Foreign Crutches

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Confronted by signs of economic vulnerability, India's economic policy makers are blaming poor performance on inadequate 'reform'. Measures to appease and attract foreign capital are being advocated and announced as a solution to the country's problems. This ignores the evidence that major policy shifts over the last two decades have fundamentally altered the economic environment, making neoliberal reform a possible explanation and not solution for the current mess. A recent example of such evidence is the just released preliminary results of the Reserve Bank of India's eighth Survey on Foreign Collaboration in Indian Industry. The survey underlines how India's balance of payments vulnerability is not the result of absent or inadequate liberalisation of the rules and regulations governing foreign investment, but occurs despite the dismantling of regulation and the liberalisation of rules which has had far-reaching consequences.

In fact, among the most dramatic shifts in the government's policy stance since the 1980s has been its attitude towards foreign collaboration in manufacturing and services. In the immediate post-Independence period, policy was influenced by the view warranted by India's colonial experience that political freedom can be meaningful only if backed by freedom from foreign capital. That experience suggested that policy favouring foreign capital partly explained India's retarded development. Hence, successful development was seen as predicated on reduced dependence on foreign capital and technology, or an effort to pursue 'self-reliant' growth.

Recent governments have discarded that position and embraced its opposite. They have veered round to the view that the true measure of economic success is the willingness of foreign firms to enter the country and establish a strong presence. So policy has been changed to attract such capital, by opening up areas that were earlier closed to foreign investors, making entry easier or 'automatic', relaxing ceilings on foreign equity holding, and liberalising the terms relating to repatriation of surpluses in the form of dividends, technical fees and royalties.

The RBI's eighth survey on foreign collaboration in Indian industry relating to the period 2007-10 suggests that this sea change in perception and policy stance has made a huge difference to foreign presence in and control over the corporate sector. The earlier, seventh survey, related to the period 1994-2001. So together these two surveys capture the changes in the nature of foreign presence that have occurred during the liberalisation years. There are indeed many problems with the conceptual basis, coverage, representativeness and comparability of these surveys. But they serve to establish the broad direction India's tryst with foreign capital is taking.

There are a number of new trends in the relationship between domestic and foreign capital that the surveys reveal. The first tendency of import is an increase in the depth of foreign financial presence. According to the seventh survey, even by 2001, there had been a significant change in the composition of firms engaged in foreign collaboration. Firms classified as 'subsidiaries', by virtue of having a single foreign company holding more than 50 per cent of local equity, had increased from 11.5 per cent of the 1143 firms covered in the sixth Survey (relating to 1986-94), to 30.5 per cent of the 545 firms surveyed in 2001. This trend appears to have intensified since then. The eighth survey relating to 2007-10 found that out of the 836 firms surveyed, 672, or around 80 per cent, were subsidiaries in which a single foreign company or group held more than 50 per cent of equity. A corollary of this was that companies identified as ‘associates’, in which the foreign partner held between 10 and 50 per cent of equity, accounted for just 13.3 per cent of sample companies in the eighth survey, having fallen from 50 and 42 per cent of the firms sampled in the sixth and seventh Surveys. Liberalisation has ensued that foreign firms are increasingly present in the form of majority or sole control companies, rather than as minority partners in joint ventures.

A second significant feature of foreign presence emerging from the surveys is a decline in the importance of technical collaboration agreements in two senses. On the one hand, the proportion of firms entering into ‘pure technical collaboration agreements’, without any or with less than 10 per cent equity participation by foreign entities, fell from 35.3 per cent of the relevant sample to 27.5 per cent and just 1.2 per cent across the three surveys. On the other hand, while in the sixth survey 815 of the 1108 companies covered had entered into 1499 technical collaboration agreements and the 545 companies covered in the seventh survey had amongst them entered into 603 such agreements, only 158 of the 836 companies covered in the eighth survey had entered into 160 such agreements. Technical collaboration agreements are losing favour among foreign firms operating in India.

Technical collaboration agreements are motivated by many objectives. One is the need to protect proprietary technology. Another is to use ownership and control of technology as means to influence the operations of an affiliate, by imposing conditions embodied in the technical collaboration agreement. Those conditions normally relate to production, marketing and trade, R&D and technology transfer. These objectives are still relevant. If yet technical collaboration agreements are on the decline it is because control through equity ownership has increased hugely after liberalisation. As a result, technological agreements as instruments of control are losing their relevance.

A third noteworthy feature of foreign presence across the liberalisation period is the sharp increase in the share of foreign equity in services and construction. In 1994-95 the shares of the leading sectors in total foreign equity of the surveyed companies were as follows: manufacturing 90.9 per cent; construction 4 per cent; and services 3.3 per cent. By 2000-01 these numbers were 81.5, 1.0, and 16.8 per cent respectively, pointing to rising importance of services. At the end of March 2010 the shares stood at 36.5 per cent, 14 per cent and 48.8 per cent. Even if variations in sample size across the surveys played a role here, the shift in favour of services and construction seems significant. Since these sectors have been the fastest growing activities in the Indian economy, foreign firms subject to loose regulation have chosen to expand their presence in these areas. Liberalisation has allowed foreign firms to expand in areas where growth has been high.

Accompanying this trend has been a growing role for technical collaboration in services. The share of the services sector in the total number of technical collaboration agreements increased from 3.3 per cent (of 1591 agreements) in the sixth survey period, to 7.9 per cent (of 603) in the seventh and 25.6 per cent (of 160) in the eighth. This could be taken as an indication of the growing importance of knowledge intensive services such as computer services, entry into which requires technology absorption from abroad. But by 2007 the software and IT-enabled services boom had peaked, with India's success in the production and export of knowledge-intensive services having already occurred. Therefore, the evidence on the rise of technical collaboration agreements in services is possibly indicative of the growing use of the technology payments (royalties and technical fees) route to repatriate profits from the services sector. It is also suggestive of the fact noted earlier that the growth in foreign presence is driven by the opportunities, that the pattern of growth and liberalisation have afforded the foreign players.

Finally, within manufacturing, the industries that traditionally dominated in terms of shares in total technical collaboration agreements, such as Chemicals, Machinery and equipment, Electrical machinery, and Transport equipment, seem to have become marginal areas in the eighth survey period. A residual category called "Other manufacturing" accounts for almost 40 per cent of all collaboration agreements. We must await the release of more detailed information to fathom what is happening here. But the pattern appears to corroborate the view that technology intensity does not explain foreign presence, challenging the premise that foreign collaboration is needed to access advanced technology.

The technology angle was indeed important in the initial post-Independence years. Despite the hostility to foreign capital then, foreign presence in India's corporate sector did increase significantly. This was to be expected. The constraints on industrialisation under colonialism meant that organised industry in India contributed very little to GDP, was limited in terms of diversification and was handicapped by the lack of a capital goods industry of any significance. Inadequate indigenous technological capability was a corollary of this stunted development. In the event, Indian industrialisation was dependent on imports of both technology and capital equipment. This required entering into technical collaboration agreements with foreign firms. Most often these foreign firms were not willing to provide technology without some equity ownership.

Unable to limit foreign presence, as a result, the government in those years opted for regulation to reduce the cost of foreign presence. This effort to reduce cost in the form of transfers through dividends, technical fees, royalty payments and inflated costs of imports from the parent firm was crucial also because these payments had to be made in foreign exchange. A country faced with balance of payments difficulties could not afford to access technology in ways that weakened the balance of payments even further.

When India revised its policy with respect to foreign investment, the country's balance of payments difficulties had not been resolved. However, the presumption was that foreign firms would use India as a base for world market production, earning the country vast amounts of foreign exchange. However, that expectation has been belied. Foreign firms do engage in export, but their principal target remains the domestic market. What the RBI's eighth survey suggests is that liberalisation has helped this effort to target the domestic market by opening up a host of new areas, including ones where technology intensity does not recommend foreign collaboration. Moreover, in pursuing the goal of profiting from India's domestic market, foreign firms are far less willing to partner with domestic firms. This makes the foreign exchange cost of liberalisation high and its implications for India’s balance of payments adverse. Unfortunately, India’s policy establishment claims the opposite.

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