LPG POLICY-ECONOMIC BOON OR BOOM FOR INDIAN ECONOMY

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ABSTRACT

LPG policy was a part and parcel of New Industrial Policy 1991. The policy has proved to be eyewash as the real growth benefits have accrued to the European Nations who dominate the IMF and World Bank. The main aim of LPG was to liberalize the economy so that private sector could work more freely with reduction in active role of government. But what the facts reveal is an ironic situation where we are just getting an insignificant part of our own growth and development due to repatriation of profits of private sector to their European Domains. Globalization which envisaged the importance of global trading has just proved to be a means for destroying our domestic industry by providing a free passage for foreign MNC's whose working motto is to destroy others and dominate with the huge economic resources they possess. The recent call to ban China product and the viral calculation messages about China's benefits from Indian Economy are just a wakeup call to our Indian Counterparts to realize the ripple effects that have been serving as a slow poison for our country once called "GOLDEN SPARROW".

Keywords : Economic Planning, Foreign Direct Investment (FDI), Globalisation, Liberalisation, Multinational Corporations, NEP 1991, Privatisation

INTRODUCTION

India has completed nearly five decades of economic planning. During this period significant progress has been made. One of the major achievements of planning has been that the Indian economy is no longer under the clouds of colonialism. India has an independent economic structure. The country is well set to attack poverty, ignorance and disease. India's national income has been continuously increasing; its rate of growth having gone up from 3.5 percent per annum during 1950-75 to about 5 per cent per annum during 1975-91, and 6 per cent since then. The proportion of people living below the poverty line has started coming down. The birth rates have also started falling. The life expectancy rate has risen. The country has built sizeable buffer stocks of food grains. The export growth rate is picking up fast. Self-reliance in a number of industries has been increasing significantly. The industrial growth rate too is picking up. The prospects for agricultural growth are getting improved, and so on.

However, there have been serious lapses and shortcomings also. The rise of growth of national income has been below that of many developing countries. The incremental capital-output ratio has more than doubled; the domestic savings to income ratio increased a while but has now become constant. The balance of payments deficits continue to be sizeable; the inflation rate has been high; and so on.

A series of sweeping changes were announced by the Government in the form of the New Industrial Policy, 1991. The basic philosophy of the new policy has been summarised as 'continuity with change.'

The new Industrial policy seeks to achieve the following objectives:

1. to consolidate the strengths built up during the last four decades of economic planning and to build on the gains already made;
2. to correct the distortions or weakness that may have crept in the industrial structures as it has developed over the last four decades
3. to maintain a sustained growth in the productivity and gainful employment
4. to attain international competitiveness.

The pursuit of these objectives will be tempered by

1. the need to preserve the environment,
2. the need to ensure the efficient use of available resources.

WHY NEW INDUSTRIAL POLICY 1991?

Various causes responsible for the limited success of planning in India can be grouped into three parts, viz.,

1. On the side of target setting, planning has suffered from two basic defects:
    a. Given the multiplicity of objectives there has been no clear-ranking of these objectives. This has resulted in a somewhat contradictory set of policies being attempted during the planning period. As a result, concessions and compromises have been extended without any compensatory advantage.

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b. There have been frequent failures to distinguish between targets and instruments within a given context of decision-making.

2. As regards the choice of instruments, Indian economic planning seems to have relied largely on certain financial allocations sector-wise. It looks that it has been the belief with the planners that once the financial allocations have been made and necessary expenses incurred, their job is done, and that the desired goals and objectives would automatically follow. This has often proved wrong.

   Similarly, for carrying out adequate planning in a mixed economy we have hardly developed mechanisms to influence production and distribution decisions within the private sector so that they conform to national priorities. This failure is very serious considering the crucial role the private sector plays in the national economy.

3. The Indian economy has been plagued by constraints which have adversely affected the working of the plans. These various constraints can further be grouped in three parts, viz.

a. PHYSICAL CONSTRAINTS

i. There is inadequacy of infrastructure. The economy has experienced serious shortages of power, coal, transport, etc. These have adversely affected the working of the different sectors of the economy.

ii. Because of the various procedural and bureaucratic bottlenecks, decision-making is slow in India. Delays in decision-making and follow-up action have two major consequences. One , in our inflationary set-up delays lead to cost escalations. Two, these lead to the loss of opportunities.

b. FINANCIAL CONSTRAINTS

i. There has been the problem of foreign exchange, which, at times, has played havoc with the economic system.

ii. Capital-output ratio has been rising in the economy. That means, we require higher and higher amounts of capital to produce a given level of output, i.e., the productivity of capital has been declining.

iii. There are problems associated with resource mobilisation, both domestic and foreign.

c. SOCIAL CONSTRAINTS

The level of rising expectations has reached the state which can aptly be described as 'aspiration explosion'. What has happened is that over the last five decades the masses have been exposed to the possibilities of better living conditions. The revolution in electronics and engineering taking place in the world has made people aware of the possibilities of better living conditions. But a slower rate of growth in the economy has not made it possible for these to be available to the masses. This has generated discontent. Consequently, not frequently, doubts have been raised about the usefulness of the planning mechanism.

NEW INDUSTRIAL POLICY, 1991

Prior to independence, there was substantial foreign investment in India. Almost all the tea plantations, most of jute mills, petroleum sector and many consumer goods industries were developed and owned by foreign investors belonging mostly to UK and USA. But after independence, the Government of India insisted that foreign investments will be allowed in India only in partnership with the Indian entrepreneurs, where majority of ownership and control will be in the Indian hands. Equity capital of most of foreign companies operating in India was diluted so as to ensure majority share of Indians in ownership and management. Many of the foreign companies were also nationalised and completely brought under Indian ownership. This naturally acted as a disincentive to foreign investors and significantly reduced the inflow of foreign capital. This had an adverse affect on the tempo of industrial development because the domestic savings could not provide the resources needed for development. Consequently the Government adopted a more liberal policy towards foreign capital and many concessions were given to encourage its inflow. Since 1991, the policy towards foreign capital has been made more liberal and the equity limit of foreign participation has been raised to 51 per cent or more, even upto 100 per cent in many industries.

In view of this low inflow of foreign investment, the Government of India has announced a liberal policy towards foreign capital. The new industrial Policy announced in July 1991 contains the following provisions with regard to foreign investment:

1. As against the past policy of considering all foreign investment on a case by case basis and that too within the normal ceiling of 40 per cent of total equity investment, the new policy provides for automatic approval of direct foreign investment upto 51 per cent foreign equity holding in 34 specified high-priority, capital intensive, high technology industries provided the foreign equity covers the foreign exchange involved in importing capital goods and outflows on account of dividend payments are balanced by export earnings over a period of seven years from the commencement of production.

2. Foreign technology agreements are also liberalised for the 34 industries with firms left free to negotiate the terms of technology transfer baded on their own commercial

judgement and without the need for prior Government approval for hiring foreign technicians.

3. In order to avail of professional marketing activities for systematic exploration of world markets for foreign products, foreign equity holding upto 51 per cent will be permitted for trading companies as well; and

4. A special Board viz., Foreign Investment Promotion Board has been set up to look into large foreign investment projects where higher foreign equity limit of more than 51 per cent may be permitted.

Further concessions were announced for foreign equity capital in 1992-93. Existing companies were permitted to raise foreign equity upto 51 per cent subject to certain prescribed guidelines. Foreign direct investment has also been allowed in exploration, production, and refining of oil and marketing of gas. NRI overseas corporate bodies are permitted to invest 100 per cent equity in high priority areas, as well as in export houses, trading houses, hotels and tourism related industries. Disinvestment of equity by foreign investors has been allowed at market rates on stock exchange as against the earlier provision of doing so at prices determined by the RBI. Foreign companies have been allowed to use their trade mark on domestic sales from May 14, 1992.

With an eye to attract Foreign Direct Investment (FDI) of $ 10 billion annually, the NDA Government, in a major policy shift, threw open (February 1, 2000) most of the industrial sectors (barring defence, aeronautics, explosives, alcohol, tobacco products) for FDI an automatic routo to NRIs and overseas corporate bodies. The main features of the latest liberalised FDI regime are :

100% FDI in

1. mining (including coal and lignite supply to private Indian power companies) prospecting of gold, silver diamonds and other minerals

2. pollution control-related equipment

3. films (in addition to high priority areas, export houses, trading houses, hotels and tourism-related industries, projects for electricity generation, transmission and distribution, roads and highways, ports and harbours and vehicular tunnels and bridges, which are already covered under automatic route)

74% FDI in

1. advertising,

2. Bangalore international airport joint venture

3. Prospecting and mining of gemstones.

CRITICAL ANALYSIS OF NEP 1991

One of the most important concerns of Economists of every developing Economy is the Protection of Domestic Industries against the Multinational Corporations (MNCs). Many of the MNC's have annual sales turnover which is larger than the aggregate GNP of the underdeveloped countries in which they operate. Their annual budget is far in excess of many developing countries. Such enormous size of operations confers upon the MNC's great economic and political power in countries where they work. These MNC's due to their huge operations enjoy a semi-monopolistic power in the markets of these countries. The rise of MNC's and their growing sphere of influence has helped in their development process. On the other hand, due to their dominance and oligopolistic character, they have harmed the growth of local enterprise and thus hampered the growth process.

ARGUMENTS IN FAVOUR OF LPG POLICY

1. LPG POLICY COVERS SAVING-INVESTMENT GAP

Rate of growth of an economy crucially depends upon the rate of capital formulation. Thus for rapid industrial and economic development, the country must save a considerably large part of its income and invest it in industry or other economic activities. But income level in underdeveloped countries is extremely low and savings are therefore meager. These savings are not adequate to step up the growth rate of the economy. The gap between domestic savings and the level of investment needed to achieve the desired rate of growth can be filled by inflow of foreign capital. Thus availability of foreign capital or direct investment undertaken by the MNC's increases the overall volume of investment by supplementing domestic savings. Larger inflow of foreign capital can help in achieving faster rate of industrial and economic growth compared to that growth rate which could be achieved by limited supply of domestic capital and the consequent low rate of investment.

2. LPG POLICY MINIMISES BALANCE OF PAYMENTS PROBLEMS

In underdeveloped countries developmental imports such as imports of machinery, raw materials, etc., rise sharply as the development process catches momentum. But exports do not grow much because traditional exports such as those of raw materials, mineral areas are now no more sold abroad but are preserved for growing domestic industries. New or non-traditional exports take time to pick up. Thus there is a persistent deficit in balance of payments. Foreign direct investment means that foreign companies or MNC's bring in their own machines, plants, equipment, etc., and buy other foreign goods required for their operation with their own resources thus eliminating the burden of foreign exchange payments in this account. Thus the gap in the balance of payments is minimised thereby, preventing the problems of foreign payments from becoming acute or assuming the dimensions of balance of payments crises.

3. LPG POLICY FILLS TECHNOLOGY AND MANAGEMENT GAP

The underdeveloped countries are not only short of capital, they are also far behind in the crucial spheres of technology and management skills that are so essential to the process of economic development. The foreign companies or MNC's not only bring their plant and equipment that is based on most upto date technology but also bring along their own engineers, modern methods or work in their respective spheres. This inflow expertise, skill and knowledge make the operations of industries effective and cost efficient. In course of time, this knowledge and expertise is transferred to the local people who learn other things either by working with the foreign experts or are imparted such knowledge through workshops and training programmes.

4. LPG POLICY ENSURES MOST EFFICIENT USE OF CAPITAL

The MNC's ensure efficient use of scarce capital resources. These companies with their worldwide and long experience, modern work methods and sharp entrepreneurial skills use the capital in those ventures which are most profitable and in a manner which is least risky. This ensures that capital is used in such a manner that it yields optimum results.

5. LPG POLICY FREES FROM PROBLEMS OF REPAYMENT

International flows of capital take two forms viz.,

1. international loans or foreign aid and
2. foreign direct investment or private foreign capital

With foreign aid, the advantage is that the country can use it according to its own programmes and priorities whereas FDI is used by MNC's to maximize their own profits which may not necessarily correspond with national priorities. Thus some economists prefer foreign loans to foreign direct investment. But over time such loans create their own problems. After sometime, loan has to be repaid in regular installments. Interest on loan has also to be paid. This sum of installment and interest paid annually is called debt servicing. Since the underdeveloped countries keep on borrowing regularly and increasingly larger funds for their development year after year, the magnitude of debt servicing also keeps on increasing. Thus the volume of net aid (gross aid minus debt servicing payments) for use in the economy gets smaller. A time may come when inflow of foreign aid may not be sufficient enough to even meet the debt servicing obligations. Thus the country may have to borrow longer or large amounts just to meet debt servicing requirements and may get into 'international debt trap.' This is a situation in which many of the developing countries (such as Mexico) got into in the recent past. India narrowly escaped this predicament. With foreign direct investment, there is no fear of such problems, because it is an investment by the foreign companies and the nation has no liability to pay it back. They will take profits only when they earn and thus there is no such burden of debt servicing or fear of debt trap.

Arguments against LPG

The argument that foreign capital supplements domestic savings and thus provides more capital resources for development may be correct to begin with. But as more and more FDI comes in and MNC's grow, they, through their big size of operations destroy competition, eliminate local entrepreneurs and inhabit growth of indigenous industry. Thus growth of MNC's may be accompanied by destruction and contraction of domestic industries.

The foreign capital is thus not necessarily helpful to the economic and industrial development of less developed countries; it may rather work in the opposite direction.

1. The argument that foreign capital prevents strain on the precarious balance of payments position of the underdeveloped countries is also not very tenable. It is true that MNC's bring in their own equipment and plants and thus no foreign exchange payment is made by the country thus minimising the balance of payments difficulties. But in the long run the MNC's may cause strain in the balance of payments through repatriation of profits, interests, royalties, management fee etc.

2. It has been argued that MNC's bring the most modern technology, management, experience and knowledge, which the local people may be able to learn by working along with the foreign experts and use it in other areas of the economy. But in actual practise such techniques, method and information are kept as closely guarded and the local people may not have any access to them. Local people may, infact, not be employed to such high ranking jobs where they can interact and learn from the foreign experts.

3. The MNC's use modern capital intensive technology which is inappropriate to the conditions in underdeveloped countries. This modern technology uses more capital but absorbs less labour. In countries where labour is in abundance and unemployment widespread, such labour saving technology is inappropriate because it does not offer many jobs and thus helps in removal of unemployment; it may in fact add to unemployment by extending automation to larger areas of the economy.

4. Experience of the underdeveloped countries shows that foreign capital instead of helping in the harmonious development of the economy, has been responsible for creating and accentuating economic imbalance in these countries. In the past, most of the foreign direct investment in the less developed countries remained concentrated in extractive industries such as mines and minerals and plantations such as tea, coffee and rubber. The motive behind such investment pattern has been not the development of the domestic economy of these

countries, but earning high profits by catering to the demand of rich international clientele. Development of tea gardens in India or investment in jute industry was motivated by such considerations. Thus, while extractive industries or export oriented production may grow, the industries catering to domestic demand may remain largely neglected, by the foreign investors.

5. Foreign capital may also lead to distortions in economic priorities and investment pattern and thus cause misallocation of resources. These MNC's are interested in producing those goods which give the maximum returns. May be the goods that offer scope for maximum profits is not the ones that fit into country's scheme of priorities. But a country inviting and accepting foreign capital has to also accept the composition and pattern of production dictated by the MNC's. Thus while a poor country may need more of ordinary cloth or drinking water, the MNC's may produce mineral water and soft drinks. This, in simple economic terms means that MNC's cause a distortion in resource allocation and production pattern by producing goods needed by the affluent sections while the urgent needs of the poor are ignored.

6. The MNC's may also lead to distortions in consumption patterns. By the massive, aggressive and sustained publicity, they can create demands and evolve market for their products. They have resources to spend and the art to attract customers. Thus, the worldwide network of MNC's in eatables like KFC, soft drinks like Pepsi and Coca Cola, junk food outlets etc., are all examples of how the MNC's have created a taste for their products and ensured wider markets for sale. This consumption pattern may not be in tune with the food and nutritional requirements of the general masses.

7. The MNC's often use their economic power and financial strength to influence government policies. They can and sometimes do, corrupt politicians, bureaucrats and other influential people to secure benefits for themselves in the form of tax concessions, investment rebates, cheaper factory sites, purchase orders for their products etc. That many politicians are on the payroll's of the MNC's and pay-offs and bribes a common feature of governments bureaucratic machinery are too well-known to invite any further comments.

CONCLUSION

Battling with the constant failure and mismanagement of its Economic Planning, India opted for New Industrial Policy 1991 with a major stress on Liberalisation, Privatisation, and Globalisation of the Economy. It was perceived that it will help India in getting rid of the present disorderly state of poor affairs leading to improper growth and development. However, the realities did not match with the expectations. The benefits accrued, of course, and the country is set on a course of development but the cost it had to pay for it is too heavy in terms of the Domestic Industries which were wiped out with the entry of Multinationals in the name of providing Investment and technological support to Indian Economy.

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