National Law School Journal

Volume 4
Issue 1 *Changing Investment Climate in India*

Article 24

1-7-1992

Climate of Confidence in the New Foreign Investment Policy

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A CLIMATE OF CONFIDENCE IN THE NEW FOREIGN INVESTMENT POLICY

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You are all aware of the peaceful revolution taking place in the philosophy and economic policies of this country. From the pace of changes taking place, we have moved from the doctrine of a state controlled economy to a stage of prelude to a free market economy. The reforms recently introduced have brought about certain fundamental changes from past polices and we now look to the future of the present.

Broadly speaking, these reforms have to an extent freed economy and commerce from the shackles of permits, sanctions and controls. We have hitherto had an overtly protected private sector, which system has inevitably led to stagnation of industry and commerce as we lived like frogs in the well shying away from the slings and arrows of the competitive world.

A large majority of industrial sectors have now opened up for foreign investment and technology tie-up for which government approvals have been rendered 'automatic', leaving only a minimal sector of core industries needing approval. For several decades we looked to foreign investment with cynicism and ruled out equity participation beyond 40%. We have now thought it the wiser to remove this inhibition and let foreigners hold more than 50% of equity capital. A large number of products and services now find place in List-III of the new industrial policy in respect of which foreign equity participation up to 51% is allowed. In certain cases equity holding in excess of 51% is being permitted. As you may all be aware, 100% foreign equity holding is allowed in 100% export oriented units. Foreign Exchange Regulations, which have always been a target of criticism of being very rigid and bureaucratic have to an extent been relaxed and matters are now dealt with expeditiously. The Government has also promised to make the rupee convertible within a period of 3 years.

The monopolies and restrictive trade practices law which provided for and prescribed many a handicap and restraint on the Indian industry has been relaxed. Big business houses can freely invest, diversify or embark into joint ventures without undergoing any more rigid and delaying procedures or permissions from the Company Law Board and the Monopoly Commission. Liaison offices of foreign companies in India are now permitted to indulge in developing export markets and canvassing export orders Foreign companies have also been permitted to set up trading companies in India with majority foreign equity participation subject to certain export requirements. Taxation of know-how, royalties, technical assistance fee etc. is reasonable and is on par with most of the developing countries. The extent of tax concession is also supplemented by reason of double taxation relief treaties with various countries. Though customs duty rates are still high, it is understandable that these cannot be reduced at once. I understand these rates are under review in respect of import of capital goods for joint venture projects. In spite of the country's balance of payments problem, we have maintained a good record of repatriation of dividend and capital and there need he no apprehension in this respect.

In the commercial field also, restrictions on import have been substantially removed. The shackles of import permits and quotas no longer haunt Indian business.

In regard to intellectual property rights, there has been a considerable amount of misapprehension of the legal situation in the country. We have statutory laws governing trademarks and patents modelled on British law. We also do have judge-made laws, as in England under Common Law, and the courts have adequately protected trademark and patent rights. Computer program and software have been well protected under the Copyright Act. There is however a controversy in regard to periodical patents for drugs, foods and pharmaceuticals the law concerning which is in the process of reconsideration and developing. Patent registration in the country so far has been with reference to process. The question of product patent is also being seriously debated and I expect the law in this respect to be laid down soon probably bringing in the product patent gradually. In general, the conditions now prevailing in the country favourably compare with those prevailing in most other developing countries elsewhere, including the far east. The concessions and liberalisation may not yet be to the extent granted or brought about in some of the other developing countries, but we certainly are on the right path in that direction. The law of the land is adequate and our judiciary is independent and strong. Though there is some amount of delay in disposal of cases, which is because of the large arrears of pending cases, nevertheless, matters of urgency are dealt with and disposed of on priority.

I understand that the Government is considering to permit foreign companies to use their foreign brand names in the local market. It is also proposed to have a special machinery for the enforcement of intellectual property rights. The chambers of commerce in India have suggested that the Government of India should consider signing the Paris Convention with some safeguards.

Now, as a lawyer, I would like to touch upon those areas which think have potential for improvement. Further liberalisation could be made by the Government in these areas, so as to make the economy and legal framework more attractive to induce foreign investment in India.

Certain impediments to a larger flow of foreign investment do exist in the perception of foreign lawyers. These could be removed to make India a more attractive country to invest in. The following are some of the perceptions of foreign lawyers gathered in their chambers removal of which may be useful for improving the investment climate. I am listing these not with a view to criticize, but only to show by removing some of these impediments (which are perceived by foreign investors and which are not easily expressed to Ministers or Government officials but are expressed more candidly in a lawyer's chamber) the climate could be improved. These are reproduced here, only with a view to making the authorities aware of what the responses are abroad, which are rarely stated in seminars.

The current changes in policy are virtually being carried on a day to day basis. Such piece-meal relaxations tend to lead to expectations of more relaxations shortly. So, the result is that foreign companies just seem to be waiting longer and longer in anticipation of further liberalisation/concessions. It would be more useful if these planned changes are announced at one go, and which changes will then be adhered to for some period of time.

The government may have done away with certain controls but the procedures have substantially been kept intact. What it ought to do have done away with was abolish these procedures along with the disbanding of controls. The investor has today to deal with the same people as he did before except that he must now obtain their 'approval' and not their license or permit.

The requirements that a foreigner has to fulfil ensure that no matter what the Government may have by the word, if 'automatic' means "without the need for prior permission", then investment in India whether for Indians or foreigners is anything but automatic. The greater the number of conditions that must be fulfilled before 'automatic' permission is granted the more will it be for some functionary to first make sure that the conditions are being fulfilled. The greater also will be the scope for exercise of discretion by the official. Most important of all the greater will be the time taken by each scrutiny and approval and consequently the delays in investment.

Foreign companies having a feel of doing business with the Indian bureaucracy, find it difficult to believe that the Indian bureaucracy has along with the new policies, also changed overnight. Many foreign investors also appear to have the impression that outside a handful of ministers and a few top civil servants, the bureaucracy does not appear to be reconciled to deregulation. A great deal of hard selling will be required to overcome the foreign investors experience and impressions of doing business in India.

51% Foreign Equity

1. Though the new policy permits foreign investment up to 51% in a large list of industries, this is subject to the joint venture company undertaking to export products listed in Annexure III to the new industrial policy. Many developing countries competing with India for foreign investment, permit up to 100% foreign equity without any export obligation;

2. The requirement of the cost of imported capital goods be met out of the foreign collaborator's equity investment appears to be another impediment to investment in capital intensive industries. (Any one familiar with modern technology and marketing intensive industries, knows that the condition is too restrictive). It would have been a lot more

useful if the Government also took into consideration certain intangibles like access to the foreign collaborators worldwide marketing networks the use of an established brand name in world markets and crucial know-how embodied in a man's or company's experience rather than impose conditions just on a mere initial outflow of foreign exchange towards import of capital goods.

40% increases to 51% Foreign collaborators having equity investment of up to 40% in Indian companies have now been permitted to raise this to 51%. This is however subject to the Indian company being engaged in any of the industries list in Annexure III of the new industrial policy. If such companies are not so engaged, then they are required to diversify into areas specified in Annexure III. Such companies are however required to cover their entire cost of import of capital goods from the 11% additionally brought in by the foreign collaborator. It is well nigh impossible to cover the cost of imported capital goods from this 11% additional foreign equity. If the objective was to encourage foreign companies to increase their equity holding so that this would result in an inflow of foreign exchange, this change may only turn out to be cosmetic for industries not engaged in high priority industries. Secondly, such a company was hitherto not required to export, so as to balance the outflow of dividend on the 40% foreign holding. This condition is now imposed on companies where the foreign collaborator increases its stake to 51%. The press note issued in this regard, requires the dividends paid to the foreign collaborator having 51%, to be balanced. It is however not clear if this balancing is confined only to the enhanced 11% or the entire 51%. If it applies to the entire 51% , it is doubtful if a foreign shareholder will want to so increase.

The relaxation by the RBI of the curbs on the import of capital goods by Export Oriented Units (EOUs) amounts to very little in the context of expectations that import curbs will be lifted with the rise in India's foreign exchange reserves e.g., one of the conditions imposed is that the EOU obtain 360 days suppliers credit. It is very difficult, if not impossible to obtain suppliers credit for such a period. In case of capital goods exceeding Rs. 100 lakhs even longer credit periods have been prescribed . One finds it hard to comprehend what exactly the (much publicised) relaxation is in this case.

Political Stability but Legislative Instability

The foreign investor not only looks for political stability, but also legislative stability. The instability of India's economic legislation is too well known. The foreign investor is so suspect of economic legislation in India that he is unwilling to base an investment decision on the tax and duty exemptions granted, apprehending not only a removal of such concessions which were granted to lure the investor, but that such concessions will be amended with retrospective effect.

Notable examples of retrospective legislation:

1. An Excise Duty amendment made in 1981 operative from 1944. But curiously its validity was upheld by the Delhi High Court and affirmed by the Supreme Court (save that it will be subject to the law of limitation.)

2. Section 80J introduced in the India Income Tax Act, 1961 withdrawing a concession given in tax to new industries was amended with retrospective effect from 1972 in 1980 (8 years retrospective withdrawal).

3. Application of FERA law retrospectively in 1973.

4. In the western world, a man's property cannot be acquired without just compensation. This was a fundamental right enshrined Article 31 of the constitution. The Article was abolished in 1978, by the 42nd Amendment. The foreigner wants an assurance that his property will not be acquired without payment of just compensation.

5. In the American constitution retrospective taxation is constitutionally invalid. In Great Britain retrospective legislation can be made in taxes but by convention are rarely made and when made, is almost always in favour of the citizen.

6. The customs duty is amongst the highest in the world and erratically increased for increasing revenue without any regard to the consequences on industry.

Necessity for "prejudgment assessment" i.e. for instance in U.S.A., before entering into an agreement between a foreigner and a local resident Company, the party can apply to a high ranking tax authority and get an advance assessment as to what the foreigner's tax liability will be during the period of collaboration. An advance assessment is then made and this assessment is adhered to by all authorities. A foreigner knows what his tax liabilities are in advance and can decide on the venture's feasibility from the tax angle with certainly. In Malaysia, Thailand and other far east countries, clauses in collaboration agreements requiring the local party to bear any increased liability of tax after the effective date of agreement and during the period of collaboration is permitted.

Though the declared policy of the Government provides for full repatriation of capital and dividend, the reality is not so in the case of repatriation of capital. When a foreigner wants to disinvest and repatriate his capital, the valuation of his shares is not based on market value or what a willing purchaser would pay a seller. The Reserve Bank of India (RBI) also restricts the foreign investor's right to freely sell shares to the person of its or his choice.

The approval process for disinvestment is beset with delays at the RBI. No interest is permitted to be earned by the foreigner for such delays at the RBI in permitting repatriation. There have been a number of instances when crores of rupees have had to be kept in current account because of delays in obtaining permission from RBI and the Income Tax Officer. To compound this, RBI impose a condition that the sale proceeds be repatriated and that such instalments will not carry interest! The foreign investor is never informed of this at the time of investment and feels a sense of being deprived at the end of the day of his legitimate monies. This certainly is most unreasonable and arbitary to any rational man.

Foreign companies find the rates of taxation very prohibitive coupled with the restriction on the right of their personnel to repatriate monies earned in India. As a result, competent and highly qualified technical and management personnel of theirs are unwilling to accept assignments in India. Only the second best and more often the third best of personnel accept such assignments. The best are reluctant to come because off heavy taxation and restriction on repatriation. The tax department even taxes whatever is paid abroad to these personnel by the employers for education and medical expenses of children of such personnel.

Foreign companies including many Japanese companies have great grievances against the tendering procedures of public sector industries. The mode of tendering by the public sector is often against the principles of natural justice and fair play. Tendering has at times become a farce. We have been informed of instances where public sector units have permitted certain favoured bidders to lower their price without allowing others to do so. Sometimes on unknown, unfair and untenable grounds, bids have been preferred or rejected.

One off the other grievances of foreign companies is against the unreasonable attitude of statutory authorities and public sector units to make legitimate payments and wrongfully withhold payments legitimately due to them. Most unfair withholding is taking place on ground that their bona fides will be questioned in Parliament. Certain public sector companies have become notorious for such practices. It may be useful in ascertaining why so many arbitrations are pendings with these statutory bodies and public sector undertakings. Almost every contract with the public sector especially with the Oil and Natural Gas Commission or Gas Authority of india, invariably goes into arbitration.

The Government has now come to the stage of permitting 51% foreign equity in the normal course. In this context it will help a great deal if a look is taken at the implications of the judgment of Supreme Court in M. C. Mehta's case (Shriram Ltd,. case). The Supreme Court in this case held that a foreign company will be absolutely liable depending on its capacity to pay if it controls the Indian company. In the case of a foreign company controlling the Indian company by a virtue of holding 51% equity, such foreign company will bear an absolute liability to pay compensation in accordance with its financial capacity. The dilemma is if such companies hold 51% they will have an absolute liability for any disaster or accident. This judgment is against all known principle of damages in jurisprudence prevalent in the civilized world. Something ought to be done by Parliament to override this judgment or modify it by legislation as there is not much hope of the judiciary overriding it.

The procedures prescribed in the Indian Arbitration Act require drastic amendment to take care of unending delays witnessed by foreign companies. It is becoming very difficult to convince foreign clients of delays in our legal judicial system. For instance, an application filed on behalf of consortium of Japanese companies in April 1990 in the Bombay High Court to appoint an arbitrator, is yet to even come up for hearing even after a period of a year and a half! The project has been duly completed by this consortium, they have closed their project office and have literally abandoned the arbitration.

Conclusion

From a constructive point of view, it may be help a great deal if these perceptions in the minds of foreign investors are removed. As I stated in the earlier para of my speech, this is a revolution that is taking place in our economic thinking. We have taken this to a point where this process cannot be reversed and will have to be now taken to its logical conclusion. We have no alternative but to integrate our economy with the global economy. We all agree that it takes a little time to achieve a completely free economy. Though the shackles of the past still remain, the era of a free economy now looms large on the horizon.