National Law School Journal

Volume 4
Issue 1 *Changing Investment Climate in India*

Article 20

1-7-1992

Industrial Approval, Foreign Investment and Foreign Technology Agreements

Rameshwar Thakur

INDUSTRIAL APPROVAL, FOREIGN INVESTMENT AND FOREIGN TECHNOLOGY AGREEMENTS

Rameshwar Thakur

Minister of State for Finance, Government of India

In order to appreciate the present policies in proper perspective, it is worthwhile to look into the genesis of our basic goals of planning, investment and developments. India has chosen the path of Planned and Mixed Economy. Pandit Jawahar Lal Nehru, the architect of Planning in India was the Chairman of the National Planning Committee appointed by the Congress in 1938. The Committee considered all aspects of planning concerned with economic and social development. Since independence, seven Five Year Plans have been implemented with the basic objectives of development and utilisation of the natural and human resources to achieve higher level of production and per capita income, provide employment, reduce inequalities and ensure social justice etc.

Around the invariant principles of planning and a mixed economy, our pattern of development has undergone constant change. The years of the 1950s and 1960s saw the building up of infrastructure and basic industries. We were dependent on food imports; and when they suddenly became unavailable in 1965, we faced starvation. This was the situation that confronted Smt. Indira Gandhi when she became Prime Minister in 1966; her first success was in banishing the spectre of famine. Since the Green Revolution in the late 1960s we have been self-sufficient in foodgrains. The total outlay in the Sixth Five-year Plan, which spanned the first half of the 1980s, was greater than in the first five Plans together; the outlay in the Seventh Plan was much greater than in the first six Plans together. The growth of national income, which till the 1970s had hovered around 3.5% a year, rose to above 5% a year in the 1980s; the average industrial growth rate increased to 8.6%. In those years we built up the third largest scientific and technical work force in the world, in addition to achievements in other areas.

Thus there is no doubt that the foundations laid in the 1960s have sustained a solid growth performance in the 1980s. However, the economic conditions of the country particularly during the last 18 months before the present Government took office in June, 1991, were very critical. The difficulties in relation to the foreign exchange reserves, the balance of payments, commercial borrowings, credit rating and others are well known. Credit was so scarce that default looked imminent.

In these circumstances the Government after careful consideration and in consultation with all concerned took swift steps to restore national and international confidence. Following are some of the main steps taken in the field of Industrial Licensing, Foreign Investment and Foreign technology:

Industrial Licensing

Industrial licensing policy has been substantially liberalised with two basic objectives in view:-

1. to raise the competitive efficiency and technological level of Indian industries to the international level, and
2. to expand the industrial base by encouraging investment, both domestic and external.

Deregulation of the system, removal of entry-barriers and debureaucratisation were essential to create an environment conducive to the spontaneous growth of industry to quicken its responses to the changes in the markets at home and abroad.

The new Industrial Policy announced by the Government in July, 1991 has been a step in this direction. We abolished Industrial Licensing for all industries except those reserved for public sector under compulsory licensing and those reserved for the SSI Sector. The list of industries reserved for the public sector has been pruned from 17 to 8, and some of the core industries like iron and steel, electricity, air transport, ship building, telephone instruments and cables have been thrown open to competition.

The number of industries requiring compulsory licensing has been reduced from 26 to 18 product groups. Only a few industries which have some significant bearing on wider national interests like security and strategic concerns, conservation of natural resources, environmental protection, health hazards, mass consumption goods and luxury consumption goods are now retained in the compulsory licensing list.

There will no longer be any investment limit. We have kept the locational conditions to the minimum, namely industrial units should not be located within 25 Kms. from the standard urban area limits of cities having a population of more than 10 lakhs according to the 1991 census. This, I hope you will appreciate, is an inevitable restriction to avoid clustering of industries in urban centres which are fast getting congested with all the attendant problems. Even this minimum locational condition is relaxed in the case of certain sunrise industries like electronics, computer software and other notified non-polluting industries. Within these minimum restrictions on the choice of products and location Indian entrepreneurs are now free to set up industries anywhere in the country and invest any amount without going through the rigmarole of industrial licensing.

Delicensing, I must add, does not mean that all the entry barriers are removed and unfettered freedom given to the entrepreneurs. This freedom of choice will be within certain clear parameters laid down by the Central or State Government for environment protection, pollution control and planned area development.

Small scale industries are fully exempted from licensing, without any locational conditions, for the manufacture of products reserved for the sector. MRTP and FERA companies are also eligible for these exemptions. We have already amended the MRTP Act through a Presidential Ordinance removing the threshold limit of assets in respect of MRTP companies and dominant undertakings. There will be no need for these companies to get prior approval from the Government to set up new industrial units. Any possibility of concentration of economic power and monopolisation of any industry, which is very remote under the competitive environment created by the new Industrial Policy, will be checked by regulating the acquisition of shares. The Companies Act has been amended making prior Government approval mandatory for anybody to acquire more than 25 percent of the shares (paid up equity) of any company.

Foreign Investment

The second area where we have made changes of far reaching consequences is foreign investment. Approval for foreign investment upto 51 percent foreign equity will be automatic in specified high priority industries if the foreign equity covers the foreign exchange requirement for the import of capital goods. Existing industries in these specified high priority areas will also be allowed to raise foreign equity from the present level to 51 percent. Import of law materials components, etc. will be allowed under the general rules. The automatic approvals will be given by the Reserve Bank of India. All companies receiving approvals for foreign equity upto 51 percent will have to balance the outflow of foreign exchange on account of dividend payments by the earnings from the export of items produced in the relevant high priority industry over a period of seven years.

Liberalisation of foreign investment is not only required by the changed scenario of fast spreading globalisation of investment and trade but is also beneficial to us on three scores. First, it would help us to tide over the balance of payments problem in the short run by bringing in more non-debt-creating flows to finance the current account deficit and replacing the debt-creating flow of external assistance, commercial borrowing and NRI deposits. The second advantage is that the foreign exchange outflow on account of servicing the capital begins only after the investment starts earning profit, whereas in the case of external borrowing, servicing the loan begins shortly after the disbursement. Thirdly, direct foreign investment is expected to bring in, apart from capital, advance technology, modern management skills and access to new external markets. On the basis of experience of some developing countries a fear is often expressed that foreign investment may not bring in the latest state-of-the art, technology or superior management skills. India, by the sheer size of its population, has a vast potential market for a large number of consumer goods, and the foreign investor would naturally be tempted to tap this market if he has a comparative cost advantage in manufacturing such goods in India. He may use obsolete or discarded technology, and he may ultimately competing out indigenous manufacturers. I think that this fear is unfounded. We have closed such a possibility by allowing the free flow of foreign investment only in specified high-technology, high priority industries and imposing the conditionality of balancing the foreign exchange outflow with export earnings over a period of seven years.

Foreign Technology

The third area of liberalisation is the import of foreign technology. Technology is fast advancing all over the world. International trade in technology is also growing fast. Unless we are able to cope up with these changes, we will not be able to face competition in the world market. So, we have liberalised the import of foreign technology by delinking it from foreign investment and simplified the procedure for acquiring it. Automatic permission will be given for foreign technology agreements in high priority industries up to a lump sum payment of Rs.1 crore, 5 percent royalty on domestic sales and 8 percent royalty on exports, subject to the condition that the total payment in foreign exchange should not exceed 8 percent of the total sales over a period of ten years from the date of agreement or seven years from the date of commencement of production. The prescribed royalty rates are net of taxes and will be calculated according to standard procedures. In respect of industries other than those in Annexure III also, permission will be automatic if no free foreign exchange is required for payment. No permission will be necessary for hiring foreign technicians. Foreign exchange for royalty on foreign technology or hiring charges of foreign technicians will be released by foreign exchange dealers authorised by the Reserve Bank of India.

The deregulation and easing of procedures would usher in a new investment climate in the country, congenial to an increased inflow of direct foreign investment. But this is only one side of the story, i.e. the demand side of foreign investment. A critical factor on the supply side is how the foreign investor perceives and responds to these changes. Profitability and security of investment are the two prime considerations governing the investment decisions of any entrepreneur. He should have confidence in the strength and stability of the Indian economy if he is to invest in the country. The package of economic reforms and policy measures initiated and implemented by the present Government in the past few months include, apart from a new industrial policy, adjustment in the exchange value of rupee, liberalisation of trade policy, tightening of money supply and credit, control of the Fiscal deficit, selective disinvestment of public sector enterprises (PSE) and bringing sick PSEs within the purview of the BIFR.

With these decisive measures, we have quickly restored international confidence. Non-resident Indians, who were withdrawing their deposits at an alarming rate in June, have ceased to do so. Our reserves which had dipped to Rs.2600 crores ($ 1.3 billion) in June, exceed Rs.9300 crores ($ 3.5 billion) after redeeming the gold we had pledged besides meeting other international obligations. Inflation, which had gone up by 16.7% has come down to 12.7%. Direct tax collections, which were planned to yield additional revenue of Rs. 2000 crores by the end of March, 1992 have yielded over 2200 crores by December, 1991 itself.

We have thus overcome the immediate crisis, and are now turning our thoughts to more basic reforms. Soon after we took office, two committees were appointed; the Narasimhan Committee on monetary reform and the Chelliah Committee on fiscal reform. Both have handed in their reports very recently and we are now in the process of detailed examinations of the recommendations for reforming our fiscal and monetary policies. We are also planning the revamping of the company law, foreign exchange regulations, law relating to capital issues etc.

We are also about to launch the **Eighth Five-year Plan.** The basic draft paper has been prepared and discussed in the recent National Development Council; the way is now clear for the formulation of the full Plan which will be implemented with effect from 1st April, 1992. The total outlay of the Plan is likely to be 100% more than the 7th Plan. It is expected that this massive Plan with priorities on employment, growth and modernisation, will usher India into a new era of all-round development.

We shall continue on this path of structural reform and expect to turn the corner within the next few months and to resume rapid growth in about a year. However, the growth process will be resumed under considerably improved legal and administrative framework. Fiscal discipline will have been tightened, trade will be much freer, exchange control will be relaxed, foreign investment will be offered more equal treatment. The Government will concentrate on its essential areas of operation — infrastructure, defence and social justice and macro economic management.