UNIT 22 ROLE OF FOREIGN TRADE IN INDIA

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22.0 OBJECTIVES

This unit is the first in this block of three units that deal with India's foreign trade. It describes the role of foreign trade in growth, and discusses the composition, volume, direction and growth of India's foreign trade.

After going through this unit you should be able to :

- Discuss the role of foreign trade in a country's economic development;
- Describe the effect of economic growth on a country's structure of foreign trade;
- Explain the relationship between national income and exports, and national income and imports;
- Comment on the changing composition of India's exports and imports;
- Examine the changing character of India's trading partners; and
- Evaluate the changing structure of India's foreign trade.

22.1 INTRODUCTION

Modern day economies are all open economies; i.e., every country cultivates and promotes economic relations with the rest-of-the-world. Economic isolation and self-sufficiency are things of the past; instead global division of labour is the rule. In face of on-going Information-Technology revolution the world is becoming only a global village. This again underlines the fact that the economic welfare of a country depends as much upon the external environment that a country faces as

upon domestic policy changes. A major component of the external sector is foreign trade. We begin the present unit with an understanding of the role of foreign trade in a country's economic growth. We will also examine subsequently in the same unit the changing structure of India's foreign trade and its implications for India's growth process.

22.2 ROLE OF FOREIGN TRADE IN ECONOMIC GROWTH

Foreign trade has worked as an "engine of growth" in the past (Witness Great Britain in the 19th Century and Japan in the 20th, besides others), and even in more recent times, ***the outward Oriented growth Strategy***, adopted by the Newly Industrialising Economies of Asia, Viz. Hong Kong, Singapore, Taiwan and South Korea, has enabled them to overcome the resource constraints of small resource-poor underdeveloped economies.

22.2.1 Contribution to Growth

Foreign trade contributes to economic development in a number of ways:

First, foreign trade explores means of procuring imports of capital goods, without which no process of development can start.

Secondly, it provides for free flow of technology, which allows for increases in total factor productivity, and some short run multiplier effects for countries with unemployed labour.

Thirdly, foreign trade generates pressure for dynamic change through (a) competitive pressure from imports, (b) pressure of competing for export markets and (c) a better allocation of resources.

Fourthly, exports allow fuller utilisation of capacity, increased exploitation of economies of scale, separation of production patterns from domestic demand, and increasing familiarity with absorption of new technologies.

Fifthly, foreign trade increases domestic workers' welfare. It does so at least in three ways: (a) larger exports translate into higher wages; (b) since workers are also consumers, trade brings them immediate gains through cheaper imports; and (c) foreign trade enables most workers to become more productive as the goods they produce increase in value.

Finally, increased openness to trade has been strongly associated with the reduction of poverty in most developing countries.

22.2.2 Barriers to Trade

As seen above, foreign trade can make manifold contributions to growth. However, most of the non-oil-producing developing countries, including India, are finding themselves face to face with a number of difficulties on the foreign trade as an "engine of growth". Among these we may specifically mention the following:

Firstly, the demand for primary commodities, which form the principal exports of a developing economy, has not kept pace with the growth of world trade or with income levels in different countries. The world trade in primary commodities has been declining for the last four and a half decades. Primary commodities formed more than 50 per cent of the total exports of the world in the year 1955. This share

came down to 35 per cent in 1977 and further 25 per cent in 1998. Four possible factors can explain the phenomenon of the fall in world trade in primary commodities: (a) the increasing tendency of the market economies to protect their agriculture by imposing tariffs and non-tariff barriers (NTBs, the insistence on 'eco-labelling or similarly the proposed German ban on the use of harmful chemicals in textile goods, are the latest instances); (b) an inadequate increase in demand for primary commodities in the developed market economies in the wake of industrialisation; (c) development of synthetic substitutes; and (d) developed country population growth rates are now at or near the replacement level so that little expansion can be expected from this source.

Secondly, exports of developing economies as a group have been slow to develop. As a result, the share of developing economies in the total world trade has maintained a downward trend. Thus, whereas this share was as high as 31 per cent in 1950, it came down to 14 per cent in 1960 and further to 4.2 per cent in 1993. This decline has been caused by factors like the emergence of trade blocs, restrictive commercial policies and the growth of monopolies. These trends are indicative of the fact that the developing economies have to face foreign trade as a barrier, to overcome, which they may require concerted efforts.

Thirdly, the declining demand for primary products in the developed markets has given rise to the problem of worsening terms of trade of the developing economies. Whereas prices of manufactured goods, especially capital goods, have been rising in the world markets, there has been a tendency for a gradual fall in prices of primary goods. For example, according to a recent UN report, in the past developing countries could get a tractor by exporting two tones sugar, now they have to export seven tones of sugar to get the same tractor. Similarly, according to another estimate 1 to 3 per cent of the GNP was lost by the developing countries due to decreasing prices of non-oil raw materials during the 1980s. Any adverse foreign trade price change works as check on economic development.

Finally, restrictive trade policies adopted by industrialised countries affect prospects for developing country exports of manufactures. Industrialised countries themselves have been faced with serious adjustment problems as a consequence of increased globalisation. Their reaction to this development has taken the form of their insistence on "fair" trade. It is a major development that tends to make it more difficult for developing countries to pull their income levels up by relying to a great extent on international trade and foreign investment.

In short, developing economies face many difficulties in their foreign trade operations. The numerous multilateral initiatives, which have been mounted to tackle these problems, have left them largely unresolved. Therefore, in the given circumstances the developing economies have to evolve a suitable trade policy-mix that may create export outlets and as well may assure supplies of essential imports.

22.2.3 Trade Policy

The term trade policy refers to all the policies that have either direct or indirect bearing on the trade behaviour of a country. The details of the various policies depend upon the broad trade strategy adopted in the country; the trade strategy, in turn, depends upon the broad strategy of development adopted by the planners. For example, if the development strategy is one of giving relatively greater emphasis on development of industry rather than of agriculture, then the trade strategy should be suitably adopted to this development strategy. Two broad types of trade strategies discussed in the literature are the following: (a) inward-oriented strategy, and (b) outward-oriented strategy.

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Inward orientation is often identified with protectionism and import substitution; outward orientation with free trade and exports promotion. However, in a broader framework, inward-looking and outward-looking strategies may be defined to encompass wider range of activities than mere trade in goods. Inward-looking strategy may then refer to all the policies, which discourage reliance on foreign resources. Under this strategy, in its extreme form, no foreign aid is permissible, no movement of factors of production to or from outside, no multi-national corporation and no freedom in international communication. Such a strategy in some form was in vogue in Russia during its Iron-Curtain Age immediately after the Second World War. However, in the present world economy, such an extreme form of inward-orientation hardly exists in any country. The opposite of this extreme form of inward-orientation is the form of outward-orientation in which free movement of capital, labour goods, multinational enterprises, open communication of inward and outward orientation in different degrees are observed.

Advocates of outward-orientation argue that openness is useful to bring about good educational effects, new ideas and new techniques, growth of new form of organisation, etc. They believe that free trading encourages learning by trade and implies achievements of dynamic transformation of the economy into higher standards of living.

Quotas and other quantitative restrictions on the other hand, interfere with the price mechanism, involve allocative and X-inefficiencies (e.g. failure to minimise costs) create distortions and impede the progress of competitive firms and industries.

As against these arguments the advocates of inward-orientation plead that inward-looking policies encourage, indigenous talent, learning to do things by oneself, domestic technological development and suitable range of products, avoiding all the ill-effects of demonstration from the outside world. Given gaps of development between the developing and the developed countries, inward-orientation is advocated as an inevitable policy. Effects of these two types of strategies on growth of output, employment, income generation and income inequalities could also be of diverse nature, and no general inference can be drawn in this context.

Check Your Progress 1

1) Mention four advantages of foreign trade to a developing economy.

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2) Mention four barriers to trade.

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3) Define the following:
   i) Inward-oriented strategy
   ii) Outward-oriented strategy
   iii) Quotas
   iv) Quantitative Restrictions

4) Pick up the correct answer in the following:

   An Underdeveloped economy exports:
   a) manufactured consumer goods
   b) manufactured capital goods
   c) agricultural commodities
   d) tools and equipments

22.3 ANALYSIS OF THE GROWTH OF INDIA'S FOREIGN TRADE

A proper analysis of a country's foreign trade can be attempted in its three components part, viz., (a) Volume of trade (b) Composition of grade, and (c) Direction of trade.

22.3.1 Volume of Trade

The volume of trade relates to the size of international transactions. Since a large number of commodities enter in international transactions and their aggregate can be found only by finding their money value, the volume of trade can be measured by finding its value. The trends in the value of trade help to identify the basic forces that may be operating at different periods in the economy. However, mere absolute changes in the value of trade may not be satisfactory guide, hence it is necessary to find the change of value of trade by relating them to two variables, viz., (i) share of exports/imports in GDP, and (ii) share of exports/imports in world trade. The share of exports/imports in GDP indicters the degree of outward-orientation or openness of the economy in regard to the trade activity. This share reflects in a broad way the nature of trade strategies adopted in the country. The ratio of exports to GDP could be interpreted also to mean supply capability of the economy in regard to exports. It can be called as average propensity to export. The similar ratio between imports and GDP gives the average propensity to import. The share of exports in the world trade indicates the importance of the country as a nation in the world economy. It reflects the market thrust that the country maintains in the world market. Changes in this ratio thus indicate the shift in the position of the comparative advantage of the country.

Further, changes in the value of exports may be compared to the changes in the value of imports. The relationship between these two variables is known as the terms of trade, i.e., the terms at which exports exchange for imports; if the exports value in terms of imports value shows an increase, the terms of trade are said to be favourable. Favourable terms of trade imply that for a given value of exports, a country can import more goods. Conversely, if the terms of trade are unfavourable a country has to give up more exports to procure a given volume of imports.

22.3.2 Composition of Trade

The composition of trade is indicative of the structure and level of development of an economy. For instance, most of the developing countries depend for their export earnings on a few primary commodities; these countries export raw materials of agriculture origin and import manufactured or industrial products, thus denying

themselves the benefits of value added. As an economy develops its trade gets diversified; it no more remains dependent on a few primary commodities. It begins to export more of manufactured industrial goods and import industrial raw materials, capital equipment and technical knowledge how.

The following questions need be analysed in this regard: (i) What is the degree of concentration of the composition of exports/imports? Has there been any change in the degree of concentration over time ? (ii) Is there any shift in the share of the primary products and manufactured products in the total export or import trade? (iii) The commodities entering trade could also be classified by various other criteria such as value added per unit of output, productivity of labour, capital intensity in production, the strength of backward and forward linkages, etc. The shifts in the commodity composition of trade in these categories would bring out the nature of structural changes in regard to income generation, employment effect and overall industrialization through linkages effects etc.

22.3.3 Direction of Trade

The direction of trade, similarly, is indicative of the structure and level of economic development. As a country develops and its trade gets diversified, it has to seek new outlets for its exports. Its horizon of choice in terms of imports also gets widened. The country begins to trade with an increasingly large number of countries. In this regard, one could ask whether there has been a concentration or dispersion of the markets for exports and sources of supply for imports.

It is in terms of these components that we have to study the trends in India's foreign trade during the last four and a half decades of economic planning.

22.4 VOLUME OF INDIA'S FOREIGN TRADE

As provided in our development plans the volume of merchandise trade has been on the rise-trade to GDP ratio has gone up from about 8 per cent in 1950 to about 20 per cent presently. The increase has been caused both by exports and imports. Table-1 below presents the growth rates of exports and imports during each of the plans.

Table-1: Growth Rate of India's Foreign Trade during Plans
(Annual percentage change)

Plan/Period	Exports	Imports
I	-	5.0
II	0.7	7.7
III	4.9	4.7
IV	13.6	11.7
V	18.3	19.5
VI	13.0	13.9
VII	19.8	16.0
1990-91	9.1	13.2
1991-92	-1.5	-19.4
1992-93	3.8	12.7

1993-94	20.0	6.5
1994-95	18.4	22.9
1995-96	20.8	28.
1996-97	5.3	6.7
1997-98	4.5	5.9
1998-99	3.9	0.9

It would be useful to analyse separately the trends in the volume of exports and imports.

22.4.1 Value of Exports

India total exports have increased by about 240 times during the last about five decades, from Rs.606 crore in 1950-51 to over Rs.1,41,604/- crore in 1998-99. However, the increase has not been uniform over the period. We can look at plan wise increase in the value of exports to have a clear understanding of the underlying trends. The relevant data is summarised in Table-2 below:

Table-2: Annual Average Value of India's Exports During the each of the Plans

(Rs. Crore)

PLAN	VALUE
First	605.4
Second	605.8
Third	752.8
Fourth	1810.0
Fifth	5346.0
Sixth	8967.0
Seventh	15582.0
Eighth	86270.0

It would be seen that India's exports were relatively stagnant during the first three plan periods; they picked up some momentum during the Fourth plan period, and in more recent period there has been a dramatic increase in the total value of exports from India.

But, as stated earlier, absolute values of exports do not convey much about the state of the economy. For one thing, all of these values are at current prices. These, therefore, do not indicate anything about the change in the total quantum of exports. Secondly, the absolute values do not bring out the changing significance of the export sector *vis-à-vis* rest of the economy. Therefore, in analysing the export performance, we must study the *relative position*.

We can employ, presently, two types of comparisons for this purpose, viz. (a) a comparison with the growth of NNP, and (b) a comparison with the growth of world exports. The relevant data for the purpose of two comparisons is given in table 3 below:

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Table-3: Selected Export Ratio of India

Year	World's Export	India's Exports as % of India's National Income
1950-51	2.20	6.8
1960-61	1.05	4.2
1970-71	0.64	3.8
1980-81	0.42	5.4
1990-91	0.52	6.9
1994-95	0.58	8.9
1995-96	0.64	9.2
1997-98	0.60	9.0

a) **Comparison with the growth of National Income**

That the rate of growth of exports was slower than the rate of growth of National Income during the initial stages of economic planning is clearly brought out by the fact that the India's exports as a percentage of India's National Income fell from 6.8 in 1950-51 to 3.8 in 1970-71.

Subsequently, however, this share has been increasing. It reflects the growing significance of the exports sector in the Indian economy (In general, successful developing economies are seen to have achieved high export share till they matured as advanced industrial economies. The aggregate exports of all high income countries are 15 per cent of their aggregate GDP; average for all low income economies including China is 18 per cent).

b) **Comparison with the growth of world exports**

Again it would be seen from table 3 that India's share in world's total exports nose-dived in the initial stages. During the eighties and the nineties, in the wake of picking up by India's exports, there has been some improvement in the ratio, which has varied between 0.50 and 0.65 per cent. These trends indicate the vast possibilities of growth available in the export sector. Many developing countries have recorded export growth rates much higher than that of India.

Thus, whereas India's exports (estimated at $ 33,613 million during 1987-89) increased at an annual average rate of 5.9% in dollar terms between 1980-92 the corresponding growth rates for some other developing countries like China, South Korea, Malaysia, Pakistan, etc. exceeded 11 per cent. While China's exports have been grown from $ 22 billion in early 1980s to $ 125 billion now, India's exports have grown from $ 10 billion to $ 25 billion in the same period. India's ranking among the world's export nations slipped form 16th in 1953 to 20th in 1983 and further to 30th presently.

It is inspite of the country's natural comparative advantages: low wages, ready access to tropical agro-produce and intelligent and educated workforce, artificially low price of inputs like raw cotton, and, of course, preferential access to OECD markets.

22.4.2 Causes of Slow Growth of Exports

We can identify the following as the major causes of the slow growth of India's

exports. First, India's exports have suffered due to a shortage of supplies and inadequate exportable surpluses. If India is to exploit the situation in the world markets to her best advantage, supplies should not only match demand, but should also leave a cushion in capacity, especially in products where we have a price advantage. In the case of important agriculture commodities there should be built-up buffer stocks of adequate size. In manufactured products, it always takes time to create new capacity and a country, which cannot increase supplies at a short notice, may lose markets and sometimes the loss may be beyond repair. It is, therefore, necessary that some built-in surplus capacity, which can take advantage of the world situation at short notice, is kept ready in selected export industries, particularly in those units, which are exporting a sizeable portion of their production.

Secondly, among the fastest growing export products have been the new technology goods such goods formed about half of the total world trade in 1980, a decade and a half- later these constitute more than two-thirds. India has yet to make its mark as an exporter of such goods, except for some recent break through in software exports.

Thirdly, intimately linked with the problem of exportable surplus is the problem of quality control. If the quality satisfies consumer preference, even a higher priced product can be sold in competitive markets. India has not been able to create an image as a supplier of quality goods. The trade is generally opposed to compulsory quality and/or pre-shipment inspection. Sometimes, even after quality control and pre-shipment inspection, there have been complaints which suggest that quality control is not thorough. Nothing harms the exports market more than a bad reputation for quality.

Fourthly, the phenomenal technological advance, coupled with the structural diversification of industries, has strengthened the competitive ability of rival producers in the international markets. Indian exports have been facing acute competition from the newly emerging rival countries, which are quoting prices much lower than what India can. This is primarily because of the fact that the domestic cost of production in India is much higher than what obtains in many other countries. If we compare a representative Indian firm vis-à-vis a Korean firm, which is a strong competitor in respect of some of our products in the international markets, we will see the wide difference in cost structure between our firm and representative Korean firm. In India, the average of cost of production as a percentage of output value at world prices is 130 but it is 98 in a representative Korean firm. If we consider the selling price of 100 in each case, the Indian firm as cost disadvantage of 30 per cent whereas the Korean firm gains by 2 per cent. Indian industries have not adequately felt the need to be cost-conscious as they have enjoyed a protected market due to restrictions on imports, high protective duties and a shortage of domestic supplies. Moreover, the productivity in Indian industry is much lower than that of its competitors. Even in the labour-intensive products the Indian cost price structure is not competitive.

Fifthly, inadequate transportation and shipping facilities have stood in the way of export promotion. Although in absolute terms, Indian shipping has made good progress since the planning began, looking at it from the angle of our needs and the vast development of the shipping industry outside, our progress is not encouraging. In addition most of our exports have severe restrictions in respect of berth facilities, navigational aids, harbour and channel depths, communications and handling equipment, which add to delays and increase transport costs.

Finally, India's exports like exports from other developing countries are pitted against tariff and non-tariff barriers imposed by the developed countries. Exports are also saddled against emerging regional trading blocs like the EU, NAFTA,

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Asia-Pacific Rim etc. These will open up opportunities as well as set ulimitations, but for us there would be plenty of scope only if we can gear up ourselves.

22.4.3 Value of Imports

India's total imports have increased more than two hundred and fifty fold during the last four and a half decades, from Rs.608 crore in 1950-51 to Rs.1,76,099 crore in 1998-99. We can have a look at overall trend in imports during the plan period, as shown in table 4.

Table-4: Annual Average Values of Imports during each Plan

Rs. Crore

Plan/Period	Value
First	735
Second	973
Third	1240
Fourth	1973
Fifth	6463
Sixth	14683
Seventh	25114
Eighth	96235

The overall trend of imports has been that of an increase right since 1954-55. While exports have been mainly dependent on world demand and availability of exportable surpluses and very imperfectly amendable to domestic policy measures, imports have been largely a matter of Government policy.

The Government's import policy since 1950-51 has fallen into two distinct phases:

The first phase extends up to 1957, which broadly corresponds to the period of the First Five Year Plan. In this period a comfortable foreign exchange position, resulting from the release of the sterling balances, led to a progressive liberalization; apart from the discriminating treatment arising out of the universal dollar shortage, imports were largely freed from controls. But they remained at a comparatively low level, the maximum level of Rs.970 crore was reached in 1951-52.

The second phase began with 1957-58. Around this time, as is well known, the development strategy adopted by Indian pitched around import substitution. There were two alternative approaches to the implementation of import substitution : (a) Use of fiscal and monetary policies such as tariffs, taxes, interest rate policies, etc. which could provide adequate protection to the domestic industry or encouraging competitive production for import substitution (b) Adoption of physical interventionist policies such as licensing, quotas, banning, etc. of imports and also adopting some tariff measures for providing protection. Import trade control became a regular feature of the country's development strategy. Since then the policy of import trade control has been regularly practised; of course, the degree of control has varied depending upon the circumstances obtaining in the economy. Initially, the main objective of the import trade control was to save foreign exchange. Over the years, the import trade control has acquired a more positive and wider role in the economic development and industrial growth of the economy. It seeks to facilitate

the availability of such imported inputs, which are needed to broaden the base of industrial production and its growth, more especially production for exports.

Imports and National Income: In discussing the level of imports it is useful to observe the relationship between imports and National Income. In planned economies the development effort is likely to increase imports faster than National Income, because investment as a proportion of national income is stepped up and the import content of investment is high in the early stages of development. This, together with the increased requirements of raw materials, intermediate and capital maintenance imports more than offset the restrictions on consumer goods imports.

The relationship between imports and GDP in India has been more or less stable; imports during the first 30 years of planning generally varied between 6.5 per cent and 8.5 per cent of national income. Again, since 1979-80, this ratio has established itself at a higher level; between 8 and 11 per cent. The stability in import ratio would suggest that there has been little change in imports required per unit of domestic product. It is, however, possible that imports required per unit of output have declined in certain categories and increased in other keeping the overall ratio constant.

22.5 TRADE DEFICITS AND TERMS OF TRADE

Except during 1972-73 and 1976-77, India's imports have exceeded her exports, the size of trade deficit has been continuously increasing. The gap assumed menacing proportions with the onset of the eighties. The deficit averaged Rs.5716 crore over 1980-85, Rs.7671 crore over 1985-90 and Rs.6,600 crore during 1990-94 and Rs.21,028 crore during 1994-99. Till the seventies, a part of the deficit was accounted for by deteriorating terms of trade. The large and the widened trade deficits in the eighties are attributable to the sharp rise in the volume of imports relative to the small increase in the volume of exports. The contribution of the movements in the unit values was to moderate the size of the deficits through improvement in the terms of trade of the country. Over the period 1980-81 and 1990-91, the net barter terms of trade improved by 30 per cent. Subsequently, during the period 1991-96, the net barter terms of trade further, improved, as would be seen from table 5 below :

Table-5: Net Barter Terms of trade

(Base 1978-79 = 100)

Year	1990-91	91-92	92-93	93-94	94-95	95-96	96-97
Terms of Trade	109.3	119.5	127.3	144.9	152.4	137.9	126.2

The year 1993-94 witnessed an improvement in the trade account that surpassed the most optimistic projections. (It prompted trade analysts to pronounce that the trade sector has slowly crossed the threshold of the famous-J-Curve and is now on its upward slope). The J-curve thesis explains that things get worse before they make a dramatic improvement. It terms of foreign trade it implies that initially the country experiences rising BOT deficits, but ultimately there emerge BOT surpluses. Sweeping tariff cuts and liberalisation of both exports and imports were undertaken as part of the reform process. Exports grew at over 20 per cent, whereas imports grew at a lower rate of 6.5 per cent. The result is that the trade deficit shrank.

Exports maintained their upward trend in 1994-95 and 1995-96 also although without much change in the export basket. During this period, imports also went up. As a result the size of trade deficits is also beginning to grow. But unlike in the past, the present trade deficits are manageable.

Check Your Progress 2

1) Which of the following statements are true?

a) There has been a dramatic increase in India's exports in more recent years.
b) India's exports as a proposition of world's exports have been continuously rising.
c) India's imports as a percentage of India's national income have been rising

2) Mention four causes of slow growth of India's exports.

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3) What do you mean by the term 'trade deficit' ?

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22.6 COMPOSITION OF INDIA'S FOREIGN TRADE

The picture that emerges from the aggregate behaviour of trade value, volumes and prices gets reflected in the composition of trade also.

22.6.1 Composition of Exports

The changing composition of exports is brought out by data presented in table-6 below:

Table-6: Composition of India's Exports

(million)

Groups	1960-61	1970-71	1980-81	1990-91	1998-99
Agriculture and allied products	284 (44.23)	487 (31.73)	2057 (30.65)	6317 (19.57)	5996 (17.8)
Ores & minerals	52 (0.81)	164 (10.68)	414 (6.17)	1497 (4.60)	891 (2.6)
Manufactured goods	219 (45.33)	772 (50.30)	3747 (58.33)	23736 (72.91)	25797 (76.6)
Mineral fuels & lubricants	7 (0.01)	13 (0.01)	28 (0.04)	948 (2.91)	89 (0.3)
Others	8 (0.01)	100 (0.06)	466 (6.94)	55 (0.02)	880 (2.6)
Total	642 (100.0)	1535 (100.0)	6711 (100.0)	32539 (100.0)	33,659 (100.0)

In table 6 we have grouped the various items of exports in five categories. It would be observed from that (a) the relative share of agriculture and allied products in total exports in on the decline; and (b) the relative share of manufactured goods is on the rise.

For more penetrating analysis, we can classify the various exports in three groups, viz., (1) Export-oriented manufactures, viz., exports through industries which are significantly export-dependent; (2) domestic-oriented manufactures, viz., exports through industries which largely cater to domestic needs and (3) non-manufactures, viz., products which are of a natural or agricultural sector. The relative share of the three groups in total exports has been 53% , 12% and 35% respectively. Apparently, manufactures, and there in too the export-oriented manufactures, have come to dominate our export basket. For a country aspiring to industrialize, a shift in favour of manufactured exports is good.

But not quite. Rather than diversification being a source of growth for them, our manufactured exports have increasingly got concentrated in a few items. From about a half in 1984-85 close to two-thirds of all manufactured exports in 1998-99 were accounted for by just three product categories, viz., leather and leather products, textiles and garments, and gems and jewellery. This can be interpreted both in a positive and a negative manner. On the positive side, the potential of these items, undoubtedly, has by no means been exhausted. In fact, given low wage rates, the country will continue to enjoy its natural competitive advantage in these labour-intensive manufactures and we should promote their exports with vigour. But, at the same time, it is obvious by now that future thrust in exports will have to come through items other than these labour-saving manufactures. Rapid growth in exports can come only through new products in the category of manufactured exports. And within this, for reasons more than one the most dynamic option is offered by the engineering industry. One, the base of the engineering industry is quite diverse and the country is capable of offering a large variety of finished products and components. Two, India's engineering exports are barely visible in the global market. This presents a tremendous opportunity for the Indian engineering industry to penetrate the global market. Three, market penetration is all the easier for we can be competitive in a number of engineering products. The industry so far as failed globally because it has tried to export products developed for an unsophisticated Indian market. The key to the success lies in how soon the engineering industry can start manufacturing specifically for foreign markets.

22.6.2 Composition of Imports

Imports, as already seen above, have been largely governed by the import trade control policy of the Government. Apparently, the composition of imports has been changing in response to the needs of the economy.

India's imports can be classified into three parts, viz., (a) consumer goods, (b) raw materials and intermediates, and (c) Capital goods. While the imports of consumer goods have been totally restricted and have been permitted only when required to meet domestic shortage, imports of raw materials, intermediate goods and capital goods have generally increased. We can observe different trends form Table7 below:

Table-7: India's Principal Imports Classified by Use

(percentage share)

Group	1950-51	1955-56	1960-61	1965-66	1970-71	1975-76	1990-91	1998-99
Consumer Goods	26.2	19.9	23.9	22.8	13.0	25.3	3.5	5.5
Raw Materials & Goods Intermediate	53.6	51.4	46.6	19.8	54.6	52.4	77.8	72.6
Capital goods	20.2	28.7	29.5	45.5	24.7	18.3	15.0	21.9
Total (inc. others)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Economic Survey

a) The imports of consumer goods, as already stated, have been allowed when they are required to meet domestic shortages. Among these the more important have been cereals, especially wheat, and pulses. Hence, these imports do not show any systematic pattern. They have been usually high in the year succeeding the bad crop year. Since 1976-77, and these imports have been negligible, primarily because of growing large food grains production during the period 1998-99.

b) The imports of capital goods like machinery and other industrial equipment short up very rapidly between 1995-56 and 1965-66, which correspond to the period covered by the Second Third Plans. It may be remembered that the stragedy of growth adopted in our Five Year Plans leaned heavily on the growth of the capital goods industries. This objective could be realised, in the initial stages, only with the help of imports since the domestic industrial structure was not geared to the task. These imports helped to develop capital goods industries, and in course of time the country was in a position to dispense with the imports of these commodities. As a consequence, the share of the capital goods in total imports has shown a continuous fall during the period 1965-90. With the on-set of the economic reforms programme, technological improvement and efficiency became the keyword for industrial survival in the emerging competitive environment. Reduction in custom duties added fuel to the already surcharged economic environment. The response of the Indian entrepreneur has been to equip himself with the latest technology. This has translated into higher imports of capital goods during the period 1991-97.

c) The group of commodities which has been growing in importance over the years consists of raw materials and intermediate goods most of which are in the nature of maintenance imports. As the growth process moved, shortage and scarcities of different types of raw materials and intermediate goods began to be felt. These shortages would adversely affect the utilisation of capital goods, but for their imports. Hence, the large imports of these commodities have been allowed. Among these imports, the most significant have been crude oil and petroleum products, fibres, fertilisers and chemical products, iron and steel, and non-ferrous metals.

Maintenance imports include four different categories of imports, viz., (i) Raw materials and components required for operating: (a) existing industrial and allied capacities at their present level and, (b) additions to these capacities which may be expected to take place over a specified period. (ii) intermediate products such as crude petroleum required for the production of various petroleum products. (iii) Fertilisers, pesticides and machinery required for increasing agricultural production. (iv) food imports required for meeting anticipated gaps at existing levels of nutrition.

To sum up, the composition of India's foreign trade reflects, to a great extent, the structural changes that the Indian economy has experienced during the last four and a half decades. It is no longer an exporter of primary commodities and an importer of manufactured goods. It exports manufactured goods and imports raw materials, intermediate goods and capital goods.

22.7 DIRECTION OF INDIA'S FOREIGN TRADE

22.7.1 Direction of Exports

A ringside view of the direction of India's direction of exports can be had from Table-8 below

Table-8: Direction of India's Exports (1998-99)
(% share)

Country/Group	Share
E.U.	25.0
USA	19.5
Japan	5.5
Russia	2.6
Other East Europe	5
OPEC	10.1
LDC	28.0
Others	8.7
Total	100.0

i) The relative importance of the UK and the USA as outlets for our exports has declined over the years. Whereas in 1950-51, these countries together accounted for more than 40 per cent of India's exports this share has come down presently to less than 24 per cent. The USA, all the same, continues to be our principal buyer. It has however to contend with EU member-nations who as a group offer us a very rich market.

ii) The export trade with the former USSR and other East European countries generally expanded during the decade 1965-75. The stimulus to exports to these countries had been provided by the mechanism of bilateral trade agreements. Of late, however, with the disintegration of the Soviet Union and the socio-economic-planned economies, the mechanism of bilateral agreements has broken down; presently these countries, all told, account for a mere 3 per cent share in India's trade.

iii) In more recent times, specially after the break-up of erstwhile Soviet Union, India's exports to Asia and Oceania markets have shown a sharp jump. In fact, the current boom in exports is sustained largely by what officials see as an unexpected and healthy rise in exports to the Asia and Oceania countries, which include the ESCAP countries like Australia, Iran, Japan, Korea, Malaysia, Singapore, Thailand, Hong-Kong, Bangladesh and Nepal. The shift in favour of these countries implies that Indian exporters have at last concentrated in markets closer home to capitalise on the advantage from lower freight cost. It is also an evidence of the outward orientation being imparted to the economy by reforms.

22.7.2 Direction of Imports

The direction of imports has been largely influenced by the development of the economy. In the initial stages of growth, a large part of the development process was financed through foreign aid, which was primarily in the form of tied aid. As a result, a large part of imports originated from the aid-giving countries. For example, in 1965-66 more than 35 per cent of India's total imports came from the USA, since then the share of the USA has declined although it continues to be our largest

supplier, accounting as it does for about 8% of our imports. This can be seen from Table-9 below:

Table-9: Direction of India's Imports (1998-99)

Country/Group	(% Share) Share
European Union	23.8
USA	9.0
Japan	5.1
Russia	1.5
Other East Europe	0.6
OPEC	23.8
LDC	17.9
Others	18.3
Total	100.0

The share of the UK in India's imports has also sharply declined although it continues to be a major supplier. Among the other major countries that have made inroads in our imports trade are Belgium, Canada, Germany and, Japan. The EU as a group accounts for about 24 per cent of our imports. With the inclusion of three more countries from January1,1995, the share of the EU is expected to increase further.

Among the centrally planned economies, the former USSR was an important purchasing centre for us. But in recent years, as already earlier noted, the importance of these countries is on the decline. Russia along with other Eastern European countries presently accounts for not more than 2 per cent of India's total imports.

A more significant development has been the emergence of oil-producing countries as a significant purchasing centre for us. This has been largely because of oil products. The OPEC alone accounts for about 22 per cent of our total imports.

22.7.3 Diversification or Concentration ?

Nine countries, viz., the UK Germany, the then USSR, Japan, Iraq, Iran, Australia and Canada had a lion's share ranging between 51-62 per cent of our exp[orts and 56 to 75 per cent of imports during the three decades from 1951-52 to 1979-80. In 1990-91 their share of exports was as high as 56.7 per cent while their share in imports has fallen down to 47.6 per cent. More recently, in 1998-99, 36 per cent of our total exports found their destination in the EU, the USA and Japan. Likewise, about 41.5 per cent of our total imports originated from the EU, the USA and Japan.

It is clear that India's foreign trade is not diversified. This can create a problem in the long run. Some recent international events like changes in economic set-up of East European countries, consolidating. Europe, etc. will rather force India to consider

new areas for her trade. On the positive side, however, accounting to recent report of international Finance corporation, Japan and United Europe will provide a huge market for India's exports. Similarly, India should establish market arrangements with these countries, getting raw materials from them and in turn supplying finished goods. Proper planning of our direction of trade will help in solving our balance of payments problems.

Check Your Progress 3

1) Identify the major exports of India.

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2) Identify the major imports of India.

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3) Give three examples of maintenance imports.

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4) What changes have taken place in the direction of India's foreign trade since independence?

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22.8 LET US SUM UP

In this unit, we described the composition, volume, direction and growth of India's foreign trade. During the last five decades significant change have been observed in the volume, composition and direction of trade. Although most of these changes have been in consonance with the development needs of the economy, one or two problems need immediate attention. The first is the problem of the deficits in the balance of trade. Growing trade deficits did post problems of resource mobilisation for the Indian planners till the recent past and, therefore, need be monitored continuously Secondly, our share in world trade has been showing a gradual fall. This tendency need be reversed if India is to play its rightful role in the international division of labour.

22.9 KEY WORDS

Composition of Trade: Refers to the nature of goods traded between the countries.

Direction of Trade: Refers to the countries with which a country exchanges goods.

Non-tariff Barriers: Different types of restrictions imposed by a country on imports from other countries.

Primary Commodities: The commodities that are extracted from nature like crops, marine products, minerals, etc.

Tariffs : Import duties imposed by a country.

Terms of Trade: Refers to the ratio of prices of exports to the prices of imports.

Trade Policy: Refers to all the policies that have either direct or indirect bearing on the trade behaviour of a country.

Value of Trade: The monetary value of goods traded between countries.

Volume of Trade: The physical quantity of goods traded between countries.

22.10 SOME USEFUL BOOKS

Government of India : Economic Survey (Annual) 2000-2001

Dhingra, Ishwar C. : The Indian Economy (2000) ,Ch.24

Joshi, Vijay and IMD Little : India's Economic Reforms 1991 2001 (Oxford, New Delhi,1996)

Reserve Bank of India : Report on Currency and Finance(Annual) 1998-99

Jalan, Bimal : India's Economic Policy (1996)

22.11 ANSWERS OR HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

1) See Sub-section 22.2.1

2) See Sub-section 22.2.2

3) See Sub-section 22.2.3 for all the four

Check Your Progress 2

1). Correct Statements are (a), (c) and (d). Read through section 22.4

2) See sub-section 22.4.2

3) See section 22.5

Check Your Progress 3

1) See Sub-section 22.6.1

2) See Sub-section 22.6.2

3) See Sub-section 22.6.2

4) Read Section 22.7 thoroughly and then highlight the major changes in the direction of exports and direction of imports

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UNIT 23 BALANCE OF PAYMENTS

Structure

23.0 Objectives
23.1 Introduction
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23.0 OBJECTIVES

This unit carries the discussion of India's foreign trade started in the previous unit further. This unit goes beyond balance of trade to balance of payments, and explains its meaning. It then describes trends in India's Balance of Payments and discusses the measures that have been taken to promote exports. After you have read the unit you should be able to:

- Distinguish between balance of trade and balance of payments;
- Explain the difference between current account and capital account;
- Explain the concept of balance of payments and its importance;
- Discuss the need for export promotion;
- Evaluate the export promotion programme of the Government of India;
- Provide suitable suggestions for export promotion; and
- Evaluate various steps taken by the Government to solve the balance of payments difficulties.

23.1 INTRODUCTION

In the last Unit, we have evaluated the changing structure of India's foreign trade since independence. Trade is only one aspect of international economic transaction. A constant flow of men, material and capital takes place between nations.

This flow involves both payments and receipts of foreign exchange. A nation needs keep a systematic record of these transactions. It is only then that an economy's dependence on the rest-of-the-world and its capability to utilise external resources for its own development gets determined. This systematic record of transactions is what we call balance of payments.

23.2 CONCEPT OF BALANCE OF PAYMENTS AND ITS USES

The principal tool for the analysis of the monetary aspects of international trade is the *balance of international payments statement*. This statement is also simply known as the balance of payments (BOP). *BOP is a systematic record of all international economic transactions, visible as well as invisible of a country during a given period, usually a year*. In other words, the BOP statement is a device for recording all the economic transactions within a given period between the residents of a country and the residents of other countries.

23.2.1 Current Account and Capital Account

The analysis of the BOP can be done in terms of its two major sub-divisions viz., (i) Current Account, and (ii) Capital Account.

1) **Current Account**: The current account of the BOP can be broken in two parts. Viz., (a) balance of trade and, (b) balance of trade in services.

   a) **Balance of Trade (BOT):** The BOT deals only with exports and imports of merchandise (or visible items). The net balance in the BOT will show the monetary value of the different in exports and imports of a country. Thus, three types of net BOT can be visualised:

      i) Deficits in BOT; these will occur. When $X < M$;
      ii) Surplus in BOT; these will occur. When $X>M$; and
      iii) Balance of BOT; these will occur. When $X = M$.

   b) **Balance of Trade in Services (BOS):** The BOS shows net receipts on account of trade in services, (or what are also called invisibles). We can broadly classify invisibles into five groups, viz., (i) services, such as banking, insurance, shipping civil aviation, royalty, consultancy services, postal services, etc. (ii) investment income, which includes profits and dividends on direct, portfolio and other investments as well as interest charges on bilateral and multilateral loans. (ii) travel both business and tourist, (iv) government transfers, and (v) private transfers. All of these transactions are two-way transactions; i.e. during any year these services would be provided by Indians to the rest-of-the- world, and foreigners would be providing these services to India. Indians would receive rewards for their services, which are called current receipts. Likewise, India would have to pay for the services rendered to it by the rest-of-the-world. These are known as Current payments (P). The net of current receipts and current payments constitutes balance of trade in services or BOS . During a year BOS make take any of the following three forms:

      i) Deficits in BOS; these will occur. When $R< P$;
      ii) Surplus in BOS; these will occur. When $R>P$; and
      iii) Balance in BOS; these will occur. When $R=P$

Balance on current account is the sum or aggregate of BOT and BOS, i.e.,

Balance on Current Account = BOT + BOS

i.e. , balance on current account is the net of all current foreign exchange earnings of a country during a year and its liabilities in the form of foreign exchange expenditure (ex) during the year. Its foreign exchange earnings come out of the

exports of merchandise and the receipts arising out of the services rendered by it. Its foreign exchange expenditure is incurred on its imports of goods and the payments due to foreigners on account of the services rendered by them. Apparently, like BOT and BOS, current account of the balance of payments may show any of the following three results :

i) Current Account Deficits: these will occur. When imports < exports.
ii) Current Account Surplus : these will occur. When imports. > exports.
iii) Current Account Balance: these will occur. When imports. = exports.

a) **Current Account Surplus** means that a country has earned more foreign exchange during a year than what it has contracted to spend. In this situation, the country's foreign exchange reserves may increase. Alternatively, it may decide to pay off its earlier debt with the help of the surplus foreign exchange it has earned during the year. A third alternative may be that it may decide to give loans to other countries out of its own surplus earnings.

Likewise, a **Current Account Deficit** implies that a country has committed to spend a larger amount of foreign exchange than what it has earned during the year. There may be two alternatives before it now. One, it may draw upon its foreign exchange reserves, and thus settle its liabilities. Two, it may borrow abroad to settle its current liabilities; but in this case it is creating future liabilities for itself in the form of external debt.

If the current account is in balance, i.e., if a country's foreign exchange earnings during a year balance its foreign exchange expenditure, there is nothing much a country has to do in this area.

2) **Capital Account:** The other component of the BOP statement of a country is the capital account. The capital account of the BOP presents transfers of money and other capital items and changes in the country's foreign assets and liabilities resulting from the transactions in the current account.

As seen earlier if a country is having a deficit on its current account BOP it need borrow from the rest of the world to square of its current excess liabilities. Likewise, if it has a surplus, it can lend to the rest-of-the world. These transactions are recorded on its capital account. All the borrowings of a country constitute the credits (cr.) in the capital account, while all lendings by it constitute its debits (dr.) in the capital account. Likewise, all repayments of old debts constitute debits, while receipts from the rest-of-the-world constitute its credits. Thus, if a country has been borrowing over a long period of time, during a particular year it would be contracting new loans (cr.) as well as paying of earlier debts (dr.) . The net of these debits and credits constitutes the capital account of the BOP.

It would be observed that the capital account transactions are designed to provide the balance of current account deficits (or surpluses). It means that if a country is having current borrowing, so that it is left with a sufficient surplus to meet its current excess liabilities, after meeting its repayments obligations of the past debt that fall due in the year. In other words, during a year,

Net capital transfers from rest-of-the-world **will equal** Current Account deficit **plus** Net repayments of past debt.

Apparently, a country will be obliged to borrow more if either its current account deficit is high or its commitments towards repayment of debt are high or both.

In any case, if a country has a deficit on its current account BOP it will need to have a surplus on its capital account BOP, the surplus on capital account will be used to finance the deficit on current account.

23.2.2 Balance of Payments

The term 'balance of payments is the' sum or aggregate of its current account and capital account. Current account and capital account will always move in the opposite directions; a deficit on current account will always meet with a matching surplus on capital account, and conversely a surplus on current account will match with a deficit on current account. And in the ultimate analysis, an economy's BOP will be in balance i.e., there will be no deficits and surpluses in aggregate BOP.

The above equality in the two sides of the BOP account is of course only an accounting equality. It would be observed that if a country continuously incurs current account deficits and finances such deficits with capital account surpluses, all that it is doing is that it is postponing its current liabilities to the future. The external debt burden will keep on increasing as new debt is further contracted.

The BOP accounts provide a link between the increase in gross external debt and the imports and spending decisions of the economy. Thus,

Increase in Gross external debt = { Current Account Deficit
- direct and long-term portfolio capital inflow
+ official reserve increases
+ other private capital outflow }

From the above relationship it would be clear that in the process of economic development a small deficit on current account is required to take advantage of the foreign savings and build up physical investments domestically.

Check Your Progress 1

1) What is balance of payments?

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2) Distinguish between visible items and invisible items of trade. Give three examples of each.

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3) Distinguish between balance of trade and balance of payments.

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4) When will a country need to have a surplus on its capital account?

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23.3 BALANCE OF PAYMENTS AND DEVELOPING ECONOMIES

It is well known in development economics that UDCs invariably start as debt or economies. In the process of development itself, these economies have to import a great deal of capital goods, consumer goods, food and raw materials and spares and components. They also have to import some new technologies and, hence, the total exchange outgo cannot be matched by export earnings. But, it is expected that in a decade or two, as the new capital goods and technologies begin to become effective and their products are directed towards exports, export goods and services become competitive in cost and quality. In that case, the volume of exports expands and, in due course, begins to overtake imports. A developing economy then moves on from being a debt or economy to a balanced one in terms of balance of payments and, finally, becomes a credit or economy, exporting more than it imports and giving credit to buyers. Thus, from being a net debt or in the beginning, it becomes a net credit or in the end and, in fact, begins to invest abroad rather than have others lending to and investing in it.

23.4 TRENDS IN INDIA'S BALANCE OF PAYMENTS

India has faced pressures on BOP from time to time either due to certain domestic compulsions or due to external factors. The whole period, covering nearly the four and a half decades, can be divided into four sub-periods depending on (i) the nature of BOP problem, (ii) the overall macro-economic environment, and (iii) the external aid situation. The four sub-periods are as follows:

1) upto 1975-76 (Period I),
2) 1976-77 to 1979-80 (Period II),
3) 1980-81 to 1989-90 (Period III), and
4) the recent phase of 1990-98 (period IV).

23.4.1 Period I (Up to 1975-76)

The entire period was very difficult for India's BOP, partly because of slow growth of exports in relation to import requirements and partly because of adverse external factors. Despite tight import controls (through quantitative restrictions) and foreign exchange regulations the current account deficit was 1.8 per cent of the GDP. Foreign exchange reserves were at low levels, generally less than necessary to cover three months imports. Almost the entire current account deficit (92 per cent) was financed by inflows of external assistance on highly concessional terms. There was hardly any commercial deficit.

23.4.2 Period II (1976-77 to 1979-80)

These few years stand out as the golden years for India's BOP. India had a small current account surplus (0.6 per cent of the GDP on an average) and foreign

exchange reserves equivalent to about seven months' imports. Export growth was good but the primary reason for the sharp improvement in BOP was the dramatic improvement in net invisibles. Net invisibles increased from a paltry Rs.193 crore in 1974-75 to Rs.2,486 crore in 1979-80.

23.4.3 Period III (1980-81 to 1989-90)

The period broadly corresponds to the period of the Sixth Plan and Seventh Plan. The Sixth Plan was launched when the economy was faced with severe BOP difficulties. In 1981, India entered into an arrangement with the International Monetary Fund for a loan for SDR 5 billion under the Extended Fund Facility. The amount was to be disbursed over a three-year period.

The BOP deficits were particularly acute during the Seventh Plan period. The current account deficit during the whole plan period was as high as 2.2 per cent of the GDP as against 1.3 per cent of the GDP during the Sixth Plan Period.

23.4.4 Period IV (1990-91 onwards)

The BOP crisis reached its climax during 1990-91; current account deficits reached a maximum of 3.26 per cent of the GDP, as would be seen from table-1 below:

Table-1: Key Indicators of India's Balance of Payments

				(As percent of GDP)	
Year	Exports (a)	Imports (b)	Trade Balance (c)	Net invisibles (d= b-c)	Current A/c deficit (f = d+e)
Average of					
1985-90	5.1	8.3	-3.2	0.9	-2.3
1990-91	6.2	9.4	-3.2	-0.1	-3.2
1991-92	7.3	8.3	-1.1	0.7	-0.4
1992-93	7.8	9.8	-2.0	0.2	-1.8
1993-94	8.8	9.7	-0.9	0.5	-0.4
1994-95	8.8	10.5	-1.6	0.8	-0.8
1995-96	8.9	12.0	-3.1	1.5	-1.6
1996-97	8.6	12.3	-3.7	2.6	-1.2
1997-98	8.5	12.2	-3.7	2.3	-1.3
1998-99	8.2	11.4	-3.2	2.2	-1.0

India was faced with a serious BOP crisis. In view of this, a comprehensive strategy to deal with it was put in place.

Although the BOP continued to be under pressure during 1992-93, there was a distinct improvement compared to the crisis situation prevailing in the middle of 1991. Since then the BOP situation has continued to register improvement, although we have not come out of the shadows completely.

23.5 CAUSES OF BOP DEFICITS

The BOP deficits have come to stay with us for long. We will take an overall view of the causes responsible for these deficits, and would like to identify them more particularly in light of receipt happening.

1) **Balance of Trade Deficits**: The first and the foremost cause of balance of payments deficit in India has been the trade deficits that India has had to encounter right since the beginning of the growth process. The import needs of the economy went on increasing without a corresponding increase in exports, resulting in mounting trade deficits.

Even in more recent times there is sufficient evidence to indicate that the import intensity of Indian industry is rising under pressure of global competition, and with search for advanced technology this trend is certain to continue. Thus, there is apprehension that unless it is matched by high export growth there may be some risk of a substantial drain of foreign exchange reserves.

2) **Declining Surpluses on Account of Invisibles**: A marked feature of India's BOP has been that it has been earning a net surplus on account of trade in invisibles. Large earnings on account of invisibles have been due to remittances form Indians working abroad and surplus earnings on travel services. In the long run, the net position on invisibles would depend on the outcome of two opposing sets of forces-one being the surplus earnings on travel services, government transfers and private transfers and the other being the deficit on investment income. Interaction of these two sets of opposing forces would not, however, change the trend in the immediate future and invisible trade would generate surplus for some more time to come. But there exists a strong possibility that in the long run the negative forces of investment income would outweigh the positive impact of the rest of the items, leading to a deficit in invisible trade thereby creating further complications in the BOP.

3) **Mounting Burden of External Debt Servicing**: Another factor behind the increasing pressure on the BOP has been steadily mounting burden of external debt servicing. This is estimated to have increased from about $ 7.6 billion in 1989-90 to about 10.73 billion in 1998-99. Not only has the total volume of external debt been increasing rapidly, the share of short-term commercial borrowing-at market rates of interest as against concessional official development assistance (ODA)- and NRI deposits designated in foreign currencies has been increasing rapidly. With the hardening of interest rates abroad, this newly evolving pattern of external liabilities has steadily pushed up the debt service liability. Indeed, it is the increasing payment of interest on external debt – payment on current account arising from the increasing total debt liability, which has added to the need for external borrowing.

4) **Dim Prospects of Getting Concessional Aid** : During the earlier course of economic development, current account deficits could easily be founded by concessional aid both from bilateral and multilateral sources. But towards the end of eighties the various sources of concessional assistance were drying up, whereas current account deficits were mounting up. The prospects for getting concessional aid on an increasing scale appear to be bleak under the given economic circumstances, mainly because of the following four factors: (a) the generally worsening climate for official development Assistance (ODA)- most developed nations have been unwilling to increase and, in some cases, even maintain the size of their contribution, (b) the view that the Indian economy is now will equipped to tap commercial sources of foreign exchange finance; (c) the entry of new claimants

on the pool, such as China and other nations of East Europe, (d) and emergence of new independent nations, like Estonia, Lithuania, Latvia, Ukraine etc. Since commercial borrowings are quite a costly proposition there is a limit, beyond which it may not be possible for the Government to borrow. Even in case of such loans care must be taken that they should be raised for projects, which are carefully selected, speedily executed and which have direct impact on increasing our exports or reducing the magnitude of imports.

Check Your Progress 2

1) What has been the most difficult period from the point of view of balance of payments of India ?

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2) Mention four important causes of balance of payments difficulties in India?

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23.6 MEASURES ADOPTED TO SOLVE THE PROBLEM

From the point of view of the measures adopted by the government to solve the problem of BOP deficits the whole period since 1950-51 can be divided in two parts, viz. (1) 1951-91 and (2) since 1991.

1) ***Till 1991***, BOP deficits were sought to be controlled by measures like (i) promoting the growth of import substitution type of industries, (ii) putting physical restrictions on imports, (iii) extending assistance for export promotion, (iv) providing incentives for increasing foreign exchange earnings on account of invisibles. The fact that these measures could only moderately be successful is brought out clearly by the fact that the country was faced with BOP crisis of unprecedented dimensions.

2) Since 1991 India has put in practice a comprehensive strategy to overcome BOP deficits. The main elements of this strategy can be identified as follows:

a) ***Fiscal and Monetary Discipline:*** Strict fiscal and monetary discipline has been sought to be adopted to control aggregate demand. The central fiscal deficit stands reduced from 8.4 per cent of GDP in 1990-91 budget to 4.5 per cent in 1999-2000.

Monetary policy has aimed at slowing down the growth of money supply. The rate of growth of money supply has been brought down from 18.5 per cent in 1991-92 to 13.2 per cent in1995-96, and 17.8 per cent in 1998-99.

b) ***Exchange Rate Policy and Foreign Trade Policy Reforms:*** Till 1993, the exchange rate of the Indian rupee was fixed by Government. Since March 1, 1993,

a new system of exchange rate determination has been introduced. This is known as the unified exchange rate system or UERS. Under this system, all payments and receipts of foreign exchange are converted in rupees at market rate of exchange. Further, Union Budget for 1994-95 introduced full convertibility on current account that makes many trade transactions relatively free of controls. As a part of foreign trade policy reforms, imports restrictions on capital goods, raw materials and components have been virtually eliminated. Thus, excess import demand will be reflected in a higher market exchange rate and self-correcting mechanism will operate to keep trade deficit in check. Along with this considerable reductions in peak tariffs, especially tariffs on capital goods, have been affected. Cash margins and interest surcharge on import credit have been abolished. Harmonised system of customs classification has been introduced.

c) ***Structural Reforms***: Among these we may briefly mention as follows: (i) substantial deregulation of trade and industry; (ii) delicensing of many industries; (iii) promotion of competition by the opening up of many areas previously reserved for the public sector to private and foreign investment; (iv) policies put in place of attract foreign direct and port-folio investment; (v) amendment of SICA to permit public enterprises to be examined by BIFR ; (vi) financial sector reformers including deregulation of interest rates, dismantling of directed credit, reforming the banking system, improving the functioning of the capital market including the government securities market, etc.

d) ***Mobilisation of Exceptional Financing*** : Steps have been taken to mobilise exceptional finance from multilateral agencies and bilateral donors. (Exceptional financing need is defined as the requirement felt over and above the inflows of official project aid, commercial borrowings, and NRI deposits). Among other related measures are: stand-by arrangement with the IMF, structural adjustment and social safety net loans negotiated with Asian Development Bank, etc.

Results: The present strategy to overcome BOP crisis is all comprehensive and well coordinated. The results of this type of strategy have been quick to appear. The pressures of BOP have considerably eased as is brought out by the fact that the foreign exchange reserves, which touched a low of # 30,000 million presently as shown in table 2 below:

Table –2 : India's Foreign Exchange Reserves

End of March	Amount # million	Import cover (no. of months)	Current Payments cover (no. of month)
1951	1914	16.8	14.6
1961	390	2.0	1.7
1971	584	2.9	2.2
1981	5850	4.5	4.0
1991	2236	1.0	0.8
1995	20708	8.2	5.9
1996	16018	5.44	3.8
1997	21261	7.00	4.0
1998	25975	7.50	4.5
1999	29522	7.50	4.5

It would be seen that whereas in 1991 we were left with meagre reserves sufficient to cover only one month's imports and 0.8 month's current payments, now we have accumulated reserves that cover about 7 months of imports and 4 months of current payments. This order of reserves is a good cushion and provides big flexibility to policy makers.

To conclude, India has formulated a successful strategy to overcome BOP limitations on growth. But, all the same, it need be remembered that a lasting solution to the BOP problem still eludes us. Our current account deficits are still large and are once again set to rise. Large current account deficits imply that we have to take resort to external borrowings, which in turn put further pressure on BOP deficits. A lasting solution to the BOP deficits is to be found only in generation of large current account surpluses. Generation of current account surpluses, at the present stage of economic development, by and large, means that we should go in a big way to expand our exports. Rapid expansion in exports is the only way to find a permanent solution to our balance of payment problem.

23.7 EXPORT PROMOTION IN INDIA

"Export or Perish" has never been so relevant during the last four and a half decades as now.

23.7.1 Rationale of Export Promotion

Among the factors that make it almost compulsive that we increase the level of our exports, the following may be mentioned .

First, the import needs of the economy are likely to increase in future unless, as already stated, we are ready to slow down our process of growth; specifically the bill on account of direct oil imports and the investment-induced imports of foreign technology and capital put together, is likely to assume an enormous magnitude in the future. It will also be necessary to reckon with the additional deficits on account of non-oil imports.

Secondly, in the context of our past experience it may no longer sound proper to depend upon external assistance to finance essential imports. As long as such assistance is available it should be made use of, but in the process, we should not burn our own sails. Instead efforts should be on to take control of the situation whenever the external pipelines get choked up .

Thirdly, our debt-servicing burden has already assumed serious proportions and is projected to grow more serious. It may not be possible or advisable any more to contract new loans to pay off the old ones.

Fourthly, given the types of technology available, which favours large production units by bringing in economies of scale, our production structure, at least in a few important sectors, may become necessary to widen the market base by exploring new market abroad.

Fifthly, exports may also be needed to raise the earnings capacity for import of essential consumer goods like edible oil food grains (if required, at any time in future), sugar etc., whose domestic shortages have very often in the past, created serious instabilities in the economy.

Finally, the existence of a highly diversified industry, with a large entrepreneurial base experienced in assimilating technology, is providing the on-going reform process with the opportunity to generate rapid expansion in manufactured exports. Such

rapid expansion of manufactured exports would not only increase the growth rate, insulate the economy from the dangers of another round of austerity necessitated by a BOP crisis, and more importantly, provide the most direct and powerful means for eradicating poverty. As the exports basket is widened to cover a greater range of labour-intensive manufactured goods and these experience similar if not higher, rate of growth, the impact on India's poor would be as dramatic as it has been in miracle East Asian economies.

In short, the export sector is being regarded 'second only to defence' . This expresses the need for a vigorous export drive.

23.7.2 Measures for Export Promotion

Export promotion is a multi-dimensional activity. As such export promotion measures adopted by the Government have embraced a number of areas like production for export, quality control, packaging export credit and finance, export incentives and assistance, export marketing organisational set-up etc. We shall review the various measures undertaken under these different heads.

A) **Export Production**

The production for export has been given a special treatment by the Government, Industrial units in the priority sector exporting 10 per cent or more of their production are granted preferred sources of supply and facilities for further expansion of their export production.

Special treatment is also being accorded to 10 per cent export-oriented units (EOUs). The EOUs can be located anywhere in the country and are eligible for duty-free imports of capital goods, raw materials and components.

Likewise, Export Processing Zones (EPZs) on the lines of Free Trade Zones (FTZs) of Singapore and Hong-Kong have been sent up to facilitate free imports and exports. Each zone provides basic Infrastrutural facilities like developed land, standard design factory buildings, built up sheds, roads, power, water supply and drainage, in addition to whole range of fiscal incentives.

Quality Control: Intimately connected with the problem of exportable surplus is the problem of quality control. The Government has enforced quality control and pre-shipment inspection through the provision of the Export (Quality Control and Inspection)Act, 1983. Under the provisions of the Act, the Export Inspection Council has been set up to discharge all the functions relating to quality control. There is compulsory export inspection for specified products.

Packaging: Attractive packaging is as important as the quality of a product. In order to promote research in development cheap, sound and attractive packaging, the government has set up the Indian Institute of Packaging.

B) **Export Credit and Finance**

Short-term export credits in the form of pre-shipment and post-shipment finance are provided by the commercial banks, which are authorised dealers in foreign exchange. These credits have been covered by a special refinance scheme of the Reserve Bank of India and are provided at a concessional rate of interest.

Exim Bank: The government has set up the Export-import Bank wide functions to finance, promote and develop foreign trade. It came into being on January 1, 1982.

Exim Bank is the principal financial institution engaged in coordinating the working of institutions engaged in financing and promoting export and import of goods. The Bank provides financial assistance to promote Indian exports through direct financial assistance, overseas investment finance, term finance for production and export development, pre-shipment credit, buyers, credit, line of credit, relending facility, export bill rediscounting, refinance to commercial banks, finance for computer software exports, marketing and bulk import finance for computer software exports, marketing and bulk import finance to commercial banks. The diversified lending programmes of Exim Bank now cover various stages of exports i.e., from the development of exports markets to expansion of production capacity for exports, production for exports and post-shipment financing. Exim Bank's focus is on export of manufactured goods projects.

C) Export Incentives and Assistance

Various types of export incentives have been evolved; these have been altered and modified from time to time to meet varying conditions. Broadly, these incentives can be classified into three categories, viz., (i) fiscal incentives, (ii) financial incentives, and (iii) special incentives schemes.

i) ***Fiscal incentives***. Under fiscal incentives the important measures that have been in vogue are income tax concessions, customs drawback, refund of excise duty, exemption from sales tax, provision for export under bond, and facility for manufacture under bond.

ii) ***Financial Incentives***. These incentives refer to the provision of cash assistance for specified export promotional efforts and export facilities.

iii) ***Special Incentives Schemes***. Easy access to imported inputs through instruments like the Open General Licence (OGL), Engineering Products Export Scheme, exemption from income tax for profit from exports lowering of the tariffs, etc. are some of the measures designed as incentives to the exporters.

D) Organisational Set-Up

The Government has established several specialized organizations for export promotion like (i) The Central Advisory Board on Trade, (ii) The Trade Development Authority, (iii) The Federation of Indian Export Organisations, (iv) Export Promotion Councils, and (v) Commodity Boards like Rubber Board, Coffee Board, Tea Board, Tobacco Board and Spices Board. Etc.

In addition , for increasing State participation in foreign trade, a number of public sector agencies have been set up, among which the more important are: The State Trading Corporation and the Minerals and Metals Trading Corporation. The STC group now includes, besides the STC, the Cashew Corporation of India, the Handicrafts and Handlooms Export Corporation, the Project and Equipment Corporation, the State Chemicals and Pharmaceuticals corporation and the Central Cottage Industries Export Corporation.

In short, the export promotion programme of the Government covers a very broad spectrum. To an extent these measures have been successful in as much as they have made stagnant Indian exports move, although at a slow rate. A consequence of the slow growth of exports has been that India's share in world exports has been

falling gradually; presently, it stands at no more than 0.60 per cent. While , on the one hand, it reflects the poor performance of exports, on the other it also indicates, given proper opportunities, the vast potentialities for growth. Let us identify our basic limitations and suggest remedies for their removal.

23.7.3 Flaws in Export Promotion

i) A major flaw in our export promotion system is that we have been giving undue emphasis to improving price competitiveness of export products and profitability of export operations. Various fiscal, financial and other incentives have been evolved mainly for reducing cost disadvantage of export products and augmenting profitability of export marketing operations. While price plays an important role in influencing the buying decisions, other factors such as quality of the product, ability of the exporters to comply with the delivery schedule etc., also are important factors influencing foreign buyers. Therefore, export promotion measures can be effective only if they are duly co-ordinated to meet the export marketing needs in all respects i.e. distribution channels, quality of the product, etc. (ii) though many export promotion bodies and export services institutions facilitate compilation and dissemination of international marketing information, vital information directly affecting export-marketing opportunities does not get properly compiled, analysed and systematically disseminated. Also, resources constraints inhibit individual firm to effectively act on market information received. (iii) the levy of indirect taxes on export products and later the refund of the same is a wasteful process as the amount to be refunded gets unnecessarily blocked with the national exchequer thereby delaying its productive use. (iv) availing of promotional measures involves various procedural formalities, which are complicated and also time-consuming. As long as the average producer is bitten by the bug "export and perish" nothing really can be achieved.

Check Your Progress 3

1) Mention four corrective measures for balance of payments pursued till 1991.

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2) Discuss the main elements of the present strategy to solve balance of payments problem in India.

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3) Mention five structural changes introduced in Indian economic policy.

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23.8 EXPORT STRATEGY

A sound strategy of export promotion need incorporate the following features:

1) **Building up a Sound Export Production Base**

Till the recent past very little has been done to build up a stable and viable export production base and supportive infrastructural facilities to cope effectively with a growing export demand. Supply constraints and infrastructural bottlenecks have, therefore, become stumbling blocks to export efforts as an integral part of the total production programme in the export oriented sectors. Therefore, it is necessary to make a deliberate production plan and to earmark a part of production for export even if there is a pressure of domestic demand on export supplies . In this connection, D.V. Kapur Committee has suggested: (i) inducing domestic producers through more incentives to export, (ii) building in an advantage in attaining economies of scale, and (iii) further liberalisation of the licensing policies aimed at injecting intense competition.

2) **Supply of Adequate Technology**

It must be realised that a mere expansion of capacity for export production is not enough; it must be based on appropriate technology to enable us produce 6-Sigma quality products (6-Sigma indicates virtually zero defect product) so that products can stand competition in international markets. There is a growing technology gap between the world and us. Our technology may be appropriate to our needs but not for exports where updated technology is necessary. India's success in agricultural, space and nuclear research shows that it has the capacity to develop the most modern technologies if necessary resources of men and material and proper incentives are provided. While talking of technology, we should also keep in mind the need for the upgradation of packaging standards. Packaging is an integral part of the product and an important element of success of exports.

3) **Concessional Supply of Intermediate Goods**

A major hindrance to exports is the high costs of basic industrial inputs-steel, metals, plastics, glass, etc. – in the country. The only way to enable our exporters to compete fairly with their counterparts abroad is to ensure that these basic goods are available to everyone-exporters, potential exporters and non-exporters – international prices.

4) **Selectivity in Exports**

In the past we had a tendency to try and export whatever we could produce in excess of our requirements. In that context and particularly in terms of planned effort it was important that we should produce for whatever could find a market. The principle is still valid; but a glance at the range of goods that figure in world imports is sufficient to show that we cannot possibly produce all the goods for which world markets exist. Some additional criteria are, therefore, required to determine what goods India should try to produce for export. India should avoid, to the maximum extent possible, goods that are capital-intensive, energy-intensive or transport-intensive or which use domestically produced inputs that themselves are capital-intensive, energy-intensive or transport-intensive.

There are many industries where India has an advantage because of relatively

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lower costs of all forms of manpower— whether it is professional or factory labour. However, while this can given an initial advantage, it should not be taken for an enduring advantage. **One**, as products become more sophisticated, labour as a cost factor becomes less and less important. **Two**, the differences in cost are narrowed down through higher levels of automation. **Three**, in processes that require large number of cheap labour, the industry is bound to shift its operation along the line of the ever-declining scale of poorer countries. So a poorer country than Indian can eventually overtake us with yet cheaper labour. Therefore, when one has established an export market on the basis of cheaper manpower, one has to be vigilant to make sure that one builds up other advantages to compensate for the inevitable loss of this temporary advantage.

5) **Expansion of Warehousing Facilities**

Warehousing facilities should be expanded in important commercial centres abroad, specially for fast-moving consumer goods. Nowadays, foreign buyers are reluctant to keep a high level of inventories and want the exporters to do so in order to enable them to buy the product in smaller quantities and at short notice. Although warehousing is an expensive operation, it pays good dividends in the long run and helps establish closer and more stable relations with the market.

6) **Supply of Trade Information**

A well directed foreign trade policy should be based on accurate trade information supported by reliable data. We have yet to conceive of a system by which this can be done. At present trade statistics are based on highly loaded information supplied by the Export Promotion Councils to obtain maximum advantage of duty drawbacks and export subsidies.

7) **Efforts to Widen and Diversity the Markets**

Indian entrepreneurs have to constantly bear in mind the fast changing trade trends and reorient their strategies, to aim at deriving higher yield by way of larger shares in the markets and better unit realisation by way of higher levels of quality and value added products. The three pronged thrust on their part would call for: (a) a relentless attempt at recovering the last ground by wresting a larger share in the world markets for sectors of traditional strength like tea, spices, jute, leather, mica and other miscellaneous agro-based products; (b) a concerted move for maintaining and enhancing the momentum gained by commodities like oil meals, basmati rice, marine products, etc; and (c) a sustained focus being kept on the sectors which have lately fared well-chemicals, engineering components, jewellery, fabrices, handicrafts, and software.

Finally, we have to realise that healthy export sector can be built up only on a strong domestic economic structure. A sound domestic economy is a must if we want a self-sustaining buoyant export sector.

In this context it may be stressed that export promotion and import substitution are neither mutually exclusive nor alternative strategies of development. They represent two sides of the same coin. The factors and policies which would be necessary to bring about an acceleration in export growth would also lead to efficient import substitution: Whether it is a better management of the public sector and an alleviation of infrastructural bottlenecks, on the other hand, or an improvement in the performance of the agricultural sector and a revival of industrial growth, on the other. In other

words, the economic determinants of the balance of payments must be related to development at a national level rather than the external sector alone, i.e., the balance of payments prospects should not be considered in isolation from the growth prospects of the economy.

Check Your Progress 4

1) Discuss the need for export promotion in India at this stage of economic development.

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2) Mention the three import measures taken by the Government for promoting exports from India.

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3) What steps we need to take to promote our exports?

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23.9 LET US SUM UP

A developing economy needs more of imports to meet the development requirements of the economy. Since the exports fail to keep pace with the import requirements the deficit is met by foreign borrowings. This has created balance of payments difficulties for India. The ultimate solution to the problem lies in promoting exports on a big scale. This needs a well-formulated strategy.

23.10 KEY WORDS

Balance of Payments: A systematic record of all international economic transactions, visible and invisible, of a country during a year.

Balance of Trade: It is an account of exports and imports of goods only of a country.

Capital Account*:* Presents transfers of money and other capital items and changes in the country's assets and liabilities resulting from the transactions in the current account

Current Account: It is an annual statement of income of a nation from the rest of the world. It states the net amount receivable or payable on account of transactions in goods and services both.

Current Account Deficit: A situation in which a country's total earnings of foreign exchange fall short of its obligations of foreign exchange during a year.

Concessional aid: Borrowing from an external source on easy terms.

Import Intensity: The ratio of imports in total cost of inputs used in the production of a commodity.

Portfolio Investment: Investment in the purchase of equity shares and debentures, etc.

23.11 SOME USEFUL BOOKS

Reserve Bank of India : Balance of Payments Manual

Reserve Bank of India : Report on Currency and Finance (Annual)

Government of India : Economic Survey (Annual)

Joshi, Vijay & I.M.D. Little : India's Economic Reforms 1991-2001.

23.12 ANSWERS/HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

1) See first para of Section 23.2

2) See Sub-section 23.2.1

3) See Sub-section 23.2.1

4) See last part of Sub-section 23.2.1

Check Your Progress 2

1) See Sub-section 23.4.4

2) Thoroughly read Section 23.5

Check Your Progress 3

1) Read Section 23.6

2) Thoroughly read Section 23.6

3) See Section 23.6

Check Your Progress 4

1) See Sub-section 23.7.1

2) See Sub-section 23.7.2

3) Thoroughly study Section 23.8

UNIT 24 FOREIGN CAPITAL AND MULTINATIONAL CORPORATIONS

Structure

24.0 Objectives
24.1 Introduction
24.2 Capital Transfers and Economic Growth
 24.2.1 Role of Foreign Capital
 24.2.2 Components of Foreign Capital
24.3 Multinational Corporations
 24.3.1 Characteristics of Multinational Corporations
 24.3.2 Significance of Multinational Corporations
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24.4 Government Policy towards Foreign Capital in India
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24.8 Some Useful Books
24.9 Answers/Hints to Check Your Progress Exercises

24.0 OBJECTIVES

This is the final unit in Block 7 on international aspects that have an impact on the Indian economy. After reading this unit, you should be able to:

- Identify the components of foreign capital;
- Explain the role of foreign capital in economic growth;
- Describe the characteristics of multinational corporations;
- Prepare a case for multinational corporations in a developing economy;
- Comment upon the need for liberal attitude towards foreign capital in India; and
- Examine the response of domestic enterprises and foreign capital to recent policy changes

24.1 INTRODUCTION

Inflow of capital from abroad is vital for growth of a developing economy, especially in the initial stages of its economic development. Modern economic history abounds with examples of countries that have successfully drawn upon the capital resources of more advanced countries for the sake of economic development. Even later, several Asian countries have performed similar feats. Let us examine India's experience in this regard.

24.2 CAPITAL TRANSFERS AND ECONOMIC GROWTH

Let us begin by discussing the meaning of foreign capital and its role in economic growth.

24.2.1 Role of Foreign Capital

The role of foreign capital in a developing economy can be analysed in terms of its gap-filling functions. Three such gaps can be identified: (i) Saving gap, (ii) Trade

gap, (iii) Technology and management gap.

i) ***Saving Gap***: The key to the development problem lies in raising the rate of capital formation. Such a raise envisages a much higher level of investment than is warranted by the present level of saving in the UDCs. The scope for sharp rise in domestic savings is limited by the prevailing low level of income, slow rates of growth and rising consumption needs in these economies. The gap between investment requirements and domestic savings can be filled by foreign capital. A little simple algebra will show why. The fundamental proposition of national accounting is that

$$Y = C + I + (X - M) \quad \ldots\ldots\ldots\ldots\ldots(1)$$

Where Y = gross national product (total spending), C = Consumption, I = Investment, X = export of goods and services plus income received from abroad, and M = imports of goods and service plus income paid abroad. All this spending generates an identical flow of income (Y); this total income equals total spending; of all income, some is consumed and some is saved. Thus,

$$Y = C + S \quad \ldots\ldots\ldots\ldots\ldots\ldots..(2)$$

Then, since spending equals total income, by substitution.

$$C + I + (X - M) = C + S \quad \ldots\ldots\ldots(3)$$

From this equal, we can, by simply manipulation, easily discover the essential constraints on capital formation. Move (X – M) to the right-hand side, reversing its sign ; cancel C on both sides, the result is

$$I = S + (M - X) \ldots\ldots\ldots\ldots\ldots..(4)$$

The algebra is clear. A country's investment opportunities are determined by its potential for domestic saving plus net capital inflows from abroad (M> X). The only way for imports to exceed export is for the country to borrow abroad ; M>X is thus equivalent to a capital inflow. The availability of foreign capital increases the availability of total resources in the economy. The increase in total resources helps a UDC primarily in two ways. *First,* it influences investment decisions. Certain programmes of development can give the optimum results if all the components of the programme are undertaken simultaneously in a phased manner. The availability of foreign capital makes this type of investment possible. *Secondly,* establishment of bigger projects and projects with a high investment component open up new opportunities of investment and thus encourage domestic entrepreneurs and savers to supply their services and savings. The addition to the total volume of resources generated thereby exceeds the addition made by foreign resources.

ii) ***Trade Gap or Foreign Exchange Gap***. A UDC is faced with two structural constraints: (i) a minimum requirement of inputs to sustain a given rate of growth of GNP, and (ii) an actual or potential ceiling on export earnings which are insufficient to finance the required imports. In such a situation, unless the constraint is removed, the growth will be lower than what the maximum potential domestic savings would have allowed. The constraints will be more severe if any of the following two situations obtains:

a) Some "strategic goods" like capital equipment and technical know-how, etc., are not available locally and could be procured only from external sources; or
b) Technical conditions of industrialisation require a complement of foreign resources along with domestic resources, so that the latter would lie idle if the former are not available.

In either of the above two situations, the availability of foreign exchange can save

an economy from the position of an impasse in which it may find otherwise, and place at her disposal high quality factors such as improved machinery, technical know-how and qualified foreign technicians which may have a beneficial effect on her development by, what Harrod called "fertilising the productivity of common labour ".

iii) ***Technological and Management Gap.*** The role of technology in bringing about economic growth is obvious. The level of technology in a developing economy can be raised through (a) the internal evolutionary process of education, research, training and experience, or (b) the external process of importing from other developed countries. In respect of the import of technology, contemporary developing countries have the added "advantages of the latecomers". This has received much attention lately. Since development has actually proceeded in rest of the world, these countries have a rather whole range of technology to choose from and do not have to repeat the process of evolving it. The import of technology, however, raises two issue, viz., (a) the choice of technology, and (b) local adaptation. The act of choosing a particular technology is dependent on the state of domestic complementary research because only the will a country be able to know the quantity and quality of the know-how to be imported and the price to be paid for it. Adaptation of technology requires that the process of import of technology should be accompanied by indigenous research and development.

Analogous to technology gap is a gap in management, entrepreneurship and skill. Foreign capital can supply a "package" if needed resources that can be transferred to their local counterparts by means of training programmes and the process of learning by doing.

To sum up, foreign capital touches three sensitive areas, crucial in the development strategy of a developing economy. It is almost true to say that the growth, at least in the initial stages, in the present times can not be a self-generating process. Indeed, with a sole dependence on the domestic resources it may be difficult to break the vicious circle within which a developing economy is usually caught.

24.2.2 Components of Foreign Capital

The inflow of capital from abroad may take either in the form of (a) foreign aid, or (b) private investment. Foreign aid includes loans and grants from foreign governments and institutions. This source of foreign capital, especially loans, has an important limitation in the form of repayments obligations. As regards private foreign capital investment, the intense academic debate relating to its effects remains inconclusive. The opponents of foreign investment have drawn attention to several imperfections and adverse effects, such as capital intensity of such investment, inappropriate technology, the possible adverse effects on income distribution, transfer pricing and the negative contribution that such investment often makes to the BOP. The advocates of foreign investment, on the other hand, have highlighted the beneficial effects in terms of encouragement to the development of technology, managerial expertise, integration with the world economy, exports and higher growth. It has also been claimed that debt financing generates fixed debt servicing obligations, while equity needs to be serviced only after profits are made. There is also substantial empirical evidence, which can be presented to support both points of view. For example, in recent years, foreign private investment seems to have contributed enormously to the growth of several Asian newly industrialising countries (e.g. Thailand, Malasia and Singapore). There are examples, particularly form Latin America and Africa, where the contribution of foreign investment has not been so encouraging.

The two important sources of private capital investment are:

i) ***Direct Business Investment***: It may comprise any of the following forms: (i) investment by branches of foreign companies, (ii) investment by subsidiaries of foreign companies, and (iii) investment by other foreign controlled companies.

ii) ***Portfolio Investment***: It may comprise: (i) equity holdings by non-residents in the recipient country's joint stock companies; (ii) creditor capital from private sources abroad invested in recipient country's joint stock companies, and (iii) creditor capital from official sources in recipient country's joint stock companies.

Investment and Collaborations although foreign investment and collaboration with foreign parties are very closely interrelated, they are not one and the same thing. Foreign investment may take place without collaboration and Vice versa. Capital participation refers to the foreign partner's stake in the capital of the recipient country's company while technical collaboration refers to such facilities provided by the foreign partner as technical services, licensing, franchise, trade marks and patents (against which he gets lump sum or royalty payments for a specified period).

In modern times, multinational corporations (MNCs) have become the major carries of foreign capital and technical know-how. We shall examine in brief the major characteristics of this form of organisation.

Check Your Progress 1

1) Mention three important gaps that need be filled by foreign capital in a developing economy.

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2) Explain the need for foreign capital in developing economy.

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3) Mention two problems associated with import of technology.

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24.3 MULTINATIONAL CORPORATIONS

An MNC is one, which undertakes foreign direct investment, i.e., it owns or controls income generation assets in more than one country, and in so doing produces goods and services outside its country of origin, i.e., engages in international production. As per the estimates made available by the UN Centre on Transnational Corporations there are in operation about 11 thousand subsidiaries abroad.

24.3.1 Characteristics of Multinational Corporations

The MNCs have certain characteristics, among which the more important are as follows:

i) ***Giant Size***: The assets and sales of MNCs run into billions of dollars and they also make supernormal profits. For example, the foreign assets of Royal Dutch Shell, the world's largest MNC, are estimated to be $ 69 billion, larger than the GDP of Pakistan ($ 40 billion), Nigeria ($ 34 billion), or the Philippines ($ 45 billion).

ii) ***International Operations***: In such a corporation control resides in the hands of a single institution. But its interests and operations sprawl across national boundaries. An MNC operates through a parent corporation in the home country. It may assume the form of a branch or a subsidiary in the home country. If it is a branch, it acts for the parent corporation without any local capital or management assistance. If it is subsidiary, the majority control is still exercised by the foreign parent company, although it is incorporated in the home country. The foreign control may range anywhere between the minimum of 51 per cent to the full 100 per cent . An MNC thus combines ownership with control. The branches and subsidiaries of an MNC operate under the united control of the parent company.

iii) ***Oligopolistic Structure***: Through the process of merger and takeover, etc., in course of time an MNC acquires awesome power. This coupled with its giant size makes it Oligopolistic in character.

iv) ***Spontaneous Evolution.*** MNCs usually grow in a spontaneous and unconscious manner. Very often they develop through " creeping increments". Many firms have become international by accident. At times, firms have also established and better opportunities prevailing in the home country.

v) ***Collective Transfer of Resources***. An MNC facilitates a multilateral transfer of resources. Usually this transfer takes place in the form of a "package" which includes technical know-how, equipments and machinery, raw materials, finished product, managerial services, and so on. MNCs are composed of a complex of widely varied modern technology ranging from production and marketing to management and finance.

24.3.2 Significance of Multinational Corporations

The MNCs have revolutionary effect on the international economic system. It is so because the growth of international transactions of the MNCs has affected the more traditional flows and international trade for many economies. Moreover, with the retreat of socialism, and failure of aid as an instrument of economic development, there has been a greater realisation of the capacity of MNCs to deliver an efficient package of practices. In the 1970s MNCs were characterised by alarmists as something of an evil *monster-almost like muggers on dusk night waiting to pounce on the innocent passerby.* MNCs were seen as pariahs, not saviours-objects of harm, not instruments for good. These attitudes have changed in the last few years. Today they constitute a powerful force in the world economy. One estimate suggests that the biggest 500 MNCs control about 10 per cent of world trade, 80 per cent of foreign investment and about 30 per cent of world GDP. Indeed the MNCs have become the main agents in the economy and in trade so much so that production and trade statistics in the form of national aggregates have become obsolete.

24.3.3 The Case for Multinational Corporations

There are several advantages, which arise as a result of the operations of MNCs. In fact, it has been emphasised that MNCs are an economic phenomenon, which no one can wish away except at the cost of remaining on a Robinson Crusoe island in an ocean of prosperity.

The benefits of MNCs may briefly be discussed as follows:

i) The UDCs are technology backward. They lack sufficient pre-sources to carry on research and development. From this point of view, MNCs have offered a great boon. They have served as agents for the transfer of superior technology. They have provided advanced technological know-how, sophisticated manufacturing processes and improved skills to UDCs.

ii) The MNCs have helped the UDCs to secure capital from the developed countries.

iii) The UDCs do not have a sufficient degree of "linkage" with other industries. The MNCs usually produce "linking effects" in the host country. They also help in the creation of "linked industries". Such linkages may be either forward or backward. The MNCs help to build up "knowledge base" and thus serve the development of human resources. They serve as carriers of knowledge and experience.

iv) The MNCs also help to build up "knowledge base" and they serve the development of human resources.

v) The operations of MNCs have a favourable effect on the balance of payments of the host country. As "Global Scanners" they possess a global marketing organisation through which they can promote exports from the developing countries.

vi) The MNCs also help in creating large scale employment opportunities by setting up their branches and subsidiaries in the host countries. Employment generation is a function of mainly two variables, first the rate of growth of investment, and secondly, the nature of technology. Investment by MNCs is, therefore, encouraged in the UDCs.

vii) In a situation where a country is already faced with a heavy debt servicing burden further borrowing by it may only push it into what may be called 'debt trap'. Private investment will help it get necessary foreign exchange resources, whereas it will help avoid adding to the debt-servicing burden.

24.3.4 The Case Against Multinational Corporations

First, MNCs are primarily profit-oriented. They tend to concentrate more on the technology–intensive branches of manufacturing, not only because they tend to capitalise on their cost advantage but also to protect their market for certain commodities. Thus, the role of MNCs in the underdeveloped world does not serve the purpose as required, because the sectors in which they invest create relatively few jobs and thus fail to help eradicate unemployment and poverty two chronic problems of the south.

Secondly, MNCs bring in their own technology, which is usually capital intensive, and hence more suitable to advanced parent countries. They make no effort to adapt an appropriate technology suitable to the needs, circumstances and environment of the host country. They strive to make industry permanently dependent on

overseas expertise and technology. It may be added, however, that if a country is as big as of India's size, there is no reason to fear that such investment can ever reach at levels which would threaten the country with the unenviable status of a banana republic.

Thirdly, the transfer of technology proves extremely costly. The MNCs charge exorbitantly in the form of fee, royalty and other charges, which put a severe drain on the foreign exchange resources of a UDC. There seems to be a historical formula in use: 70 per cent more of a given inflow of foreign capital per year flows out from the host country in the visible forms of profit and dividend. Also, MNCs are being accused of creating a major brain drain in the country, for they whisk away the top skilled manpower available in the country.

Fourthly, MNCs promote regional economic disparities. These create islands of development and prosperity in the ocean of underdevelopment.

Fifthly, the presence of MNCs may prove detrimental to the long-run industrial development of the country. If a strong MNC is operating in a particular field, the local firms may find it difficult to compete with it.

Sixthly, although MNCs could have played a catalytic role in the promotion of research and development in the developing economies, their performance in this connection is far from satisfactory. They expenditure on scientific research in negligible.

Seventhly, in the business operations the MNCs very often take resort to undesirable and corrupt practices. A report of the UN have given a lucid account of many of such practices, rigging of bids, price fixing and other forms of market distortions. They also take resort to devious means to increase their profit, e.g., recent moves by MNCs in India to diver high-profit activities to their 100% owned subsidiaries from the listed affiliates in which they have simple majority equity stake.

Eighthly, MNCs prefer to participate in the production of mass consumption and non-essential items. A plethora of international brands selling junk food, designer jeans and sunglasses do not make for meaningful investment.

Finally, once financial liberalisations are in place and freer movement allowed, international capital could quickly make a developing country bend to its will by destablising, for example, the currency market and forcing devaluations or withdrawing support to Government bonds and endangering the continuance of the Government itself.

In a partial response to the above arguments it may be stated that many of the old myths are no longer valid. Present day Third World Governments are not exactly powerless like those of yesteryears, nor are the modern MNCs unscrupulous, insensitive and interventionist. They have transformed themselves into modern MNCs, which acknowledge their responsibility to the concerns and interests of the host countries and basically operate on the basis of maturity of interest of both. MNCs are increasingly losing the sense of loyalty to their home country to provide employment. They are in search of bases where they can produce their products most competitively. The slogans "Think global, act local" and "multi-domestic" are working reality with most multinationals today. In view of this, there has been a perceptible change in the attitude of the UDCs towards the MNCs.

24.3.5 Regulation of Multinational Corporations

In view of the fact that MNCs do possess a potential that can be gainfully

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exploited, most of the UDCs have chosen to regulate their activities rather than to dispense with them altogether an effort to separate the gold from the dross.

First, the threat of nationalisation is an effective tool of regulation. Although nationalisation should be resorted to only in the extreme situation, the very fact that it can be exercised makes the corporations act in a disciplined manner.

Secondly, the Government may allow collaboration in certain selected industries or certain selected regions where the operation of MNC is felt highly suitable.

Thirdly, MNCs many be allowed to invest for specific period. Thus, after a certain period of time restrictions may be imposed on foreign holdings, or there may be provision for gradual disinvestment.

Fourthly, a multi-tax system may be followed by the Government. The MNCs be taxed at a higher rate. Fifthly, the host country may lay down certain export criteria.

Finally, MNCs may be asked to carry out a minimum fixed share of their total research and development activities within the host countries.

Check Your Progress 2

1) What is multi-national corporation?

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2) Identify four major characteristics of a multinational corporation.

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3) Mention four important benefits associated with multination corporations.

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4) Mention four limitations of multinational corporations in India.

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24.4 GOVERNMENT POLICY TOWARDS FOREIGN CAPITAL IN INDIA

In the planned economy of India, foreign capital has been assigned a significant role, although it has been changing over time. In the earlier phase of planning, foreign capital was looked upon as a means to supplement domestic investment. Many a concession and incentives were given to foreign investors. Later on, however, the emphasis shifted to encouraging technological collaborations between Indian entrepreneurs and foreign entrepreneurs. In more recent times, efforts are on to invite free flow of direct foreign investment. It would be instructive in this background to examine the Government's policy towards foreign capital before we analyse the role of foreign capital in the Indian economy.

Foreign investment in India is subject to the same industrial Policy as all other business ventures, plus some additional policies and rules specially governing foreign collaborations.

The first articulate expression of free India's attitude towards foreign capital was embodied in the IPR, 1948, which emphasised, at once, the need for carefully regulating as well as inviting private foreign capital. It laid special stress, inter alia, on the need to ensure that in all cases of foreign collaboration, the majority interest was always India. This was followed by the Fiscal Commission of 1949-50 which recommended that foreign investment may be permitted, first, in the public sector projects needing imported capital goods, and secondly, in new private industries where no indigenous capital or technical know how was likely to be available. This was followed by a statement on policy towards foreign capital made by the Government on April 6, 1949. The underlying principles of the policy by and large are valid even now. These may be enumerated as follows:

i) Foreign capital once admitted will be treated as par with indigenous capital.
ii) Facilities for remittance of profits abroad will continue.
iii) As a rule, the major interest in ownership and effective control of an undertaking should be in Indian hands.
iv) If an enterprise is acquired, compensation will be paid on a fair and equitable basis.
v) The Government would not object to foreign capital having control of a concern for a limited period and each individual case will be dealt with on its merits.

In short, the Government promised non-discriminatory treatment of foreign investment and free remittance facilities for both profit and capital. An emphasis was laid on the employment and training of Indians in higher positions. In keeping with these guidelines, the general policy was to allow such foreign investment and collaborations as were in line with the priorities and targets of the Five Year Plans. The policy was to restrict foreign collaboration to those cases which would being technical know-how indigenously for developing new lines of production.

These principles define the broad contours within which the State Policy towards foreign capital has been framed all through the different Five Year Plans. Beginning with the First Plan in 1951, four distinct phases can be marked. The First Phase lasted till 1965, and was characterised by a liberal attitude towards foreign capital. Many concessions and incentives were given to foreign capital participation in the industrial development of the country. In the Second Phase beginning with the mid-sixties, the liberal attitude of the State yielded place to strict controls and the broad policy was to restrict the area of operations of foreign capital. In the Third phase,

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beginning towards the end of the decade of seventies, the policy was marked by a certain liberalization. The policy changes eased the restrictions on FDI inflows.

The Fourth phase, beginning with the adoption of economic reforms programme since July 1991, has adopted a liberal attitude towards foreign capital and has aimed at attracting a free flow of direct foreign capital and has aimed at attracting a free flow of direct foreign investment. This preference for private flows over aid is basically accounted for by the fact that the world is now aid- foreign godfathers left to bail us out.

Foreign investment and enterprises which are branches or subsidiaries of foreign companies as well as joint ventures involving foreign collaboration are subject to all the laws governing Indian enterprises – the companies Act, the MRTP Act, the Income Tax Act — as well as industrial regulations under Industries (Development and Regulation) Act along with the rules framed by the Government of India. Of direct relevance to foreign enterprises is the FERA (1973) , which came into effect from January 1, 1974.

24.5 NEW ECONOMIC POLICY AND 1991-99 POLICY CHANGES

The New Industrial Policy, 1991 can be described as a major revolution as far as decisions concerning foreign investment and foreign technology agreements are concerned. Among the important policy changes the following may be mentioned (i) approval will be given for direct foreign investment up to 51 per cent equity in high priority areas, (ii) procedural reforms to smoothen the process of entry of foreign capital, (iii) removal of different restrictions relating to matters like employment of foreign nationals, acquisition of real estate in India by overseas corporate bodies, use of foreign brand names, use of trade marks, royalty outflows etc.

These changes are pointers to the fact that, lately, the Government is keen to attract more of foreign investment. It seems it has come to be believed that it is better to allow equity than to go out to borrow. For one thing, dividend remittances on equity will start only when the unit starts producing . Secondly, capital is generally never repatriated. Profit also is normally re-invested. The company meanwhile makes a substantial contribution to GNP and domestic market becomes competitive. Thirdly, direct foreign investment brings technology. This technology spills over into other sectors, which supply components and inputs. Also when DFI firm produces cheaper and better capital goods or intermediate products, the competitiveness of sectors, which use these, improves. The competitive edge will spur development and accelerate the growth process.

The recent economic reforms have, undoubtedly, improved the foreign investment environment in India; as a matter of fact, the success of the new economic policy hinges in a large measure on the liberal response of the foreign capital. In this connection, we need examine two aspects: viz., (a) Response of the Domestic industries and, (b) Response of the foreign capital.

a) **Response of the Domestic Industries**

As far the domestic industry is concerned there can be two aspects of it, namely (i) apprehensions of the industry, and (ii) likely positive gains.

i) Apprehensions of the Indian Industry : After having experienced with MNCs for

the last six years or so of liberalisation , Indian industry has following to complain about them :

a) Cow-boy approach of landing in India, hastily choosing a partner, making a mistake and then breaking the relationship;
b) Leverage an Indian partner to get in, and then move quickly to a 51% equity;
c) Setting up a 100% subsidiary despite a joint venture;
d) Supply second hand plant and machinery declared obsolete in their own country;
e) Short term focus for quick profits;
f) Sales approach to India as distinct from manufacturing; and
g) Using expatriate managers and CEOs rather than competitive Indian management.

ii) Likely Positive Gains: A few of these can be counted as follows:

First, presence/entry of MNCs per se has not rung the death knell for the Indian industry, some of the examples being detergents, food processing and razor blades. Indian companies need to look afresh at strategic options to improve their operational efficiency.

Secondly, several of the MNCs may wish to enter into strategic alliance in a joint-venture from rather than starting full-scale manufacturing operations in India at this stage due to time needed for generating confidence in the process of reform; and other countries in the region are perceived to be more open. If this "wooing" period is utilised by Indian companies to search for ways and means, including search for a joint venture partner. Such a strategy will help bring about a technological upgradation in the concerned industry as a whole. This will also ensure competition among "equals".

Thirdly, joint-venture is a cheaper way of acquiring technology. Foreign equity being a deferred payment is superior to lump sum know-how purchase. Repatriation by way of dividends can only be made out of profits as against servicing of debt. This would also tend to shift forex outflow to the future. Joint venture is also a more assured mode of continuous technology upgradation.

Fourthly, high levels of repatriation by way of dividend by some of the existing companies which operated in protected markets is unlikely to be the case with the new MNC investment. Liberalisation would increase competition and eliminate artificially high protection induced profits.

Finally, while the entry of MNCs in consumer goods industry has received high visibility and evoked strong emotive reaction, several investment proposals are in other areas. Infrastructure and high technology industries may be the largest beneficiaries of the FDI flows. Besides, the so-called luxury industries, such as white goods, consumer electronics, passenger cars are not only potential foreign exchange earners but also large employment generators in the tertiary sector. Surplus capacity all around so as to keep up pressure on marketing and first-hand assessment of the cost advantages in India, are some of the factors which would induce natural growth of exports by MNC enterprises fare higher and faster than generated by export obligation conditionality.

b) **Response of the Foreign Capital**

The response of the foreign capital to recent policy initiatives has not been very enthusiastic as would be seen from table-1.

Table-1: Inflow of Foreign Direct Investment

Year	Approvals	($ million) Actual Inflows
1991	325	155
1992	1781	233
1993	3559	574
1994	4332	858
1995	11245	2100
1996	11142	2383
1997	15752	3330

Following observations can be made from table-1.

i) Foreign direct investment, as revealed by the size of approvals granted by the Government of India, has rapidly increased over the last six years; as a matter of fact these have been consistently increasing.
ii) The actual inflows began with a trickle; they have started to pick up only slowly.
iii) How slow is the process would be clear from the fact that whereas India, at best has been in a position to attract 3.1 billion only in 1997, capital inflows to China over the last 10 years have averaged over # 20 billion per year.

All this means is that there are still certain issues, which need be cleared, and solutions found for them. Among these, the following may be identified.

First, it is obvious that what really matters to foreign investors in arriving at investment decisions is not what dramatic departure from the past practices has been introduced by the new policy but how the improved climate compares with investment markets elsewhere. What they seek is comparative advantage among different investment markets.

India offers two basic advantages to foreign investors: One, availability of inexpensive manpower, and two, the existence of the vast domestic market.

As to the former, it is argued that low wage levels may be offset by productivity level to a large extent. For example, not-withstanding sizeable improvement in productivity in almost all the sectors over the last four and a half decades, Indian worker's output a year in 1990, estimated at $ 3261, was lower than that of even Sri Lanka, Pakistan, Philippines and Bangladesh. Further, industrial relations may have a direct bearing on productivity.

As to the second, the vastness of the Indian domestic market is definitely a great inducement for investment in manufacturing industry in India. However, under the new policy the foreign remittance of profit in foreign exchange has to be fully covered by export earnings. Obviously, remittance of dividends does not take place immediately after the commencement of production operations. Also, the foreign exchange requirements or the remittance of dividends payable to shares held by foreign partners should be limited in amount in comparison with total turnovers. In consequence, such ventures would have only to export a limited part of their products up to the export standard in terms of quality in a short period of time; this would require extraordinary efforts, even if several essential prerequisites are satisfied.

To do so, it may well be found indispensable to import some parts and components.

But the import of parts and components has to be taken care of by purchasing foreign exchanged at the market determined rates. This is again bound to add to production costs. Whether the products thus manufactured are competitive enough for export is a question that requires close examination.

Second, there is the question of exit policy. While the policy is understood to be currently under review by the government and a set of new rules are anticipated to be announced, disinvestment by foreign partners in joint venture in India is at present under a highly restrictive control by the government. Required approvals are both cumbersome and time consuming and the sale price of equity shares to be disposed of by foreign investors are virtually dictated by the RBI. While the underlying thinking behind such a system is not incomprehensible, it has probably been making potential foreign investors more cautious in considering investment proposals in India.

Third, although no one doubts the firm determination of the government at the highest level to vigorously pursue the objectives of economic reform, foreign investors may be interested to know how relevant matter are going to be dealt with by officials in terminal offices, since it directly affects their business operation.

Finally, foreign investors would have to be convinced that the existing comparative advantages are not offset by the comparative disadvantage they have to cope with. They would wish to examine security situation and living conditions affecting foreign residents in India. They would also be concerned with the availability, quality and reliability of local vendors producing parts and components. Likewise, they would have to look into whatever shortcomings may be found in infrastructural facilities and services, including telephone and other telecommunication services, power supply, water supply, and road and railway transportation. The cost of doping business in India continues to be high. The regulatory system is still non-transparent. Contacts count, particularly in areas like oil, power, telecom, financial services and consumer durables.

In short, a number of question have still to be answered before investment decisions may be taken even under the newly created environment.

In short, a number of question have still to be answered before investment decisions may be taken even under the newly created environment.

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Check Your Progress 3

1) Pick up the correct statements among the following

   i) India has never allowed foreign capital to enter India.
   ii) Since 1991 all foreigners are absolutely free to set up shop in India without any permission from the Government.
   iii) Foreign Exchange Regulation Act, 1973 applies only to foreigners and not to Indians.
   iv) Foreign capital need be regularly serviced in the form of interest payments.

2) Mention the four basic principles that have guided the government's policy towards foreign capital in India.

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24.6 LET US SUM UP

In view of the growth strategy adopted in our plans it was necessary to make use of foreign capital. Foreign capital has been required to fill different types of gaps a developing economy is normally faced with. During the first four decades of planned economic development, foreign resources were sought to be tapped by way of external borrowings. But the overall experience with external borrowings was non-too-happy. Since 1991 there has been a dramatic change in attitude towards foreign capital—foreign capital is now being more freely permitted to set up a short here. Foreign investment, both direct and portfolio, is a favoured channel of foreign resources now than external borrowings.

24.7 KEY WORDS

Saving Gap: Inadequacy of domestic saving to meet investment needs of the economy.

Foreign Exchange Gap: Inadequate availability of foreign exchange in relation to its requirements.

Technology Gap: The distance between the state-of-art technology and technology available to a developing economy.

Portfolio Investment: Expenditure on the purchase of shares and debentures issued by the corporate sector.

Multinational Corporation: A corporate body which controls income generating assets in more than one country.

Nationalisation: Government take-over of the assets hitherto owned by private enterprise and capital.

24.8 SOME USEFUL BOOKS

Government of India : Economic Survey (Annual)

Reserve Bank of India : Report on Currency and Finance (Annual)

Vijay Joshi & I.M.D. Little : India's Economic Reforms 1991-2001. Oxford University Press

24.9 ANSWERS OR HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

1) See Sub section 24.2.1

2) Thoroughly study Sub-section 24.2.1

3) See Sub-section 24.2.1

Check Your Progress 2

1) See First Para in Section 24.3
2) See Sub-section 24.3.1
3) See Sub section 24.3.3
4) See Sub section 24.3.4

Check Your Progres 3

1) None of the given statements is correct
2) See Section 24.4.1

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