# India's Open-door Economic Policy

By Kyoko Inoue

The liberalization of the Indian economy has picked up speed since Indira Gandhi's return to power as prime minister of India in January 1980. There has been a series of moves to liberalize the economy, such as the approval of foreign capital imports, the easing of restrictions on the activities of foreign capital-affiliated business enterprises, big corporations and large groupings of companies, and the loosening of controls on imports.

The liberalization of the Indian economy began with the easing of import restrictions in the latter half of the 1970s, when foreign currency reserves increased sharply because of the sudden surge in remittances by Indian migrant workers in the Middle East. This liberalization policy is being pursued today as part of the Gandhi government's overall economic program. As can be seen from the 5 billion SDR loan from the International Monetary Fund (IMF), as well as from the enlarged scope of activity of foreign-capital enterprises and other large corporations, the easing of trade restrictions, the aggressive imports of foreign capital and technology, etc., this is an "open-door" economic policy different from the former development program, which was controlled and "closed" and moreover stressed the home market over exports.

## A vulnerable economy

First, let us look at the economic background of India's switch to an economic liberalization policy. In the latter half of the 1970s, India's economic growth was progressing relatively smoothly. The Fifth Five-Year Plan (1974/75-1978/79) had achieved a 5.2% real annual GDP growth surpassing the targeted 4.4%. The country enjoyed good agricultural production and a low consumer price increase, as well as an extremely healthy balance of international payments and an increased foreign currency reserve, as foreign trade proceeded smoothly and remittances increased from the Indian migrant workers abroad.

Indian Prime Minister Indira Gandhi

However, in 1979, with the rise in the international oil price, the cost of imported oil and oil products rose sharply, and consumer prices showed a marked rise due to a severe drought which caused food shortages. At the same time, industrial production remained stagnant. The result was a big drop to minus 4.8% economic growth in the 1979/80 fiscal year. Beside the foreign elements of the oil crisis and the increased oil price, India was hit by the *force majeure* of unseasonable weather. These events revealed the vulnerability of India's economic structure and forced the country to face up to the need to cope quickly with a worsening balance of international payments.

With the hike in international oil prices, the cost of imported oil and oil products jumped from Rs16.9 billion in the 1978/79 fiscal year to Rs52.6 billion in fiscal 1980/81 (Table 1). At the same time, other imports also rose sharply, and with exports failing to keep pace, India's trade deficit marked a steep rise, while the balance of current accounts, together with the balance of international payments, worsened (Table 2). Even if India were to meet the immediate crisis with stopgap measures such as eating into the foreign currency reserves accumulated during the 1970s, obtaining further foreign assistance and aggressive borrowing, some form of economic restructuring was necessary, fundamentally and over the long term.

Improving the trade balance depended on increasing exports and holding down imports; in either case, the strengthening and expansion of domestic production were necessary. Measures to cope with oil purchases abroad, which accounted for 30–40% of all imports, were also necessary to hold down overall imports.[1] Moreover, domestic production needed to be expanded to hold down other large-volume imports such as iron and steel, cement, paper, fertilizer and foodstuff. The nurturing of industries whose products would replace imports has been given high priority by successive Indian governments; however, progress has been slow, and in fact protective measures to promote domestic industries have had the opposite effect of markedly lowering the technological and productive levels in many sectors.

Under these circumstances, to promote domestic industries as an alternative to imports, it is essential that productivity and the quality of goods be raised. But, to do so, the bottlenecks in production must be overcome. These bottlenecks concern goods and services that are basic to the economy, such as electric power, coal and transportation. Other pertinent issues involve the quality, cost and availability of machinery and of basic industrial materials and products, and the question of technology and capital availability. Consequently, India is faced with the need for a comprehensive program covering all the foregoing issues.

*Kyoko Inoue is a senior researcher at the Current Affairs Department of the Institute of Developing Economies. She specializes in international relations in South Asia.*

**Table 1 Foreign Trade** (in Rs. million)

| | Export | Import | Import: Oil and Petroleum | Balance |
|---|---|---|---|---|
| 1978/79 | 57,263 | 68,143 | 16,869 | |
| 1979/80 | 64,588 | 91,426 | 33,329 | -26,838 |
| 1980/81 | 66,832 | 125,603 | 52,635 | -58,771 |
| 1981/82 | 78,059 | 136,076 | 51,895 | -58,017 |
| 1982/83* | 88,298 | 143,558 | 55,977 | -55,260 |
| Apr.-Dec. 1982 | 61,184 | 104,165 | | -40,599 |
| Apr.-Dec. 1983* | 68,583 | 101,783 | | -35,582 |

Sources: Government of India, Economic Survey 1983/84, pp.142-143, pp.148-149
Economic Times, March 23, 1984
*Figures are provisional

**Table 2 Balance of Payments*** (in $ million)

| | | 1978/79 | 1979/80 | 1980/81 | 1981/82 |
|---|---|---|---|---|---|
| Trade balance | | -2,238.9 | -4,165.8 | -7,546.0 | -6,825.2 |
| Non-monetary gold movement | | 32.1 | 6.4 | — | — |
| Invisibles (net) | | 1,909.3 | 3,213.8 | 4,740.4 | 3,683.1 |
| Current account (net) | | -297.5 | -945.6 | -2,805.6 | -3,142.1 |
| Capital transactions | Private (net) | -40.3 | -26.9 | 122.6 | 91.3 |
| | Government (net) | 14.0 | 279.6 | -237.0 | -262.0 |
| | Amortization payment (gross) | -563.7 | -660.4 | -867.6 | -729.0 |
| | Repurchase of rupees from IMF | -251.4 | -103.0 | -9.5 | -38.5 |
| | Banking capital (net) | -9.6 | -100.8 | 16.1 | -14.0 |
| Errors and omissions | | 715.0 | 13.1 | -199.8 | -441.0 |
| Total deficit | | -433.5 | -1,544.1 | -3,980.8 | -4,535.3 |

Source: Government of India, Economic Survey 1983/84, pp.138-139.
*Figures are provisional.

## Steps toward liberalization

In July 1980, the Indian government announced its New Industrial Policy. India's industrial policy began with the Industrial Policy Resolution of 1956, which established the principle of basing national economic development on the public sector. The operations of the private sector and foreign-capital enterprises were restricted by measures such as the Monopoly and Restrictive Trade Practices Act (MRTPA), the Foreign Exchange Regulation Act (FERA) and the Industries (Development and Regulation) Act. However, these regulations and controls were not rigid, and the trend since the latter half of the 1970s has been toward their relaxation.

A feature of the 1980 New Industrial Policy was the relaxation of the production controls on private enterprises. Then, in 1982, the operations of private enterprises were further liberalized; in particular, large business enterprises and foreign-capital companies were no longer barred from producing transportation machinery and tools, electrical equipment, chemical and pharmaceutical products, and industrial machinery. They were also permitted to enter fields of production hitherto restricted to medium and small enterprises, on condition that such production would promote exports.

At the same time, the MRTPA and the FERA were also revised. In the MRTPA, the definition of "dominant" and the restrictions on the operations of dominant enterprises were relaxed. In the case of FERA, exceptions were recognized to the maximum 40% foreign equity rule applying to Indian foreign capital-affiliated enterprises—and in some cases foreign equity of 51% has been approved. And recently, in certain areas of investment where foreign participation is banned by FERA, cases, billed as exceptions, have appeared of foreign firms participating in the capitalization of Indian enterprises.[2]

The foregoing cases indicate a softening of the attitude toward the operations of large enterprises and foreign capital-affiliated companies and toward foreign capital and foreign business tie-ups.

Furthermore, in an effort to attract foreign capital, measures were taken in 1980 to promote direct oil-dollar investments in India, and, in 1982, approval was granted for non-resident Indians to invest in Indian enterprises through stock and bond purchases as an incentive to remit foreign currency earned abroad.

Attracting special attention as a new form of business tie-up with foreign enterprises is the contract formally signed in October 1982 (with production initiated in December 1983) between Maruti Udiyog Ltd., a government enterprise, and Suzuki Motor Co., Ltd. of Japan for the production of a subcompact car called "Maruti." In the past, the tie-ups between India's public sector enterprises and foreign companies had taken the form of turnkey production, technical tie-ups and the provision of materials, services and capital; however, under the Maruti-Suzuki contract, foreign capital participation in an Indian public sector enterprise has been approved for the first time, with Suzuki authorized to obtain an eventual 40% equity in Maruti.[3] It is also of great significance that through this project, India will receive the latest technology in motor vehicle production and related fields. The establishment of Maruti-Suzuki joint project is a clear indication of the Indian government's policy to positively welcome foreign capital and technology.

In the foreign trade sector, a positive liberalization policy has been in effect since 1980. In particular, the 1982/83 fiscal year import policy announced in April 1982 incorporates extensive liberalizaton moves, such as the removal of most of the import restrictions imposed for the protection of domestic industries and most of the controls on imports of capital goods, basic materials and industrial machinery. This import liberalization continued in the 1983/84 and the 1984/85 fiscal year trade policies, with import restrictions eased on some high technology products and on capital goods.

In November 1981, the Indian government decided to avail itself of International Monetary Fund (IMF)'s Extended Financing Facility to an aggregate of 5 billion SDR over a three-year period. The Indian government pledged to carry out a mid-term economic adjustment incorporating measures to expand production and capital investment by liberalizing imports and introducing new technology and to control inflation through financial and fiscal means. This acceptance of large-scale IMF financial assistance indicated that India was earnestly setting out toward economic development through liberalization, using the IMF fund as leverage.

## Problems arising from liberalization

In January 1984, Prime Minister Gandhi announced the decision not to use 1.1 billion SDR of the IMF loan. In other words, with 1.1 billion of the 5 billion SDR still unused, India was declining further IMF aid as being no longer necessary. According to the Indian government, this action became possible because of "careful management of our foreign exchange resources" and an "improved foreign exchange situation."

While it is true that India's foreign trade

deficit is decreasing with the reduction in oil imports and that deterioration of the balance of international payments is being kept in abeyance, these alone are not convincing reasons for reducing the IMF loan. The trade deficit, while decreasing, is still large at the Rs50 billion-level, and exports are sluggish. The foreign exchange reserve has been steadily decreasing from Rs51.5 billion in November 1983 right down to Rs44.3 billion in January 1984. Industry has not recovered from its long stagnation, and it is difficult to describe the restructuring of the economy as a success. There is also the fact that, while declining further aid, India has been aggressively seeking loans from the International Development Association (IDA) and the Asian Development Bank (ADB). Thus, some questions arise regarding the Indian government's decision on the IMF loan.

One possible interpretation is that the reasons for the decision are both political and economic. There has been strong domestic criticism that the terms of the IMF loan, tied as it was to economic liberalization, meant abandonment of India's economic sovereignty. Moreover, it is possible that, with general elections to the Lower House of the Indian Parliament scheduled for late 1984, the government felt that such criticisms could be suppressed by reducing the remainder of the IMF loan and pointing to its economic successes. It is also possible that concern over increasing foreign debts made it appear desirable to restrict further foreign borrowings.

In reality, however, the lack of capital, and the delay in progress of development projects due to this lack, has become extremely serious. This is the final fiscal year of the Sixth Five-Year Plan (1980/81–1984/85), and, according to the mid-term appraisal issued in August 1983, the ratio of project objectives achieved is extremely low if that of crude oil production is excluded. Capital investment, in particular, has been sluggish, with public sector investments during the first four years of the plan reaching only 62% of the target.

The foremost reason for this stagnancy in investment, the very basis of economic development, is lack of capital. In February 1984, the government announced that, because of the lack of funds, a 10% cut in government sector investments will be instituted under the current five-year plan, that is, by the end of the 1984/85 fiscal year, and that all new projects will be postponed except for those in the electric power, coal and transportation sectors financed by foreign aid and those planned with foreign credit. A cut in the scale of capital investment is fatal to the execution of economic development programs and economic policy.

Hereafter, India no doubt will have no alternative but to maintain its development program by accepting foreign aid, capital and technology on a selective basis, especially for its key projects. At any rate, the shortage of domestic funds will lead to increasing demand for foreign capital.

For this fiscal year, India has applied for loans to the World Bank (for approximately US$3.5 billion) and to the ADB (for approximately US$2 billion). Prior to Japanese Prime Minister Yasuhiro Nakasone's visit to India at the beginning of May this year, India sounded out Japan on a ¥95 billion loan, outside the framework of the regular yen assistance, for financing natural gas pipeline construction. Incidentally, the fiscal 1983 yen loan increased by 5% over that of 1982 to reach ¥34.7 billion. With aid through international agencies tending to grow smaller in recent years, India is extremely aggressive in negotiating direct assistance from abroad.

Until quite recently, India did not consider large-scale foreign commercial loans, and almost all foreign financing was in the form of soft loans from international agencies and foreign governments. But India now has no recourse but to negotiate high-interest foreign commercial loans in order to obtain development funds. The foreign commercial loan balance as of March 31, 1984 had reached Rs51 billion (approx. US$4.3 billion), an amount already exceeding the target set in the Sixth Five-Year Plan. Moreover, the commercial loans hitherto were reserved for financing specific projects, but now there are moves to seek non-project commercial loans.

As the influx of foreign capital increases, cumulative foreign indebtedness is becoming a matter of concern. Foreign debts have risen from US$12 billion at the end of the 1980/81 fiscal year to reach approximately US$18 billion at the end of the 1982/83 fiscal year. The repayment rate was a low 8% in the 1980/81 fiscal year but rose to 14–15% in 1983 and is expected to rise to 20% when the repayment to IMF begins in 1986. Hence, unavoidably, India will be faced hereafter with the issue of cumulative debt repayment.

Today, India's economic liberalization policy is not necessarily proceeding smoothly. For instance, since non-resident Indians were allowed in 1982 to invest in Indian enterprises, their equity holdings in India have risen sharply.[4] This excessive capital investment has raised concern on the part of the enterprises of a possible takeover threat from the non-resident Indians; hence, in May 1983, the investment of non-resident Indians was limted to 5% of the paid-in capital of an enterprise. The permissible ceiling of non-resident Indians' investment is the center of controversy in India at present, but the Indian government considers their investment as an important source of foreign capital and has not changed its basic stand of welcoming such investments. It is calling on wary private Indian enterprises "not to kill the goose that lays the golden egg."[5].

Looking at the present state of the Indian economy, there still appears no sign that the economic liberalization policy has raised production or has improved the trade balance. Industry still remains stagnant, and some domestic sectors have even suffered from the sudden rise in the influx of foreign goods resulting from the freeing of imports. No doubt, more time is required to achieve the results envisioned by the economic liberalization policy. As pointed out above concerning investment by non-resident Indians, liberalization is turning out to be a zig-zag affair, with further difficulties likely to follow. However, India's desire to open a new chapter in its economic development by introducing foreign capital and technology appears to be authentic. ●

"Maruti" vehicle produced jointly by Maruti Udiyog Ltd. of India and Japan's Suzuki Motor Co., Ltd.

[1]With increased domestic crude oil production, India's self-sufficiency rate for oil has risen from 35% five years ago to 65% today.

[2]In December 1983, Arab-Gulf Investment Company Pty. Ltd. was established by one Kuwaiti and two Indian companies to handle investments from the Middle East.

[3]At the outset, Suzuki Motor's initial equity in Maruti was 26%.

[4]Investment by non-resident Indians in Indian business enterprises' stocks and bonds has increased from Rs111 million in 1982 to Rs261 million in 1983.

[5]Stated by Finance Minister Pranab Mukherjee in the Lower House of the Indian Parliament on December 14, 1983.