STATE REGULATION OF FOREIGN PRIVATE CAPITAL IN INDIA

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The basic objective of the paper is to underline the evolution of regulatory administration of foreign private capital in India,[1] in the period following the attainment of political independence in 1947. Regulation of foreign private capital in India can concretely be seen in terms of the changing attitude of the Indian Government towards this form of business in the country. The changing attitude, in its turn, found manifestation in the nature of interventions that the Government was seeking to make at various points of time to influence the process of economic development in the post-independence era. The present paper is an attempt to bring out these changes in the attitude of the Indian Government towards foreign private capital in the four decades.

The regulatory administration can be seen to be comprising of two distinct sets of policies. In the *first* set are those instruments which provide the overall framework for industrial development and include the Five Year Plans and the statements related to industrial policy. The *second* includes specific legislations enacted at various points of time and which can be called the 'instruments' of policy initiatives. Most of these legislations are however, not applicable exclusively to foreign private capital, but are used to regulate private capital in general. We would discuss the first set of policies at the outset before discussing the specific regulatory mechanisms subsequently. *Finally*, we would discuss briefly the effect of various changes in policies brought about by the Government in an effort to influence investment by foreign private capital in India.

Changes in Industrial Policy and Plan Priorities

For analysing the regulatory administration, the four decades can be divided into five phases. The first phase coincides with the completion of the first decade after independence of the country during which the role and place of private capital (of which foreign capital was a part) was defined through the Industrial Policy Resolution (IPR) adopted in 1956. Immediately after the IPR was adopted, the Government was beset with the foreign exchange crisis and was compelled to make concessions to foreign private capital for meeting the foreign exchange requirements. This marked the beginning of another phase in the involvement of foreign capital in the country, we would be discussing this phase as the second phase. The Government adopted a more liberal attitude towards foreign capital after the mid-1960s. In this phase, the third phase, the Government, acting upon the dictates of the World Bank, devalued the rupee and made several changes in the official policy in order to encourage private sector investment. The beginning of the next phase, the fourth phase, can be seen through the amendment of the Foreign Exchange

1. Foreign private capital would be taken to represent both foreign finance and foreign technology. Both finance and technology was considered essential in the framework within which the policy makers visualised the participation of foreign capital in the country as we shall be discussing below.

Regulation Act (FERA) in 1973. FERA of 1973 laid down the guidelines for the level of foreign equity holding that was permitted in the Indian economy and the implications of the adoption of the Act has to be examined. The 'eighties have marked yet another phase in the involvement of foreign capital in the Indian economy. Foreign capital has been found to participate in the country's industrialization process in a much greater degree in the 'eighties than in the past.

Phase One: Evolution of Policies in the First Decade after Independence (1947-57)

The evolution of the economic policies in the post-colonial period was conditioned by three sets of economic agents, the State as the harbinger of industrialization in the country, the indigenous business interests and the foreign capital. The role of the State was unequivocally accepted by the indigenous business lobby even before the country had attained political independence. In 1944, the leading industrialists of the country formulated the Bombay Plan in which the pre-eminent role of the State in the post-colonial era was spelt out. It was, thus, left entirely to the nascent State to evolve a set of policies that could bring about industrial development.

Within the first few years after 1947, the attitude of the Government towards foreign capital changed rapidly. Two documents presented in the immediate post-independence period reflect the change. The first document, presented in January 1948 by the Economic Programmes Committee of the Congress Party, the party that was running the Government brought out the antagonism towards foreign capital. But in the next document, the Industrial Policy Statement of Government, presented in April 1948, there were signs of a change in attitude towards foreign capital. The Industrial Policy Statement argued that foreign capital was valuable in bringing resources for development and that it also provided technology and knowledge for rapid industrialization of India.[2]

It seems that the Industrial Policy Statement of 1948 (IPS 48) was not good enough to remove apprehensions of foreign capital in India. The IPS 48 did not provide, particularly to the British companies a clear assurance or guarantee to security for their future. Foreign capital, on the other hand, was given to understand that "conditions under which they may participate should be carefully regulated in national interest." It was further stated that foreign capital would be regulated under a new legislation. The proposed legislation under IPS 48 was to provide for "scrutiny and approval by the Central Government of every individual case of participation of foreign capital and management in industry." On specific issues it spelt out that: (a) as a rule the major interest in ownership and effective control, should always be in Indian hands; and (b) the training of suitable Indian personnel for purpose of eventually replacing foreign experts would be insisted upon.[3]

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2. India, Ministry of Industry and Supply, Industrial Policy Statement, 1948.

3. Ibid.

The two assertions could not leave the foreign business interests happy as on all basic decisions they had to deal with Government at the individual case level. There was no guarantee against take-over. Further, on critical issues like compensation in the event of a take-over, or the nature of restrictions envisaged on repatriation of profits, diversification and normal growth or expansion the Government did not make any pronoun-cements. It was also not clear as to how the major interest in ownership and effective control would get decided. Did it mean transfer, take over or changing of hands for all foreign owned or managed companies? The IPS 48 left a variety of issues wanting a clear statement. Some of the issues were sought to be clarified by the Prime Minister, Jawaharlal Nehru in his statement to the Parliament on April 6, 1949.[4] This statement, till date, remains the only document where the role and place of foreign capital in India is stated in explicit terms. The April 6, 1949 statement marked a retreat from the IPS 1948 in one significant aspect. While the latter had stated that "as a rule major interest in ownership and effective control should always be in Indian hands", the Prime Minister in his statement opined that there can be no hard and fast rule in this matter. The statement further clarified that the "...Government would not object to foreign capital having control of a concern for a limited period....". Similarly, with regard to control in Indian hands the Prime Minister said Government would not object to the employment of non-Indians in posts requiring technical skills and experience when Indians of requisite qualifications were not available, as long as the foreign enterprises attached vital importance to the training and employment of Indians for such positions in the quickest manner. Adding a further note of clarification the Prime Minister explained that "the stress on the need to regulate, in the national interest, the scope and manner of foreign capital and control (as per the IPS 48) arose from the past association of foreign capital and control with foreign domination of the economy of the country." It was explained that India, with low level of domestic savings rate, needs foreign capital to undertake larger investments for rapid industrialization. Foreign private capital was also important because "in many cases scientific, technical and industrial knowledge and capital equipment can best be secured along with foreign capital". The Prime Minister also assured the foreign capital that:

(a) the government do not intend to place any restriction or impose conditions which are not applicable to similar Indian enterprises.

(b) the Government would also so frame their policy as to enable further foreign capital to be invested in India on terms and conditions that are mutually advantageous.

(c) the Government does not foresee any difficulty in continuing the existing facilities for remittance of profits;

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4. Statement made by the Prime Minister Jawaharlal Nehru in Parliament on April 6, 1949. Before that in the Industrial Policy Statement of April 6, 1948, the policy regarding participation of foreign capital was mentioned in very broad terms, See India, Constituent Assembly of India (Legislative) Debates, Vol III, No. 1, pp. 2385-86.

(d) the Government has no intention to place any restriction on withdrawal of foreign capital investments.

(e) in case of compulsory acquisition of any foreign concern, compensation will be paid on fair and equitable basis.

To dispel fears, especially in the mind of the British capital in India, the Prime Minister stated further in the same statement:

> "I should like to add a few words about British interests in India which naturally form the largest part of foreign investments in India. Although it is the policy of the Government of India to encourage the growth of Indian industry and commerce (including such services like banking, shipping and insurance) to the best of their ability, there is and will still be considerable scope for the investment of British capital in India. These considerations will apply equally to other existing non-Indian interests. The Government of India has no desire to injure in any way British or other non-Indian interests in India and would gladly welcome their contribution in a constructive and cooperative role in the development of India's economy."

In the following years, the Government's position regarding foreign participation became more transparent. Indications of this came again in the statement made by Prime Minister Nehru in 1951. He stated "We have always welcomed foreign capital in the past and we welcome in the future".[5]

The form in which the Indian Government expected foreign capital to flow in was stated by the Finance Minister John Mathai in 1950. According to Mathai, "...Capital from foreign countries [should be] looked for .....in the shape of equity capital on the basis of joint participation on strict business considerations without any political strings attached to it."[6] The role of foreign capital was stressed again the First Five Year Plan in 1951. The Plan said that the Government's policy in this regard gives the following assurances to foreign capital:

(a) there will be no discrimination between foreign and Indian undertakings in the application of general industrial policy;

(b) reasonable facilities will be given for the remittance of profits and repatriation of capital, consistently with the foreign exchange position of the country; and

(c) in the event of nationalisation fair and equitable compensation would be paid.[7]

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5. Srivastava, P K, 'Foreign Participation in Indian Industry", Eastern Economist, Annual Number, 1964, p. 1487.

6. USA, Dept of Commerce, Investment in India: Conditions and Outlook for United States Investors, 1952, p. 27.

7. India, Planning Commission, The First Five Year Plan, December, 1952, p.437-38.

But despite the change in official policy towards foreign capital from 1949, inflow of new investments from abroad did not take place in any significant manner. The second survey of India's Foreign Liabilities and Assets conducted by the Reserve Bank of India in 1953 (the first survey was conducted in 1948) showed that foreign business investments in India increased by about Rs.130 crores between June 1949 and December 1953.[8] In 1954, it was reported that there had actually been a disinvestment since 1945 of about Rs. 35 crores.[9]

The trend of low participation by foreign private capital was seen throughout the period 1947-57. Two factors were primarily responsible for this situation. The first was the absence of a clearly defined industrial strategy in the First Five Year Plan where the emphasis was laid on the development of infrastructural facilities in the country[10]. The Industrial strategy was defined only in the Second Five Year Plan, during the implementation of which the Government's policies also changed, a point that we shall be dwelling on later. The second factor was the initial hesitancy of the indigenous capitalist class to collaborate with foreign private capital in the immediate post-independence phase. This point needs some elaboration which we shall now discuss.

The 1949 statement by Nehru, encouraging foreign capital to invest in India, appeared to drive a wedge between the foreign business interests and the Indians. The wedge was driven further as the government kept up its policy to encourage foreign private capital by offering inducements in the form of tax exemptions, a guarantee of exchange facilities for the remittance of profits, repatriation of capital (including capital appreciation, if any) and import of essential requirements.[11] The Federation of Indian Chambers of Commerce and Industry (FICCI) provided the bulwark against foreign capital in this phase, although, as it has been pointed out, some of the important individuals belonging to this lobby were not overtly opposed to the entry of the latter.[12] The main demand made by FICCI was that "majority interests and effective control" should be with the Indians.[13] The section of the indigenous business group opposed to foreign private capital made a demand for limiting the sphere of activities of foreign capital. The Fiscal Commission was made aware of this position and in its report in 1949-50, it records this point. In 1953, the

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8. RBI, Report on the Survey of India's Foreign Liabilities and Assets, as on 31st December 1953, Examiner Press, 1955, p. 82.

9. Stated by the Finance Minister C.D. Deshmukh in reply to the Demand for Grants. See India, Lok Sabha Debates, First Lok Sabha, 17 April, 1954.

10. Patnaik, Prabhat, "Imperialism and the Growth of Indian Capitalism", in Blackburn, Robin, Explosion in the Sub-Continent, Penguin, 197 , p. 58.

11. The Department of Commerce in the USA made these observation: quoted by Sadhan Gupta, a member of Lok Sabha, while participating in the discussion of allocation of budgetary funds for the Finance Ministry in the Indian Parliament. See India, Lok Sabha Debates, First Lok Sabha, 15 April, 1954. Columns 4839-42.

12. G.D. Birla represented this line of thinking, see Kidron, Michael, op cit., p. 106.

13. Ibid., p. 104.

attitude of the Indian business turned most antagonistic. The Swadeshi League was formed to fight the monopoly of Hindustan Lever (then Lever Brothers) in the soap industry, and very soon this sentiment spread to the other sections of the industry to such an extent that FICCI adopted its "Swadeshi Resolution" in its Annual Meeting.[14] FICCI was critical of what it thought was indifference towards Swadeshi in the "Social and economic regeneration of the country."[15] In a subsequent memorandum to the Government, FICCI contended that the newly emerging foreign firms were creating difficulties for indigenous industries and it demanded that foreign capital be excluded from spheres in which it would adversely affect Indian interests. This demand for carving out areas for operation of foreign and local business, thus, became one of the main planks of the protests made by the latter.

The Government, on the other hand, started exploring areas for foreign participation in the Indian economy and the first area where inflow of foreign capital was ensured was the oil industry. After two years of negotiations, the Government signed agreements with three oil companies in 1953 for construction of refineries in the country. The agreement included an undertaking from the Indian Government of non-expropriation for 25 years and reasonable compensation thereafter.[16] Along with this the Government started negotiations with Western private capital for investments in the steel industry.[17] The agreements in the steel industry were signed only in 1956, but the effect of these initiatives by the Government on the indigenous business lobby was quite marked.

The hostility of the indigenous lobby soon gave way to a collaborative attitude. A FICCI sub-committee comprising leading industrialists gave substance to this attitude in their report in January 1955.[18] Although FICCI as a whole was more cautious, it nonetheless expressed its views in the same vein. Some of the influential members of the indigenous business lobby gave substance to the change in attitude by entering into joint venture agreements with foreign companies. One of the more important of these was the one that Birla entered into with Kaiser for an aluminium complex. This brought in a new phase in the relations between the Indian business groups and foreign private capital, one which marked the beginning of collaboration between the two. This process was aided further by some modifications made by the Government in its policies.

The first significant change in Government policies following the change of attitude of the private sector in India, was the adoption of the Industrial Policy Resolution (IPR) in 1956. There was one major policy shift from the earlier Industrial Policy Statement in 1948. While the 1948 Statement had given private sector ten years to operate before being nationalised, IPR, 56 clearly marked out the areas in which private sector could expand in an uninhibited manner. Schedule A gave a list of industries which were to be in the

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14. Ibid., p. 108.

15. Ibid., p. 108.

16. Harrison, Selig S (ed), India and the United States, Macmillan, New York, 1961, p. 156.

17. Patnaik, Prabhat, op cit., p 59.

18. Ibid., p. 109.

exclusive domain of the public sector. Schedule B contained industries where the private sector could also participate in the expansion but in general public sector was to take up the reins of expansion. All other industries were left for the private sector to expand in an uninhibited manner. The adoption of this policy can be seen as a part of the overall policy of the Government for encouraging inflow of foreign capital in the country. Foreign investments were not subjected to any statutory obligations and were allowed to operate in any sphere of activity within the overall framework of planned development which was laid down by the Five Year Plans.[19]

There was, however, one condition that the Government had sought to introduce: it wanted the Indians to have a share in management and to hold key positions in the foreign companies which were wholly owned subsidiaries of foreign companies. On the face of it, the behaviour of these subsidiaries seemed to suggest that the Government was succeeding in forcing the foreign companies to dilute their equity holding and that Indians were getting a share in the management of these companies. Several companies, which included Hindustan Lever, Dunlop, Guest Keen Williams, Philips India (now known as Peico Electronics and Electricals), Imperial Tobacco (now known as ITC Ltd) and Union Carbide, offered shares to Indians.[20] But the main reason behind this move by the foreign subsidiaries was not related to the Government compulsions. It has been pointed out that these subsidiaries of foreign companies were increasingly feeling the need for local intermediaries who could perform diverse range of activities which were involved in dealing with the Government.[21] The multifarious clearances which had to be obtained from the Government at each stage in the running of an enterprise in India gave rise to this need. Thus, one finds that while the Government was insisting on dilution of foreign equity in order that the Indians get effective say in management, the foreign parents gave shares to the Indians with the objective of making the latter work as functionaries who had little or no say in management. This was because dilution of equity per se did not mean any dilution in the effective control of the foreign investor in an enterprise. It has also been pointed out that "some foreign firms consider corporate control as an essential condition for their entry into the Indian market" and "in such cases they frequently take 40 per cent of shares" in the joint venture.[22] This implies that the foreign companies found it profitable to operate with less risk capital at stake in a joint venture since they could exercise effective control over such an enterprise with a less than majority stake in equity capital.

The real attitude of the Government towards foreign capital in general, and foreign private capital in particular can be seen in the manner in which different policies were

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19. RBI, India's Foreign Liabilities and Assets 1961: Survey Report, 1964, Reserve Bank of India, p. 15.

20. Kidron, Michael, op cit., p. 258.

21. Ibid., p. 263 ff.

22. See, U S A, Dept of Commerce, Investment in India, Conditions and Outlook for United States Investors, 1963, p. 12.

re-stated. We have already shown earlier how the Industrial Policy was diluted in 1956 when IPR was adopted. But even this policy was considerably watered down within a few years of its enactment by ensuring a large area for the private enterprise. The Finance Minister, T T Krishnamachari expressed these sentiments of the Government in opening up the industrial field for private participation in a letter to Eugene Black, President of the World Bank in 1956. He said, " [I]n making my own comments, I should like to emphasise once again that India's interest lies in giving private enterprise, both Indian and foreign, every encouragement to make its maximum contribution to the development of the economy particularly in the industrial field."[23] Thus, when the implementation of the second Five Year Plan (1956-61) had begun, the policies of the Government towards foreign private capital started becoming more accommodating. A number of factors contributed to the change. The first was the programme of industrial development that was taken up in the Second Five Year Plan, we had alluded to above, which brought in its wake the problem of providing resources. The second was the concern of the Government at the rapidly depleting foreign exchange reserves, accumulated after the Korean War Boom. And the third, the most crucial determinant, was the role of the external influences, like the World Bank, and later by the United States Agency for International Development (USAID), in influencing the economic policies of the Indian Government.

Phase Two: The Foreign Exchange Crisis and the Changing Attitude of the Government

The feature of this phase was a larger inflow of foreign private capital as compared to the earlier period, a trend that was maintained till the middle of the Third Five Year Plan.[24] By 1958, at least seven of the seventeen industries that figured in the Schedule A of IPR, 56, which included industries that were to be exclusively under State control, were opened to private interests.[25] These industries included armaments, heavy machinery and heavy electrical plant. A much greater shift in policy was seen in the case of the Schedule B industries, which, according to IPR, 56, were to be progressively state owned. Of the twelve industries included in the Schedule B, in as many as nine industries private sector was in the forefront in setting up new units. Although these changes in official policy were beneficial to the private sector in general, the actual beneficiaries were foreign controlled companies and to that extent the changes can be interpreted as a shift in favour of foreign capital. In heavy plant and machinery producing sector, ACC Vickers Babcock Ltd and Larsen and Toubro Ltd were the first entrants.[26] The latter was initially a foreign controlled

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23. Davey, Brian, The Economic Development of India, Spokesman Books, 1975, p. 145.

24. If the approvals granted for foreign participation by the Controller of Capital Issues in the Ministry of Finance are taken as indicators of inflow of foreign private capital this tendency is observed. See India, Ministry of Finance, Quarterly Statistics on the Working of Capital Issues Control, one hundred fifty eighth issue, p. 13.

25. Kidron, Michael, op cit., p. 143.

26. Ibid., pp. 143 ff.

company, but in the subsequent years its status as a foreign controlled company is doubtful as no shares are held in the country of origin of the Company, Denmark, and the foreign shareholders divested their portfolio almost entirely. In the heavy electrical plant or power equipment sector there was substantial foreign participation. English Electric Co Ltd already had a large production capacity which was further expanded in 1959. The most significant foreign entry took place in the form of Siemens India Ltd, a West German subsidiary. Siemens made its entry in 1957, and despite the presence of the public sector Bharat Heavy Electricals Ltd, the foreign subsidiary continued to grow in stature. The aluminium industry was left for public sector in the Second Five Year Plan document, but in 1958 Government allowed foreign capital to enter the industry through the Birla-Kaiser collaboration.

The heavy chemicals and the drug industries were next in the line. The expansion in the drug industry was earlier planned though the involvement of public sector in Hindustan Antibiotics Ltd and Indian Drugs and Pharmaceuticals Ltd in bulk drugs production. But by 1957-58 the State sector projects were drastically cut and private sector, which included a large number of foreign subsidiaries, were given preference. In the chemical fertilizer industry, the process of relaxation of government policies took a number of years. This was caused not by any strength of the government vis-a-vis the foreign business interests but by the fact that the foreign interests by themselves did not come up with any proposal for setting up new ventures. Once the foreign interests were able to present a firm proposal the Government relented by offering foreign collaborators 49 per cent share in total equity in a public sector project.[27]

The changes, we had mentioned above, had been influenced by three factors, (a) the resource needs of the economy for industrialization, (b) the foreign exchange crisis, and (c) the external influences. We would briefly examine these factors below.

The inter-relationship between the first two factors mentioned above is quite obvious. The resource needs for industrialization as viewed by the Government was quite intimately linked to the foreign exchange position in the economy. But the foreign exchange needs of the economy as viewed by the Government appear to have been exaggerated when the magnitude of foreign exchange used by a country like China, which was at a stage of development quite akin to that of India, is considered. Prof P.C. Mahalanobis, who provided the structure of India's Second Five Year Plan, drawing this comparison between India and China mentioned that China, with a 50 per cent bigger population succeeded in getting a head start with the help of foreign loans of only Rs 1057 crores spread over 7 or 8 years. In contrast, the view in India was that the country required large volumes of foreign exchange over a considerable length of time. An estimate of the foreign exchange needs of the country was provided by the Indian Industrial Delegation after visiting several Western countries in September-November 1957. It said that for India

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27. Madras Fertilizers Ltd was formed through financial participation by two American companies and the Indian Government.

to develop Rs. 50,000 crores in foreign currency was essential. This led the delegation to arrive at the conclusion that foreign capital was needed "for at least the next 25 years and in substantially large amounts."[28]

The view of the representatives of Indian business interests regarding the importance of foreign capital appears to have been endorsed by the Government as it started seeking funds from bilateral and multilateral agencies like USAID and the World Bank. This move of approaching the World Bank gave rise to the second compelling factor behind the change in the Government's policies. It is a well known fact that the World Bank provides credit only after certain broad policy initiatives are taken by the host countries regarding foreign capital. The World Bank's official position on the role of foreign capital was made clear in the Report of the Banker's Mission to India and Pakistan in 1960. The report suggested that if aid seeking Governments were to use the potential sources of aid to the full they would have to create conditions which would attract private capital from abroad.[29] The form in which the World Bank wanted foreign capital to participate in the Indian economy was, however, made abundantly clear much earlier when the Government had sought the Bank's assistance for financing the Rourkela Steel Plant in 1956. The Bank insisted that the German collaborators who were supplying technology should have more leverage than had been offered to them in the proposed project which was to be in the public sector.[30] The negotiations fell through and as hindsight suggests, the reason for the government to adopt a strong position at that juncture was that the critical point in foreign exchange availability had not been reached. Once this point was reached after 1957, the dictates of the foreign agencies was quite evident and as we have discussed earlier, policy changes were effected by the Government which gave a larger role to foreign capital in the Indian economy.

The process of liberalization of Government policies in respect of foreign capital continued in the 1960s. In May 1961, a press note issued by the Government on the role of foreign private capital stated thus,

> "Basically, the policy regarding foreign investments would be to attract private foreign capital in those fields, in which the country needs to develop in pursuance of the Plan targets. While Government have been encouraging the investment of private foreign capital in the country, it is to be recognized that this has necessarily to be on a selective basis.
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> If any projects is approved for development in the private sector and, if imported plant and machinery are required, foreign capital investment would ordinarily be welcome as a form of financing the project.
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> While Indian majority holding would be generally welcome, the ratio of

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28. Mahalanobis, P.C., Talks on Planning, Asia Publishing House, 1961, p.75n.

29. Kidron, Michael, op cit., p. 176.

30. Ibid., p. 153.

foreign capital in joint venture enterprises, the extent of foreign share holding that is to be permitted in any case etc., have necessarily to be judged on merits. This judgment is made after evaluating the technical skills offered and after weighing the requirements of foreign exchange for the purchase of equipment from abroad and the desire of Indian collaborators to play an effective part in the company's management."[31]

An "illustrative list" of 26 industries was prepared in which the Government would "ordinarily" be willing to consider private foreign capital in joint ventures.[32] Many of these industries included those that appeared in Schedules A and B of IPR, 56.[33] The note also spells out the need to simplify procedures relating to consideration of applications in cases involving foreign participation. An expression to this was given by the Government in the setting up of the Industries Development Procedures Committee in 1962.

The setting up of this Committee was one of the significant steps initiated by the Government in this period for encouraging inflow of foreign capital and with it foreign technology by stream-lining procedures for obtaining various government clearances, including import of equipment and machinery. The foreign investors had for long complained about the web of Government procedures that needed to be complied with. The Industries Development Procedures Committee was set up under the Chairmanship of T Swaminathan, Additional Secretary in the Department of Technical Development.[34] The Committee included several important industrialists and the recommendations of the Committee can also be taken as an indicator of the aspirations of the dominant section of the private sector in the country. The Swaminathan Committee recommended that in case of 22 industries special procedures should be adopted. 16 industries of these 22 were those which appeared in the "illustrative list" of 26 industries mentioned in the press note of May, 1961 in which foreign capital was to be allowed. The Swaminathan Committee was, therefore, an attempt to provide a freer flow of foreign private capital in the country.

The significance of the Committee should be viewed in light of the statements that were being made by the prospective western investors in which investment climate in the country was commented upon. The prospective investors made particular references to the administrative controls that existed in the country to monitor private investment, an issue that was taken up in a much bigger way by the World Bank after the mid-1960s.

The viewpoint of the Government was put in a forthright manner by the then Finance Minister, T.T. Krishnamachari in 1963. His contention was that the stage had

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31. Kust, Matthew J., Foreign Enterprise in India, Laws and Policies, University of North Carolina Press, 1964, p. 142.

32. Hazari, R K (ed), Foreign Collaboration: Report and Proceedings of the Seminar held by the Centre of Advanced Studies, Department of Economics, University of Bombay, 1965.

33. Verma, S P (et al), Political Dimensions of Multinational Corporations in India, Indian Institute of Public Administration, 1983.

34. India, Ministry of Industry, Industries Development Procedures Committee, 1964.

been reached where there was justification for "opening the doors even wider to private foreign investment."[35] Although he added a note of caution in his statement by mentioning that care should be taken "that the vital areas of development were not mortgaged for ever to foreign private investment", the tenor of his views was nonetheless quite clear.

It might be noted here that the Government had only one objection as regards financial collaboration - it wanted Indians to have a majority in the ownership of the enterprises. This policy of the Government regarding majority Indian ownership fell in line with what the foreign investors were thinking about financial participation. Available evidence indicates that even they were not too keen on having a majority ownership and "generally preferred" having 40 per cent ownership.[36] It appears, therefore, that ownership was not the primary objective of foreign collaborations in joint ventures, they were more interested in establishing control and they were able to do so with lesser than majority ownership.[37]

The changes in official policy which were brought about in a piece-meal manner till the mid-1960s can be said to be a forerunner of the liberal regime that was to follow in which control and regulations were being relaxed with greater regularity. The devaluation of the rupee in 1966 provided the initial momentum for the change in policies and was accompanied by relaxation of controls for the import of capital goods and technology and all this was done with a view to increase inflow of foreign capital in the country.[38]

Phase Three: The Devaluation of the Rupee and the Relaxations in Policies

The new phase was marked by a series of modifications of the existing policy instruments which was done to keep them in tune with the changing perspective of the policy makers. The first instrument whose effectiveness was curbed during this phase was the Capital Issues (Control) Act.[39] This legislation was enacted in 1947 to keep a check on the expansion of the private sector and it did so by putting limits on the amount of capital a

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35. Hazari, R.K. (ed), op cit., p. 6.

36. USA, Dept. of Commerce, Investment Factors in India, Overseas Business Reports, December, 1962.

37. We shall be discussing this aspect in the following section where we would be providing evidences.

38. Capital in its 14 July, 1966 issue, states, "its (Government's) Socialist zeal for controls and regulations has cooled off a little, thanks to the douche of realism administered by the World Bank and the USA", p. 60.

39. This Act enacted in 1947, was used in consonance with the Industries (Development and Regulation) Act of 1951 for regulating private investment in the country. Under this Act any company which wanted to raise capital in excess of Rs 25 lakhs had to seek permission from the Controller of Capital Issues in the Ministry of Finance. The earlier exemption limit was Rs 10 lakhs and was raised in 1963. Exemption limit under the Act was first introduced in 1949 when the Capital Issues (Exemption) Order was introduced. Companies raising capital below Rs 5 lakhs were exempted from seeking permission of the Capital Issues Controller, see Simha, S L N, The Capital Market of India, Vora & Co. Publishers Pvt Ltd, 1960, p. 35.

company could mobilise from the capital market. In 1966 the Government decided that except for bonus shares (issued for capitalisation of undistributed profits which are held as reserves), issue of capital by private limited companies, government companies and banking and insurance companies would not require the sanction of the Controller of Capital Issues, the implementing authority of the Capital Issues (Control) Act.[40] A large number of companies could, therefore, raise capital for expansion of their production units in an uninhibited manner.

Relaxation involving the other instrument of policy, Industries (Development and Regulations) Act, followed soon after. In November 1966, the Government passed an order which allowed companies to freely diversify production upto 25 per cent of their total output without any licence under the Act.[41]

In the specific area of import of technology, the other purpose for which foreign business interests were invited, the Government gave expression to its attitude in accepting the Mudaliar Committee's report on Foreign Collaboration.[42] The major recommendations of this Committee, which submitted its report in 1967, were:

(a) a positive approach is needed to the problem of import of know-how, particularly of process know-how, or product design;

(b) generally speaking, in industries where substantial import of capital goods is involved and where the Government's policy allows foreign capital participation, joint ventures involving foreign equity participation are more beneficial as compared to other forms of collaboration;

(c) no rigid rule should be followed in the matter of duration of technical collaboration agreements; normally, the duration of the original agreements should be between 5 to 10 years from commencement of production;

(d) on the question of avoidance of repetitive import of technology, where a number of collaborations, say 5 or 6, had already been approved in a particular field of industry, it would be more appropriate to consider the likelihood of an existing unit giving process know-how or product design to a consultancy firm on the basis of a negotiated agreement. Fiscal incentives should be given to existing units which pass their know-how to others; and

(e) a liberal approach would be worthwhile in regard to foreign collaborations in the case of substantially export oriented industries.[43]

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40. Economic and Political Weekly, Oct 22, 1966, see also Capital, Oct 27, 1966, p. 763.

41. The details are given in the following section where we would be discussing the Licensing System at length.

42. The Government accepted the report of the Committee in 1969, see Capital, Jan 9, 1969.

43. India, Ministry of Industrial Development and Company Affairs, Report of the Committee on Foreign Collaboration, May 1967.

The Government accepted these recommendations in general,[44] and these were incorporated in the Fourth Plan framework, adopted in 1969.[45] This marked a major shift in the policy for technology import, as the Government had been maintaining till then, that foreign technology was permitted to enter only in high technology areas and in areas when plan priorities demanded their entry.

Following the recommendations of the Mudaliar Committee, the Government considered that a number of steps should be taken to secure two important objectives:

(a) there should be no undue delay in the disposal of cases for foreign collaboration and as far as possible, all applications should be disposed of within 3 months; and

(b) intending collaborators should know clearly about the facilities available for foreign investment.

With a view to minimising the procedural delays in the disposal of applications relating to foreign investment and collaboration, the Government laid down a procedure for the disposal of such applications. The Foreign Investment Board was set up in 1968 and was assigned responsibility for expeditious disposal of the applications. In January 1969, the Government issued three illustrative lists of industries where (a) financial collaboration was permitted (b) only technical collaboration was permitted, and (c) no collaboration was considered necessary. This step taken by the Government has been interpreted by some as the toughening of attitude towards foreign capital, but viewed in association with the immediately following course of events, which took a more liberal view of foreign participation, this move by the Government appears more like a statement of intentions and not like a policy statement. In 1970, the collaboration policy was further liberalised along with the new licensing policy. This was done, as the Government contended, with a view to bridge technological gaps that existed in several sectors of the economy. An illustrative list of 121 items in which technological gaps existed and for which foreign collaboration would be permitted, was drawn up. Similarly, illustrative list of 123 items where there was likelihood of sustained demand for the product and scope of investment, was also published to enable entrepreneurs to avail of the opportunities afforded by liberalisation.[46] Majority foreign participation was permitted in certain low priority areas and non essential fields of production for cases where production was largely for exports. The earlier policy of not allowing foreign collaboration in trading activities was relaxed where such collaboration was needed to augment exports. Similarly, majority foreign participation in new enterprises

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44. India, Committee on Public Undertakings (1975-76), Eighty Ninth Report:Foreign Collaboration in Public Undertakings, Fifth Lok Sabha, 1976, p. 5.

45. India, Planning Commission, Fourth Five Year Plan, 1969-74, pp. 311-12. Although foreign collaborations in low-priority areas were in evidence even earlier, a fact that was brought out by the Industrial Licensing Policy Inquiry Committee (see India, Industrial Licensing Policy Inquiry Committee, 1969, pp. 130-36), it was for the first time that official policy encouraged collaboration in low-priority areas.

46. India, Committee on Public Undertakings, op cit., p. 7.

was considered (i) if the development of the particular industry was essential in national interest; (ii) if the field of technology was one where little or inadequate progress was made or where considerable additional development was considered necessary; or (iii) if it was felt that the project in question could not be set up without foreign participation.[47]

The policy of inducting domestic equity in foreign majority companies was strengthened in 1972. Till then, the extent of dilution by foreign majority companies was done by examining each case individually and to overcome the long delays caused by this procedure it was decided to introduce the "dilution formula."[48] According to the formula, whenever a foreign majority company undertook an expansion programme, was required to issue a certain share of fresh equity to Indians. A company having 75 per cent or more of foreign equity was required to issue 40 per cent of the additional equity to the Indians. Companies having foreign equity between 60 and 75 per cent were required to issue a third of their new equity to the Indians and all the other foreign majority companies were required to issue a fourth of their issue to the Indians. The dilution formula set the tone for the Foreign Exchange Regulation Act in 1973 (henceforth FERA, 73), the single most important policy initiative towards foreign capital in India, which was brought in soon after.

Phase Four: FERA and its Implications

By a large measure FERA, 73 provided an opportunity to foreign business interests to consolidate their holdings in the country. For the first time the Government made a formal declaration that foreign companies upto 40 per cent foreign equity would be treated as Indian Companies and could be allowed unrestricted access to any segment of industrial activity. (See Section II for a detailed discussion.) This was probably the assurance foreign companies were looking for, from the Government. Immediately after this pronouncement several wholly owned subsidiaries and branches of foreign companies expanded their capital base manifold after keeping it unchanged at a particular level for a long time. Some of the prominent companies in this category were Colgate Palmolive, Ponds, Abbott Laboratories.

The formulation of the Fifth Plan in 1974 saw the Government expressing similar sentiments as those expressed by Prime Minister Nehru in 1949. It said,"Foreign collaboration must serve to supplement and accelerate the development and utilisation of indigenous technologies and production capabilities in a manner which advances the country's efforts to attain overall self-reliance as rapidly as possible."[49] But while the Government was expressing its intents of making foreign private capital to serve the national interests in the best possible manner, it did not evolve any mechanism to ensure

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47. See, India, Estimates Committee (1971-72), Nineteenth Report :Industrial Licensing, Fifth Lok Sabha, 1972.

48. Ganesan, A V, "Domestic Participation in Ownership of Existing Transnational Corporation Subsidiaries in Developing Countries: The Indian Experience", Workshop on Regulating and Negotiating with Transnational Corporations, Port of Spain, 5 - 18 July, 1982, pp. 5-7.

49. India, Planning Commission, Fifth Five Year Plan, 1974-79,Part II, p. 135.

that the expected results were achieved. Thus, it is found that while the Government wanted to exercise selectivity in import of technology and avoid imports when technology was available domestically, technology imports have been allowed to take place freely.[50] We shall dwell on this point later in the paper.

It can, thus, be seen that in nearly three decades after the attainment of political independence, the State as the major initiator of development policies in the country, had adopted policies which basically did not militate against the operation of foreign capital in the country. What started as a strong anti-foreign capital position was slowly, yet unmistakingly, diluted. The changes in policies and enactment of new legislations like FERA, 73 did not militate against the interests of the foreign companies. Majority ownership was never the prime consideration of the foreign companies, as we have shown earlier. The foreign investors were more keen on having complete control over the joint venture they were participating in and they did enough to ensure their control. There were, however, certain policies which were aimed at reducing the area of activity of the foreign companies. The nationalisation of insurance activity in the 1950s and that of coal and oil in the 1970s foreclosed the option of private foreign capital to operate in these areas, but these moves by the Government do not appear to have affected the ares of influence of foreign capital in the country in any significant manner. In the post-independence period, foreign companies were moving away from their traditional sectors of involvement, i.e., extractive and trading activities, which characterised the colonial pattern of investment. Manufacturing sector was gaining prominence during this period. The manufacturing sector tacitly adopted the priorities set forth by the developed countries and in pursuance of these priorities dependence on foreign private capital was taken as inescapable by the policy makers (the various policy statements referred above testify this). The urgency shown by policy makers stemming from the fact that they considered foreign private capital as necessary, was reflected in the series of relaxations of policy.[51] What emerged after the relaxations of policy, especially after the policy change effected in 1969, was that foreign private capital was sought to be given a virtual monopoly position in the Indian economy.[52] This policy change allowed financial collaboration, (i.e., setting up joint ventures in India), only in areas where indigenous technology was not available. The new policy, in effect, discriminated against the Indian companies which, from the same year, 1969 were brought

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50. Committee on Public Undertakings in its Eighty Ninth Report to the Fifth Lok Sabha had found that there were a number of cases where private sector companies were allowed to import technology when public sector companies had developed the same technology, see India, Committee on Public Undertakings, op cit., Appendix VI.

51. The Indian experience at this point should be compared and contrasted with that of Japan. While Japan, even by adopting the Western priorities in the industrial sector, could pursue an independent development path, India has been caught in the web of dependence on foreign private capital.

52. Goyal, S K, "The New International Economic Order and Transnational Corporations", Corporate Studies Group Working Paper No. 5, p. 86, also published in Secular Democracy, Annual Number, 1983.

under the Monopolies and Restrictive Trade Practices Act (MRTPA) and were subjected to various regulations.[53]

The relaxation in Government policies was not done all at once, as we have described above, but it was spread over long stretches of time. This tendency of not going in for relaxation all at once, was the only distinguishable feature of India's development strategy, standing in contrast to the experience of the Latin American countries. But the more recent phase of industrialization, the 1980s, makes the difference between the Indian experience and that of the Latin American countries less marked. The pace of relaxation of policies was accelerated in the 1980s,[54] and in this respect the present phase of industrialization stands out from the earlier phases.

Phase Five: The New Opening Up: The 'Eighties

The opening up of the economy since the 1980s has two distinct phases, the dividing line being the change in Government in 1985. While in the first phase, the political leadership did not threaten to pull down the entire edifice of economic development built over the four decades, in the second phase several questions have been raised by the Government about the key elements that constituted the basic economic structure. For instance, the role of economic planning has come to be questioned and not surprisingly, therefore, it is found that for the first time public sector investment planned for in five years is less than that of the private sector in the Seventh Five Year Plan.[55] In keeping with this the role and place of public sector in the Indian economy has come to be questioned quite regularly in the recent past.

The signals for the new developments in the Indian economy were given in 1980 when the Government announced its new industrial policy. The new policy laid the foundations for the liberalisation of economic policies that was to follow. The accent was on improving the price competitiveness of Indian industrial products and this was seen to be possible only with the aid of imported technology. The policy declared "Government will consider favourably, the induction of advanced technology and will permit creation of capacity large enough to make it competitive in world markets, provided substantial exports are likely. The purpose of introducing such a policy would not be only to encourage exports but also to enable industry to produce better quantity products at lower costs which ultimately benefit the consumer in terms of price and quality."[56]

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53. We shall discuss this point in greater detail in the following section.

54. Paranjape, H K, "New Lamps for the Old! A Critique of the New Economic Policy", Economic and Political Weekly, September 7, 1985, p. 1516.

55. In the draft Seventh Five Year Plan, about 47 per cent of the total investment in the five year period was to come from public sector.

56. Statement on Industrial Policy announced by the Minister of State for Industry Dr. Charanjit Chanana in the Parliament on July 23, 1980, see India, Ministry of Industry, Guidelines for Industries, Part I, Section II, p. 41, 1982.

A number of steps were taken to meet the demands to the industrial policy statement. In the beginning of 1981, Commerce Ministry announced that 100 per cent export-oriented units would be allowed free access to foreign collaboration without being subjected to the provisions of FERA, 73 and permitted to import capital goods, components and raw materials without any restrictions. Their imports were exempted from import duties and their purchases of indigenous capital goods and raw materials from excise duties. Their finished goods were also exempted from excise duties and other duties.[57] In 1983, further liberalisations of the import policy were effected in order to benefit 100 per cent export-oriented units. The list of items for which no import licence was required was enlarged.[58] The export-oriented units were opened up as an avenue to increase investment by foreign companies and, therefore, these concessions can be interpreted as concessions given to foreign private capital for investing in the country.

The liberal policy of importing technology was given a further push in the form of the Technology Policy adopted in 1983. Although the policy had mentioned that gaps in technology available to Indian industry would be identified before technology imports are allowed, in practice, however, very little of this was in evidence. A large number of projects, especially in the public sector, went ahead with maximum foreign assistance and that too in a situation where the public sector organisations were competent to execute such projects.[59]

Several areas of industrial activity were also opened up for foreign investment. The communications industry was earlier reserved for the public sector, but in 1984 foreign equity upto 49 per cent was permitted to enter in the industry.[60] The electronics industry was also opened up simultaneously and the reason given by the Government for free technology imports was that the Indian industry had to be competitive internationally. Import duties on components were reduced to help the Indian industry develop its competitive edge.[61]

The licensing system was made more liberal after 1985 through broad-banding. This measure was introduced to provide flexibility to production units for changing their product-mix within a certain specified range without seeking Government permission to do so. It was first introduced in the machine tools sector and was later extended to the automobile sector and the drugs industry. All this led to a record number of new collaborations in a single year, 1986, in which more than 1200 collaborations were entered with by Indian Companies.

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57. Economic and Political Weekly, January 24, 1981, p. 85.

58. Economic and Political Weekly, April 16-23, 1983, p. 605.

59. Example of such cases can be seen in the power and fertilizer sectors where turn-key contracts were given to foreign companies.

60. Economic and Political Weekly, April 7, 1984.

61. International Monetary Fund, India-Recent Economic Developments, Supplement I, March 14, 1986, p. 10.

It can thus be seen that throughout the period after the attainment of political independence in 1947, the Indian Government has been trying to adopt a conciliatory position vis-a-vis foreign capital. The Government started with the anti-imperialist rhetoric, a legacy of the pre-independence Congress Party, and it adopted certain regulatory policies aimed at private sector in general, interspersed with policies aimed at foreign private capital as well, but over a period of time it modified these policies in a way which proved to be beneficial for foreign private capital in the long-run.

As mentioned above since 1949 there has been no other policy statement that exclusively deals with the place, and role of foreign private capital in the country. There have, however, been a number of references to foreign private sector in different regulatory enactments. This is what we shall turn to below.

The Specific Instruments of Policy for Regulating Foreign Private Capital

Foreign direct investments in India are subject to a number of specific regulations. Most of these regulations, however, treat the foreign sector as a part of the private corporate sector and not as a special case within the corporate sector. We would discuss some of the more important of these regulations in an attempt to see whether the regulations impinged upon the growth of foreign direct investments in India. The enactments are important in so far as they seek to influence the decision of foreign private capital to invest and expand its operation in the country.

Industrial Licensing System

The most important regulation in India is the Industrial Licensing System which is governed by the Industries (Development Regulation) Act of 1951 (henceforth IDRA, 51). The licensing system was developed with a view to channelising the private sector endeavours into socially desirable channels, as spelt out by the Government in its various Policy Statements. The principles on which the IDRA, 51 and hence the licensing system was based was given by the Industrial Policy Statement of 1948. As we had discussed earlier, the statement had highlighted the pre-eminent position of State sector in the process of economic development in post-colonial India. In pursuant to these objectives, the Industries (Development & Regulation) Bill was introduced in the Constituent Assembly in 1949 and was subsequently passed in 1951. In a way, the licensing system can be seen as a fore runner of the planning process that took shape in 1951. Simultaneously with the enactment of IDRA 51, one of the important tenets of the planning mechanism, viz., regulated use of the available productive resources in the country, was applied in the industrial sector. The main provisions of IDRA, 51 can be stated as under,[62]:

(a) all existing industrial undertakings in the 'scheduled industries' list, i.e.,

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62. See, India, Estimates Committee(1971-72), Nineteenth Report :Industrial Licensing, Fifth Lok Sabha, 1972.

industries listed in the First Schedule of the Act which included 37 industries (modified to 42 industries by an amendment in 1953), had to be registered with the Government within the prescribed period and were issued certificates of registration. To facilitate this, the Government enacted another legislation in 1952, the Registration and Licensing of Industrial Undertakings Rules, 1952.

(b) no new industrial undertaking of a major size could be started in a scheduled industry, no new product could be manufactured and no substantial expansion (the definition of what constituted "substantial expansion" was modified later, as we shall see below) of an existing undertaking could be effected without a license from the Government.

(c) no change of location of an industrial unit could be brought about without the permission of the Government.

(d) the Government reserved the right to revoke registration or licence in case of any misrepresentation, etc, by the party concerned, or failure on the part of licences to take effective steps.

(e) under Section 15 of the IDRA, 51,the Government was given powers to order investigation into the working of an industrial undertaking and if investigations revealed that the undertaking was being managed in a manner detrimental to a particular industry or the country's economic development, the Government had powers to issue directions under Section 16 of the Act to the management, in respect of prices, production, quality and other areas of the undertaking's performance. In the event of an undertaking not carrying out these directions, the Government could take over the management and appoint authorised controllers to manage the company.

(f) the Government had comprehensive powers to control and regulate the supply and distribution and prices of any of the articles listed in Schedule A of IPR, 56.(this provision was introduced after IPR, 56 was adopted)

In order to meet the provisions of the IDRA, 51, two bodies were formed under the Act. The Central Advisory Council was to advise the Government on matters related to the development and regulation of the Scheduled industries. The Development Council for each industry was given the task of setting production targets, product standardization and facilitating training and skilled personnel.

From the 1960s, IDRA, 51 has undergone several modifications when exemptions were provided to specific set of enterprises. Along with this, other relaxations were also made, some of which undermined the very objectives for which IDRA, 51 was enacted. In February 1960, industries employing less than 100 workers and not using electricity and 50 workers, using electricity and whose fixed assets did not exceed Rs 10 lakhs, were exempted from the purview of the IDRA, 51. In January 1964, the exemption limit for

industries in terms fixed assets employed was raised to Rs 25 lakhs. This exemption was, however, not applicable to coal, textiles, roller flour mills, oil seed crushing, vanaspati, leather and safety matches industries.

The most significant relaxation provided under the IDRA, 51 came in 1966. The Government passed an order which allowed companies to freely diversify production upto 25 per cent of their total output without any licence under the Act.[63] The diversification of production was allowed subject to three conditions: (a) no additional plant and machinery could be installed, except for minor balancing equipment, (b) no additional foreign exchange expenditure could be made, and (c) the items to be produced were not reserved for the Small Scale Sector.

In 1967, the November 1966 position was further diluted. It was announced that if diversification (in accordance with the earlier relaxation) had taken place in priority areas, raw materials could be imported for use in the diversified range of activities.

The Industrial Licensing Policy was modified quite substantially in 1970 in the process of accepting some of the recommendations of the Industrial Licensing Policy Inquiry Committee (ILPIC) which was set up to review the working of the industrial licensing system. The main changes were:

(1) raising the exemption limit of the undertakings from Rs. 25 lakhs to Rs. 1 crore. But this exemption was not made available for the following categories of companies.

   (a) those belonging to or controlled by the larger industrial houses as identified by the ILPIC;

   (b) Indian subsidiaries of foreign companies, i.e., companies with foreign equity in excess of 50 per cent;

   (c) dominant undertakings as defined by the MRTPA

   (d) those operating in the `Core Sector' (defined below) or areas reserved for the small scale sector; and

   (e) those which required more than 10 per cent of the value of increase in assets in foreign exchange.

(2) a new concept of the `Core Sector' was introduced for limiting the investment activity of large houses, dominant undertakings, as defined by the MRTPA, and foreign companies. The Core Sector comprised a number of major industries, fertilizers, pesticides, tractors, power tillers and selected electronic and petrochemical items being the more prominent of these. (Several of these industries were reserved for the public sector by the IPR, 56).

(3) existing licensed or registered undertakings having fixed capital not exceeding Rs 5 crores were exempted from licensing provisions for

63. India, Industrial Licensing Policy Inquiry Committee, 1969, p. 27

substantial expansion, provided the aggregate value of such expansions did not exceed Rs. 1 crore.

(4) industrial undertakings, licensed or registered, were given the freedom to diversify their production by taking up manufacture of new articles without a licence, provided that the new article were not reserved for the public sector or the small scale sector, no additional plant and machinery other than minor balancing equipment and no additional expenditure in foreign exchange were involved. And lastly, diversification was allowed to the extent that the diversified production cost did not exceed 25 per cent of the licensed or registered capacity by value.

(5) The banned list for the purposes for providing industrial licence was discontinued and it was replaced by a policy of reservation for the small scale sector.

The Core Sector was further extended subsequently. The Industrial Licensing Policy of 1973 made this list more elaborate and included 19 industries and was listed as the Appendix I industries. In 1982 five more industries were added to the list of Appendix I industries.

An important element of the licensing system during this period was the policy towards small scale sector. The policy of protecting the small scale sector was introduced in the sixties. This policy was adopted with a view to reduce the existing disparities in the ownership of productive capacity in the country and to prevent the expansion of monopoly houses in the country. Initially a limited number of industries were reserved for exclusive development by the small scale sector. In 1969 the reserved items were only 47. Subsequently, the list of reserved items was increased to 177 in 1972 and to over 700 items during 1977-78. In recent years the reserved list has increased further and it includes more than 800 items.

The licensing policy of 1970 introduced a special schedule of industries having 6 products of mass consumption over which there were controls as regards pricing and distribution. In 1973 this list was expanded to include 8 products. Along with this, the 1973 policy gave a list of "other articles" which consisted of 11 engineering and 2 chemical products which were using scarce raw materials, both imported and domestic. In 1982, the list of "other articles" was increased from 13 to 66 and the two lists, viz., the Special Schedule of industries and "other industries" were put together as a single list of 78 items in 1983. A further expansion of this list took place in 1984 and it included products like harvesters, tractors and automobiles, both 2 wheelers and four wheelers.

The industrial policy statement of 1980 set the tone for changes in the licensing policy that were to follow. As mentioned above, for the first time the policy explicitly stated the desirability of the private sector to develop in the Indian economy. Several steps were taken to foster the expansion of the private sector. The first was the extending of the "automatic growth scheme", started in 1975 to cover 15 engineering industries, to all

Appendix I industries. Under this scheme an enterprise was allowed to expand its capacity by 5 per cent a year and upto 25 per cent in capacity in a five year plan period. This expansion was in addition to the 25 per cent expansion that was being allowed since 1966. The coverage of industries was further expanded in 1982 when 45 industries were added. A further relaxation was granted simultaneously in respect of funding such expansion schemes. While the original 1975 scheme had a clause that all funds should be raised from internal resources in order to bring about the expansion in capacity, the 1982 restatement withdrew this restrictive clause. The only restriction that was brought in was for covering the non-dominant MRTP Companies, (i.e., companies not having dominance in any line of activity but belonging to the large industrial groups as identified by ILPIC) which had now to obtain a clearance under the MRTPA.

More significant from several angles was the second relaxation that the private sector was granted in the form of re-endorsement of capacities. The enterprises, under the scheme for re-endorsement of capacities, were granted an increased licensed capacity upto one-third on the existing level if actual production exceeded licensed capacity by 25 per cent. The re-endorsement scheme had yet another element which encouraged the companies to continuously increase installed capacity ignoring the licensed norm. This was done in the name of adding a "dynamic element" in the licensing system. According to this new scheme, an enterprise was allowed to increase its capacity continuously by one-third if it was able to increase its actual production continuously.

The degree of effectiveness of the Industrial Licensing System as a regulatory mechanism has been discussed extensively in several studies conducted by the Corporate Studies Group. The Functioning of the Industrial Licensing System brought out the fact that foreign controlled companies and Indian monopoly house companies had the tendency to either underutilize or overutilize the licences granted.[64] Instances of excess capacity installation brought out in the study show that in some cases actual capacity exceeded licensed capacity by more than 10 times.[65] Over-installation of capacity seems to have been the most widespread in the drug industry. This was brought to light after the scheme of re-endorsement of capacities was announced when a large number of companies came forward to avail of the opportunity.[66] The re-endorsement scheme showed that although

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64. Cases cited include those of Hindustan Lever, Glaxo Laboratories and Bayer, which violated the licensed norms in respect of all licences examined in the study. Hindustan Lever had 13 licences, Glaxo had 10 and Bayer had 8 licences. Peico Electronics and Electricals (formerly Philips India) violated the licensed norms in 12 of the 17 licences examined in the study, Dunlop India in 10 out of 11, Union Carbide in 10 out of 12 and Guest Keen Williams (GKW) in 20 out of 21, see Corporate Studies Group, Functioning of Industrial Licensing System: A Report, January 1983, Table-III.13, pp. 74-75.

65. Ibid., Appendix IV, pp. 123-26.

66. Replies given by the Government in the Indian Parliament shows that in case of a number of companies, capacity re-endorsed by the Government exceeded 100 per cent of the existing licensed capacity. Three foreign drug companies, Searle India, Wyeth India and Organon, declared installed capacities exceeding 1000 per cent over the licensed levels.

there were apparent controls imposed over the growth of the private corporate sector through the instrument of industrial licensing in actual practice growth of private sector (and with it the foreign sector) could not be curtailed.

Violation of licensing policy of the Government practised by the foreign controlled companies took yet another form. This was expansion in areas which had been closed for them and reserved for the small scale sector. Most of these areas constituted low technology areas and given the intention of the Government of allowing foreign private capital into only the high technology areas, operation of foreign private capital in these areas was banned. The Government, however, did not succeed in keeping these areas reserved for the small scale sector and foreign controlled companies like Hindustan Lever, Glaxo Laboratories, Britannia Industries, Bata India and Pfizer have been able to keep producing and also produce in excess of the licensed norms.[67] Apart from directly operating in areas reserved for the small scale sector, the big business in India has functioned in a way that have made the smaller units appendage to them. The study on "Small Scale Sector and Big Business" conducted by the Corporate Studies Group has discussed this phenomena at length. Several companies like Bata India, Singer Sewing Machine Co (now called Indian Sewing Machine Co), Peico Electronics (formerly Philips India) and ITC, have been marketing products of the small scale sector and as a result the small scale units have not been able to take maximum advantage of the opportunities provided by the market.[68] The inability of the Government to decrease the control of the larger companies on the marketing channels and to provide independent status to the small scale sector has defeated the very purpose for which reservation for the small scale sector was introduced.

The licensing system had, thus, a limited role to play in regulating foreign private capital in India. Although it had set out to channelise the growth of private sector in areas which were in accordance with the plan priorities, in practice licensing did not prove to be any hindrance for private enterprise. The companies could not only pre-empt licences for setting up units, as ILPIC had shown,[69] they had installed capacities in excess of the licensed capacity as well.

One of the positive measures undertaken by the Government after the ILPIC report was presented was the enactment of the MRTPA in 1969. Through this legislation the growth of monopoly in the Indian economy was sought to be curbed. For identifying monopoly elements in the economy, the Government had adopted the twin criteria of market concentration and the volume of productive assets under the control of various groups. Groups of inter-connected undertakings (GICU) or individual undertakings having

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67. Goyal, S K, "New Industrial Licensing Policy:An empirical assessment", Corporate Studies Group Working Paper No., Annexure II, pp. 48-50.

68. Goyal S K, Chalapati Rao, K S and Nagesh Kumar, Small Scale Sector and Big Business, February, 1984, pp. 115 ff.

69. India, Industrial Licensing Policy Inquiry Committee, 1969, Chapter V.

assets of Rs 20 lakhs or more, were brought under this regulation. Also, GICUs or individual undertakings controlling not less than one-third of the market for goods and services and having assets of not less than Rs 1 crore, had to register under the MRTPA. These undertakings had to seek permission from the Government for bringing about substantial expansion of existing capacity or setting up new undertakings.

In case of a number of foreign controlled companies it was found that the criteria of dominant undertakings was not applicable to them as the Government was using a highly aggregative product classification for administering MRTPA.[70] Companies like Colgate Palmolive and Hindustan Cocoa Products (formerly Cadburys India) were some of the beneficiaries of this product classification followed by the Government. The discrimination in favour of foreign private capital in the administration of MRTPA took another form. While in case of Indian monopoly houses GICUs were sought to be identified and companies belonging to GICU expected to register with the Government, no such exercise was done for the foreign controlled companies. Foreign companies have often set up joint ventures in India with more than one Indian partner and this fact is not taken note of by MRTPA. Nagesh Kumar had identified several foreign companies which had more than one affiliate in India but these affiliates were not taken to be inter-connected through their foreign links, the links existing in India were taken as the basis for inter-connection, if any.[71]

The MRTPA also did not take note of the fact that foreign private capital was encouraged to develop as natural monopolies in the country. We had seen earlier that the policy changes since 1969 allowed foreign capital to enter only in those areas where domestic endeavour was found wanting. The foreign companies were, thus, given the scope of dominating the market in these areas, but MRTPA made no attempt to curb this form of growth of monopoly in the country.

But even when the foreign controlled companies have come under the purview of MRTPA, they have been able to increase their dominance in the economy. One of the ways in which this has been done is through the joint sector. The concept of joint sector was first suggested by the ILPIC as a means of decreasing economic concentration in the economy. This was done with the Government taking up the role of a promoter in conjunction with the private sector. Social control over the industry was sought to be kept through this mechanism. Here again, the actual working of the phenomenon of joint sector shows that the purpose for which it was evolved has been put behind. Several companies, which were prevented from increasing their production capacity by MRTPA regulations, have been able to increase their dominance over specific lines of activity using the joint sector. The study on "Joint Sector" by M R Murthy shows that in some cases foreign controlled companies have been able to increase their strangle hold over the economy by operating through joint sector enterprises. Two prominent foreign controlled companies,

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70. Nagesh Kumar, "Regulating Multinational Monopolies in India", Corporate Studies Group Working Paper No. 9, also published in Economic and Political Weekly, May 29, 1982.

71. Ibid., Annexure.

Peico Electronics and Electricals and Phillips Carbon Black have been able to increase their dominance in their respective areas of activity through this mechanism.[72]

These evidences indicate that the Licensing System as a regulatory mechanism has been quite ineffective in controlling the growth of foreign private capital in the country. The foreign controlled companies have violated the regulations and even when cases of such violations have come to light the Government has been found wanting in taking punitive measures against the offending companies. It might, however, be argued that the Government did not take any action against the foreign controlled companies because it was expecting that foreign private capital would give the country access to foreign capital and technology. We would turn to this question in the concluding section, but before that we would see the working of the other policy instruments of the Government in the following pages.

Foreign Exchange Regulation Act (FERA)

The Foreign Exchange Regulation Act of 1973 (FERA, 73) remains the only legislation that specifically seeks to regulate foreign private investment in India. All other legislations treat foreign companies as a part of the private sector. Section 29 of FERA, 73, a new section that was introduced by amending the original Act of 1947, laid down that enterprises operating in India (banking and insurance companies were excluded and so were the airline and shipping companies) having foreign stake in equity in excess of 40 per cent could carry on their activities only after obtaining the approval of the Reserve Bank of India.

FERA, 73, as passed by the Parliament in September 1973, gave the impression that one of the main objectives of Section 29, was to check the extent of control of non-nationals over productive enterprises. This was one way of finding justification for the less-than majority share of 40 per cent in total equity of the companies that was allowed to the non-residents under the Act. The notification issued for administering section 29, however, revealed that the real purpose of enacting FERA, 73 was not to curb the strangle hold of non-nationals over the productive enterprises, it was aimed at conservation of foreign exchange, among other things. Companies engaged in certain specific fields of activity, including those producing substantially for exports, were allowed to retain up to 74 per cent of foreign equity. In effect, what FERA, 73 did was to prevent wholly owned subsidiaries of foreign companies from operating in India. In recent years, this policy has also been relaxed for companies engaged in 100 per cent export oriented units and those operating in the Export Processing Zones. The exemptions were provided in keeping with the new Industrial Licensing Policy of 1970. As we had discussed earlier, the Licensing Policy had introduced the concept of the Core Sector in which foreign majority companies were allowed to expand. FERA, 73 fell in line with the Licensing Policy and it permitted a

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72. Murthy, M R, "Joint Sector Enterprises in India", Working Paper, Institute for Studies in Industrial Development, 1990.

maximum foreign equity of 74 per cent in enterprises operating in the Core Sector. The same exemption was extended to enterprises engaged in predominantly export oriented activities. In order to qualify as export oriented and to avail of the concessions, enterprises had to export a minimum of 60 per cent of total production. A third category of enterprises could hold maximum of 74 per cent of foreign equity, those engaged in the manufacture of products using sophisticated technology. For determining the nature of technology it was proposed to consult the Department of Science and Technology. The notification of December 1973 stated in this regard that in assessing the level of technology involved "consideration will be given, inter alia, to aspects such as (i) whether the technology is used for the manufacture of products which would otherwise necessitate imports, (ii) whether discontinuance of the manufacture of products with the technology would have adverse impact on the economy, etc."[73] Control of foreign private capital that was thus attempted through FERA, 73 formed a part of the strategy adopted by the Government in which the long term cost of allowing foreign private capital to operate in the country was never questioned. The dependent nature of industrialization that emerged as a result was aided considerably through the unbridled expansion of foreign private capital in the key sectors of the economy.

The FERA, 73 guidelines were further relaxed in 1976 when a few other categories of companies were allowed to retain majority ownership. According to the modified format, dilution of foreign stake in companies could be made at three levels of foreign ownership, viz., 74 per cent, 51 per cent and 40 per cent, depending upon the nature and character of the activities of foreign companies.[74] Majority foreign ownership was allowed under FERA, 73 if a company was engaged in any of the following activities,

(a) in specific high priority ares, listed in Appendix I of the Industrial Licensing Policy Statement of 1973;

(b) using high technology in production units; and

(c) exporting 60 per cent or 40 per cent of their own production.

If the turnover from any or all of the three sets of activities mentioned above exceeded 75 per cent of the total turnover of the company or if the exports by themselves exceeded 60 per cent of the total turnover, the company was allowed to retain 74 per cent foreign equity. If the turnover from the same set of activities exceeded 60 per cent of the total turnover or exports by themselves exceeded 40 per cent of total turnover, the company was permitted to hold 51 per cent of foreign stake in equity.

These categories of companies not withstanding, sterling tea companies having

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73. India, "Guidelines for Administering Section 29 of Foreign Exchange Regulation Act, 1973", Ministry of Finance, Dept of Economic Affairs, December 20, 1973, reproduced in Iyer, K V and Kumar L R, Foreign Collaboration in Industry:Policies and Procedures, Vol II, Indu Publications, 1985, pp ECR 21-27.

74. India, "Clarification and Amplification of Guidelines issued for Administering Section 29 of FERA, 1973", Ministry of Finance, Dept of Economic Affairs, April 16, 1976, Ibid., pp ECR 28 ff.

plantations in the country were allowed to retain 74 per cent foreign equity after they had converted themselves from branches to Indian companies.

The status of companies which complied with the FERA, 73 guidelines was made clear in 1977 in the new industrial policy statement. It said that "..... companies with direct non-resident investment not exceeding 40 per cent will be treated on par with Indian Companies, except in cases specifically notified, and their future expansion will be guided by the same principles as these applicable to Indian companies."[75] Not only was this assurance given to foreign companies under FERA 73, an additional opportunity was provided to these companies to increase their foreign stake by changing the nature of their activities. Accordingly, if a company diversified its activities to include any of the Appendix I industries of the Industrial Licensing Policy Statement of 1973, or if it utilised sophisticated technology or moved into export intensive areas it could retain a higher foreign equity holding. The only stipulation under this scheme was that the company had to complete the diversification within a stipulated time frame by applying for industrial licences.

It can thus be seen that FERA, 73 provided a number of opportunities to foreign controlled companies to expand their operations in the country.[76] For the first time the Government came out with an assurance to foreign business interests that 40 per cent or less of foreign share in equity would be treated at par with the wholly owned Indian Companies. The 40 per cent foreign equity level suited the foreign business interests well, since for long they were keen on having a lower risk capital but total control over a joint venture in India.[77] This can be seen from the memorandum of association of several companies, a compilation of which has been done in the Corporate Studies Group. For a sample of 56 companies of which the prospectuses were available (document that has to be issued prior to offering equity shares to the public for subscription), it was found that in 32 companies foreign partners kept control over the board of directors with a 26 per cent or less share. In one instance, involving the cosmetics manufacturing company, Ponds India (till recently an affiliate of Cheseborough Ponds Inc of USA), the foreign partners could control the board by being only a member of the company, i.e., even by owning a solitary share of the company.

The fact that companies can be controlled by foreign investors through a less-than-majority stake in ownership has found expression in subsequent years in the phenomena of "voluntary dilution" of several foreign drug companies.[78] These companies have reduced their foreign stake to around 40 per cent of total equity even in a situation

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75. Statement on Industrial Policy made in the Parliament on December 23, 1977, see India, Ministry of Industry, Annual Report, 1977-78, Appendix I, pp. 268-84.

76. For a discussion and elaboration of this point see Encarnation, Dennis J and Vachani, Sushil,"Foreign Ownership:When Hosts Change the Rules", Harvard Business Review, 1985.

77. We had mentioned this earlier, see f.n. 20.

78. Martinussen, John, Regulations in Vain?, International Development Studies, 1986, p. 69.

where they could have retained a much higher share holding under FERA, 73 because they were considered to be in the "high technology" field.

The effectiveness of FERA, 73 as a regulatory mechanism should be assessed from yet another angle: the compliance of companies which attracted FERA, 73 provisions. It has been pointed out that the compliance of companies was not very encouraging.[79] A large number of branches retained their original status long after they were issued directives to convert themselves into companies registered in India.[80] FERA, 73 does not appear to have met even the limited objective that the Government had set out to meet. As we had mentioned earlier, the primary reason for FERA, 73 appeared to be conservation of foreign exchange through reduced remittances on account of dividends. But the foreign companies did not act in a way that would have resulted in the fulfillment of this objective. The foreign partners diluted their own share in total equity of the joint ventures by issuing fresh capital to Indian shareholders and not by reducing their stake through disinvestment.[81] This implied that the number of shares on which the dividend remittances were made after dilution of foreign stake remained the same as before.

FERA, 73 also does not impose any restrictions on the remittances. A prior permission is required from the RBI, but no statutory minimum level is stipulated for making any remittance. Dividend remittances upto Rs 5 lakhs or 25 per cent of total issued equity capital of an enterprise, whichever is less, are permitted even without prior permission of the RBI. Unlike some countries like South Korea, which imposes a ceiling on remittances at 20 per cent of total investment,[82] India does not control such remittances and this appears to be in keeping with the assurance given by the then Prime Minister in his 1949 policy statement on foreign capital in this regard.

It can thus be seen that quite contrary to the generally held view regarding the adverse effect of FERA, 73 on foreign private investment in India, the Act provided several incentives to foreign business enterprises to consolidate their position in the country.

The Patent Laws

An integral part of joint ventures involving foreign private capital is the sale of proprietary items that can take various forms, machinery and equipment or designs and drawings. This necessitates a look at the Patent Laws existing in the country in order to find out whether the existing laws impinge on the participation of foreign private capital in India.

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79. Ibid.

80. S.K. Goyal " The New International Economic Order and Transnational Corporations", p. 88.

81. See Chaudhuri, Sudip, "FERA:Appearance and Reality", Economic and Political Weekly, April 9, 1979.

82. UNCTC, National Legislation and Regulations Relating to Transnational Corporations, United Nations, 1983, p. 19.

The justification for Patent Laws lies in the fact that the development of a product or process involves an expenditure that is disproportionately large in relation to the returns. The low returns arise because of the low cost involved in the diffusion of the technology embodied in the product or process. Thus, it was felt that the innovator should be provided with monopoly rights over the technology for some length of time, in order that the returns from the R&D expenditure can be made attractive. In India, industrial property of this nature was protected under the Indian Patents and Designs Act, 1911, until the new Act was adopted in 1970.

The role of the Indian Patent Laws, in determining the attitude of foreign private investment towards India should be viewed from two angles. The first is whether foreign collaborations brought in patented products or processes in any significant volume and the second is whether there have been any instances in the past where foreign companies have not found the laws prejudicial to their interests. We would dwell on these aspects briefly.

As regards the first aspect, the Reserve Bank of India, in its second survey on foreign collaboration revealed that "unpatented know-how was a constituent of the agreements entered by over 90 per cent of companies in the private sector."[83] In the fourth survey which was published recently it was revealed that patent rights were transferred in only 2 of the 371 cases of collaboration that were analysed. Patents were transferred in conjunction with technical know-how or trademarks in 187 other cases.[84] This implies that in less than half of the total cases of collaborations examined by the survey, patented know-how was transferred. It must be added that the fourth survey conducted by the RBI covered only about 24 per cent of all collaboration cases on account of non reporting by the companies. If one considers some specific industries it is found that in at least two, electrical equipment and machine tools, in recent years not many cases of collaboration involved a transfer of patent rights.[85] The obvious conclusion that follows from this is that in most cases of foreign collaboration, unpatented know-how was provided to the Indian Companies and consequently the question of infringement of patent rights did not arise.

But in cases where patent rights were transferred to India and there was a claim made by the company that its rights had been infringed, the Indian Laws have protected the foreign company. In a case quoted by Bagchi , Bhattacharya and Banerjee, involving the German pharmaceutical company Hoechst and the Indian company Unichem Laboratories, the former claimed an infringement of its patents rights.[86] Unichem, on the other hand, had claimed that it was manufacturing the same product as was done by Hoechst, but the

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83. RBI, Foreign Collaboration in Indian Industry : Second Survey Report, Reserve Bank of India, 1974.

84. RBI, Foreign Collaboration in Indian Industry : Fourth Survey Report, Reserve Bank of India, 1985, p. 36.

85. Bagchi A K, Banerjee, P and Bhattacharya U K, "Indian Patents Act and its Relation to Technological Development in India : A Preliminary Investigation", Economic and Political Weekly, Vol XIX, No 7, February 18, 1984.

86. Ibid.

process know-how was the one developed by Haffkine Institute of Bombay. The court ruled in favour of Hoechst and this ruling brings to light an inherent bias in the Patent Act which benefits the foreign companies. Clause 107(2) of the Patent Act of 1970 states that "any substance of the chemical composition or constitution as the first mentioned substance shall be presumed, unless contrary is proved, to have been made by the aforesaid patented method or process". This clause concedes patent protection for the substance and ignores the importance of process know-how.[87]

The importance of process know-how is particularly important for countries like India which have the capability of developing new processes and of becoming independent of the foreign companies. The Patent Law of 1970 does precious little to protect the interests of the host country and infact discourages indigenous effort to develop process know-how by protecting the interests of the foreign business interests.

Taxation Laws

The last instrument of policy we shall be considering here in some detail is the tax structure prevailing in India for foreign business interests.

For purposes of taxation, foreign company means a corporate entity that is incorporated outside India. The Income Tax Act of 1961 which makes this distinction between a foreign company and others, makes a further distinction between a `domestic company' and the rest. A domestic company, according to the Act means an Indian company or any foreign company which has made the following arrangements for declaration and payments of dividends in India: (i) the share register of the company for all shareholders shall be regularly maintained at its principal place of business within India in respect of any assessment year from a date not later than 1st April of such year, (ii) the general meeting for passing the accounts of the relevant accounting year and for declaring any dividends in respect there of shall be held only in a place within India, and (iii) any dividend declared shall be payable only within India to all shareholders. The companies which do not make these arrangements for dividend payments are taxed at a higher rate to compensate for the loss of revenue on dividends declared by such companies outside India out of profit earned in India.

Non-residents are taxed only on income received, arising or deemed to be received or to arise in India. Income deemed to arise in India is defined in Section 9(1)(i) of the Income Tax Act, 1961 as "all income accruing or arising, whether directly or indirectly, through or from any business connection in India or through or from any property in India or through or from any asset or source of income in India or through the transfer of a capital asset situate in India". This, in the words, implies that for any agreement executed outside India even if it was for setting up a business enterprise in the country, no part of the

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87. This aspect was brought out in a note of dissent during the discussion by the Joint Select Committee on the Patent Bill, see, India, The Patents Bill, 1965 (Report of the Joint Committee), Lok Sabha Secretariat, 1966.

payment much in respect of this agreement was to be taxed under Indian Tax Laws.

The Income Tax Act, as applicable to the foreign business interests in India, has two grey areas. The first relates to the concept a "business connection" which is used to identify the place where the taxable income is seen to have been generated. The second is the question whether the accruals of a foreign business entity from its Indian Partner can be treated as income, as opposed to capital receipts. The first problem arises primarily in case of technical collaboration agreements, in which clearly identifiable sets of transactions between the two parties cannot be formed within the precincts of the Income Tax Act. A financial association has been taken as an indicator of business association, so that foreign direct investment can be taken to indicate the existence of business association between a foreign controlled company in India and its foreign associate. The second problem holds equally for financial and technical collaboration. The question primarily is whether the foreign collaboration is able to generate future income earning assets. Several instances have been provided to indicate the extent of the problem in India. A celebrated case from the UK, (the tax laws in India still have the basic structure as provided by the UK Tax Laws) in which the issue of treating technical know how was decided, the judges ruled that receipt from the sale of know-how was a capital receipt only.[88] In yet another case involving the Motor & General Finance Ltd, the judgment passed by the court said that `the question whether a particular receipt is a revenue receipt or a capital receipt is a question of law, for it is impossible to determine the nature of a receipt without considering the provisions of the Income Tax Act..". This adds a dimension of indeterminism in the sphere of assessing the nature of the accounts to the foreign business interests. In the particular case referred above, the Commissioner of Income Tax (CIT), the respondent in the case, referred the issue back to the Income Tax Act! The foregoing implies that the foreign business interests can even avoid being taxed under certain circumstances by making distinction between capital receipt and revenue receipt nebulous. The Income Tax Act makes a clarificatory statement regarding foreign capital participation and this statement, in our view, should be seen in light of the previous statement where it was contended that the tax laws prevailing in the country give scope to the non-residents to escape the Income Tax Act. The statement said that where shares were allotted to a non-resident in the form of equity capital and payment is not taxable as income accruing or arising or deemed to accrue or arise in India, the Department (Income Tax) would make no attempt to bring to tax the profits or gains merely on the ground that the shares were in India. Only those shares that were issued at the time of incorporation of the Indian Company in lieu of services rendered by the foreign company were exempted from income tax and capital-gains tax. Further, if these shares, issued at the time of incorporation were sold subsequently, capital gains resulting from the sale were subjected to tax.

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88. Bagchi, Amiya Kumar and Dasgupta, Subhendu, "Imported Technology and the Legal Process", in Bagchi, Amiya Kumar and Banerjee, Nirmala (eds), Change and Choice in Indian Industry, K. P. Bagchi & Co, 1981.

A company operating in India is also liable to pay surtax under the Companies (Profits) Surtax Act, 1964 on the part of "chargeable profits" that exceeds the statutory deduction, i.e., 15 per cent of the capital of the company or Rs 2 lakhs, whichever is greater. The income of foreign corporate investors in India mainly consists of dividends on their equity holdings, interest on loans and royalties and technical service fees under technical collaboration agreements. All these items are exempt from surtax as they are excluded from `chargeable profits'.

What we have indicated above is the fact that although a differential rate of income tax which discriminates against a foreign company, i.e., branches of foreign companies, exists in India, in practice no such discrimination is normally seen. The foreign companies have taken advantage of the nebulous manner in which the Income Tax Act has sought to impose tax laws, for instance, the unclear distinction between receipt on revenue account and capital account. Not only have the foreign companies (branches and joint ventures taken together) taken advantage of the tax laws, the Income Tax Act itself provided them with several concessions at various points of time.

Tax Incentives

A number of incentives are provided to foreign companies. The more important of these concessions are:

1 In case of a foreign company deriving income by way of royalty or fees for technical services received from Government or an Indian concern in pursuance of an agreement made by the foreign company with Government or the Indian concern after 31st March, 1976, and approved by the Central Government, the tax on such income is payable, under the terms of such agreement, by Government or the Indian concern to the Central Government, the tax so paid, is not included in the total income.

2 Interest payable by an industrial undertaking in India on borrowings made abroad for purchase of raw materials or components or capital plant and machinery, is deductible from total income. Similarly interest received by a foreign investor from an industrial undertaking in India is exempt from income tax.

3 Profits and gains derived from an industrial undertaking in a free trade zone are exempted from total income in respect of the assessment year.

4 Tax deduction of 20 per cent on profits or gains are allowed to industrial undertakings newly established in backward areas for a period of 10 years.

5 Investment allowance is granted at the rate of 35 per cent of the cost of new plant and machinery installed for controlling pollution or protection of environment. The grant of the allowance is subject to the condition that an amount equal to 75 per cent of the investment to be actually allowed is credited to a reserve known as `Investment Allowance Reserve Account' and is to be utilised within a period of 10 years for the purpose of acquiring new machinery, plant and equipment etc.

6 The Indian tax laws contain liberal provisions for depreciation of capital assets. Plants and machinery have been classified under 7 broad categories of usefulness and the rates of depreciation allowance vary from 5 per cent to 100 per cent: 100 per cent depreciation allowance being provided to energy saving devices and systems. An additional sum equal to one half of the amount admissible as normal depreciation allowance is also admissible in the year of installation of new plant and machinery as a further deduction from 31st March, 1980.

7 Expenditure incurred on scientific research is deducted from taxable income for the year in which it is incurred.

Effectiveness of Other Regulations Pertaining to Foreign Private Capital

Apart from these specific laws relating to proprietary rights and income earned, an important area in which the Indian Laws have proved very ineffective is environment protection. It has long been recognized that foreign companies resort to unethical practices in areas like drugs and pharmaceuticals[89] and that they promote harmful products. The most glaring violation came to light in the much discussed case of gas leakage from a plant owned by Union Carbide in Bhopal. The company had paid scant attention to the laws set by the Government for environment protection and this led to the disaster. So weak were these Laws that even after two years the Indian Government has not been able to bring the Union Carbide to face charges in the Indian courts. This has resulted in protracted law suits in the USA which has allowed the offending company to avoid paying any compensation to the victims of the tragedy.

Concluding Remarks

The discussion on different policy mechanisms for regulating foreign private capital in India shows that:

(a) the mechanisms by themselves were quite ineffective in controlling the growth of foreign controlled companies in the country. In case of the Licensing system, as we had seen, the Government had no machinery to curb misuse of licences issued. Even when misuse of licenses were brought to light, the Government was found warning in taking punitive action against the offending companies;

(b) the scope of Government regulations in respect of foreign private capital, in particular, was reduced progressively in the four decades since 1947.

The reduction of controls over foreign private capital was done primarily because

89. S.K. Goyal, " The New International Economic Order and Transnational Corporations", p. 88.

the Government saw foreign companies as conduit of two crucial inputs, viz.,finance and technology, for its industrialization process. This was made clear by Prime Minister Nehru in his 1949 policy statement. While Nehru emphasized the need to augment domestic savings with foreign capital, the later policy makers have sought capital from foreign companies not in a direct form, i.e., in the form of equity participation, but in the form of a trade surplus. Foreign private capital was expected to promote exports and to meet the foreign exchange requirements of industrialization. In respect of technology, several policy documents had underlined the importance of foreign private capital to accelerate the development and utilization of indigenous technologies.[90] In the following pages we would try to see if the policy initiatives of the Government in respect of foreign private capital have had the desired results.

The participation of foreign private capital for augmenting domestic resources was never realized in the country. Ever since the Second Five Year Plan when the Government had to resort to heavy deficit financing,[91] foreign private capital did not respond adequately to the needs of the country.

The Second and the Third Five Year Plans also saw the maximum gross inflow of foreign private capital in the country. The peak was reached in the middle of the Third Five Year Plan,[92] but after the Third Plan period gross inflow fluctuated around a relatively low absolute level. This has given rise to situation where most of the present day foreign private capital is found to be of a pre-1947 vintage.[93] These older companies have registered large increases in scale of operation and the increases have been achieved not through fresh inflow of capital but by capitalization of reserves.[94] The extent to which growth of FCCs have been financed from domestic sources can be gauged from a study conducted for 50 largest foreign subsidiaries in the period 1956-76.[95] The study shows that domestic resources accounted for 94.6 per cent of finances mobilised by foreign subsidiaries for their expansion schemes. Over the years, dependence on domestic sources was found to be increasing. While in the first 9 years, 1956-65, domestic sources

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90. see f.n. 47.

91. India, Planning Commission, Third Five Year Plan, especially Chapter VI.

92. If the approvals granted by the Controller of Capital Issues are taken as an indicator of the level of gross inflow, it is found that from a low level of Rs. 3.51 crores in 1956, gross inflow went up to Rs. 9.37 crores in 1960 and to Rs. 18.39 crores in 1963. In 1959 there was a large inflow of Rs. 21.65 crores, but this inflow was made up almost entirely by the investment made by a foreign oil company, see India, Ministry of Finance, Quarterly Statistics on the Working of Capital Issues Control, one hundred fifty eighth issue, p. 13

93. In 1984, 39 per cent of the assets of foreign controlled companies (companies having 10 per cent or more of foreign equity) belonged to companies which were incorporated prior to 1947.

94. An analysis of the approvals granted by the Controller of Capital Issues for capitalisation of reserves show that some of the more important FCCs in India have expanded their capital base almost entirely through capitalisation of reserves. For example, Hindustan Lever's extent of dependence was 96 per cent and Britannia Inds, Chloride India, Hoechst and Warner Hindustan relied entirely on capitalisation of reserves for expansion schemes.

95. Chaudhuri, Sudip, "Financing Growth of Transnational Corporations in India, 1956-76", Economic and Political Weekly, August 18, 1979, Table I, pp. 1432-33.

accounted for 87.4 per cent of the total finances, in the remaining period, 97.0 per cent of the finances came from domestic sources. About one-half of the domestic sources of finance in the entire period taken together were made up by the companies' internal sources, i.e., through capitalisation of reserves and accumulated depreciation. This implies that the foreign companies have exploited only the domestic market for their capital requirements and have not brought in fresh foreign capital as the Government had wanted them to.

As mentioned above, the policy makers had seen a greater role of foreign private capital in indirectly augmenting the capital needs of the economy and this was through the generation of a trade surplus. Towards this end the Government took a number of policy initiatives which we have discussed earlier. Exporters were offered a number of incentives,[96] and this included free access to foreign finance and technology. The results of these policies followed by the Government for promotion of exports have been brought out by K.S. Chalapati Rao in a paper on the export performance of large corporate sector. In the study, foreign controlled companies were split up into various categories according to the percentage of foreign equity held in 1984. 63 companies falling under the purview of FERA, 73 i.e., having foreign share exceeding 40 percent, showed a negative net foreign exchange earnings in the period 1975-84.[97] We had mentioned earlier that under FERA, 73, a company could retain a foreign share in excess of 40 percent if it was producing items which used sophisticated technology. In either case, the company was expected to perform well on the international market.[98] The other foreign controlled companies (those having 40 per cent or less of foreign equity) showed a progressively declining net foreign exchange earning. During 1975-78, former FERA companies, i.e., companies which were falling under the purview of FERA, 73 in 1973 and had subsequently diluted their foreign equity stake in conformity with FERA, 73 requirements, and other companies having 10-25 per cent foreign equity showed a positive net foreign exchange earning, but in 1981-84, under these categories registered negative figures for the same. In 1981-84 all categories of foreign controlled companies registered negative net foreign exchange earnings.

The behaviour of foreign controlled companies on the extent payments front should be looked at in conjunction with the type of products they have been exporting and the area to which they were exporting. Hoechst India Ltd, the largest exporter in the pharmaceutical industry exported 92.07 per cent of its products to rupee trading areas. The second largest exporter, Glaxo, was also heavily dependent on rupee trading areas for export markets Union Carbide, though essentially a chemicals manufacturing company, earned 64 per cent of export earnings through export of marine products. Peico Electronics and Electricals has also shifted to exporting marine products. In 1984, over 39 per cent of its exports were accounted for by exports of marine products.[99] These tendencies of some of the important foreign controlled companies bring forth the question regarding the nature of technology these companies are bringing in the country and the price the country is paying in the process of technology import by these companies.

In an earlier discussion we had seen that the Government was professing the need to adopt selectivity in import of technology. It was said that technology import would be allowed only if (a) indigenous technology was not available and (b) the area of activity for

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96. See Chalapati Rao, K S, India's Export Policies and Performance: An Evaluation, Corporate Studies Group Working Paper.

97. Ibid., Table VII, p. 75.

98. Ibid., p.78

99. Ibid., pp. 95-96.

which collaboration was being sought was a priority area (exceptions were made in case of export-oriented industries). Further, import of technology was expected to give a fillip to indigenous R&D efforts. Technology import was, therefore, seen as a transitory phase, at the end of which the country would have reached a level where it could not only cater to its own needs but also export to the world markets. It requires hardly any elaboration to state that these expectations of the past four decades since 1947 remain largely unfulfilled. Technology imports have continued unhindered in almost all areas of industrial activity, particularly in recent years, when the Government approved collaborations for non-essential products like fast foods.[100] The more striking aspect of technology import has been the repetitive import of technology which has been displayed prominently by some of the important FCCs like Peico Electronics and Electricals and Siemens. Till 1986, Peico had entered into collaborations 42 times and Siemens India 19 times.

The import propensity of the FCCs has brought out the ineffective nature of monitoring mechanism followed by the Government in respect of technology imports. In recent years, more evidences of the tardy monitoring mechanism have come through. If one looks at the collaborations approved since 1980 it is found that in a number of industries, telecom equipment and auto ancillaries being the more prominent of these, there have been large volumes of repetitive import of technology. Such import of technology, apart from having its implications on the external payments position of the Indian economy, has a longer term implication on the development of indigenous R&D in the country. It has been shown in some studies that the continued presence of foreign firms in an industry is detrimental to the efforts made at technology indigenisation. In the drug industry, the pre-eminence of foreign companies affected the fortunes of firms which had based their production capacities on indigenous technology.[101] The fertilizer industry also shows a similar pattern where indigenous technology was undermined by technology imports.[102]

The Government in the post-colonial India expected foreign private capital to provide the necessary impetus to development, in the form of capital and technology, and based upon this expectation it had given several incentives to foreign capital to expand in the country. Through the five phases we have discussed in the paper we have tried to indicate how the Government policies have changed from the view-point of foreign capital. Foreign private capital found the policy initiatives taken by the Government quite in tune with what they were expecting in India. To that extent the changes affected in different policies appear to be conciliatory postures taken vis-a-vis private sector in general and foreign sector in particular. As a consequence what remains of the regulatory administration in the country is no more than a mere rhetoric.

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100. The source of information for the data on foreign collaboration is the 'Directory of Foreign Collaborations' compiled by the Institute for Studies in Industrial Development (ISID).

101. Chaudhuri, Sudip, Indigenous Firms in Relation to Transnational Corporations in the Drug Industry in India, Ph.D. thesis submitted to Jawaharlal Nehru University, 1984.(unpublished)

102. Dhar, Biswajit, "Factors Influencing Technology Selection", Economic and Political Weekly, Annual Number, 1984.