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MNCs AND INDIA'S NEW ECONOMIC POLICY

by

S. Shiva Ramu*

Indian Institute of Management
Bangalore

*Professor, Indian Institute of Management, Bangalore

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ABSTRACT

This paper is divided into two sections. The first section deals with the Foreign Direct Investment (FDI). It gives a brief overview of the dependencia theories of the 1960s and the US response to them. This is followed by a brief on IMF Fund Adjustment Program which is viewed as unilateral pressure in favour of the MNCs. The changes in the flow of FDI and the changing theories explaining the behavior of MNCs are discussed. Section II deals with India's new economic policy, its implications and the direction of change. This is followed by a discussion on the expectations of policy makers and the likely response from MNCs.

MNCs AND INDIA's NEW ECONOMIC POLICY

S. Shiva Ramu

Introduction

Up to World War II, many developing countries were dependent on the colonial powers. Multinational activities, both trade and investment, followed the interest of colonial powers. After World War II, there was a change in the attitude of the ex-colonies towards the developed countries. This created economic nationalism in most of the developing countries. In the 1960s this was dominant in the case of the Latin American countries. Dependencia' theorics regarding MNCs and the host countries' economy (Osvaldo Sunkel, 1972) were proposed. These theories were also enunciated by writer, Jean-Jacques Servan-Schreiber. In his book 'The American Challenge' in the late 60s, he spoke against the American companies' onslaught on European companies. He assumed that because of the size of these companies and their financial structure, they were able to dominate the European economy. Similarly, the oil producing countries were against the 'Seven Sisters' who dominanted the global oil market. Various countries adopted different strategies to deal with the dominance of MNCs in the global system. The European countries tried to promote big companies by allowing their mergers and takeovers among the European companies. Oil producing countries created an international cartel OPEC to counteract dominant American companies. Similarly, the Japanese tried to promote their own national enterprises and

some developed countries promoted state enterprises (Anastassopoulous, 1987). Several developing countries tried to nationalise their resource-based industries where there was a dominance of MNCs (Shiva Ramu, 1975).

Dependencia

As there were varied reactions to this, several new theories were propounded, some theories tried to explain the dependency of developing countries vis-a-vis MNCs (Moran, 1978). Other non-dependent theories were based on oligopolistic practices, bureaucratic politics and transnational relations. The basic dependencia propositions were three, viz., (1) host countries received too few benefits (2) FDI distorts local economy and (3) FDI distorts host country's political process.

The first proposition combined with the transnational relations of the non-dependency theory would indicate that any distribution depends on the characteristics of the project, characteristics of the host country and exegenous factors like uncertainty and international competition. The second proposition assumes that most of the MNCs, due to their oligopolistic position, preempt local economic base, provide inappropriate technology and worsen income distribution. The third proposition assumes that MNCs will get involved in the political process of the host country bringing their pressure from the home country. This has been the experience of Latin American countries.

U.S. Response

Dependencia theories are developed as a counter-argument for U.S. response in the global economic system. U.S.A. became a dominant player in the global system after World War II. U.S. reacted with "self interest is best interest" kind of attitude. The political response had been to protect the U.S. economic interests (see Table A-1).

U.S.A. tried to restrict sales of hi-tech and military products to socialist countries in the bi-polar situation which emerged after World War II. It enacted several legislations for this purpose. It also tried to promote free trade in the global scene confident of its superior comparative advantages. However, all is changed during the 1980s. Protectionist pressures increased due to trade imbalances and structural unemployment. Many industrial countries tried to extend the national trade legislations to combat 'unfair' competition. Industrial countries reduced tariffs to the average level of 5-6% after the Tokyo Round negotiations. But there were more and more voluntary export restraints (i.e. importing country arranges with the government of exporting country for a restriction as to the volume of the latter's exports). Most of these restraints are directed against Japan and NICs. U.S.A. established the Export Enhancement Program in May 1985 to help its farm sector against the EEC.

Similarly, in the area of FDI, U.S.A. was dominant up to the 1960s. It tried to protect U.S. investments in Latin

America by introducing the Hickenlooper Amendment in 1962 to help U.S. businesses and establishing the office of Foreign Direct Investment in 1968. It went further by introducing the Gonzalez Amendment requiring American representatives to veto any loans to a country by the Inter-American Development Bank, if that country nationalizes the U.S. business. However, these strong arm tactics lost their power by the end of the decade.

The whole scenario changed in the 1980s. There was a surge of European and Japanese companies taking over U.S. companies in the U.S. The earlier dominance was lost. U.S.A. enacted the Omnibus Trade and competitiveness Act 1988 to protect against the onslaught of other countries both in trade and investment. In trade, they tried to mention names of countries and industries where retaliation was proposed under Special and Super 301. An amendment proposed to the Act (Boxout Amendment) to protect US companies take-overs by other countries, was initially defeated. However, later a provision was included in the Act which gave the President powers to review certain mergers and take-overs (Exon-Florio Provision).

All these indicate the changing scenario in the global economic system. U.S.A. which was dominant in the early 1950s and 1960s has become a defensive player in the 1980s. Now it is turning more towards the 'Principle of Reciprocity' in its trade and investment activities.

IMF: FUND Adjustment Program

Many developing countries started perceiving the Fund adjustment programs of IMF as a cover for dominance by industrial countries. As U.S.A. lost its dominance, it joined other developed countries to orchestrate for the liberalisation of developing countries. This would enable the MNCs of developed countries to dominate the global economic system.

The Fund has been changing its policies to support growth-oriented adjustment. Initially, an attempt was made to overcome the Balance of Payments problems through the Compensatory Financing Facility for Export Fluctuations (1963) and the Facility for Financing of Fluctuations in the cost of Cereal Imports (1981). These two were replaced by the Compensatory and Contingency Financing Facility (CCFF 1988). The developments in oil prices were incorporated in the stand-by arrangements (1986). Subsequently the CCFF was broadened and finance is provided up to 122% of the member's quota in the Fund. Contingency element of CCFF can be attached to arrangements under the Structural Adjustment Facility and the Enhanced Structural Adjustment Facility (ESAF). The country using these facilities has to cooperate with the Fund in addressing the BoP difficulties. Contingency financinq is monitored on the basis of the baseline projections (net sum of deviations from projections in the underlying program e.g. export and import prices: the unexpected movements in prices multiplied by the volumes

specified in the program).

The Fund Adjustment Program normally suggests the changes in economic policies such as fiscal, monetary, exchange rate, trade and domestic structural changes (see table A-2). The optimal mix of policy instruments are left to the country concerned to decide. The implementation of the policies is reviewed mid-yearly so that new policy adjustments can be incorporated.

Arrangements require the adoption of a comprehensive three-year policy framework. The emphasis on growth orientation has led to more attention on the impact of monetary, fiscal and exchange rate policies. There has been a changed emphasis from traditional areas of responsibility to new policies like enhanced competitiveness. The monitoring of program implementation is designed to provide mutual assurances. Performance criteria are viewed as critical and reviewed mid-year. Waivers and modifications of these criteria provide flexibility (IMF 1987).

Based on the experience of several countries using Fund facilities are some do's and don'ts of reform programs from across different regions and stages of development. The summary statement is given in Table A-2b. Similarly, there are alternatives in the speed at which reform can be introduced. The arguments for gradualism and shock treatment are given in Table A-2c. India has adopted gradualism for the present. Any program element which affects the economy

adversely can be modified midstream. All these depend on the political will and th capacity of the economy to adjust. The details of a Fund financing to India during 1981-84 is given in Table A-3.

The Patterns of FDI Flows

The merchandise trade of the world has increased to $3.1 trillion in 1989. World trade in commercial services $680 billion in 1989. Since 1983, the trade in manufactures has been the main contributor to merchandise trade. By 1987 the foreign direct investment stock reached an estimated $1 trillion. The Group of 30 reviewed the trend of FDI and found that the surge in FDI was more during the 1980s, when more than 70% of FDI assets were acquired. The flow of FDI increased from $123 billions (1981-83) to $327.6 billions (1984-87). Nearly 70% of FDI outflows and 60% of inflows were 5 developed countries, namely, France, FDR, Japan, U.K. and U.S.A. All the developing countries show a declining trend in FDI flows. The outflows declined from 2.1% to 1.2% and inflows from 27.5% to 21.2% between 1981-83 and 1984-87 respectively.

The major structural changes in FDI flows during the 1980s have been due to the liberalisation of service industries and the emergence of Japan as a major investor. The politics of FDI has been varyied. U.S. politicians are against foreign owned firms in the U.S. and are trying to extend the rationale of "protectionist thinking from the

trade field". FDI politics in Europe concentrates more on takeovers and mergers which may affect both inward and outward FDI. Another contention is that of "level playing fields" for corporate control as some European companies are bid-proof due to concentration of shares in a few hands. Japan has become vulnerable due its to small inflow of FDI and large outward flows. Most of the developing countries "remain halfhearted" (Group of 30).

The experience of developing countries during the 1980s indicates that higher growth is achieved through a higher level of investment (including FDI) and efficient utilization of existing resources. This can be verified with the experience of India vis-a-vis some of the other developing countries.

Basic information regarding population and GNP per capita in 1989 is given in Table A-5. A comparison of twelve countries both in the absolute and relative growth of GNP during 1965-80 and 1980-89 is given. It indicates that India lagged behind all the other countries in terms of absolute GNP in 1989 as compared to 1965, though there are variations in the rate of growth.

The net FDI position in 1970 and 1989 is more in favour of the high growth countries compared to India. Many countries like China, Malaysia, Thailand and Indonesia in the Asian region have more FDI than India. Similarly, the proportion of exports to GNP shows a marked change during

1965-89 (Table A-6). The average growth pattern of export and import during 1965-80 and 1980-89 shows varying response by different countries (Table A-7).

Theories of MNC

Several branches of economic literature have tried to explain the behaviour of inter-country economic relations. Dunning (1988) tries to explain the behaviour of MNCs in international economic relations and tries to answer questions like - Why do they go international, where do they go and how do they go. To answer these three questions, he tries to develop a paradigm of OLI, i.e., Ownership advantage, Location advantage and Internalisation advantage.

Location advantages can be explained by three theories i.e., theory of capital movement, theory of trade and theory of location. According to the Theory of capital movement, the differential interest rate and human knowledge creates the movement of international capital. The theory of trade started with absolute advantage (Adam Smith) to comparative advantage due to labour cost (Ricardo) and then the factor endowments (Hecksher-Ohlin) were refined by Samuelson (1948). But subsequently Leontief (1953) showed a paradox on the basis of an empirical test of a trade pattern. It indicated that U.S.A. was exporting labour intensive products and importing capital intensive products. This paradox has been explained by taking into account the role of demand conditions, tariff and non-tariff barriers, role of capital mobility and technology. As most of the models of trade deal

in products only, this behaviour was inexplicable. When factor services were added, the Trevis model explained the potential gains of trade and factor movements under various assumptions of technology, factor endowment and economies of scale (Sham L. Bhatia, 1984). Similarly, the theory of location started by Weiber was followed by Losch and Hotelling where they explained the activities through locational interdependence. All these three theories combined will provide locational advantage in the case of MNCs.

The ownership advantage is also based on three theories - theory of industrial organization, theory of innovation and theory of the firm. The theory of industrial organization assumed perfect competition and later on developed imperfect competition, either due to artificial restrictions or due to entry barriers. The theory of innovation viewed technological progress as an evolutionary factor which moves along with the expansion of market. Large companies are likely to apply major and minor innovations. Schumpeter felt that individual entrepreneurs will introduce innovations in accordance with expectations. In recent theories, innovations depend on the codification and diffusion of knowledge (Boisot, 1983). The theory of the firm explains the limits on the growth of a company in becoming a large business house and the limits on the size of the firm. Coase and Williamson have introduced a "transaction cost" of participating in markets. Whether it is market or hierarchy depends on the transaction cost. These three theories provide the ownership

advantages in the sense of market access, and economies of scale.

The theory of the firm provides internalisation advantage for effective management control, like quality control, price discrimination and avoidance of property rights. Depending on these OLI advantages, the route of servicing the market by MNCs may result either in foreign direct investment, trade in goods and services or contractual resource transfers.

There are two types of market failures in international production and trade. The reasons for internalisation by MNCs is due to both natural and unnatural market imperfections. The natural imperfections are price of knowledge, transaction costs due to uncertainty, quality control and difficulty in making a contract. There are several unnatural imperfections in the market due to tariff and non-tariff barriers in trade, and regulations regarding FDI. Most of the arguments for market liberalisation are based on the demand for removing artificial market imperfection imposed by the government regulations in the global economic system.

INDIAN POLICY AND MNCs

Regulation and Response

The previous section described the theories underlying the behavior of MNCs in their global activities. In this section, an attempt has been made to give briefly the regulation of Indian policy and response of MNCs. Three aspects are covered viz., the FDI entry control system, technical collaboration and export orientation of MNCs. The artificial barriers imposed have been effectively internalised by MNCs in India for last four decades. The changes introduced in 1991 with respect to foreign exchange, trade policy and industrial policy are reviewed. An indication of their future directions, expectation of policy makers and likely response of MNCs are given. The present policy is only a small step towards removing the artificial barriers imposed on both domestic and foreign firms.

FDI Entry Control System

The regulation of the entry of MNCs in most developing countries has the following 8 elements (San Deo 1986):

- Sectors : priority economic activities
- Geography : desired location
- Ownership : more local ownership
- Acquisition : regulation of the number of local firms acquired by MNCs
- Content : increased local contents in FDI based prodn.
- Exports : requiring a given level of exports
- Empoyment : regulating the number of foreign employees at various levels
- Repatriation: restricting repatriation of profits and capital

In India, these are regulated through the following Acts:

- Industrial Development Regulation Act 1951
- Technology Policy
- Industrial Policy Resolution 1956
- MRTP Act 1969
- FERA 1973

With all these regulations, MNCs in India account for nearly 26% of assets and 30% of sales of total private corporate sector in 1972 (Lieten 1987). This has not changed much since. The behavior of MNCs in India is different from that in developed countries. Foreign firms have not entered industries where a high level of general skill is required. The propensity is more towards multiplant intensive industries and are kept out of capital intensive activities

(Sanjaya Lall 1985). The policy of high technology activities has resulted in 'unpackaging' the bundle. Two areas are excluded in India. They are marketing and capital-intensive activities.

Technical Collaboration

The number of technical collaborations during 1950-86 was around 10,865. The industry-wise classification is given in Table 1. This indicates that majority of technical collaborations were in machine and machine tools followed by mechanical, electrical engineering, and chemical & pharmaceutical industry. The country wise analysis indicates a shift from U.K. to U.S.A. and West Germany. The transfer of technology is one of the elements in MNCs' global strategy. They tried to protect their global market and through sales of intermediate and capital goods. Besides, there were many restrictive clauses on export and sale of the acquired technology.

The negative effects of the Indian policy were:

- growing bondage of Indian firms e.g. Shell and Mafatlal (Leiten 1987)
- repetitive imports of similar technology (Bajaj, 1990)
- increase the dependence of Indian firms on related imports (Shiva Ramu, 1989)
- problem in the export of erstwhile collaborated products (Shiva Ramu, 1987)

The example of Hazemeyer and Co., indicates that it got 4 separate technical collaborations with Electric Control Gear Pvt. Ltd., for the production of fuses, switch gear and air

circuit breakers. This is also evident if one analyses the break-up of 10,865 agreements during 1950-86. It shows that 4056 companies had single agreements, while the rest of the agreements are accounted by 1522 companies.

No. of Foreign Collaborations (1950-86)

Industry	Members	%
Mechanical Engg.*	1451	13.4
Machine & Machine Tools*	3240	29.8
Metallurgical*	653	6.0
Electrical*	1313	12.1
Transportation*	739	6.8
Telecommunication*	776	7.1
Chemical & Pharmaceutical*	1169	10.8
Textiles	219	2.0
Rubber & Leather	249	2.3
Cement & Gypsum	126	1.2
Paper & Pulp	99	0.9
Glass	112	1.0
Others	719	6.6
Total	10,865	100.0

Source: NE Vyas Publishers: "Directory of Foreign Collaborations in India", Ahmedabad.

* Major Multiple collaborations evident

Exports

During the 1970s, MNCs accounted for 25% of the world export of all commodities and 20% of all manufacture. Since then, the exports by MNCs have been less than 10% of total

exports and intra-MNCs trade was mere 3.2% (Saxena, 1987).

The Indian policy of looking with a control system has sheltered a large number of inefficient firms. The expansion of MNCs was controlled (dilution of foreign share holding, technical payments and diversification). Many estimates put the contribution of MNCs in India's exports at 5 to 10%. Sanjaya Lall (1985) tried to test the relationship between different variables and its effects on MNC exports. The export performance of 24 industries indicate a positive relation between foreign shareholding and export and the export incentive system partially counteracted against the high costs of local production. MNCs had a negative effect on export performance in capital intensive industries and a marginal effect in management-intensive industries.

The case studies of Dutch MNCs in India (Lieten 1987) analyse the export performance of MNCs. For example, Hindustan Lever tried to fit with the government policy of export orientation. The total value of exports increased during 1978 to 1981 from Rs.180 million to Rs.685 million. As soon as FERA approval was given, the exports dropped to Rs.465 million in 1983.

The so-called 'impressive success' of HL was hardly 10% of its total sales. The government recognised HL as a Trading House. HL exports footwear, garments, carpets and SSI products in addition to its own products. It started a 100% export-oriented unit in Kandla for exporting one million

polyster shirts. Production at Kandla depends on the import of fabrics from the Far East. When one views the forex contribution of HL, one gets a blurred picture. It imports from hard currency areas and exports to East European countries on Rupee terms. Further in 1985, the total foreign exchange payment was Rs.1038 million (import of raw material, capital goods, dividend payments and other payments) and exports was Rs.738 million, resulting in net drain of Rs.300 million in foreign exchange.

Several countries in Asia have promoted Export Processing Zones. By 1975, China, India, Republic of Korea, Philippines and the Republic of Vietnam had established EPZs. Later Pakistan, Indonesia and Thailand followed. The main objective was to promote exports by attracting foreign capital and enhancing the technology (Vittal, 1977). However, this experiment has not been successful in India. EPZs hardly contribute much to the export efforts of India. The above case of HL describes the pattern adopted by a few MNCs.

Foreign Exchange and Trade Policies

The exchange rate arrangements are tied with monetary policy instruments and exchange rate policies. During structural reforms, exchange market interventions and other monetary policies may have a different effect. This is due to imperfect asset substitution and different sppeds of adjustment rate in the market. For example, wages, prices and interest rates may not reach long term equilibrium immediately. The optimal mix of stabilisation policies may vary over the reform programme (Mathieson, 1988).

In contrast to this, here we are taking the exchange rate regime with major emphasis on the foreign trade sector and minor emphasis on monetary policies.

As many governments find it difficult to manage the foreign exchange system, they either use currency pegging or manage the exchange rate or try to restrict the use of foreign exchange which in turn affects the external sector. The exchange rate and trade policy are two sides of the same coin. There are several exchange rate regimes. They can be distinguished on the basis of the degree of their flexibility and the frequency of adjustment allowed. Table 1 gives the different exchange rate regimes and their corresponding problems. Several countries have pegged their exchange rate to a single currency like the US dollar, French franc,

Austrian dollar, South African rand and the Indian rupee. Some countries have pegged their currency to a currency composite, either SDR or other exchange arran ements which involves multiple exchange arrangements. And there is a flexibility limit vis-a-vis a single currency or a group of currencies. Four countries have links with single currency. Most of the EEC countries have a cooperative arrangement. Under the third category of a more flexible exchange rate arrangement, there are three alternatives, (a) adjust according to a set of indicators; (b) managed floating; and (c) independently floating. Each has its own problems as given in Table 1.

Table 1

Exchange Rate Regimes

Exchange Rate	Problems

- Currency pegs
  - single currency
  - currency composite
	- Cannot prevent exchange rate variability
	  - may be prone to black market exchange rate

- Flexibility Limited
  - Single currency
  - Cooperative arrangements	

- More Flexible
  - Adjusted to a set of indicators
  - Independently floating
    - auction
    - Inter bank spot exchange market
	- Predictability of exchange rate movement and may lead to adversely affecting expectations of future price movements
	- Managed floating
	- Parallel black market may emerge
	Limited state of institutional development

Whenever there is a short run problem in international reserves some countries restrict the use of foreign exchange. This can be done in several ways. These controls are used as temporary measures.

Exchange and Trade Restrictions

Restrictions

- Import licencing
- Taxes on imports
- Advance import deposits and multiple exchange rates
- Restrictions on international service transactions
- Surrender requirements and retention allowances
- International capital transactions

As there is a liberalisation process going on in many countries, special techniques are being tried out by different countries to move towards more open and flexible systems (Quirk 1989). The alternative techniques are as follows:

Techniques towards an open and flexible system

Techniques

- Auction and Interbank exchange market
- Forward foreign exchange markets
- Move from outright forward contracts to futures and options markets later
- Import license auctions
- Open general licensing (list of commodities)
- Tariff reforms
  - simplification of the tariff structure
  - reduction in the dispersion of tariff rates
  - lowering of the average tariff rate
- Capital liberalisation
  - Simultaneous liberalization of
    - exchange rate,
    - interest rates and
    - capital controls

The policy introduced in India has been summarised in Table A-8. The new policy starts with the managed

Table 2

Foreign Exchange and Trade Policy
Current and Likely Movements

Exchange Regime	Restrictions	Flexible Systems
New Policy 1991		
Managed floating system	Retention Allowances Advance import Deposits	Tariff Reforms Capital Liberalization
Likely Move		
Independently floating system	No restrictions	- Tariff Reforms - Capital liberalization - Auction and inter-bank exchange market Forward foreign exchange markets Futures and options markets

floating system (existing one) using restrictive trade policy like retention allowances and advance deposits. It is trying to reform the tariff structure and move towards capital liberalisation. In the next 2-3 years, the currency may move towards convertability. The trend will probably move towards an independently floating system of exchange regime with no short term restrictions. There may be changes in the tariff structure including reduction in tariff rates and

removing the quantitative restrictions and capital liberalisation, both in the foreign exchange sector as well as domestic market. With this, there may be a trend, initially towards auction and inter-bank exchange market. This may be followed by forward foreign exchange markets which in turn may facilitate futures and options foreign exchange market.

Industrial Policy

The government's new industrial policy is considered to combine "continuity with change" (Table A-9). Earlier experiments were only partly successful. Free Trade Zones like Kandla and Santa Cruz (Bombay) did not attract enough FDI to India nor contributed significantly to the export efforts of India. Liberalisation policies like allowing FDI up to 40% and imports of inputs led to foreign exchange problems. The current policy is trying to integrate India with the global economy. This is being done by introducing changes in all related policies such as fiscal, monetary, trade, exchange rate and industrial policies.

The industrial policy has removed restrictions on MRTP and FERA companies and has allowed greater share for FDI in India. Besides, it has decided to privatize public enterprises to some extent. Here it has taken cautious measures. It has not adopted the British style of fast privatization. On the one hand, it is trying to give autonomy to public enterprises through the instrument of M.O.Us. The government intends divesting a part of the shares of public sector

companies to mutual funds and financial institutions. The former style has been adopted from the French system and the latter from Germany and Japan which used commercial banks for privatization.

Policy Makers' Expectation

The major objectives of these policy measures are:

- correct the distortions in the economy,
- maintain a sustained growth in productivity,
- growth in gainful employment, and
- attain international competitiveness.

These objectives can be achieved through more reliance on market forces and less reliance on state regulation. Market imperfection has resulted due to state interventions. The idea is to liberate the industrial activities from the bureaucratic maze of license Raj. These policy measures have changed the concept of dominance from the basis of assets to market dominance. This is in consonance with the globally accepted measure of dominance. These policy measures are expected to free the constraints on the growth of enterprises in the domestic economy.

The earlier restrictive policy towards FERA companies in the domestic market and liberal policy towards the Free Trade Zones have not really attracted FDI to India. This has been liberalized to the extent of 51% of foreign equity and it has been decided to treat them as equal to national companies.

Other restrictive clauses in the PMP and convertibility clauses have been removed. As any other domestic company, foreign companies come under the general policy of forex regulations. This has been slightly removed in the case of foreign technology agreements.

With these changes, it is expected that more market forces will operate in India's domestic economy. As there is no market differentiation between domestic and foreign companies, all are treated equally. This will enable more FDI and technology to flow into India in near future.

Likely response of MNCs

The macro-economic variables, which explain the private investment rates in any economy, can have either positive or negative effects. Some of these effects are:

Positive effects	Negative effects
- Real per capita GDP growth rate	- Real Deposit interest rate
- Per capita GDP level	- Domestic inflation rate
- Public Investment rate	- Debt-service payments ratio
	- External debt to GDP ratio

Besides the above economic factors, political stability and investors confidence play an important role. With the current structural adjustment program in India, some of the market distortions are being removed. However, when the MNCs look at Asia as a region, India is far from being liberal.

Normally liberalization involves changes in the following:

- Entry restrictions
- Proportion of ownership
- Procedure for screening
- Transparent incentives and
- Rules for repatriation of profit.

Now, the proportion of equity allowed is 51% which is considered as majority holding. It has been found that the approach of MNCs towards foreign investment entirely depends on its ownership advantage and internalization advantage. Depending on these advantages foreign entry is made either as a fully-owned subsidiary or as a partially-owned subsidiary. Many Asian countries allow full ownership and even Indonesia gives up to 80% ownership. In this context, India is yet to liberalize ownership restrictions.

Many Asian countries like Indonesia, Malaysia and Korea have liberalized the entry restrictions. They have opened more than 80% of the industrial sector to FDI. Though India has liberalized many sectors, some incongruencies remain as in motor car, white goods and electronics (entertainment). These are considered luxury items in India.

FDI is subject to screening procedures in most countries. India has removed several licensing formalities. However, SIA clearance is now required in cases where the import component is more than Rs.2 crores. Foreign companies may view this as a temporary restriction due to the forex problem. They may expect this restriction to be removed at

the earliest because for many of them FDI and Trade are two sides of the same coin.

Regarding special incentives for MNCs, India does not differentiate between domestic and foreign companies. As such, there are no special incentives as were given in FTZ. But there is a slight incentive for MNCs in the FTZ, as they can sell in the domestic market a little more than they could earlier with a reduced tariff rate (50% of normal).

MNCs normally expect their profit to be easily repatriable. India has linked repatriation with exports. As such only MNCs which can recover their profit through exports can look favourably. Others will have to wait until these restrictions are removed.

In sum, MNCs reactions would be:

- Wait and see the effect of the new policies on the economic structure.
- Those already existing will try to expand their operation.
- Those who are in the negotiation stage like IBM & Coca Cola will test the policy.
- Those who have industry specific technology may provide technology but not firm specific or proprietory knowledge. Those having the latter may wait for the full ownership provision.
- Those who can integrate Indian operation globally, will enter if there are locational advantages.
- The new policies are likely to encourage Indian companies becoming MNCs like Korean Chaebols (e.g. Samsung, Hyundai, etc.).

ANNEXURE

Table A-1
FDI Political Response of U.S.A.

Legislation	Nature
TRADE:	
- The Export Control Act, 1949 - The Munitions Control Act, 1950 - The Mutual Defence Assistance Control Act, 1950 - Voluntary Export Regulations	Control of exports and imports
FDI & AID	
The Hickenlooper Amendment 1962	- The President can suspend aid to countries that expropriate US property without compensation beneficiaries: IT&T in Brazil & Argentina - United Fruit in Nicaragua - Exxon in Peru
The Office of Foreign Direct Investment, 1968	Control US FDI in foreign subsidiaries (more than 10% equity)
The Gronzalez Amendment, 1972	- Inter American Development Bank, vote against loans - threatened Jamaica for its intention to nationalize the bauxite industry

These are outlived, many US companies are against their use. No protests from U.S. for nationalization of the following:

- Pasco Sulphur case in Mexico (1965-66)
- Anaconda in Chile (1969-70)

contd..

Table A-1 Contd.

FDI in the U.S.	
First proposal: The Bryant Amendment to the Omnibus Trade Bill of 1988 House Resolution 5410 defeated	impose restrictions on the take-over of U.S. firms by foreign companies
The Exon-Florio provisions included in Omnibus Trade Bill, 1988 as Section 5021	Power to review certain mergers, takeovers by the President
Proposals Pending	
HR 3699 to amend the Trade Act of 1974	Calling for reciprocal treatment respect to foreign acts, policies etc.
HR 3265 to introduce bill Cable Television Ownership Act 1984 to amend the communications Act of 1934	Prohibition of foreign ownership in cable TV systems
Actions under	
Omnibus Trade and competitiveness Act 1988	
- Super 301	Foreign unfair trade practices against India Brazil and Japan in 1989
- Special 301	Intellectual property: to retaliate against India is named in 1989

Both these are under the Uruguay Round of multilateral trade negotiations as:

TRIMS = Trade Related Investment Measures
TRIPS = Trade Related Intellectual Property Rights

Source: - Shiva Ramu (1975)
- Moran, Theodore H. (1978)
- The CTC Reporter, No.29, Spring 1990

Table A-2a

IMF: Fund Adjustment Program Package

Policies	Objectives	Direction of change
Fiscal	Reduce government deficit	- Reduce Spending - Increase tax base - Reduce tax evasion
Monetary	Stabilize prices	- Restrain credit expansion - Liberalise interest rate - Prudent Regulations - Reduce market segementation
Exchange Rate	Rational use of forex	- Incentive to export - Devaluation - Macro economic stability thro' currency convertability
Trade policy	Liberalise	- Quantitative control to price mechanism - Liberalise FDI entry

Domestic Structural changes	- Remove price distortion
	- Move to more competition
	- Market forces in the allocation of resources
	- Incentives reflecting scarcity
		- Remove price control
		- Remove subsidies
		- Economic pricing of inputs (utilities, energy, etc.)
		- Wage policy
		  - restrain real wages in organised sector
		  - Increase flexible wages in labor market
		- Divesture of public sector

Source: Based on,

- Pfeffermann, Guy and Weigel, Dale R.: "The Private Sector and the Policy Environment" Finance & Development, Dec. 1988.
- Heller, Peter: "Fund-Supported Adjustment Programs and the Poor" Ibid.

Table A-2b

Seven Lessons in Reform

1. Lack of ownership undercuts the program
2. Flip-flops in reform hurt credibility
3. Institutional Demands must not be glossed over
4. Attention to macro economic instability is fundamental
5. Vulnerable people must not be forgotten
6. Partial attemps often fail
7. It pays to be realistic

Source: IBRD: World Development Report 1991 p.152.

Table A-2c

The Speed of Reform

Gradualism	Shock Treatment
- more than 2 years	- less than 2 years
- may have perverse effects	- welfare gain is achieved quickly
- allows mid-course adjustment	- drastic reform due to too slow social perspective
- allows for political fine tuning	- can improve the political sustainability
- preferred due to administrative constraint	- occurs in a climate of crisis

Source: IBRD: World Development Report 1991, p.117

Table A-3
Earlier IMF Loans to India

Resources: - Stand by and Extended Arrangements

Arrangement:
- Date of Agreement: Nov.1981
- Original Expiration date: Nov.1984
- Date of cancellation: May 1984

Amounts (SDRs mil.):

- Committed : 5,000
- As % of quota: 291
- Drawn : 3,900

Economic Condition

- inefficiencies in key economic sectors
- infrastructure bottlenecks
- cost-price distortions
- adverse weather
- weak fiscal conditions
- weak production bases
- strain in balance of payments

Design of Program

- correcting cost-price distortions
- relaxing industrial regulations
- liberalising trade policies
- restrained financial management
- reduce budget deficit

Performance

- economic growth in line with program target
- relative financial and price stability
- improvement in external current account

Post Program

- 1985 liberalization in industrial licensing, import policy, and tax and financial reforms, increased limit of MRTP companies termination of import monopoly
- Disappointments: weakness in export performance, control on imports, delay in policy implementation

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Source: Based on:
Bijan B. Aghavli, In-Su Kim, and Hubert Neiss: "Growth and Adjustment in South Asia" in Finance and Development, Sept. 1987.

Table A-4

FDI FLOWS FROM FIVE MAJOR COUNTRIES:
SHARES 1981-83 AND 1984-87

(%)

Country	Outflows		Inflows	
	1981-83	1984-87	1981-83	1984-87
France	7.4	5.7	4.0	4.8
F D R	7.7	8.5	1.9	1.5
Japan	10.6	14.1	0.7	0.7
U.K.	22.2	18.7	11.3	7.5
U.S.A.	18.3	25.3	35.2	43.8
Sub-total	66.3	72.4	53.0	58.4
All Developed countries	97.9	98.8	72.5	78.8
Developing countries	2.1	1.2	27.5	21.2
Total in $ bil.	123.0	327.6	123.0	327.6

Source: The CTC Reporter, No.27, Spring 1989, pp.16-17.

Table A-5

Basic Information for Twelve Countries

	Pop.mil. mid.1989	GNP 1989 per capita ($)	GDP (bil.$)* 1965	GDP (bil.$)* 1989	GDP (growth rate around %) 1965-80	GDP (growth rate around %) 1980-89
India	832.5	340	50.5	235.2	3.6	5.3
China	1,113.9	350	67.2	417.8	6.9	9.7
Indonesia	178.2	500	3.8	93.9	7.0	5.3
Egypt	51.0	640	4.5	31.6	7.3	5.4
Philippines	60.0	710	6.0	44.3	5.9	0.7
Thailand	55.4	1,220	4.4	69.7	7.3	7.0
Turkey	55.0	1,370	7.7	71.6	6.2	5.1
Mexico	84.6	2,010	21.6	200.7	6.5	0.7
Argentina	31.9	2,160	16.5	53.0	3.4	-0.3
Brazil	147.3	2,540	19.4	319.1	9.0	3.0
Korea	42.4	4,400	3.0	211.9	9.9	9.7
Malaysia	17.4	2,160	3.1	37.5	7.4	4.9

* rounded off

IBRD: Table 1 p.204-205
Table 2 p.206-206
Table 3 p.208-209

Table A-6

Exports of goods and Nonfactor Services (% of GDP)

($ mil.)

Country	Exports as % of GDP 1965	1989	Net FDI 1970	1989
India	4	8	0	425
China	4	14	..	1,400
Indonesia	5	26	83	735
Egypt	18	22	..	1,586
Philippines	17	25	-29	482
Thailand	16	36	43	1,650
Turkey	6	22	58	663
Mexico	8	16	323	2,241
Argentina	8	16	11	1,028
Brazil	8	7	407	782
Korea	9	34	66	453
Malaysia	42	74	94	1,846

IBRD: Table 9 p.220-21
Table 23 p.248-249

Table A-7

Trade Growth Pattern

Average Annual Growth rate (%)

Country	1965-80	1980-89	1965-80	1980-89
India	3.0	5.8	1.2	3.5
China	..	11.5	..	11.7
Indonesia	9.6	2.4	..	- 0.4
Egypt	- 0.1	9.2	3.6	6.5
Philippines	4.6	1.3	2.9	0.4
Thailand	8.6	12.8	4.1	8.4
Turkey	5.5	11.4	7.7	7.4
Mexico	7.7	3.7	5.7	- 4.7
Argentina	4.7	0.6	1.8	- 8.2
Brazil	9.3	5.6	8.2	- 1.6
Korea	27.2	13.8	15.2	10.4
Malaysia	4.6	9.8	2.2	3.7

Table 14 p.230-231

Table A-8
Foreign Exchange and Trade Policy

The first indication of problems in the Indian FOREX position was indicated in November 1990 itself when the Reserve Bank of India insisted on 50 per cent cash margins for opening letters of credit. This was done with the intention of preserving FOREX and discouraging imports. As the country's reserves declined, RBI increased the cash margins to 133 per cent and then to 200 per cent. In addition to external resources, RBI also effected domestic credit when they introduced freeze on cash credit drawals on May 9, 1991 and later forced the banks to maintain 10 per cent incremental cash reserve ratios.

On July 3rd, 1991, a new trade policy was introduced. It tries to link all imports to exports. It allows 30 per cent REP licences. The route followed by REP licences is called EXIM scripts and these are freely tradable. EXIM scrips will eventually be traded by financial institutions also. It is also expected that EXIM scripts will be replaced with foreign exchange service which will be more easily tradable. As a part of this new policy, cash compensatory support (export incentives) were abolished. The new policy has an advance licensing scheme feature. The replenishment rate in advance licensing exports will be increased from 10 per cent to 20 per cent of net foreign exchange earned. Besides, all imports are decanalised. The public sector imports also come under this scheme. In July, the Indian currency was devalued by nearly 20 per cent.

During the budget presentation in July, some more changes were introduced. The exchange rate adjustments on 1st and 3rd July 1991, and the enlargement and liberalisation of replenishment licensing system were directed towards trade policy reform. This has been identified as a transitional phase where a regime of quantitative restrictions will move towards the price-based mechanism. The other policies which were changed are:

- Reserve Bank of India has stipulated a floor of interest and no ceiling, giving freedom to commercial banks to charge their interest rates. Similarly, for term finance, once the minimum has been prescribed at 15 per cent.

- There will be a Security and Exchange Board in India which will regulating and manage the functioning of stock exchanges in the country.

- NRI investment on non-repatriation basis in certain infrastructural area was liberalised.

- Bureau of Industrial Cost and Prices has been transformed to Tariff Commission.

- Customs duty which was varied and reached more than 300 per cent has been reduced to the ad valorem rate of basic plus anciliary duties of custom to a maximum of 150 per cent.

- For import of capital goods and machinery, tax has been reduced from 85 to 80 per cent and tax on components has also been reduced by 5 per cent from the existing rate. The export-oriented undertakings and units in the free trade zones have been allowed to divert their production to the domestic market at half the import duty leviable on such goods which should not be less than the excise duty levied on similar items produced in the domestic tariff area and for several other products like finished leather goods and some raw materials, duties have also been reduced.

- The government intends to amend the Customs Act so that the customs tariff are in line with the the Harmonised Commodity Descriptions and Coding System which has been adopted by India in terms of International Convention on the harmonised system.

Table A-9

Industrial Policy:

The changes announced in July (24), 1991 regarding the industrial policy relate to the following areas: (Table A-9).

A. Industrial Licensing

B. Foreign Investment

C. Foreign Technology Agreements

D. Public Sector

E. MRTP Act

A. Industrial Licensing

The main features are:

- Only 8 industries are reserved for public sector
- 18 industries come under licensing scheme 34 industries do not require licensing
- Imported capital goods are automatically cleared if they are covered by foreign equity or are less than Rs.2 crores and others require clearance from the Secretariat of Industrial Approvals (SIA) in the Department of Industrial Development
- No license for expansion
- New broad brand facilities for existing units
- No Phased Manufacturing Programs (PMP) for new units
- Flexible location policy

The procedural consequences of these are removal of all existing registration schemes. They have to file only an information memorandum. The lists will be harmonised with the Indian Trade classification.

B. Foreign Investment

- Approvals up to 51% of foreign equity and 24% in SSI units
- Outflows balanced by exports and imports as applicable to domestic firms
- FDI need not be accompanied by foreign technology agreements
- Same facilities extended to trading companies
- A new Special Empowered Board to be constituted to negotiate with large foreign companies.

C. Foreign Technology

- Automatic approvals for foreign technology agreements up to lumpsum payments of Rs.1 crore, 5% of royalty on domestic sales and 8% for exports
- All others need specific approval under general procedures
- No permission necessary for hiring foreign technicians and foreign testing of indigenously developed technologies.

D. Public Sector

- Focus on strategic, hi-tech and essential infrastructure
- Sick units will be referred to BIFR
- Some proportion of shares of public enterprises will be offered to financial institutions, mutual funds, general public and workers
- Boards of public enterprises made more professional and given greater powers
- MOU system to improve performance and same presented to Parliament.

E. The MRTP Act

- Removal of threshold limits of assets of MRTP companies
- No approvals required for expansion, mergers, takeovers and appointment of Directors
- Emphasis on controlling and regulating monopolistic

restrictive and unfair trade practices

- MRTP Commission to exercise punitive and compensatory powers.

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