utilized and the contract of service is approved by the Government. But the concession to managerial personnel is admissible only for a period of six months.[16] The above discussion of Indian taxation,

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16. NCAER, Foreign Investor and Tax Reforms, p. 5.

with respect to private foreign investments, suggests that, although the Indian tax rates are very high on paper, in actual fact "most foreign enterprises qualifying for the special tax incentives would ordinarily have very little tax liability during the first five years of operation."[17] Thus, taxation as at present does not seem to be a serious impediment in the way of foreign investments, though a lowering of present rates could be helpful.

Exchange regulations. The existence of exchange and trade controls creates a major element of uncertainty for foreign investments in India. The uncertainty arises from the possibility that the Government, should it choose to do so, can at any time imperil the operation of foreign enterprise by the simple denial of exchange or license. However, the Government of India's record so far is very good.[18]

There are at present no restrictions on the remittance of income earned on foreign investments in India. Certain procedural formalities must be complied with, but after the initial steps, the remittances become, more or less, automatic. As a matter of fact, most companies in India have chosen to reinvest a good portion of their profits in the company instead of remitting abroad.

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17. U.S. Department of Commerce, Investment Factors in India, OBR 62-40 (Washington, 1962), p. 14.

18. Kust, Op. cit., pp. 217-222.

Repatriation of capital is also generally approved, with some limitations placed on investments made before 1950 and, more recently, on investments involving low-priority imports. Because of India's foreign exchange difficulties, some imports are not considered of sufficiently high priority to be allocated a license either on a cash or medium-term credit basis and are permitted only if financed by long-term investment from abroad. Accordingly, before issuing the import license, the authorities require the investor to agree to retain his investment in India for 10 years. There may be some flexibility in this time limit. Repatriation of capital for approved high-priority investment projects is unrestricted.

American investors, however, have available, if they wish it, a guarantee against inconvertibility. India entered into an agreement with the United States in 1957 under which the United States Government provides guaranties that Indian currency receipts (transfers of earnings and capital repatriation) for new or expanded private American investments can be converted into dollars. This Investment Guarantee Agreement was amended in December 1959 to include provisions for compensation to American investors in the event of expropriation. It does not cover war risks or risks of devaluation.

Exchange regulations affecting the importation of goods into India may be a limiting factor for some investors. Ordinarily assurances are given that the required import licenses will be issued for an approved project. In a situation of extreme foreign-exchange stringency, however, import licenses may be revoked or prohibited. The earning of foreign exchange through exporting from India is encouraged by the granting of rebates of the import duty on imported materials which go into the manufactured export product, and in the textile industry by an export-retention scheme permitting manufacturers in India to retain a certain portion of export proceeds for the purchase of required materials.

Low stage of economic development. India is at a low stage of economic development. This makes it frequently necessary for the new enterprise to provide for itself such facilities as power and workers' housing and to depend upon imports for certain types of metals, chemicals, machinery and other specialized items produced only in more highly industrialized countries. This factor is impeding the inflow of foreign private capital. Although less important now than in the early 1950's, this factor is still extremely important. There are still serious bottlenecks in the availability of power, fuel and railway transport facilities. India's overall power supply situation is critical. However, there is some variation of present and prospective availability according to the electrification programs of the various states. Apart from ensuring a steady long-range supply through contracting where possible with local power distribution authorities, a foreign firm has to take into account that in areas where hydro-electric power is not balanced by thermal power facilities, a seasonal cut-off may occur in the dry season.

In regard to fuel supplies, India has ample coal reserves (mainly of inferior non-coking grades) but they are concentrated mainly in Eastern India. The shortage of rail cars for transportation of coal may lead to supply difficulties, particularly in Western and Southern India; increasingly, companies in those areas are being obliged to use fuel oils. While India's refining capacity is increasing and new oil deposits are being located, there is often a shortage of some grades of petroleum supplies and uncertainty about their long-range availability. Because of India's heavily overtaxed rail facilities, location of an industrial site both for raw materials procurement and marketing is important.

Regarding complementary supplies, the situation is encouraging compared with the early 1950's. The United States Department of Commerce notes:

> At least one major U.S. company which experienced difficulty in maintaining output because of reduced allocations of foreign exchange for imported components, reports considerable success in having components made locally by Indian contracting firms. Another long-established U.S. firm has operated in this manner for many years, producing machinery for local use and export. Normally, possibilities along this line are limited because of the general raw materials shortage and the difficulty in establishing links with numerous sub-contractors. However, the rapid development of industrial estates (industrial parks) in many parts of

India is expanding the number of firms which may be able to act as ancillary suppliers to larger industries.[19]

<u>The Indian market</u>. The Indian market has two contradictory influences on private foreign investments; one is its small size for most consumer goods; and second is the potential marketing advantages which arise from (a) the Indian Government's determination to industrialize the economy and meet the continuing foreign exchange shortage, and (b) India's proximity to Southeast Asian, Middle Eastern and African markets.

A major limitation on the growth of consumer goods industry is the fact that, although India's population now numbers 500 million, fewer than 5%[20] of the population can be considered as significant consumers of soft goods. For most of the population, which is rural - eight out of every ten Indians live in villages[21] - increases in income are spent for additional food supplies, locally-made clothing and bare essentials such as kerosene lamps and simple cooking utensils. Demand for such consumer goods as radios, refrigerators, air-conditioners and pharmaceuticals has received a significant impetus in recent years from the social welfare programs of the Government and the provision of group amenities for workers in government and private industrial plants.

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19. <u>Investment Factors in India</u>. p. 18.

20. <u>Ibid</u>., p. 6.

21. Indian Investment Centre, <u>Basic Facts of the Indian Economy</u> (New Delhi, 1962), p. 1.

Owing to the determined effort to industrialize its economy and to meet the continuing foreign exchange shortage, India is restricting the import of a wide range of manufactures while encouraging their local production. In such a situation, foreign producers, if they wish to gain access to the Indian market, have to establish their plants in India. The government is also following the policy of restricting industrial participation to a relatively small number of producers in each field to assure maximum utilization of capacity. The foreign companies participating at the present stage of industrial development are likely to have an enormous advantage with regard to future growth in the Indian market.

Labour problems. Labour troubles have not represented a serious problem for foreign companies:

> Although a few foreign companies have experienced long and crippling strikes, most foreign firms have not encountered too much trouble on this score. Absenteeism, wage negotiations, and employment practices, however, are problems that require special handling and close attention....Some foreign firms are obliged to negotiate with communist-controlled unions, but, to date, most companies affected have not regarded this as a major difficulty.[22]

Regarding employment of foreign personnel, the Prime Minister of India issued a Statement on April 6, 1949 as follows:

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22. U.S. Dept of Commerce, Investment Factors in India, p. 18.

> In the matter of employment of personnel, Government would not object to the employment of non-Indians in posts requiring technical skill and experience, when Indians of requisite qualifications are not available, but they attach vitial importance to the training and employment of Indians even for such posts in the quickest possible manner.

This position still stands. To our knowledge, no foreign firm has ever complained against this position.

Profitability of investment. The rate of profit after tax of foreign controlled enterprises was 10.1 percent in 1953. Rate of profit for other years is given in Table 19. Highest rate of profit was achieved in 1956. Since then, the rate of profit is falling. In 1962, it touched 7 percent. During 1955-62, the average rate of profit was 8.6 percent.

Since 1957 detailed figures of profits are available for foreign branches and foreign controlled rupee companies (see Table 20). Foreign controlled rupee companies or foreign subsidiaries have been earning a higher rate of profit on sales compared to foreign branches. Foreign branches earned the highest rate of 7.6% on sales in 1958 and the lowest rate of 5.3% in 1961-62. Foreign subsidiaries earned the highest rate of 11.3% on sales in 1962-63 and the lowest of 9.5% in 1957.

Tea plantations have been earning between 10.7% and 15% of profit on sales while manufacturing branches have been earning between 4.3% and 12%. Foreign manufacturing subsidiaries have been consistently earning

Table 19

Rate of Pfofits After Tax on Direct Investments
1953-62

At the end of	Direct Investments (Rs millions)	Profits Earned (Rs millions)	Rate of Profits (%age)
1953	3263	330	10.1
1954	N.A.	450	N.A.
1955	3865	382	9.9
1956	4097	464	11.3
1957	4306	351	8.1
1958	4341	345	8.0
1959	4437	379	8.8
1960	4957	406	8.2
1961	5272	443	8.4
1962	5676	390	7.0

Source: Reserve Bank of India Bulletin (August, 1960) and (April, 1966).

Table 20

Profit Rates of Foreign Branches and
Foreign-Controlled Rupee Companies

	Gross Profits[a] as % of Sales					
	1957	1958	1959	1960-61	1961-62	1962-63
A. Branches of Foreign Companies						
1. All companies	7.4	7.6	7.2	5.8	5.3	6.2
1.1 Manufacturing	4.3	6.7	8.5	10.6	9.1	12.0
1.2 Trading	4.3	4.2	2.6	1.9	2.3	2.6
1.3 Tea plantations	10.7	12.0	12.6	15.0	12.8	15.0
1.4 Others	21.0	16.3	17.3	18.3	14.3	15.2
2. Companies incorporated in						
U.K.	8.7	9.4	10.0	7.5	6.6	7.6
USA	4.7	4.3	2.6	0.9	2.3	3.9
Other countries	14.9	15.0	4.8	0.4	0.4	0.5
B. Foreign-Controlled Rupee Companies						
1. All companies	9.5	9.7	10.7	10.8	11.0	11.3
1.1 Manufacturing	11.8	12.0	12.9	12.7	12.8	13.1
1.2 Trading	2.8	3.7	4.2	4.8	5.2	5.2
1.3 Others including tea plantations	9.2	6.5	6.6	5.5	5.6	6.4
2. Companies with controlling interest in						
U.K.	9.8	9.5	10.3	10.4	10.1	10.6
U.S.A.	9.7	11.3	12.6	12.2	14.2	12.9
Other countries	7.0	10.3	11.4	11.5	12.9	13.6
C. Public Ltd. companies	8.0	8.5	10.0	10.3	10.2	10.1
D. Private Ltd. companies	6.2	7.0	7.6	6.7	7.3	7.3
E. Indian Controlled companies	7.3	8.0	8.3	9.3	9.3	9.5

Note: For 1957, 1958 and 1959, figures are available on a calendar year basis. For 1960-61, 1961-62, and 1962-63 figures are available on a fiscal year basis.

For 1957-59, statistics were for 201 foreign branches and 108 foreign-controlled rupee companies. For 1960-63

Table 20 (continued)

	Gross Profits(a) as % of Total Capital Employed(b)					
	1957	1958	1959	1960-61	1961-62	1962-63
A. Branches of Foreign Companies						
1. All companies	7.3	7.9	7.6	8.0	7.9	9.1
1.1 Manufacturing	5.6	9.6	11.0	13.4	11.5	14.4
1.2 Trading	7,7	8.5	5.3	4.7	6.2	6.9
1.3 Tea plantations	6.6	7.1	8.4	9.5	8.7	10.2
1.4 Others	9.1	8.0	7.1	7.6	6.2	6.8
2. Companies incorporated in						
U.K.	7.0	7.6	8.2	9.3	8.7	9.7
U.S.A.	8.0	8.8	5.1	2.0	5.3	8.6
Other countries	19.9	18.4	4.8	0.9	0.9	1.3
B. Foreign-controlled Rupee Companies						
1. All companies	11.7	11.9	13.3	13.2	13.3	13.7
1.1 Manufacturing	13.5	13.8	15.5	14.5	14.2	14.5
1.2 Trading	6.2	8.1	8.0	7.2	8.3	8.9
1.3 Others including tea plantations	8.0	5.7	6.8	10.1	9.9	11.3
2. Companies with controlling interest in						
U.K.	12.1	11.6	13.1	13.0	12.9	13.9
U.S.A.	13.5	14.0	16.1	14.0	13.7	11.1
Other countries	7.8	11.9	13.0	13.6	14.2	15.4
C. Public Ltd. companies	7.5	8.0	9.8	10.1	10.0	10.1
D. Private Ltd. companies	8.5	9.3	10.1	10.5	11.1	11.3
E. Indian controlled cos.	6.8	7.5	8.1	9.5	9.4	9.4

statistics were for 251 foreign branches and 169 foreign-controlled rupee companies.

During 1957-59, Public Ltd. cos. were 1001 and Private Ltd. cos. 334; total corporate sector comprised 1334 cos. of which Indian controlled cos. were 1226 and foreign-controlled 108. During 1960-63, Public Ltd. cos. were 1333 and Private Ltd. cos. 501; total corporate sector comprised 1834 cos. of which Indian controlled cos. were 1665 and foreign-controlled 169.

(a) Includes managing agents remuneration, interest charges, provision for tax but excluding depreciation.
(b) Total net assets.
Source: Reserve Bank of India Bulletin(January, 1963), pp. 35 and 38; (March, 1965), pp. 338,345 and 350.

12%-13% during 1957-63. Foreign subsidiaries have been earning about 20 percent more than the Indian controlled companies.

Foreign branches have been earning between 7.3% and 9.1% of profits on total capital employed while foreign subsidiaries earned between 11.7% and 13.7%; the Indian controlled companies were earning, during the same period of 1957-63, from 6.8% to 9.5%.

About one-third of total profits earned on foreign direct investments were reinvested[23] in India during 1956-62, in spite of the fact that the Indian Government permits the remittances of profits to the foreign countries. In such a situation, one can assume that the rate of profits of foreign investments in India is not a major deterrent to further foreign investments.

Mineral Resources and policy.[24] At the beginning of the chapter we mentioned that only those low-income countries which possessed natural resources, mostly in the form of oil and non-ferrous metals, and permitted these resources to be exploited by private foreign companies, were able to attract private foreign capital in any significant amount.

In India, petroleum and mineral development is intended primarily for the public sector. However,

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23. *Reserve Bank of India Bulletin* (April, 1966), p. 365.

24. Kust, *op.cit.*, pp. 447-457.

existing private enterprises in these industries are permitted to continue and may, if deemed in the national interest, be allowed to expand.

The important laws on oil and gas are the Oilfields (Regulation and Development) Act 1948 and the Petroleum and Natural Gas Rules, 1959. These laws prohibit any exploration or production of petroleum and natural gas except under license or lease, granted by the State Government with the approval of the Central Government.

Although the development of the petroleum industry is, according to the Industrial Policy Statement of 1956, the exclusive responsibility of the public sector, the Government of India has recently invited private foreign firms to explore and produce petroleum in the country. The following statement by the Minister of Mines and Oil, Government of India, reflects this changed mood:

> But large-scale oil exploration programme must be undertaken involving expenditure of great amounts of foreign money in a comparatively short time if we have to attain the target of producing about 14 million tons of crude oil by 1966. Government have, therefore, decided to invite foreign oil explorers also to join in the quest for oil in India subject to mutually acceptable terms for exploration and also assuring that such arrangements with foreign oil explorers fall, generally within the ambit of India's Industrial Policy Resolution.[25]

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25. India, Ministry of Steel, Mines and Fuel. <u>Oil Prospects in India</u> (Delhi, 1959), p. 3.

Marketing, distribution, and refining of petroleum products, until recently, have been handled primarily by three foreign oil companies - Burmah Shell, Standard-Vacuum, and Caltex. Two government refineries - Baruni and Nunmati - are now in production.

All other minerals fall within the purview of the Mines and Minerals (Regulation and Development) Act, 1957. According to this Act, any person who is not an Indian citizen may not be granted a prospecting license or mining lease without previous approval of the Central Government. Foreign enterprise is not heavily involved in mineral development in India. Unlike the case of petroleum, there is no standing invitation to foreign capital to make proposals for prospecting and mining of minerals.

Industrial policy of India does not encourage the inflow of foreign capital in minerals. As far as petroleum is concerned, its known reserves are very meagre. So a large flow of foreign capital is not expected in petroleum and mineral development in India.

Conclusion. We have discussed above a number of important factors which affect the flow of private foreign investments into India. We learn that taxation, the principle of screening policy, labour problems and profitability of investments are perhaps only mildly, if at all, responsible for the meagre inflow of such investments to India. The small inflow seems to be due primarily to the vote-catching slogans such as "socialist pattern of society", as well as complicated bureaucracy involved in the handling of the screening policy, inadequate information regarding investment opportunities, low stage of economic development and lack of mineral oils and non-ferrous metals for exploitation by foreign companies.

CHAPTER VI

THE EFFECTS OF FOREIGN INVESTMENTS IN INDIA

In this chapter, we shall attempt to assess some important effects of foreign investments in India since 1948.

Share of foreign investments. During the fifties, in India, the share of foreign investments was about 3 percent of total investments, 6.3 percent of total private investments and about 17 percent of total corporate investments (see section IV, Chapter III).

A little less than half of the corporate sector in India during 1951-65 was associated with foreign firms. The share of non-residents in the foreign-associated corporate sector during the same period was 38.3 percent (see Table 15).

In almost three-quarters of foreign investments, the "control" was held by non-residents (refer to Table 9). Foreign controlled investments - so called direct investments - are those in which the non-resident ownership of shares is 40 percent or more.[1] Under Indian conditions, where local ownership is often very dispersed, it can be assumed that a large part of foreign investments in which non-resident ownership was between 25% and

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1. For detailed definition of direct investments, see section I, Chapter III.

40% is also foreign controlled. Adding this to the controlled category of 40 percent or more, brings the total of foreign investments under foreign control to about 90 percent (see Table 16).

So we see that a relatively small amount of foreign investments in the total investments in India has been able to control a significant part of the corporate sector of the Indian economy.

Technical know-how.[2] One of the assumed advantages of foreign direct investments is that they are usually accompanied by know-how. Such investments were three-quarters of the total foreign investments in India. In addition to these investments, a large and rapidly growing number of technical-collaboration agreements have been made since 1957 between Indian and foreign enterprises (see Tables 13 and 14).

Foreign direct investments and technical-collaboration agreements apparently have a useful role to play in the Indian economy which is deficient in technical know-how. Indeed, the foreign collaborated plants do have technologically intensive equipment and highly specialized foreign technicians working in them. This, however, has not helped the growth of a suitable technical know-how in the Indian economy.

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2. This section has borrowed heavily from Michael Kidron, "Excess Imports of Capital and Technology in the Brivate Sector", Economic Weekly (April, 1965), pp. 705-707.

The reason is that special care is taken by many foreign collaborators to see that the importing of a technology is divorced as far as possible from the imparting of that technology to the local labour force. Patents are used to this end, as are the licensing arrangements and the many restrictive clauses written into collaboration agreements. Partial technologies are supplied and fundamental research and development are confined to the foreign partners' home firms.

Most of the technologically intensive equipment in the foreign collaborated firms remains underutilized. Then why was such equipment imported? It was imported for the following reasons:

(a) The Indian partners had started with little idea of the equipment required for production and little experience of the technological approach likely to be adopted by the foreign partner.

(b) Even if they had an inkling of the extent of the gap between requirements and recommendations, they were unwilling to debate every last detail before concluding the collaboration agreement, since they had more to lose than their collaborators from its termination or from the retarded growth of easy working arrangements and mutual understanding. As the outlay on such equipment was normally the foreigner's concern, the Indian partners did not pay a direct penalty and could afford, therefore, to be liberal.

Similarly, most of the highly specialized foreign technicians are underemployed. Most of the large collaborated firms have on their payroll three foreign technicians. The three are highly skilled and specialized. Their particular specialties are required for between two and four days a month on average. For the rest they operate on a level they themselves consider inferior to that of their immediate Indian subordinates. There is more here than an over-import of expensive know-how. The fact that these foreign technicians receive many times the remuneration of their immediate, and frequently more skilled, Indian subordinates, breeds frustration and irresponsibility within the firm which affect directly the degree of waste, the amount of machine breakdowns etc.

Effect on the balance of payments. We noted in Table 4 that the gross increase of foreign business investments, excluding revaluation, was of the order of Rs 6216 million during 1948-62. This was comprised of: (a) retained earnings, Rs 2061 million; (b) non-cash inflow, Rs 2055 million; (c) cash inflow from private sources abroad, Rs 702 million; (d) inflow from official sources abroad, presumably cash, Rs 1398 million. During the same period there was repatriation of foreign investments equal to 1938 million - 1640 million of private investments and 298 million of official investments. Item (a) does not affect a country's balance of payments; (b) is not even recorded in India's published balance of payments. India's balance of payments includes only those items which involve foreign exchange dealings; non-cash inflow is not such a item. Only (c) and (d), and repatriation are included in the balance of payments. Subtracting repatriation from (c) plus (d) gives a favourable balance of 162 million. If we add to this, item (b) - and it must be added since it is an economic transaction between the residents of India and the residents of the rest of the world - we arrive at a favourable balance of Rs 2217 million during 1948-62.

During the same period, some profits and dividends were remitted which must be deducted from the inflow of capital to determine the net long-term effect on the balance of payments. Unfortunately, figures for the remittance of profits are lumped with the payment of interest on government loans in the item investment income in the current account of India's balance of payments. In such a case, we may check the data on profits earned and remitted in the foreign enterprises.

Estimates of profits earned by the foreign controlled enterprises - so-called direct foreign investments - are given in Table 21. During the seven years, 1956-62, profits earned on direct investments were Rs 2778 million and profits remitted or distributed were Rs 1878 million. During 1954-55, profits earned were Rs 832 million of which Rs 460 million[3] were retained

3. Table 4, Chapter III.

Table 21

Profits[(a)] after Tax of Foreign Controlled Enterprises

(Rs millions)

	Plantations	Mining	Petroleum	Manufacturing	Services	Total
Profits earned						
1953	123	(b)	68	67	72	330
1954	215	(b)	77	84	74	450
1955	95	(b)	92	107	88	382
1956	107	12	166	124	56	464
1957	53	19	125	107	46	351
1958	49	12	110	129	45	345
1959	57	12	108	161	40	379
1960	67	14	100	178	46	406
1961	67	10	80	222	64	443
1962	73	8	84	189	36	390
1956-62	473	87	773	1110	333	2778
Profits distributed						
1956	90	11	69	68	36	273
1957	68	5	71	69	43	256
1958	63	11	54	78	48	254
1959	48	1	45	90	48	233
1960	64	6	39	115	41	265
1961	53	1	59	134	38	285
1962	56	1	80	127	48	312
1956-62	442	36	417	681	304	1878
Profits retained						
1956	17	1	97	56	20	192
1957	-15	14	54	38	3	95
1958	-14	1	56	51	-3	91
1959	9	11	63	71	-8	146
1960	3	8	61	63	5	141
1961	14	9	21	88	26	158
1962	17	7	4	62	-12	78
1956-62	31	51	356	429	31	901

(a) Profits refer to proportionate profits of non-residents only.

(b) Included under Services.

Source: Reserve Bank of India Bulletin (August, 1960) and (April, 1966).

Note: Totals may not add up because of rounding.

and Rs 372 million remitted abroad. During 1948-53, profits earned were Rs 1800 million[4] of which Rs 700 million[5] were retained and Rs 1100 million were remitted abroad.

Total profits earned by foreign direct investments in India during 1948-62 thus were 5410 million and total profits remitted were Rs 3350 million. Since there is no readily available information for profits earned on equity portfolio investments and interest earned on creditor portfdio investments, and since a larger share of portfolio investments was made after 1955 (refer to Table 9), it may be assumed that remittances on account of portfolio investments were of the order of Rs 300 to 400 million during 1948-62. Adding this to remittances on account of direct investments, we arrive at the figure of Rs 3650 to 3750 million or a round figure of Rs 3700 million.

We must add to this item, the foreign exchange payments on account of technical and professional services, management fees, office expenses, advertisement charges, royalties, charges for patents etc. These items formed about 65 percent of the item "miscellaneous" for the years 1956-62, the years for which separate figures were available[6] in India's balance of payments.

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4. K.M.Kurian, Impact of Foreign Capital on Indian Economy (New Delhi, 1966), p. 236.

5. Table 4, Chapter III.

6. Reserve Bank of India, India's Balance of Payments 1948-49 to 1961-62 (Bombay, 1963), p. 78. The item

Payments on account of the above items were Rs 163 million in 1956-57, Rs 161 million in 1957-58, Rs 149 million in 1958-59, Rs 176 million in 1959-60, Rs 236 million in 1960-61 and Rs 268 million in 1961-62. For the other years, 65 percent of the total for "miscellaneous" has been used to get the amount of payments for the above items. During 1948-56, total "miscellaneous" payments were Rs 1313 million.[7] Payment for royalties, fees etc. would work out to be Rs 853 million. Payment on account of miscellaneous for the nine months of 1962 (April to December) was Rs 223 million;[8] payments for royalties etc. would thus be Rs 145 million. Thus, during April 1948 to December 1962, payments for royalties, patents, professional services etc. were Rs 2151 million.

Adding Rs 2151 million to Rs 3700 million million makes Rs 5851 million as a debit item, on account of foreign business investments, in India's balance of payments.

We noted earlier that for almost the same period, foreign business investments generated a credit item of Rs 2217 million in India's balance of payments. The effect

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"miscellaneous" appears in the current account of India's balance of payments and includes payments for technical and professional services, manageemnt fees, office expenses, advertisement charges, payments for royalties and patents and others. Details of these separate items are usually not published.

7. Ibid., pp. 86-93.

8. Reserve Bank of India. Report on Currency and Finance, 1962-63 (Bombay, 1963), Statement 66.

of foreign investments was thus unfavourable by Rs 3634 million during 1948-62.

We have ignored so far the effect of foreign business investments on India's export promotion and/or import substitution. Foreign controlled firms were responsible for most of the exports of tea and jute, particularly the former. However, in recent years, there has occurred a shift of foreign investments from traditional export earners like tea and jute to import users like petroleum and manufacturing. This shift is responsible for changing the trade balance of the foreign controlled firms from a surplus to a deficit. In 1951 and 1952, their exports exceeded imports by an average of nearly 70 percent.[9] By 1956-58, they were running an import surplus of 10 percent on the average.[10]

Foreign business investments directly contributed to a debit of Rs 3634 million in India's balance of payments during 1948-62. Their indirect contribution - through export promotion and/or import substitution - was not any better. This is a serious situation because a major rationale for welcoming foreign capital is its possible contribution to foreign exchange resources.

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9. <u>Reserve Bank of India Bulletin</u> (Feb.,1954), pp. 103-105.

10. <u>Reserve Bank of India Bulletin</u> (January, 1960), pp. 14-15.

One would not make it a condition that foreign capital must have its own export surplus to meet the transfer payments if the domestic economy - domestic investment sector plus foreign investment sector - can do the job. But Indian exports are virtually stagnant.

In a situation of stagnant exports, foreign investments must earn enough export surplus to meet the foreign exchange payments on account of profits remitted abroad, capital repatriation and royalties etc. on patents and collaboration agreements. If this is not done, then the case for foreign investments is largely demolished in a country like India.[11]

Company practices. In foreign companies in India, the foreigners are still occupying many highly paid positions; however, they are being increasingly replaced by Indians. Tables 22 and 23 are revealing in this respect.

The absolute number of non-Indians receiving salaries of Rs 1000 and above is regularly declining since 1954, though proportionally the share of non-Indians has been declining since 1947. In 1947, non-Indians were holding 92.1% of the posts carrying Rs 1000 or more per month, while in 1965, their share was a mere 15.6 percent.

In 1965, in the salary range of Rs 1000-2000, Indians held more than 96 percent of the posts; in the

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11. Kurian, op. cit., p. 243

Table 22

Indians and Non-Indians Receiving Salaries of Rs 1000 and Above Per Month in Foreign Controlled Firms in India

Year	Indians		Non-Indians	
	Number	Percentage	Number	Percentage
1947	504	7.9	5844	92.1
1951	1784	20.4	6953	79.6
1954	3346	32.3	7008	67.7
1955	3995	37.0	6810	63.0
1956	4862	42.5	6566	57.5
1961	10229	70.1	4364	29.9
1962	11535	74.2	4001	25.8
1963	12434	77.7	3570	22.3
1964	13824	81.5	3135	18.5
1965	16302	84.4	3014	15.6

Source: 1947-55: India, Ministry of Commerce and Industry, <u>Press Note</u> (Dec. 12, 1958).

1956-65: India, Ministry of Industry, <u>Press Note</u> (May 18, 1966).

Table 23

Posts Held by Indians in Foreign Controlled Firms in India as a Percentage of the Total Number of Posts, per Salary Bracket

Monthly Salary (Rs)	1957	1958	1964	1965
1000-1500	77.7	84.2		
1501-2000	54.2	62.2	95.8*	96.5*
2001-3000	29.4	36.5	81.0	85.0
3001-5000	13.7	16.4	45.1	52.4
5001 and above	5.1	6.0	16.8	21.0

* Includes the salary bracket of Rs 1000-2000.

Source: As in Table 22.

salary range of Rs 2001-3000, 85 percent of the jobs were held by Indians. In the salary range of Rs 3001-5000, more than half the posts were held by Indians in 1965, compared to less than one-seventh in 1957. In 1965, every fifth officer in the salary range of Rs 5001 and above was an Indian, whereas in 1957, only one in twenty was Indian.

Indian officers in the foreign firms earn higher salaries than their counterparts in the Indian Government or Indian firms. They are a caste apart; a caste of snobs who practice the art of mimicry of everything foreign, especially British; their promotions depend, among other things, upon this art of imitation.[12] They are Indians and at the same time not Indians. This kind of social problem will exist in all underdeveloped countries where salaries in foreign firms are adjusted to expatriate levels.

Practices of foreign firms are sometimes criticised if they use their international links against the interests of the country in which they are operating. Foreign petroleum companies in India would illustrate this point.

Practices of foreign petroleum companies pose serious problems in India because of the various arrangements in existence between the companies operating in India

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12. V.S. Naipaul. An Area of Darkness (London, 1964), pp. 62-63.

and their associates abroad. On account of the close links between the subsidiaires and branches of the oil companies operating in India, and their affiliates abroad, the reported price of imported crude oil may not represent the actual price paid. To that extent, profits accruing to these enterprises, and remitted abroad, may be larger than they are shown to be. The possible sources of leakage have been indicated in a recent report of the Indian Ministry of Steel, Mines and Fuel.[13]

There is an agreement between the Government of India and the foreign oil companies in India that the former would provide foreign exchange for procuring crude oils from the Middle East. The Oil Price Enquiry Committee fears that the most economical use has not been made in all cases of the foreign exchange made available to the foreign oil companies for the purpose of importing crude oil.[14] One origin of this fear is the fact that foreign oil companies in India settle the remittances of foreign exchange on the basis of invoices of their immediate consignors who are not the original producers or suppliers of crude oil. In such a situation, it is difficult to know precisely what transpires between the original producers or suppliers and the immediate consignors. Thus,

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13. Report of the Oil Price Enquiry Committee (Delhi, 1962).

14. Ibid., pp. 21-22.

it is difficult to believe, without tangible proof, that the invoices of the immediate consignors represent no more than the true prices paid for purchases of crude oil at the source of supply.

Another origin of the fear that an economical use has not been made of the foreign exchange made available to the oil companies in India, is that the oil companies in India do not put pressures on their suppliers for discounts, although such are normally available to other purchasers. The Oil Price Enquiry Committee has the following to say on this point:

> It is understood that the agreement of the consortium of the major oil companies with the producing countries of the Middle East provides for sharing of profits on the basis of the posted prices under the 50-50 arrangement and not on realized export prices. Thus the discounts are allowable by producing companies from this 50% share of profits. As the major oil companies operating in India and/or their foreign associates have interest in the Consortium operating in Iran, or they are otherwise associated with the producing companies, they may not be interested in depressing the profits of the producers in the Middle East and would be reluctant to apply pressure on their suppliers for discounts, even though normally available to other purchasers. Their inability to obtain discounts from their suppliers is, therefore, no proof of the position sought to be established by them that discounts are not available on products in the Middle East.[15]

However, India has now succeeded in splitting the phalanx of the Western Oil companies and obtaining crude oil at reasonable and practical prices which the

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15. Ibid., p. 33.

oligarchic nature of the international oil industry has so long denied to her.[16]

Another foreign investment sector which has been criticised in recent years is that of the foreign pharmaceutical companies in India.[17] Over 85% of the patents granted in India (almost 100% for essential drugs) are owned by foreigners. The pricing practices of the foreign pharmaceutical companies, protected by patent rights, are determined elsewhere on considerations largely unrelated to the domestic economy. In this connection, the following quotation from a report drawn up by a U.S. Senate Committe under the chairmanship of Senator Kefauer, is very revealing:

> India which does grant patents on drugs, provides an interesting case example. The prices in India for the broad spectrum antibiotics, aureomycin and acromycin are among the highest in the world. As a matter of fact, in drugs generally, India ranks among the highest priced nations of the world - a case of an inverse relationship between per capita income and the level of drug prices.[18]

It is further noted that 16 capsules of broad spectrum antibiotics were sold in 1960 in the United States at $5.10; in India (which grants patent rights)

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16. Economist (May 25, 1963), p. 811.

17. S.S. Sokhey, "Manufacture of Modern Drugs Forging Ahead", Economic Weekly (February, 1962), pp. 235-241.

18. Administered Prices in the Drug Industry. Report No. 448, 87th Congress (June, 1961).

at $6.50, and in Argentina (which does not grant patent rights) at $1.19.[19]

It is unfortunate that the foreign pharmaceutical companies are charging exorbitant prices. However, the Indian consumer would be equally resentful of being charged such high prices by a domestic pharmaceutical company. The remedy for this situation lies, not in a blanket prohibition of foreign investment in the pharmaceutical sector of India, but, in correcting defects in the present patent system.

Infant industries. Foreign companies have at times been accused of trying to squeeze out the domestic infant industries in the underdeveloped countries; such, indeed, was the fate suffered by the Indian infant industries, during the 1920's and 1930's, at the hands of the foreign shipping and match companies.

Foreign shipping companies in India have repeatedly engaged in rate cutting wars to rout any Indian entrant in the shipping business. "The rate cuts varied from 50% to 93.75% and were so severe, in certain cases, as to cause the withdrawal of the Indian concerns after suffering huge losses."[20]

Whereas foreign shipping companies in India destroyed the domestic entrants by engaging in rate-

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19. Ibid.

20. Nurul Islam, Foreign Capital and Economic Development: Japan, India and Canada (Tokyo, 1960), p. 187.

cutting wars, the Swedish Match Company in India engaged in a deliberate advertising campaign aimed at undermining the reputation of the matches made by the domestic producers. "In 10 years after its formation under the protection of the tariff wall, 25 to 30 factories managed by domestic enterprise, had to be closed down owing to its competition and in the 1930's in the course of 3 years (1935-37) the Indian share in the total output decreased from 67% to 33% with the consequent increase in the share of The Swedish Trust."[21]

However, one should exercise caution in attributing destruction of domestic infant industries to _foreign_ monopolies. In fact, infant industries could as easily have been destroyed by _domestic_ monopolies. The fault, hence, lies with monopolies, foreign or domestic.

Conclusion. Private foreign investments have proved to be a doubtful blessing. On the positive side, they supplemented private investments and provided an immediate relief to the balance of payments.

These positive effects seem to have been more than counterbalanced by the negative effects. One-sixth of the corporate sector - the most dynamic - of India is controlled by non-residents.

There was an import of technology which was not suitable, being not in conformity with the factor endowments of the country.

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21. _Ibid_., p. 188.

Long-term impact of these investments was a serious deficit in the Indian balance of payments. The balance of payments problem was further aggravated by the behaviour of foreign oil giants operating in India.

CHAPTER VII

SUMMARY AND CONCLUSIONS

<u>Summary</u>. India's present leadership does not seem prepared to make a fundamental reorganization[1] of the economic, social and political institutions so that the potential economic surplus may be fully mobilized. Foreign capital is welcome to supplement domestic savings.

Foreign capital is also welcome because it gives an immediate relief to India's balance of payments. India has been suffering from unfavourable balance of payments for more than a decade. She is importing mainly food, industrial raw materials and capital equipment. Her main exports are tea, cotton textiles and jute textiles. There

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1. Fundamental reorganization refers to (i) a clear-cut and effective break with the anti-developmental caste system and the privileges of certain classes and individuals in the society and (ii) a reorganization which looks for guidance to science rather than astrology.

The caste system in India is growing and has become a powerful political force. See M.N. Srinivas, "Caste in Modern India", <u>Journal of Asian Studies</u> (August, 1957).

Land reforms have not yet been fully carried through in spite of the fact that such reforms were promised early in the fifties by the now ruling party.

Most of the important leaders of India have been and are regular visitors to their family astrologers at events of personal and national crisis. A recent advertisement in a reputed Indian newspaper illustrates the hold of astrology on the Indian leadership. The advertisement reads: "Accurate predictions. Consult Professor Swamy. Famous Palmist. Patronized by Governors,Ministers, Judges, Politicians, Leading Editors, Maharajas, Business Magnates," <u>Hindu Weekly Review</u> (Nov. 7, 1966), p. 14.

are three ways of bridging the gap between imports and exports: (i) Imports must be cut; (ii) exports must be expanded. If neither of these is possible, then (iii) foreign capital must be made available.

Chances of cutting imports are very limited. Food is needed for the growing population. India has added about 200 million people to her population since independence in 1947.

Industrial raw materials and capital equipment are required for the investment projects. Rate of growth will be further slowed down if capital equipment is not made available. At her present stage of development, India's domestic resources are inadequate to manufacture capital equipment needed for development projects in the various plans.

Prospects of expansion of exports are dim because these exports face (a) inelastic world demand, (b) increasing competition from synthetic and other substitutes, (c) restrictive and discriminating commercial and excise policies specially followed by Western Europe and particularly towards cotton textiles and tea and (d), the inflationary situation in the country.

India is deficient in technical know-how. Foreign direct investments and technical collaborations between Indian and foreign enterprises should apparently be useful to meet this deficiency.

During 1948-62, there was a net inflow of foreign business investments of Rs 4709 million, three-quarters of which were direct investments. There was a gross increase of foreign investments (excluding re-valuation) of Rs 6216 million, of which official organizations contributed Rs 1398 million and private sources Rs 4818 million. The total of Rs 4818 million was comprised of: (a) retained earnings Rs 2061 million; (b) cash inflow Rs 702 million and (c) non-cash inflow Rs 2055 million. Outflow of foreign investments during this period was Rs 1938 million - Rs 1640 million private investments and Rs 298 million official investments. Immediate effect of these investments was a credit of Rs 2217 million in India's balance of payments.

The share of foreign business investments was only 3 percent of the total investments during the fifties. India and many other Afro-Asian countries could not attract foreign investments in large amounts. A large share of the international flow of private capital moved either among the industrially advanced countries themselves or to countries which had a substantial industrial sector; then came the low-income countries which possessed natural resources, mostly in the form of oil and non-ferrous metals and permitted private foreign companies to exploit these resources; other low-income countries (and India is included in this group) could attract little foreign capital. The small inflow of foreign capital in India seems to be due primarily to vote-catching slogans such as "socialist pattern of society", complicated bureaucracy involved in the handling of the screening policy, inadequate information regarding investment opportunities, low stage of economic development and the shortage of mineral oils and non-ferrous metals for exploitation by foreign companies.

Share of foreign business investments was 6.3% of total private investments during the 1950's. However, the share of foreign-associated issues was 45.1% of all authorized capital in the corporate sector of India during 1951-65. The share of non-residents in the foreign-associated corporate sector was 38.3%.

During 1957-65, 2340 technical-collaboration agreements were made between India and foreign enterprises. About half of such agreements were in the machinery sector.

In spite of the fact that three-quarters of foreign investments were direct and that there were more than two thousand technical-collaboration agreements, there has not been much gain in the development of domestic technical know-how. This is because most of the technology imported is unsuitable for India's factor endowments. Even when it is suitable, it has not helped local technical know-how because many foreign collaborators take special care to see that the importing of a technology is divorced as far as possible from the imparting of that technology to the local labour force. Fundamental research is confined to the foreign partners' home firms.

Inflow of foreign investments generated a credit item of Rs 2217 million in India's balance of payments during 1948-62. During the same period, Rs 3700 million of dividends and profits were remitted abroad; another Rs 2151 million were paid in foreign exchange for technical and professional services, management fees, office expenses, advertisement charges, payments for royalties and patents etc. Thus, net direct effect of foreign investments was a debit of Rs 3634 million in India's balance of payments during 1948-62. Their indirect contribution - through export promotion and/or import substitution - was no better.

We also noted that foreign petroleum companies in India do not seem to have made an economical use of the foreign exchange made available to them under the refinery agreements. Foreign shipping and match companies abused their monopolistic positions to destroy the Indian infant industries in these sectors. Foreign pharmaceutical companies under the protection of patent law have been charging exorbitant prices for drugs in India. Solution of these abuses lies in curtailing the monopoly powers of such undertakings and improving the patent law in India.

Conclusions. Private foreign investments in India have proved double-edged. On the one hand, they supplemented domestic savings and provided an immediate relief to the balance of payments. These favourable effects were, on the other hand, more than offset by the unfavourable effects.

Non-residents control one-sixth of the corporate sector of India. An unsuitable technology was imported and little attention was given to the development of local technical know-how. Long-term impact of these investments on balance of payments was very unfavourable and this was further aggravated by the behaviour of foreign oil giants operating in India.

Ways should be sought to mitigate the unfavourable effects of foreign investments. In a situation of stagnant exports, foreign investments must earn enough export surplus to meet the foreign exchange payments on account of profits remitted abroad, capital repatriation and royalties on patents and collaboration agreements. This means that foreign investors must be persuaded to invest in export promoting and/or import substituting industries.

In theory it is all right to suggest that foreign investments need not generate their own export surplus to meet debt servicing. It will be enough if growth potentiality of the economy is raised. Debt servicing will be looked after if the economy becomes more productive. This does not happen in practice. Debt servicing has become a very serious problem, not only in India but also in many other underdeveloped countries.[2]

Industrial research institutes must be developed in India. Basic research must be carried out there. Indian and foreign enterprises may collaborate to develop technology which is in conformity with the factor endowments of the country.

Whatever the amount of foreign capital and whichever form it takes, it will be simply washed away if the underdeveloped country shirks its responsibility to accept sacrifices involved in achieving economic development. There is no simple equivalence between the amount of the country's foreign investment and its rate of development. A country's development, in the last analysis, depends on its own efforts.

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2. Dragoslav Avramovic and others, Economic Growth and External Debt (Baltimore, 1964).

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