CHAPTER FIVE

CHAPTER - 5

THE BALANCE OF PAYMENTS IMPACT OF PRIVATE FOREIGN INVESTMENT ON THE INDIAN ECONOMY

The preceding discussion on the growth of private foreign investment in India shows a substantial increase in PFI since independence. The foregoing analysis also suggests that the behaviour patterns of foreign investment has largely been influenced by India's foreign investment policy from time to time. In recent years, India has witnessed a remarkable inflow of foreign capital in response to stabilization and structural adjustment policies. At this juncture, a question may be raised about the impact of PFI on India's economic growth. For, private foreign investment on large scale can be invited in future only if it can be shown to have assisted India's effort for economic development.

As stated earlier, foreign capital brings funds for investment in order to accelerate the growth process. It also provides technology for setting up and modernization of industries. However, outflows on account of foreign investment may build up pressure on the country's balance of payments. This may necessitate a compromise on the growth objective of the country. That is why the balance of payment effects of private foreign capital has been the prime concern of the official policy-makers in a country like India.[1] The purpose of the present discussion is to examine the effects of PFI on India's balance of payments.

The evaluation of balance of payment effect of PFI is a complex task and has been defying the economist the world over in the construction of a theoretically satisfactory framework within which it could be tested. Most of the studies employ a framework based on different assumption about what would happen in absence of foreign investment.[2] Nevertheless, it is argued that if a country wishes to evaluate the cost and benefits derived from setting up a plant with foreign investment it must examine the following alternatives.[3]

Firstly, an indegenous plant can be set-up by raising the same amount of capital and other resources domestically. However, this alternative can not be considered, because the need for PFI arises precisely due to the reason that capital is not available locally. Secondly, as an alternative to the above an enterprenure can borrow abroad with fixed interest liability and set-up a plant by buying knowhow through a licensing arrangement. But, this alternative also loses its relevance due to the fact that it has become increasingly difficult to obtain loans in the present situation. The third alternative is to borrow partly form local market and partly from abroad for the purpose of importing plant and equipments. It would be difficult to assess the merits of the above alternatives in the absence of appropriate informations. Considering, the apparent difficulties involved in assessing these alternatives, it can, therefore, be inferred that the analysis which run in terms of capital inflow/outflow has a stronger logical validity for evaluating the BOP effects of PFI than the analysis based on indirect effects. It may be noted here that paying attention only to the cost of servicing

the PFI in the form of remittance of dividends, fees, and royalties over time would amount to taking a very narrow point of view.[4]

A more pertinent issue with regard to balance of payments is whether a particular investment will mean a net contribution to the country's ability to meet foreign exchange requirement over-time after allowing for all the outgoings in servicing the investment as well as other consequential remittance. Thus, evaluation of the BOPs effects requires viewing PFI from two angle first is the direct BOP effects and second the overall BOP effects.[5]

I

THE PROCEDURE FOR ESTIMATING THE BALANCE OF PAYMENT EFFECT AND SOURCESOF DATA

As just mentioned, there are two methods of evaluating the balance of payment effect of foreign investment in a country, first is the direct BOP effect and second is the overall BOP effect.

1. The Direct Effect on Balance of Payments

The inflow of foreign capital in the form of equity capital net of capital repatriation augments foreign exchange resources. This represents the direct benefit Investment income and other allied payments drain off foreign exchange resources and hence represent direct costs. The difference between the inflows and outflows which a policy of continuous PFI is known in as "The Direct Balance of Payment Effects" of private foreign investment. Thus,

Direct Effect of PFI on BOP	=	**Equity inflow - Remittance of Dividends, Royalty, Technical Fees and Payment to Foreign Technician in Foreign Currency**

The above relationship can be expressed in absolute terms or in the form of ratios. In the equation, the result will be negative if servicing on the right hand is greater than the inflow of equity capital.

2. The Overall Effects on Balance of Payments

The direct effect on BOPs of PFI is only a part of the total effects. As pointed out above it is also necessary to consider the indirect effect of PFI in terms of net foreign exchange earnings through exports and foreign exchange outgoings through imports. This along with the direct effect constitute the overall effects on BOPs. Thus,

Overall Effects of PFI on BOPs	=	**[Equity inflow - Remittance of Dividend, Royalties, Technical Fees and Payments to Foreign Technician] - [Export - Import facilitied by PFI]**

The overall effects will be negative if the equity flows are less than the outflows.

3. Sources of Data

To examine the balance of payment effects of foreign investment in India, the principal sources of data are the surveys conducted by RBI from time to time.[6] These survey provide the data on PFI in the following form -

(a) Foreign subsidiaries which include branches of foreign companies not incorporated in India and which hold more than 50% of share capital;

(b) Minority participation companies where the parent foreign companies own less than a 50% of share capital in Indian enterprises.

(c) Where the foreign company has a pure technical collaboration agreement with the Indian company without any equity participation.

These survey reports constitute a comprehensive source of factual material for studying the impact on India's BOP. As the results of all the surveys have been presented broadly on the same lines, it facilitates the construction of a continuous data set on the financial aspects of foreign investment in India. The coverage of the surveys is shown below.

Table 5.1 : Coverage of Companies with Foreign Investment by RBI Surveys

Survey	Period covered	Number of companies covered			
		Sub.	MPC	Pure Tech.	Total
1st	1960-1963	224	367	236	827
2nd	1964-1969	197	433	247	877
3rd	1970-1972	184	460	215	859
4th	1977-1980	70	375	149	594
5th	1981-1985	47	411	262	720

Sources : RBI survey on Foreign Collaboration in Indian Industry, 1968, 1975, 1985 & RBI Bulletin Sept., 1995.

The available surveys of RBI give data upto 1986 only. Therefore, from 1986 onwards, the data published in various issues of RBI bulletin in the form of finances of FCRCs will be considered.[7] However, these data pertains to only to Indian companies involving FDI, operating mainly in manufacturing sector. Therefore any comparison in a time series framework may not be strictly possible. Nevertheless, a comparison between inflow and outflow of foreign exchanges during different years will certainly indicate the BOP impact of PFI in India.

The BOP effect has been calculated by taking into account the following :

(i) Inflow of funds on account of annual increase in share capital;

(ii) Outflow of funds as result of dividend remittance, royalty, technical fees, and payment to foreign technicians in foreign currencies;

(iii) Net inflow/outflow on account of foreign currency loans, i.e., Inflow of foreign currency loan minus interest payments;

(iv) Imports and Exports affected by the individual firms;

II

THE FINDINGS

1. Direct Balance of Payment Effects of Private Foreign Investment in India

Table 5.2 explains the direct effects of PFI on India's current account deficit. This table shows that the effect has been negative. However, the negative effect

is showing a declining trend. The direct effect here is calculated by taking into foreign currency loans related flows :

Table 5.2 : Direct Balance of Payment Effect of Private Foreign Investment in India with Foreign Currency Loans

(Rs. Crores)

Period	Total Net Outflow*	India's current account BOP Deficit	Column (1) as % of (2)
	(1)	(2)	(3)
1960-61 to 1972-73	108.04	5602.00	1.93
1977-78 to 1985-86	84.48	15674.00	0.54
1985-86 to 1990-91	262.77	53708.00	0.49

* Net outflow = Equity flow - (Dividend + Roy + Tech. Fees + Pay. to Foreigners)
Source : Compiled from A-11, A-12 and A-13

It may be noted that subsidiaries have been largely responsible for the negative direct BOP effect. This form of organisation explained 2.90% of India's C/A BOP deficit during 1960-73, 0.76% during 1977-86 and 0.49% during 1986-91 (vide Table A.11). However, net inflow in case of minority participation companies (MPC's) was positive through out the period. For instance, during 1960-73 they were responsible for easing BOP deficit to the tune of 1.69% and 1.21% during 1977-86 (vide Table A.12). Indian enterprises with technical collaboration only also contributed to BOP deficit, though, marginally. Thus, pure technical collaboration (PTC's) were responsible for 0.72% of India's C.A. deficit during 1960-73 and 0.14% during 1977-86. (vide Table A.13)[8]

It is relevant to point out here that estimation of direct BOP effect of foreign investment with foreign currency loans (FCL's) reduces the negative direct BOP effect. One may note that PFI mainly comes in the form of equity capital. The proportion of FCL's in PFI during the period under consideration is quite small. Therefore, direct BOP effect without taking into consideration FCL's would throw a better light on BOP implication of PFI. The same is attempted in Table 5.3. It is clear from the table that the negative BOP effect of PFI is enhanced when FCL's are not considered. It emerges form the analysis that FCL's are better form of foreign investment from the standpoint of BOP effect. However, generally FCL's cannot be seperately obtained without equity participation by foreign companies.[9]

Table 5.3 : Direct Balance of Payment Effect of Private Foreign Investment in India without Foreign Currency Loans

(Rs. Crores)

Period	Total Net Outflow	India's current account BOP Deficit	Column (1) as % of (2)
	(1)	(2)	(3)
1960-61 to 1972-73	213.54	5602.00	3.81
1977-78 to 1985-86	413.26	15674.00	2.64
1985-86 to 1990-91	324.50	53708.00	0.60

Source : Compiled from A-11, A-12 and A-13.

2. The Direct Effect of Private Foreign Investment on India's Balance of Payment in Manufacturing Sector

Here it should be mentioned that in post independent India, it is the manufacturing sector that has attracted increasing inflow of PFI in India. Therefore, in order to have a clearer view of the direct BOPs effect, a more rational course would be to consider the BOPs effects of PFI in manufacturing sector alone. A few studies have followed similar approach.[10] The result is given in Table 5.4.

Table 5.4 : Direct Balance of Payment Effect of Private Foreign Investment in Manufacturing Sector in India with Foreign Currency Loans

(Rs. Crores)

Period	Total Net Outflow	India's current account BOP Deficit	Column (1) as % of (2)
	(1)	(2)	(3)
1960-61 to 1972-73	81.33	5602.00	1.45
1977-78 to 1985-86	289.09	15674.00	1.85

Source : Compiled from A-14, A-15 and A-16.

It can be seen from table 5.4 that manufacturing sector alone was responsible for a high proportion of BOP dificit than PFI as a whole. Here also subsidiaries form of investment were responsible for a major part of deficit. It accounted for 1.70% of India's Current account BOP deficit during 1960-73 and 1.07% during

1977-86 (vide Table A-16). If the FCL's are excluded to escertain the direct BOP effect, than the negative effect increases as shown in table 5.5.

Table 5.5 : Direct Balance of Payment Effect of Private Foreign Investment in Manufacturing Sector in India without Foreign Currency Loans

(Rs. Crores)

Period	Total Net Outflow (1)	India's current account BOP Deficit (2)	Column (1) as % of (2) (3)
1960-61 to 1972-73	128.93	5602.00	2.30
1977-78 to 1985-86	405.87	15674.00	2.59

Source : Compiled from A-14, A-15 and A-16.

To sum-up, it can be stated that the direct BOP effect of PFI in India in general, and in manufacturing sector in particular, has been negative. If foreign currency loans are excluded than the negative contribution to India's C.A. BOPs deficit increases. Further, considering PFI in all sectors the direct BOPs effect has declined during the two sub-period. This is mainly due to fact that the total dividend outflow as a percentage of total outflow has declined from a high 56% during 1960-64 to 25% during 1977-81.

This is so due to declining PFI in sector like mining and plantations. However, in the case of manufacturing sector the direct effect has increased because the share of dividend outflow in the total outflow remained constant.

3. Overall Balance of Payment Effects of Private Foreign Investment in India

As mentioned earlier the direct of PFI is only a part of the total effects. It is also necessary to consider the overall effects by taking into account the exports and imports facilitated by PFI. This is done in the following section. The Table 5.6 gives the overall effects of PFI on India's BOPs.

Table 5.6 : Overall Balance of Payment Effect of Private Foreign Investment in India with Foreign Currency Loans

(Rs. Crores)

Period	Total Net Outflow	India's current account BOP Deficit	Column (1) as % of (2)
	(1)	(2)	(3)
1960-61 to 1972-73	2205.75	5602.00	39.37
1977-78 to 1985-86	1925.75	15674.00	12.29
1986-87 to 1990-91	270.93	53780.00	0.50

Source : Compiled from A-11, A-12 and A-13.

The above table reveal that PFI has been responsible for about 40% of C.A. BOPs deficit in India during the period 1960-73. Thus during this period private foreign investment had a serious implication on India's BOPs. The main reason for this is that PFI in India is mainly oriented towards production for domestic market rather than exports.[11] This is substantiated by the table 5.10, we shows that for the year 1960-64 exports constituted hardly 5.23% of the total value of

production.While the share of exports was only 4.5% during 1970-73. Moreover, various restrictive clauses relating to export leave very little scope for export.

For the second sub-period, however, the overall effect of PFI has declined to reach a level of 12%. This is not only due to improved performance on export front, but also due to the increasing flow of share capital vis-a-vis outflow in the form of royalties etc.

As in the case of direct BOP effect, in the overall BOP effect also the subsidiaries were largely responsible for India's C.A. deficit. During 1960-73 it explained 21% of the deficit (vide A-17) However, during the second sub-period the net inflow was positive. They contributed 1% in reducing the BOP deficit during 1977-86.

Unlike the direct effect the MPC's overall BOP effect was negative. For instance, they were responsible for 9% of BOPs deficit during 1960-73 and 8.4% during 1977-86 (vide A-17) even Indian enterprises with only technical collaboration also have contributed greatly to India's BOP (10% during 1960-73 and 12% during 1977-86 (vide A-17).

In this case also the overall BOP effect of PFI in all sectors in India increases when FCL's are excluded as per table 5.7.

Table 5.7 : Overall Balance of Payment Effect of Private Foreign Investment in India without Foreign Currency Loans

(Rs. Crores)

Period	Total Net Outflow	India's current account BOP Deficit	Column (1) as % of (2)
	(1)	(2)	(3)
1960-61 to 1972-73	2305.14	5602.00	41.15
1977-78 to 1985-86	2249.56	15674.00	14.35
1986-87 to 1990-91	334.24	53780.00	0.55

Source : Compiled from A-11, A-12 and A-13.

4. Overall Balance of Payment Effects of Private Foreign Investment in Manufacturing Sector in India

If similar exercise is carried out for manufacturing sector only, than emerges that during 1960-73 the manufacturing sector contributed about 32% to India's BOPs deficit and 16% during 1977-86 with foreign currency loans. If foreign currency are excluded than the contribution to India's BOPs on account of PFI in manufacturing increases to 33% during 1960-73 and 17% during 1977-86. (vide table 5.8 and 5.9) The subsidiary form of investment contributed the largest (40%) to deficit during 1961-73, whereas during 1977-88, it was MPC that contributed the highest 63% (vide A-18).

Table 5.8 : Overall Balance of Payment Effect of Private Foreign Investment in Manufacturing Sector in India with Foreign Currency Loans

(Rs. Crores)

Period	Total Net Outflow	India's current account BOP Deficit	Column (1) as % of (2)
	(1)	(2)	(3)
1960-61 to 1972-73	1821.83	5602.00	32.51
1977-78 to 1985-86	2583.09	15674.00	16.48

Source : Compiled from A-14, A-15 and A-16.

Table 5.9 : Overall Balance of Payment Effect of Private Foreign Investment in Manufacturing Sector in India without Foreign Currency Loans

(Rs. Crores)

Period	Total Net Outflow	India's current account BOP Deficit	Column (1) as % of (2)
	(1)	(2)	(3)
1960-61 to 1972-73	1868.49	5602.00	33.35
1977-78 to 1985-86	2699.67	15674.00	17.22

Source : Compiled from A-14, A-15 and A-16.

The above analysis shows that the overall BOP effect of PFI in all sectors as well as in manufacturing sector has been negative throughout the period under consideration. Nevertheless, the silver lining is that the negative contribution to India's BOP's has declined. Therefore, if the trend is maintained then there is every possibility that the overall effect could turn out to be positive in the years

to come. The main reason for this reduction in the negative contribution is the progressive decline in the cost ratios overtime (vide table 5.10). The servicing cost in the form of dividend, royalties etc. as a proportion of value of production has declined. Not only the value of exports as a percentage of value of production has increased but the ratio of imports to value of production has also fallen over the years. These favourable development have thus reduced the negative BOP effect.

Table 5.10 : Cost Ratios of Private Foreign Investment in all Sectors in India

No	Annual Average Cost	1960-64	1970-73	1977-81	1985-86	1990-91
A)	Direct remittance cost as a % of value of production	2.13	1.37	1.02	1.15	1.53
B)	Value of import as % of value of Production	19.95	8.09	6.52	10.68	7.11
C)	Value of exports as % of value of production	5.23	4.45	5.62	3.65	9.28
D)	Total cost as % of value of Prodn. (A+B)	22.08	9.46	7.54	11.83	8.64

Source : Compiled from A-19.

The analysis just attempted shows that for the entire period under consideration, the direct as well as the overall effect of PFI in all sector and in manufacturing sector alone, on India's BOP have been adverse. However, over the years the negative impact have been declining. Here, it should be noted that the conventional methods of calculating the BOP impact of foreign investment, may

be deceptive because they consider only directly measurable cost items for which informations and data are available. These methods do not take into account ingenious ways of transfering surplus from host countries to the parent countries. One such way known as "Transfer pricing" is difficult to detect and remain a hidden cost.[12]

5. Transfer Pricing

It refers to such practices as overpricing of imports and/or underpricing of exports. It involves artificially fixing the prices of goods and services, which are imported by branches and subsidiaries in developing countries from their parent companies, above the international level. Similarly exports are underpriced which means the goods are exported by the same branches and subsidiaries to their parent companies at a price below the international level. This method is used by multinational companies to siphon off profit from the host countries. The MNC's also employ this methods in those developing countries where tax rate are generally high and in those developing countries where a high rate of profit attract political attention. Although transfer pricing is widely used in foreign trade, the opportunities for such action are clearly greater in intra-firm trade.[13]

In recent years, the problem of transfer pricing has become the single most issue facing the MNCs. A study by Ernst and Young carried out on 200 MNC found that 82% of respondents stated that transfer pricing is a major

international issue.[14] This is hardly surprising since majority of world-wide trade is estimated to take place between firms in host and home countries.[15]

In India limited efforts have been made to determine the outflow on account of transfer pricing.[16] Some instances suggest a sizeable volume of it. For instance, a study[17] showed that a drug librium. was sold in Indian market at more than Rs. 6555 per kg. by a Swiss MNC firm operating in India while the same drug was available in the market at Rs. 312 per kg. Thus, the extent of overpricing was almost 7000%. Furthur, a study by three US based economist indicated that staggering amount ranging from Rs. 14000 to Rs. 40000 crores was taken out of India through pricing rigging of exports and imports during 1992-95 in India's trade with a single country namely USA. In another study of foreign drug companies it was found that overpricing was to tune of 127p.c. during 1972-76.[18]

In the absence of relevant data it is not possible to indicate the impact of transfer pricing on India's balance of payment. At the same time it has to be recognized that the adverse impact of PFI on India BOP would be much larger if the effect of transfer pricing could be incorporated in the analysis.

III

REASONS FOR ADVERSE BALANCE OF PAYMENT IMPACT OF PRIVATE FOREIGN INVESTMENT IN INDIA

Several possible reasons can be given for the adverse BOPs effects of private foreign investment in India. These can be classified as follows :

1. Higher profit and resultant higher dividend repatriation.

2. Capitalisation without inflow of capital.

3. Low export intensity.

4. High import intensity.

5. Higher cost of technology transfer.

1. Higher Profit and Resultant Higher Dividend Repatriation

The profit earned by a company determines the dividend declared by it, therefore, profitability of foreign subsidiaries will indicate the outflow in the form of dividend. The profitability can be measured as a ratio of gross profit to capital employed. It has been pointed one that foreign firms operating in India are generally more profitable than domestic firms.[19]

This is supported by A-20 which indicates that profitability of foreign controlled companies in India was higher than that of Indian Controlled firms. For instances during 1963-64 it 13.8% and during 1979-80 it was 16.2%. Whereas for Indian companies it was 10% and 11.4% respectively. Likewise, a yearwise comparison also reveals that profitability and dividend ratios were higher in foreign subsidiaries than that in Indian companies. A case study of chemical industry in India also found that the profitability (measured as ratio of profit to sales) of foreign firms was higher at 11% compared to 3% for domestic firms. A similar picture was obtained for electrical machinery industry where the profit ratio of 13% for foreign firms was higher as compared to 9% for domestic firms during 1985-90.[20]

Thus the profitability of foreign firm in India being relatively higher, remittance on account of dividends are higher in case of foreign firms and they put burden on India's BOPs. (vide A-21) The foreign firms are generally more profitable because of their better standing in the market. They generally used improved technology which tended to reduce their cost of production. Not only this, they were able to charge a higher price for their product in view of their greater creditworthiness.[21] Further, other factors like entry barriers, degree of product differentiations etc. also explain the differences in profitability.[22]

2. Capitalisation Without Inflow of Capital

One of the remarkable feature of modern multinational management is their ability to acquire control over foreign operations without exporting capital from home.[23] This is done through conversion of retained earning into equity shares, which have implications on dividend outflow without corresponding inflow of capital or through issue of bonus share. Moreover, even if foreign companies bring in capital from abroad, still a large part of the issue is borrowed locally.[24]

The above contention is supported by RBI surveys conducted in India which indicates that reinvested profit constitute a large share of FDI inflow in private sector in India.[25] For instance, during 1976-80 of the total flows of FDI worth Rs. 240 crores, the share of retained profit amounted to Rs. 212 crores (85%). Similarly during 1986-87, out of total FDI flows of Rs. 177 crores, the share of retained earning was more than 56%. An analysis of capital structure of eight

leading drug companies in India in a study shows that the total equity inflow constituted only 13.5% of the equity capital of these companies during the period 1986-87.[26] In case of one company, Cynamid, the actual inflow was negative. Further a large part of capital inflow was in kind in form of import of machinery rather than in cash.[27] Thus it can be inferred that capitalisation without actual inflow of capital has adversely affected India's BOP.

3. Low Export Intensity

Foreign controlled companies in general have lower export intensity (exports/ sales) as compared to Indian controlled companies. A case study of 45 engineering firms operating in India reveals that Indian controlled firms exported more than 4 times that of similar foreign controlled firms during the period 1973-77.[28] In another study it has been discovered that "export propensities" (exports/sales) of affiliates of US MNC's operating in India averaged only 5% p.a. between 1966-86. Whereas, the affiliates of the same US MNC's operating in Hong Kong on average exported 70% of value of their total sales.[29] The lower export intensity of firms having foreign collaboration is corroborated by a study[30] which found that export intensity of selected automobiles firms having foreign equity participation was not better than other enterprises. Despite their advantages in export markets, and fiscal incentive offered by government, the proportion of their output that foreign firms export is not significantly different from that of local firms.[31] The export intensity (exports/value of production) of Indian firms having foreign collaboration is revealed by table 5.11 for the period

1961-86. The foreign firms on an average exported about 3.4% of the value of production for the year 1960-61, 5.3% for the year 1977-78 and 3.7% for the year 1985-86. For the entire period the export earning average about 3.8% per annum. The service payment in form of dividends, royalties etc. absorbed more than 40% of the export earning during 1961-80 the remaining amount was not sufficient to pay for imports.[32]

Table 5.11 : Foreign Exchange Transaction of Private Foreign Investment in Manufacturing Sector in India

(Rs. crores)

Sr. No	Items	1960-64	1965-66	1972-73	1977-78	1985-86
A)	Value of Production	790.40	1630.20	4609.90	5152.50	17406.40
B)	Export earning	26.80	42.10	187.60	274.00	635.60
C)	Outflow of (1+2) Foreign exchange	169.57	179.91	316.48	330.56	2121.00
	1) Import	155.20	156.10	265.90	281.60	1858.40
	2) Service Payments (Div + Royalties etc)	14.35	23.81	50.58	48.96	262.60
D)	Net position (B-C)	-142.75	-137.81	-128.88	-56.56	-1485.40
E)	B as % of A	3.39	2.58	4.07	5.32	3.65
F)	C1 as % of A	19.64	9.58	5.77	5.47	10.68
G)	C2 as % of A	1.82	1.46	1.10	0.95	1.51
H)	C2 as % of B	53.54	56.56	26.96	17.87	41.32

Source : Compiled from A-19

The main reason for the lower export intensity of foreign firms in India, is the restriction placed by these firms in India in the field of exports.[33] Foreign collaborators have shown an explicit desire to control sales on export side. This is because the interest of foreign collaborators are best served if the products are sold only in the local market which are protected by import restrictions and tariff barriers, in fact, the basic intention of foreign investors has been to cater to needs of local people.[34] As a corollary clauses are incorporated in collaboration agreements which restricts the Indian companies freedom to sell abroad. The restriction takes the form of total ban on export or geographical restrictions, or exports with the collaborator's consent. The table 5.12 shows that for the period 1964-70 regulatory clauses of one kind or the other is prevalent in 60% of the agreement, during 1977-81 in 65%, and during 1981-86 in 71% of agreements. More than 85% of the restrictive clauses related to that of export during the 1964-70, 94% in 1974-81, 95% in 1981-86. Thus it is obvious that foreign collaborators seek to maximize profit by imposing certain clauses in the collaboration agreements with regarded to exports.[35]

This is supported by a study on 33 Indian Automotive components industry in India conducted in the year 1991 which reveals that among the 55 foreign collaboration agreement, 42 had export restrictions clauses.[36] The high incidence of these restrictions may lead one to believe they are largely responsible for poor export performance. It is also possible that product produced by these firms were not competitive in the international market, even

those firms which manufactured products of international standards may have found the domestic market to be more attractive.[37]

Table 5.12 : Restrictive Clauses in Foreign Collaboration Agreements in India (Numbers)

Sr. No	Types of Restrictive clauses	1964-70	1977-81	1981-1986
1.	Restriction in Exports	956	594	1000
2.	Conditional payment clauses	94	31	74
3.	Other Restrictions	235	91	71
4.	**Total**	**1285**	**716**	**1145**
5.	1 as % of 4	74	83	87
6.	Total no. of agreements.	1098	580	942
7.	Total no. of agreements with restrictive clauses	654	376	671
8.	7 as % of 6	60	65	71
9.	Total no. of agreement with export restrictions	564	354	639
10.	9 as % of 6	51	61	68
11.	9 as % of 7	86	94	95

Source : Compiled from A-22.

4. High Import Intensity

Even if the export intensity is lower, the impact of PFI on BOP can be expected to be favourable if the import intensity (imports/value of products) of foreign firms operating in India is low. Table 5.11 demonstrates that import intensity (II)

of Indian firms having foreign collaboration is much higher than their export intensity (EI). For instance during 1960-61 the import intensity was almost 20% while the export intensity was only 3.4%. Even though II has declined over the years, it still remained higher than the EI. Import intensiy was about 11% in 1985-86 compared to EI of 3.7%. Just as lower export intensity can be related to export restriction clauses, the higher import intensity can be connected with various restrictive element in the foreign collaboration agreements which have introduced a built-in conditions for imports. The higher import intensity of foreign firms have been demonstrated by a studies conducted in India,[38]

The higher import intensity of foreign firms can be explained in terms of "source rigidity".[39] This suggest that rather than being "Global Scanners" who source their imports from the globally most cost effective locations the affiliates of MNCs tend to source their inputs from home country. This is because it allows them to use a technology with which they are familiar, and also create a market for products of the parent company. In addition such intra-firm sales are a mechanism for profit shifting through the device of "transfer pricing" as explained in earlier section.

5. Higher Cost of Technology Transfer

The other factor straining the balance of payments of the host country is the charges paid for the technology imported by the affiliates. Technology is transferred in two forms : One, in the form of such industrial property rights as

patents, process technique and the like; the other, in the form of technical assistance and training connected with it.[40] The higher cost of technology transfer is due to the following :

(i) High charges on sale of know-how and technology

The licensing agreements between local firm in developing countries and its foreign collaborators generally stipulates that the licensee pay a royalty for the patent, know-how or trademark received and technical fees for the technical assistance. The agreements also provide for the mode of payments. If royalty is paid in lump-sum the external reserves are affected only once. If it is paid as a percentage of the net sales of the licensee product over the life of the contract, than it will exert a continued pressure on external resources for the period of contract which is generally of 5 to 10 years.[41] In some cases, the agreement additionally provide for the sale of licensee product to the parent company at a lower than the arm's length price i.e. the price which would be obtained in an open market or in a transaction between unrelated parties. This causes an additional loss of foreign exchange. Yet again, the charges are sometimes convertible into equity share of the affiliate causing a permanent drain from the external reserves in the form of dividend repatriation. The high cost of technology imports is shown is table 5.13. According to this table the payment for technology imports have increased steadily from 27% in 1960-61 and 51% in 1990-91.

Table 5.13 : Total outflow on Account of Technology Transfer of Foreign Collaboration in Indian Industry

(Rs. crores)

Sr. No.	Outflow on Account of	1960-1973	1977-86	1986-91
1.	Royalties	59.39	80.31	169.69
2.	Technical fees	54.28	126.97	234.38
3.	**Total (1+2)**	**113.67**	**207.68**	**404.07**
4.	Dividend Repatriation	306.16	333.58	389.50
5.	Total outflow (3+14)	419.83	540.86	793.57
6.	3 as % of 5	27.08	38.32	50.92

Source : 1) For 1960-1986, Compiled from A.23.
2) For 1986-91, Compiled from Basic Statistics relating to Indian Economy, Aug 94, CMIE, Bombay.

The high cost of technology imports in Indian is substantiated by numerous studies. A study of direct cost of technology transfer, for the period 1968-1980, in three petrochemical complex, set up in the country, shows that in case of two complex set up with foreign equity participation, more than 55% of profit were appropriated by collaboraters. In the third complex which set up in the public sector with technology acquired under licensing, however the cost was substantially lower at about 4 percent of profits.[42] Similarly another study found that out of total remittance of Rs. 399 crores made from Indian Enterprises to organisations abroad for technology transfer in 1981-82 royalties and technical fees accounted for Rs. 312 crores.[43]

(ii) Repetitive collaboration

It may mentioned that import of technology to India has not been always to new areas or industrial techniques but has been 'repetitive'. It is a situation of multiple collaboration where entrants into existing product lines seek separate license contract with foreign firms, regardless of availability of similar technology in the country.[44] This leads to duplicate and repetitive payments and over-import of technology. The Dutt Committee has documented cases of 'repetitive collaborates" in India. According to the committee during 1956-1965, out of 625 product groups examined, in 363 product group there repetitive collaboration.[45]

Further, collaborations agreement have been entered in non-essential sector like cosmetics, toothpaste, icecream, etc. and also for those products which are already being produced in well established set-ups in India,[46] in some cases popularity of foreign brand names among Indian elite consumers outweighed technological consideration, competitive terms and prices of imported technology.[47] All these have entailed heavy payments of royalties and technical fees (table 5.13) at a time when country was facing foreign exchange shortages.

Thus, whatever may be case, the BOP import of foreign collaboration on the whole have been negative due to higher cost of technological imports.

IV

CONCLUSION

The analysis of the impact of foreign investment on balance of payment reveals that the continued outflow of capital in the form of dividend repatriation, interest transfers and other service payments (Royalties, Technical fees, Payment in Foreign Currencies to Foreign workers) has had a serious foreign exchange implications for India throughout the period under consideration. In the period of economic development of India, the burden of service payments cannot be brushed aside. Even though, negative impact of PFI on balance of payment has been declining over the years, foreign investments still continue to exert pressure on India's balance of payment. Various outflows mentioned above far exceeded the inflow on account of share capitals. What is more, the exports generated by these firms lagged far behind their imports. Number of factors such as higher profit and dividend repatriation, low export intensity, high cost of technology transfer, etc. were responsible for the adverse effect of PFI on India's balance of payment. If the effect of 'transfer pricing' could be incorporated in the analysis of balance of payment effect, then the balance of payment impact could be more adverse than what is implied by the analysis of measurable cost items.

The payment of investment income and repatriation of capital would require the Indian economy to set aside a part of future output and foreign exchange

resources for these purposes Unless, the investment of foreign capital increases the economy's total output and accelerates exports and improve B.O.P position of the country, PFI would continue to be a burden on the economy.

From the findings it can be seen that the subsidiaries form of foreign investment has largely contributed to India's balance of payment deficit. This suggests that PFI in other forms like minority financial participation will be an appropriate form of foreign investment. As it will not only provide funds for investment but also help to secure technology from abroad. It may also be mentioned that export-oriented foreign investment alone, and not PFI in general, help the country in export promotion. This can reduce the negative effect of balance of payment to a large extent.

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