

Performance reviews of the Indian Economy are most times in the same framework as the Annual Economic Survey of the Ministry of Finance. There is a good deal of commonality of approach and the nature of analyses. The economic indicators cited are the same. These may be the rate of GNP growth; capital accumulation; savings; budgetary deficit; performance at exports and imports; balance of payments or sectoral growth. Since these reviews are often under the same paradigm as the official survey, these fail to raise questions and underscore other basic developments in the economy which are not captured by the macro-level aggregates. The reviews tend to be reactive in nature. What we need is an alternative paradigm. It may prove helpful to identify the nature of the basic transformation through which the Indian economy has been passing, especially on aspects which official sources choose not to comment upon.

The Indian regulatory system has been revised drastically during the past few years. The framework of change has been to 'open up' the Indian economy as it was believed that under the planning era the country had become an extremely 'closed' economy. The origins of the closed and restrictive system can be traced back to Industrial (Development and Regulation) Act (IDRA), Monopolies and Restrictive Trade Practices Act (MRTPA), Foreign Exchange Regulation Act (FERA) and Industrial Policy Resolutions of 1948 and 1956. In order to set the system right, the FERA provisions have been considerably diluted. Foreign equity can now be held as high as 100 per cent as against the earlier ceiling of 40 per cent. FERA, once a dreaded piece of legislation, stands as good as withdrawn. Provisions relating to concentration of economic power, in Chapter III of the MRTP Act, stand deleted. The industrial policy changes have altered the place of IDRA as the chief investment regulatory instrument. Restrictions on new investments have been withdrawn and reservation for public, small scale sector and for other 'priority' sectors are no more in vogue. Discussions on priority sector, essential and luxury goods, high import content, indigenous production, export obligations and incentives have ceased. These expressions are now out of use. Until recently foreign capital was not encouraged in internal trade and low technology indigenous production. The three major legislations, which provided the legal backing to the regulatory system, have fallen. It is time to ask: What did India gain by liquidating MRTPA, FERA and the IDRA?

### **Foreign Capital**

There are assertions that the policies towards liberalisation have enabled India to gain a special status in destinations for foreign investments. The number and size of the approvals for foreign investments is not a reliable basis to assess the actual flow of Foreign Direct Investment (FDI). India did receive substantial FDI, though the amount is far lower than the expectations. One needs to examine the size and the nature of the FDI as also what has not materialised. It would be equally fruitful if the un-realistic assumptions of the policies are identified to find answers to questions like 'where did we go wrong?'. One also needs to identify the basic characteristics of the FDI as observed during the last five years.

Foreign direct investments have not always been for setting up of new enterprises or additional production capacities in India. Foreign investments have taken forms other than manufacturing. Two, the main beneficiary country of the recent liberal policies appears to be U.S. and given its political domination and military superiority in the present day world (a uni-polar system) the new pattern of FDIs acquires a special significance. Three, if one examines the spatial spread of the new foreign investment proposals, the lion's share has gone to the advanced states of India and other developed locations. The states of Maharashtra and Gujarat get the largest chunk and the lowest is for U.P., Bihar, Assam and Rajasthan. The implications of the new investments on regional imbalances could be serious. Four, a good part of the flow of foreign capital to India is in the secondary capital market. Investments in the secondary market are by their very nature fluid and unstable. These can be liquidated fast. The interest of the investors is in financial gains without relating to any one type of manufacturing or other productive activity. Investments in stocks are also amenable to manipulation of stock exchange prices. Given the vast financial backing of the foreign investors vis-a-vis the weaker Indian players at the stock exchanges, there is high vulnerability of the Indian capital market. This has been amply demonstrated during the past few months.

Five, while there are a variety of question marks about the new entrants and large investors, the existing foreign-controlled companies have expanded in a phenomenal manner during the last few years. This can be well documented. Six, the number and size of the FDIs in collaboration with Indian large industrial houses has never been so significant. New MNCs to India enter the market in collaboration with well established Indian monopoly houses. These collaborations, however, may prove to be short lived arrangements. Entry with a bang and the break up in a short time is well noticed. DCM-Daewoo collaboration has been acknowledged as having broken up and the collaboration of Godrej with Procter & Gamble is already a thing of the past. Greaves gracefully exited from their joint venture with Foseco and TVS disappeared from TVS Whirlpool. Thapar is on the way out from Thapar Dupont. The instances can be multiplied. Foreign companies entering for the first time into the Indian market take full advantage of the political connections, knowledge and experience of local trade networks, goodwill and prestige of their Indian counterparts. Soon, foreign collaborators start feeling uncomfortable with the relatively weak financial position and consequent inability of the host partner to match large resources required for fast expansion. The Indian counterparts also do not have the matching staying capacity. The liberal investment regime obviated the need for foreign investors to collaborate with Indian parties. Seven, the visibility of foreign sector in India has got escalated in a marked manner and the actual inflow of foreign capital is not commensurate with the increased visibility of FDI. One does not need to labour on this aspect as it is well reflected in growing domination of Ads on TV channels, Radio, Newspapers and large hoardings in all urban centres. Eight, one suspects that a good part of the new FDI is accounted for by the retained profits and flows directed at consolidation of control over Indian business by the already existing multinational corporations at throw away prices. The Hindustan Lever, Phillips, Siemens, Colgate Palmolive and the like have

expanded their net assets and sales in a phenomenal manner.

### **Who Benefits from New Policies?**

An assessment of the performance of the Indian economy should seek to underline the major beneficiaries of the new policies initiated in the liberalisation thrust. Is it that the major beneficiaries in terms of fast growth have been the ESSARs, Videocons, Reliance, ITC, Hindustan Levers and the like and not the small and medium entrepreneurs who have chosen to remain on their own without getting patronage of foreign capital? Some information on the directional change needs to be indicated.

Another prominent feature of the recent years is the aggressive manner in which foreign based MNCs are taking over Indian manufacturing units or are establishing franchise relationship with Indian entrepreneurs. The prominent cases of such takeovers include Lakme, Tata Oil Mills, Milkfood and Kissan by Levers; Coca-Cola having taken over Ramesh Chauhan's Thums Up and Limca; Maruti Udyog, a public sector company soon to surrender majority stake to the Suzuki of Japan.

### **External Trade, MNCs & Transfer Pricing**

It is common to discuss performance of the economy at exports and imports. Percentage changes in imports and exports serve only a limited purpose. The nature of the changes in imports would probably be more significant. Most of the consumer goods imports as are now openly marketed in India would not have been possible in a planned economy. The nature of the change in the import basket should make us ask the medium and long term implications of the trends on the existing production capacities in the Indian economy. Has removal of fiscal and non-fiscal restrictions made a difference to the import structure of India? Reductions in customs duties especially of goods which carried high duties or were on the banned or restricted lists, should result in enhanced imports.

During the last few years the "related party imports" have increased in a phenomenal manner. This is a direct consequence of the entry of foreign capital and the policy to encourage Indian entrepreneurs to enter into joint technical and financial ventures with foreign based enterprises. Increase in the 'related party imports' should not be a surprise since the foreign collaborator is likely to suggest sources and the technical specifications of the capital goods and the raw materials only from his associates. Newly formed joint ventures will be obliged to import machinery, CKDs or SKDs and raw materials from the parent company or the associates of foreign partner. Coca-Cola or Pepsi are known to have imported capital equipment, bottling plants and essence, from their parent companies and do not permit the Indian soft drink bottlers, who have franchise arrangements with Coke/Pepsi, to obtain supplies from other sources. Maruti Udyog is another case in point. During the initial period Maruti Udyog Limited (MUL) imported CKD (Completely Knocked Down Kits) from their associate company, the Suzuki. MUL continues to obtain materials, spare parts and other semi-manufactured items from the

Suzuki of Japan and its Suzuki associates. If Honda, Xerox, Kodak, Mitsubishi, Daimler Benz, Ford or any other MNC invests in India it could justifiably be assumed that the investing company would be permitted to import whatever it requires, to make the new enterprise a success. Ensuring of standards and quality may be one other reason for it. 'Related party imports' are unavoidable. Do Indian laws have an effective regulatory mechanism to deal with such situations? How to control "transfer pricing" practices in 'related party imports'? Transfer pricing is a reality. A country when opting for market-oriented policies needs to put into place an efficient mechanism to monitor and regulate potentially harmful practices of this nature. India has yet to make a beginning.

### **Consumerism, Brand Names & Media**

There has been a thrust in establishing brand names through mass media including the satellite communication channels. The drive at establishing brand names and patents has to be viewed in the background of the special efforts being made by the World Trade Organisation (WTO) to protect Intellectual Property Rights (IPRs). The effort at promoting brand names by MNCs has been in products which have high demand elasticities. For instance, the Indian market has virtually been captured by the two giant American soft drink producers, namely, Pepsi and Coca-Cola. All other soft drink manufacturers have been either taken over or have got liquidated or have only a limited presence. This has happened for various reasons including the far larger financial backing and international consumer acceptability of their products. The other products in which MNCs have already entered are: ice-cream, chewing gum, detergents, convenience foods, alcoholic beverages and cosmetics. Needless to say, MNCs have also entered the consumer durables segment in a big way. The enhanced visibility of these brand names suggests that for the rich sections there is now nothing that is available abroad and not in India. The relative significance of imports on account of automobiles, televisions, VCRs and the large range of other new consumer products needs to be examined.

### **Concentration of Economic Power**

India has been experiencing growing concentration in business power of a few monopoly houses -- Indian and foreign. The growing concentration, however, is not reflected in the net assets. The phenomenon of growing concentration in private hands can be understood better through a study of sales turnover as a measure of business power. It seems that product monopolies are getting built in a number of common consumer products; and the entry of smaller manufactures is becoming more and more difficult. The financial strength of the existing MNCs and new entrants is a key factor in this process. New product monopolies are also getting established through the commercial licensing and franchise mechanism of the MNCs. It is natural that small enterprises would find it safer and more secure to enter into long term contracts for exclusive sale agreements. In such contracts large corporations take up the responsibility to market products of the small scale

sector under their own banner and trade name. For instance, *Dalda*, a hydrogenated vegetable oil, is manufactured by many a small independent enterprise but strictly according to the specifications, packaging and other norms of production as given by the Levers. The practice of such sub-contracting is quite common and widespread in the pharmaceutical industry of India. This is true of both Indian and foreign companies. For instance, the fast growing Ayurvedic medicine producer, the Dabur, is having a multiple of sub-contractors to provide products marketed by them. Colgate, Singer, Bata, Ciba-Geigy, ITC, Gillette, Ponds, Reckitt & Colman, Godrej and Batliboi are just few other instances for this phenomenon. The growing concentration of business power, when measured in terms of overall sales or product-wise sales, indicates the capacity of the few to influence price structure so as to reap a high monopoly rent.

### **Inflation & Prices**

Price changes, as reflected by Wholesale Price Index (WPI), and Consumer Price Index (CPI) are often quoted and misquoted. The aggregate figures and the trends in the WPI and CPI do not capture the extent of burden or relief on different strata of the society. For instance, there can be a whole variety of clothes -- some cheaper and others more expensive. To group all clothing under one category does not improve understanding of the changes in prices of clothing for the poor and the rich, separately. The practice of aggregating prices of low and high quality cancels out a reduction in price of high quality clothes with the increase witnessed in prices of the cloth used by the poor. Within each broad category of goods, say food articles, there are a number of articles (for instance, confectionary and IMFL) which do not enter the common man's consumption basket. There is a need to present price changes in terms of their impact on different strata of people. While the WPI and CPI are aggregate figures, analyses of revised groupings of commodities for the rich and the poor would be extremely helpful in observing what one is looking for. We may consider constructing separate consumer price indices for the urban and rural poor, to better assess and appreciate how inflation and price changes are affecting the poor. There is a contradiction in the impression created by frequent government announcements with regard to wholesale price index changes and the manner in which government servants are accommodated by provision of dearness allowances. The need to change the basis on which prices are monitored and announced by the government in their weekly rituals of informing public is only too obvious.

### **Corporate Governance and Public Financial Institutions**

The structural changes taking place in the Indian economy, particularly in the organised sector, seem to be going without proper appreciation. A discussion on the takeovers and acquisitions should reveal a variety of the shortcomings and ills suffered by the Indian corporate sector. The extent of equity shares held by the institutions in India's major private sector corporations is often quite significant. If one takes the contribution of

the public sector financial institutions in the risk capital of India's top conglomerates the share of the private managements would be much lower than that of the institutions. Thanks to the inter-corporate investments and the Indian legal system, a large number of the Indian corporations are indeed public owned but privately controlled and managed. No one can takeover these corporations without the official nod! What has been or should be the role of the financial institutions like the LIC, ICICI, IDBI, and IFCI towards takeover bids? These issues are rarely discussed. The only time, when the role of financial institutions came up for some public debate, was in the matter of the takeover bids for DCM and Escorts by Swaraj Paul.

The relationship of public agencies and individual companies is more of a selective patronage than what would have evolved in response to societal needs. This is one reason for government nomination of nominee Directors on private management boards. In spite of repeated discussions there is no clear set of objectives that the nominee directors are supposed to pursue. While there is quite an emphasis on the need to introduce transparency in public decisions it would be difficult to explain why serving and retired civil servants dominate the list of nominee Directors.

The same holds true of the public sector management boards. An additional problem in their case is vacancies at the top. It needs to be reviewed if public corporations can really be expected to run effectively without having timely nominations to top positions. It is true that public sector performance needs vast improvements and this is a task that needs to be examined at individual unit level. Why have we not been able to make much progress on these aspects? We need to debate in order to evolve effective alternatives.

### **Resource Mobilisation & Taxation**

An important aspect of public policy is the size and nature of public resources: how these are raised and how these are spent. What is the magnitude of the loss due to the lowering of tax rates and the other concessions to the corporate sector? The tax revenue of the central and state governments as percentage of GDP has been falling during the last five years. The ratio declined from 18 to nearly 14 per cent. A reduction in the tax revenue would demand cuts in public expenditure reducing productive investments and subsidies that could be either for the vulnerable sections or for high priority and desirable activity in material interest. There could be a larger budget deficit if it is decided to sustain the same level of government expenditure. The state could privatise or sell certain rights in public property. Alternatively, the state could obtain loans from within and outside the country or seek more of direct private investments. A reduction in the tax rates (would) benefit those for whom the tax cut is relevant. A declining percentage does not imply a general public relief. The same would be true of the subsidies. Who are these people? Which strata of

the country is affected by the fiscal changes? It needs to be analysed.

Whenever government expenditure is reduced, the first victim invariably, is the social sector *i.e.*, education, health and other social programmes. A reduction in education would have long term consequences for the society and a cut in the provision for primary education would directly hit the life of the poorer strata. While a cut on higher education reduces the potential for technology development and professional growth, cuts in expenditure on medical services and maintenance of public hospitals would create more hardships for children and the old as also the poor. In short, a reduction of tax revenue would set a process in motion that has serious implications.

These issues are not under discussion. It is not being debated as to why did India's biggest scams emerged during the very early stages of implementing the package of 'reforms'. Corruption in high places has set an unfortunate trend; the measure of corruption is no more in terms of lakhs of rupees; it is in the hundreds of crores! Will this make us insensitive to corrupt practices? Also, is it that the often heard remark 'everyone is corrupt' has an empirical basis? Or, the areas of corruption are limited and there are only a few thousands who would qualify to be the pace setters. The entire Indian nation cannot be condemned as being corrupt and un-ethical. Besides this, in an economic review of the country the economics of corruption need to be high lighted. It is high time that we look back at the Santhanam Committee Report as also other reports from the Indian archives.

An alternative framework for a performance review of the economy is needed and it must include, among others an analysis of:

- \* Who has benefitted from the new policies and who has been adversely affected -- among large, medium and small enterprises?
- \* How far foreign-based MNCs are taking over or making Indian enterprises dependent, through licensing/franchise relationships?
- \* How has import liberalisation affected the import basket and what are their implications in the medium and long-terms?
- \* How far is our regulatory mechanism capable of handling the phenomenon in 'related party imports' and 'transfer pricing'?
- \* What are the implications of the MNCs entering the consumer durables market in a big way, with their brand names?
- \* What has been the nature of direct foreign investment in the Indian economy and where has it been going, and with what consequences?
- \* Is economic power getting more and more concentrated in monopoly houses -- Indian and foreign?

- \* What has been the role of financial institutions vis-a-vis the corporate sector and what should it be?
- \* How have the fiscal changes under the new liberalised regime affected the common man?
- \* Do we need to construct new consumer price indices to assess the impact of price changes on the urban and rural poor?
- \* How far has the phenomenon of corruption got a boost under the new 'open' economy?