Economic Overview

Despite massive public investment in industrial development since independence, agriculture is still the mainstay of 70 percent of India's people. Most agricultural production is done either on small, family-owned plots or larger, feudally-organised farms. Gradual modernisation of rural areas has encouraged many farm workers to move into trading or small-scale industry, breaking down the feudal organization of production in much of northern India. In addition to farmland, India is richly endowed with the minerals such as coal, iron ore, bauxite, manganese, chromite, limestone, dolomite and barite - the major industrial raw materials for manufacture of steel, cement and aluminum. India's recoverable crude oil reserves as of January 1991 were estimated at 993 million metric tons (MT), equivalent to about 16 years of consumption at current rates. Natural gas reserves of approximately 858 billion cubic meters are yet to be fully tapped. Much of gas may be used for feedstock for gas-based fertilizer plants and for power generation.

India's electricity generation capacity as of March 1992 totaled about 76,000 megawatts, with an average plant load factor of around 55 percent. Despite government efforts to increase electricity generation,
output remain 8-10 percent below demand. India as the forth largest railway network in the world, and an extensive road system. Bombay is the largest port, handling about 25 percent of total traffic. Other major ports include Kandla, Madras and Marmugao. Indian airlines and Air India provide domestic and international service. Recent opening to air taxi service as expanded domestic travel opportunities. India is also served by many foreign airlines, including Delta and , beginning February 1993, United Airlines. India is linked to most other countries via telephone and telex, but the communication system is overtaxed and unreliable; inadequate infrastructure remains a serious constraint on economic performance.

Basic industries such as steel, fertilizers and cement account for 39 percent of total industrial output; and consumer goods, 24 percent; intermediate products, 21 percent; and capital goods, 16 percent. India’s principal exports include gems and jewellery, textiles and apparel, chemical, engineering product, leather product, iron ore, tea and seafood. Major important are machinery, transport equipment, crude oil and petroleum products, rough diamonds, iron and steel product, and chemicals.

Real GDP growth was low in 1991/92, at only two percent, compared to the 5.6 percent average annual growth rate of 1980’s. Demand limitation measures taken by the government to reduce fiscal/trade deficits and to slow inflation were the primary cause of the slowdown. Despite low per-capita income, uneven distribution of income and wealth has created a consumer-class market estimated at 200 million people. Since July 1991, the government of India has begun deregulating much of the industrial sector. The rupee was devalued and made partially convertible as the step towards full convertibility. The central government’s fiscal deficit has been cut
from nearly nine percent of GDP in 1990 to just over six percent in 1991, and is expected to fall to five percent in 1992. The government has invited private sector participation in many industries previously reserved government-owned firms, including power generation, telecommunication, and other infrastructure industries. Foreign investment and trade policies are also being liberalized. These measures reflect a fundamental shift from a command economy to greater market orientation. India has not seen such rapid policy change since gaining its independence in 1948. However, more radical changes taking place in other countries competing for foreign investment and trade, combine with the increasing demands of India’s burgeoning population, have led many local observers to call for speedier implementation of policy decision and an accelerated timetable for new reform measures. In particular, they cite the need for a more comprehensive, market-oriented labour relation policy and urgent need for reform of India’s antiquated financial sector. More rapid structural adjustment will depend heavily on the government’s ability to meet its macroeconomic stabilization goal - a fiscal deficit of five percent of GDP in 1992/93, single-digit inflation, and increase export earnings.

The Government of India in July 1991 deregulated most domestic industries, allowing Indian firms to make investment and marketing decisions more freely. Industrial licensing has been eliminated, except for small list for security and strategic reasons. The list of industries reserved for public sector firms has been cut from 17 to eight, with further cuts in the offing. Public sector firms will now concentrate on high technology and essential infrastructure. Parliament has approved an amendment to the Monopolies and Restrictive Trade Practices Act (MRTPA) eliminating the capital ceiling of 1.0 billion; all firms above this limit had been considered potential
monopolies and their decisionmaking tightly controlled by the government. These companies will now be able to expand and modernize without prior government approval. The requirement for a convertibility clause in project loan agreements with government-owned financial institution has also been dropped. The requirement - always concern to foreign investors - gave the financial institutions the right to convert a portion of any loan into equity. This amounted to a continual takeover threat that gave the government leverage over basic business decision of private firms. Indian businessmen say as a result of these policy changes they have been able to reduce their visits to New Delhi.

Openness to Foreign Investment

India's post-independence policy of economic self-reliance treated foreign investment as a necessary evil. Foreign firms were allowed to enter the Indian market only if they had technology not already available in India. The present government is more respective to foreign direct investment, seeing it as a means of dealing with India's debt-induced balance of payments problems and making domestic industry more competitive. The July 1991 industrial policy is simpler, more liberal and more transparent than its predecessor. It provides automatic approval through the Reserve Bank of India (RBI) for direct foreign investment (up to 51 percent) and technology agreement in 34 high-priority industries, as long as the foreign equity covers capital goods import requirement and the project is "foreign exchange neutral." Foreign firms already operating in India in any of the 34 high-priority industries have also been allowed to raise their stakes to 51 percent. This industries account for 85 percent of industrial output. In addition, foreign trading companies engaged primarily in exports may hold up to 51-percent equity in their local operation. The previous policy limited foreign equity in manufacturing
to 40 percent and subjected investment proposals to lengthy case-by-case review. The old policy also include exports guarantees and local content requirements for most foreign investments. Ownership in trading firm was generally limited to less than 40 percent. This requirement have been eliminated under the policy, although the exports guarantee is still require for investment in industries reserved for small-scale firms. Liberalization of investment policy has thus far been limited to greenfield investments; acquisition, mergers and takeovers of existing firms as permitted only if negotiated with exiting management and approved by shareholdes.

The new policy permits equity above 51 percent in high technology industries, subject to approval by the Foreign Investment Promotion Board (FIPB). Full foreign ownership is allowed in power generation and electronics. Recommendation of the FIPB are submitted for approval to the Cabinet Committee on Foreign Investment (CCFI), headed by the Prime Minister. The FIPB also screens proposals that do not fit the automatic approval criteria, and projects that might create political problems with domestic industry. To expedite proposals, a five-member committee chaired by the Finance Minister has been made responsible for approval of investment under Rs. 3.0 billion (about $105 million). The CCFI now considers only those cases which involve larger investment, major policy issues or cases referred by this new committe. Nonresident Indians (NRIs) and overseas Corporate Bodies (firms with NRI majority ownership) may hold 100-percent ownership in all industries except those reserved for the public sector.

Moreover, the government extends incentives to firms willing to negotiate export performance and value-added guarantees. Those which export 100 percent of their output as well as these firms in export processing Zones are permitted to raise foreign currency loans
freely from banks, international financial institution, foreign collaborators, etc. Such loan must be repaid from the net foreign exchange receipts of the project being financed and are not guaranteed by the Indian financial institutions. India's trade policy provides duty-free import of raw materials, components and spares for export production. The Indian Income Tax Act exempts export earning from corporate income tax. These policies do not discriminate between Indian and foreign firms.

Transfer Policies

There are no a-posteriori restrictions on remittance of debt service or payment for imported inputs. Such transfers are made in freely usable currencies at the legal market-clearing rate. There are no dividend-remittance restrictions for firms in the 34 high-priority industries; remittance limits for other firms are negotiated as part of the investment approval process, and may be linked to export or technology transfer performance requirements. Remittance of royalties is limited to five percent of domestic turnover and eight percent of export turnover, plus up to Rs. 10 million in lump-sum payments. Remittance of funds from liquidation of assets are complicated by lack of a policy on business closure, but foreign firms permitted to liquidate assets have generally been able to repatriate the proceeds without let or hindrance.

Expropriation and Compensation

Since the wave of nationalizations and expropriations in the early 1970's, there have been few instances of direct expropriation in India. Compensation and due process meeting international standard have been observed in all cases. Exercise of the convertibility clause
in loan arrangement with government financial institute has resulted in increase in government ownership of private firms, an indirect form of expropriation. However, this has not affected U.S. investors.

**Dispute settlement**

There have been no investment disputes over expropriation or nationalization since 1990, nor are there any ongoing disputes that originated prior to 1990. However, government demands of penalty payments for alleged overcharging for pharmaceuticals during the 1980’s could lead to de-facto expropriation of some foreign drug companies’ assets in India. The case is now under litigation. Indian courts provide adequate safeguards to enforce property and contractual rights. India is not a member of the International Center for the Settlement of Investment Disputes nor of the New York Convention of 1958 on the recognition and enforcement of foreign arbitral awards. The government has no plans at present to become a member of these international dispute settlement conventions.

**Performance Requirements**

The new investment policy abolished local-sourcing requirements for both new and existing foreign investments. In June 1992, the government removed all controls on dividend repatriation by foreign firms except those in consumer goods or other non-priority industries. Previous policy called for dividend payments to be balanced against export earnings over a seven-year period. Present guidelines grant automatic approval for foreign licensing agreements in high priority industries, with royalty payments up to five percent of domestic sales and eight percent of export sales along with lump-sum payments of up to Rs. 10 million. In specific cases, the govern-
ment may permit larger payments. Present policy still requires at least 49 percent of equity to be held by Indian nationals in most cases. Previous requirements for gradual reductions in foreign equity and conditions on technology transfer have been dropped under the new policy.

India has a fairly liberal plant location policy. No approval is required from the central government to set up plants in any location other than cities of more than one million population. In such cities, non-polluting factories may be established outside a 25-kilometer radius. Environment regulations and local government zoning policies also affect plant location. There is no requirement to employ host country nationals, and previous restrictions on employment of foreign technicians or managers have been eliminated. All foreign investments are vetted for "foreign exchange neutrality," the requirement that foreign exchange inflows and outflows be balanced within 5-7 years of the initial investment. Enforcement of this requirement has not been rigorous in the past.

**Right to Private Ownership and Establishment**

Foreign investors can set up shop in specified priority industries or in wholly-export-oriented units under the terms and conditions outlined above. All other investments require Indian government approval. Domestic entrepreneurs do not face such limits on right of establishment or percentage ownership in any enterprise not reserved for government-owned firms or small-scale producers. The right to acquisition is tightly circumscribed for foreign firms, and requires negotiated agreement with the domestic firm being acquired. Foreign firms are not permitted to buy equity shares in Indian markets. The right to dispose of business interests is also limited where such disposition would result in business closure. Present policy
does not permit liquidation of a firm without prior approval of the central and state governments, all concerned labour unions and any domestic partners. Public sector companies have had preferential access to credit in the past, and some also receive confessional exchange rated for imports. This policy is currently under review as part of a more general effort to privatize or streamline the public sector. The limited privatization now underway is being accomplished through sale of equity to government-owned mutual funds. These funds are then free to trade in the shares they have purchased as they see fit, including the right to sell shares to the general public. Since foreign firms, other than foreign pension or mutual funds, are not allowed to trade in local stock markets, foreign participation in privatization is quite limited.

Protection of Intellectual Property Rights

India's legal system offers rigorous protection for acquisition and disposition of all intellectual property rights except product patents for chemicals, pharmaceuticals and food products. However, weak enforcement of copyright law, unclear statutes on use of foreign trademarks, and lack of product patent protection as noted above led the U.S. Government to initiate an investigation of India's intellectual property practices in May 1991, under the Special 301 provisions of the 1988 Trade Act. In April 1992, the investigation found progress in all areas except patent protection. As a result, the United States withdraw duty-free import rights under the Generalized System of Preferences for Indian pharmaceutical and chemical products. India remains a priority under Special 301. Indain patent law prohibits product patents for any invention intended for use or capable of being used as a food, medicine or drug, or relating to substances prepared or produced by chemical processes. Processes for making such products are patentable, but the patent term is limited to
the shorter of five years from the grant of patent or seven years from the filing date of the patent application. Product patents in other areas are granted for 14 years from the date of filing. Stringent compulsory licensing provisions have never been applied. There are broadly defined "licenses of right" applying to food and process patents. India is not a member of the Paris Convention.

In 1992, the Indian Government introduced amendments to the Copyrights Act to include coverage of rental rights for video cassettes, communications through satellite, cable or other means, to narrow the exemption of public administration of rights and to recordings, to provide collective administration of rights and to limit judicial discretion on the level of penalties imposed on copyright violators. The government also took steps to improve copyright enforcement by establishing a Copyright Enforcement Advisory Council to coordinate state government enforcement policies, provide training to local enforcement officials and compile nationwide data to copyright offenses. The government expects to introduce new trademark legislation in early 1993, intended to codify in the statutes existing court decisions on use and protection of foreign trademarks, including servicemarks. Pending the new legislation, the government has issued regulations permitting registration of foreign trademarks and eliminating the requirement for hybridization of foreign trademarks with local marks.

Capital Markets and Portfolio Investment

A fairly wide range of financial institutions and services are available in India. In addition to the stock exchange of Bombay, Calcutta, Madras and Delhi, financial institutions at the central and state level provide long and short-term financing. Availability of commercial
loans and interest rates are regulated by the Reserve Bank of India. Domestic and foreign banks are required to maintain substantial liquidity reserves in the form of government securities.

Most foreign investors experience little difficulty in raising capital from the domestic capital market. Capital issues by firms having foreign collaborations are generally oversubscribed. Private firms have access to a variety of instruments such as short-term commercial paper of 3-6 months maturity, issuance of equity shares and/or debentures, and acceptance of deposits from the public. Although the Securities and Exchange Board of India was given statutory authority to regular markets as of 1992, it lacks many of the regulatory tools available in other countries, such as an effective law against insider trading.

Mutual funds and investment institutions are active players in the capital market, though regulations to encourage portfolio investment are minimal. Foreign Institutional Investors (FII) are now permitted portfolio investment in the Indian capital market. The FII can invest up to ceiling of 24 percent of the issued capital of any company or a single FII up to five percent of the issued capital. In addition, there is no lock-in period for the prescribed investment and also no restriction on total volume of investment. The tax rate on long term capital gains (i.e., more than one year) is 10 percent and short-term gains 20 percent. The Securities and Exchange Board of India has been designated as the single window agency for registration.

**OPIC Programs**

India's only bilateral investment agreement is with the U.S. Overseas Private Investment Corporation (OPIC). Since 1963, OPIC has provided coverage for over 100 U.S. investment projects in India. As the government steps up efforts to court foreign investment, OPIC
activities will continue to increase. In recognition of that fact, OPIC is organizing an investment mission to visit India in January 1993. In April 1992, India became the 113th country to join the World Bank's Multilateral Investment Guarantee Agency.

**Labour Policies**

India has the world's third-largest pool of scientific and technical personnel—an important attraction for foreign investors. The working population is growing by 2.6 percent annually, slightly higher than the general population growth rate. Unemployment is well over 20 percent, so there is no shortage of labour. However, labour productivity is low. Despite relatively low wage rates in India, many foreign companies have found the ratio of labour costs to total production costs of operations in India not significantly different than that for operations in higher-wage countries. Lack of adequate primary education limits the trainability of unskilled and semi-skilled labour. The July 1991 industrial policy provides for hiring of foreign technicians without prior government approval. Effective from September 26, 1992, the Reserve Bank announced an increase in the remittable per-diem rate from $1000, with an annual ceiling of $200,000 for services provided by foreign technicians payable to a foreign firm. Technical personnel can now remitt up to 75 percent of their monthly net income through authorized exchange dealers. Total duration of employment of a single technician limited up to three months at a time. Employment in excess of three months requires clearance by the Ministry of Home Affairs.

Industrial relations are governed by the Industrial Disputes Act of 1947. The Act curbs unfair labor practices by employers, workers or trade unions through imposition of fines and imprisonment. Wage increases are normally negotiated between unions and management. The number of person-days lost due to strikes and lockouts has declined from about 24 million in 1990 to about 13-14 million in 1991.
Workers' rights as defined by the International Labour Organization are guaranteed under the Indian Constitution. Workers may form or join unions of their choice. Payment of wages is governed by the Payment of Wages Act, 1936 and Minimum Wages Act, 1948. Wages range from about $3.00 per day for unskilled manual labor, over $150 per month for skilled production workers, to as much as $1,000 or more per month for professional staff. Layoffs, retrenchment and closure are governed by the Industrial Disputes Act, 1947; prior permission from the appropriate level of government is needed for closures or layoffs. Firing for cause is permitted under Indian law.

**Foreign Trade Zones**

Export processing zones (EPZ) and wholly-export-oriented units (EOU) are intended to provide an internationally competitive, duty-free environment for exporters. Investments in EPZs or EOUs are automatically approved within 15 days of application, provided export obligations and capital goods financing requirements are met. India has six export processing zones while the seventh, at Vishakhapatnam in Andhra Pradesh, is under construction. Units in these zones may be 100 percent foreign-owned or joint ventures with majority foreign equity holding. Investment by services firms may also be considered. The five-year (1992-97) Export and Import Policy gives export firms duty-free import of all goods, including capital goods; five-year income tax exemption; exemption of excise tax on capital goods, components and raw materials; and permission to sell 25 percent of output in value terms (except jewelry, diamonds, precious stones, motorcars, etc.) as well as up to five percent "seconds" sold in the domestic market against payments of appropriate taxes.
The government requires minimum added-value of 20 percent for most products, and 60 percent for computer software and plant tissue culture. The law does not discriminate against foreign-owned firms. The government has also decided to extend incentives available to units in EOU s and EPZs to the new electronics hardware technology parks. While there is no free port at present, the PHD Chamber of Commerce and Industry has recommended the Andaman and Nicobar Islands and Bombay as locations for free ports to attract greater foreign investment. The Raunaq Singh (a prominent industrialist) panee set up by the government earlier had recommended Goa as a free port but no action has yet been taken to implement the panel's recommendations.

**Capital Outflow Policy**

India's policy on capital outflow remains restrictive, since foreign exchange stocks and non-debt inflows are limited. Outward investment is permitted in support of Indian capital goods and technology exports or foreign assistance programs. Major incentives for investment in overseas ventures are: reimbursement of 50% of expenditures toward market development assistance; Indian Exim Bank credit to developing countries to encourage export projects; confession al import tariffs on imports of used equipments for re-export by Indian investors; and 50% income tax exemption on earnings from exports of project and consultancy services. Indian equity investment in 161 joint ventures as of was Rs. 1.21 billion. Another Rs. 4.55 billion has been approved for joint ventures yet to be implemented. The size of these ventures is generally small; 36% are located in West Asia, followed by 18% each in the Europe-America region and Africa, with the remainder in South-Asia. As a part of the liberalized policy framework, the government will give automatic approval for
joint ventures abroad within 30 days of the equity participation through export of domestic plant and machinery below $2.0 million. Joint ventures with equity participation above that amount require approval from an interministerial committee. Approval is normally granted within 60 days. In March 1992, India introduced partial convertibility of the rupee under the Liberalized Exchange Rate Management System (LERMS). LERMS requires all export and invisible receipts to be surrendered to authorized exchange dealers, with 40% exchanged at the official rate (presently about Rs. 25.50 to a dollar) and 60% at the market rate (about Rs. 29 to dollar). This system assures the government of cheaper foreign exchange for its imports of petroleum products, essential drugs, and other government purchases. Payment of interest, principal, dividends, royalties, etc., are all converted at the market rate.