

AN EVALUATION OF FOREIGN PRIVATE  
INVESTMENT CLIMATE IN INDIA

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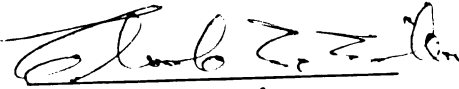
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## ABSTRACT

### AN EVALUATION OF FOREIGN PRIVATE INVESTMENT CLIMATE IN INDIA

by Anant R. Negandhi

This research involved the study of the private foreign investment climate in India. The main purpose of the research was to investigate various obstacles and impediments to foreign investment in India, particularly the obstacles that are inherent in the Indian government's policies. The ultimate aim of the study was to pinpoint shortcomings in these policies, which, if removed, could result in increasing the inflow of foreign private investment into India.

In the last few years, the Indian government has been trying to attract more foreign investors in India. Greater investments from the industrially advanced countries are needed to promote rapid economic development in India and to provide needed foreign exchange, along with advanced managerial and technical know-how.

To increase such investment, the Indian government has made several adjustments in its policies, but these changes have failed to produce desired results.

Since World War II, several studies have dealt specifically with the obstacles and impediments to United States private investment in the lesser-developed countries. These studies include: the so-called Paley Report, Re-sources for Freedom; a report by Mr. Gordon Gray, special assistant to President Truman, entitled Report to the President on Foreign Economic Policies; the National Industrial Conference Board study of Obstacles to Direct Investment; the United States Department of Commerce survey of Factors Limiting United States Investment Abroad; and the Barlow and Wender study of Foreign Investment and Taxation. Most of these researchers disclosed that fear of war and expropriation and socio-economic and political instability were limiting factors for the greater inflow of United States private investment into the underdeveloped countries.

On the basis of the findings of these researches this author formulated two hypotheses which, in general, asserted that socio-economic and political instability, fear of war, and fear of expropriation were not limiting factors for the greater inflow of foreign private investment into India. But the factors which do limit such investment are inherent in certain Indian government policies.

To test these hypotheses and to achieve the main purposes of this study, 188 American companies in the United States were surveyed by questionnaire, and some eighty-two



executives of the American, British, and Indian companies were personally interviewed. Prior to this, extensive library work was done to collect factual data concerning Indian socio-economic and political conditions and the Indian government's various policies affecting investment in India. Within the limitations of the research design and the conceptual framework, findings of the study support both of these hypotheses.

The main findings of the study show that Indian socio-economic and political conditions were stable and favorable for foreign private investment. This was confirmed both by factual data and by foreign investors' evaluations of these conditions in India. It also was found that such factors as red tape and excessive government bureaucracy, pragmatism in Indian industrial and foreign investment policies, and higher tax rates were limiting the greater inflow of foreign investment into India. Other factors limiting such investment in India were: foreign exchange and import policies, Indian policies concerning minority participation of foreign companies, the 'uncommercial' attitude of Indian government officials, and lack of proper communication channels between the foreign investor and the Indian government.

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## CHAPTER I

### INTRODUCTION

The main purpose of this research is to investigate various obstacles and impediments to foreign private investment in India. More specifically, the research attempts to ascertain obstacles that are inherent in Indian government policies and to pinpoint shortcomings in these policies which, if removed, could result in increasing the inflow of foreign capital into India.

In the last few years, the Indian government has been trying hard to increase the private investment from the industrially advanced countries. Foreign private investment is needed to promote rapid economic development in India and to provide much needed managerial and technical know-how. To attract such investment, the Indian government has made several changes in its foreign investment policies. But still the inflow of such capital into India is quite inadequate.

Although much has been written on the subject of obstacles and impediments to United States private investment in the lesser developed countries, none of these studies provides guidelines for precise policy changes that may be needed to increase the inflow of foreign investment

into India. In other words, most of the previous researches in this field of inquiry have thus far disclosed general factors limiting United States private investment abroad but have not attempted to determine the importance of specific factors in retarding investment in the lesser developed countries.

A study undertaken by the President's Material Policy Commission in 1951 stated that the fear of legal uncertainties, fear of expropriation, excessive controls on import-export, and limitation on convertibility of earnings into United States dollars were some of the important factors limiting United States private investment in foreign countries.<sup>1</sup>

In 1950, Gordon Gray, in his study of the United States foreign economic policies, said:

. . . there are now substantial obstacles to an expansion of such investment. The present international tensions are a controlling deterrent in those areas where an actual military threat exists. In other areas the obstacles are largely due to actions or expressed unfriendly attitudes of other governments towards foreign capital, political instability, fear of government control or expropriation and economic difficulties, particularly those resulting in exchange restrictions. . . . A lack of adequate basic services, port facilities, roads, power facilities, sanitation facilities, irrigation, etc., is also a bar to many types of private

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<sup>1</sup>William S. Paley, Resources for Freedom, A Report to the President by the President's Materials Policy Commission, Vol. 1, June, 1952.

industrial development.<sup>2</sup>

The research undertaken by the Foreign Economic Commission in 1953 stated similar obstacles and impediments to United States private investment in underdeveloped countries:

The small flow of private investment abroad may be attributed to the concern of potential investors over the general political, economic and military uncertainties abroad as well as over other aspects of the "climate" for investment in particular countries. . . .<sup>3</sup>

Countries desiring to attract capital must provide a secure legal status for private capital and enterprise, domestic as well as foreign. United States investors can hardly be expected to venture into countries and fields which local capital and enterprise consider unattractive or insecure. On the other hand, United States investors will venture into areas with political and economic stability which provide fair and equitable treatment and with it, an opportunity for reasonable profit and an assurance of remitting earnings.<sup>4</sup>

Barlow and Wender in their study of Foreign Investment and Taxation<sup>5</sup> found that the unfriendly attitude of foreign governments, lack of interest and knowledge,

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<sup>2</sup>Gordon Gray, Report to the President on Foreign Economic Policies, United States Government Printing Office, Washington, D.C., 1950, pp. 57-62.

<sup>3</sup>Clarence B. Randall, Report to the President and the Congress, Commission on Foreign Economic Policy, January, 1954, p. 17.

<sup>4</sup>Ibid.

<sup>5</sup>Barlow and Wender, Foreign Investment and Taxation (Harvard Law School, International Program in Taxation), Harvard University Press, Cambridge, 1955.

convertibility problems, and poor 'climate' for investment were some of the important factors limiting United States private investment in foreign countries.

The researches of the National Industrial Conference Board<sup>6</sup> and the United States Department of Commerce<sup>7</sup> have been more specific and detailed.

The National Industrial Conference Board Study, conducted in 1949, stated the following obstacles and impediments to United States private investment in India:

1. Multiple exchange rates
2. Control of capital movements
3. Limitation on remittance of profits
4. Export and import quotas
5. Lack of trained native personnel
6. Inability to recruit personnel in the United States
7. Foreign restriction on importation of personnel from home country
8. Burden of Social Security legislation
9. Special taxation of foreign enterprise
10. Discriminatory enforcement of tax laws

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<sup>6</sup>Obstacles to Direct Investment, National Industrial Conference Board, New York, 1951.

<sup>7</sup>Factors Limiting United States Investment Abroad, United States Department of Commerce, Washington, D.C., 1953.

11. Restriction of foreign investment to certain fields
12. Required local participation
13. Nationalization and expropriation
14. Inability to deal with responsible government officials
15. Lack of adequate roads, railroads, harbors, or storage facilities
16. Inadequate power facilities
17. Underdeveloped banking system
18. Lack of health and sanitary facilities
19. Inadequacy of housing, recreational, and shopping facilities for employees.<sup>8</sup>

However, here also, as in previous research, no attempt was made to discover whether certain factors mentioned by companies as obstacles actually prevented investment or were regarded merely as minor problems. Other weaknesses of this survey, with respect to India, lie in its small sample size and in the timing of the research undertaking. The research sample consisted of only 21 United States companies operating in India.<sup>9</sup> During the present time there are about 178 United States companies operating

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<sup>8</sup>Obstacles to Direct Investment, op. cit., p. 95.

<sup>9</sup>Ibid., p. 94.

in India.<sup>10</sup> Therefore, the sample size of this survey can hardly be considered as representative for the present time.

With respect to its timing, the survey was conducted in 1949-50 when India had just won her independence and was facing serious problems of resettling refugees from Pakistan. (In 1947 India was divided into two different countries, and the new nation of Pakistan was born. Some twenty million Hindus then living in Pakistan were asked to leave that country.) A survey conducted during such turmoil tends to exaggerate the importance of some factors.

The Department of Commerce Survey of Factors Limiting Foreign Investment was published in 1952. It is the most comprehensive survey yet made of the experience and attitudes of companies interested in foreign investment. The survey was conducted by using the interview technique. In all, about 400 companies were interviewed for this study. The purpose of this survey was to discover legal and other impediments to private investment abroad and to find the methods and means whereby these impediments could be removed or decreased.

The findings of this survey are reported by area and by country. With respect to India, the survey reported certain specific obstacles and impediments to United States

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<sup>10</sup>United States Department of Commerce, Investment Factors in India, Washington, D.C., December, 1962, p. 2.

private investment:

1. The nature of India's screening policy, which has denied admission to some types of investment
2. Slow and costly procedural setup
3. The existence of import, export, exchange, and other controls
4. Government policy of nationalizing certain types of industries.
5. Lack of proper communication channels between potential investors and the Indian government
6. The unfamiliarity of the American investor with Indian business ways and custom
7. Low stage of Indian economic development
8. Absence of a double-taxation agreement between India and the United States
9. High tax rates.<sup>11</sup>

The findings of this research have increased our understanding of some specific obstacles and impediments to United States private investment in India. But still this survey is unable to provide us with an understanding of the relative importance of such specific factors in investment decisions. In other words, no attempt was made in the

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<sup>11</sup>Factors Limiting United States Investment Abroad, op. cit., p. 101.

Department of Commerce survey to determine the relative importance of various obstacles which retard investment in India. It can be seen from their findings that such general factors as "low stage of economic development" and "fear of nationalization" and such specific factors as "slow and costly procedural setup," "high tax structure," and "screening policy" were listed together, but one has no way of knowing which of these factors were critical and which ones were of minor importance. Unless we know the relative importance of factors retarding investment in India, it becomes very difficult, if not impossible, to make specific policy changes to attract investment.

Moreover, this survey, as well as all other research mentioned above, was conducted during 1949-52. But as pointed out by the Department of Commerce, "the study of foreign investment problems must be continuous since it requires the evaluation of rapidly changing conditions."<sup>12</sup>

It is indeed true that ever since these studies were conducted India has witnessed many major changes in her socio-economic and legal frameworks. Some of the events which may have changed the entire investment climate are given below.

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<sup>12</sup>Ibid., p. 1.



### Some Important Changes in Indian Economic Policies

1. Drastic changes in Indian economic policy were announced in 1951. The new policy advocated a philosophy of 'mixed' or planned economy. Under this philosophy the Indian government's role in development of industries has increased considerably. Substantial governmental investment in the economy during 1951-63 has created both opportunities and problems for private enterprise in India. But the over-all effect of the new economic policy on the private investment climate has not been investigated.

2. In 1956, the Indian government announced its industrial policy. Under this policy, private enterprise--both domestic and foreign--is restricted to starting new business in the so-called basic and heavy industrial sectors. The foreign investor also is restricted to establishing majority owned subsidiaries. But the over-all effect of these changes on private investment has thus far remained unexplored and undocumented.

3. Changes in the tax structure in recent years have altered investment opportunities for private enterprise. Prior to 1951 the tax system was designed primarily to raise sufficient revenues for the expenditure of government on administrative and allied services. However, since then the fiscal policy of the Indian government has been pushed into higher gear to meet an enormous increase in the needs of the

developing economy. But the effect of high taxation on private investment has remained a matter of speculation.

This study therefore was undertaken to incorporate the effects of these and other changes in Indian socio-economic, political, and legal conditions on the foreign private investment climate in India.

### Justification of the Study

The Indian government has fully recognized the role and importance of foreign investment and licensing arrangements in promoting economic development in India. This is quite evident from various high-level pronouncements made from time to time. G. L. Mehta, former Indian ambassador to the United States and now chairman of the Indian Investment Center, recently said:

the justification of foreign private enterprise lies not only in the compulsions of our foreign exchange problem but our needs of securing advanced technical and managerial know-how. . . . Trade in capital and know-how takes place among advanced countries and even among countries which have no capital or foreign exchange shortages . . . I would therefore, say . . . foreign investment would be advantageous to us. . . . We are a part of the comity of nations and should not seek to close our doors to winds of knowledge and skills from abroad.<sup>13</sup>

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<sup>13</sup>G. L. Mehta, "Investment of Foreign Capital in India," Broadcast talk over All India Radio, New Delhi, March 24, 1964.

The Finance Minister of India in his recent budgetary speech said:

In the matter of foreign private investment our attitude has always been one where we have welcomed such investment and have given it fair and hospitable treatment.<sup>14</sup>

He further added:

I think the stage has come when we would be justified in opening the doors even wider to private foreign investment.<sup>15</sup>

Despite the Indian government's favorable attitude toward private foreign investment, the inflow of such capital investment into India is small. The net inflow of all foreign business investment was only 77.6 million dollars in 1956 and 80 million dollars in 1959.<sup>16</sup> Total outstanding foreign private investment in India at the end of 1960 was only 1.45 billion dollars.<sup>17</sup> The limited participation of North American investments is strikingly emphasized by the following statistics. At the end of 1959, total United States private investment in India was 172.9

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<sup>14</sup>Quoted from Monthly News Letter, Indian Investment Center, New Delhi, India, December 15, 1963, p. 1.

<sup>15</sup>Quoted from A. C. Banerjee, "Role of Foreign Private Investment in India's Development," India News, Washington, D.C., February 4, 1964, p. 4.

<sup>16</sup>S. Kannappan and E. Burgess, Business Performance Abroad, A case study of Aluminum Ltd. in India, National Planning Association, Washington, D.C., 1962, p. 20.

<sup>17</sup>India News, Indian Embassy, Washington, D.C., December 12, 1962, p. 4.

million dollars or about 4 per cent of the net annual global outflow from the United States as recorded in recent years.<sup>18</sup> The inflow of foreign private investment has increased during 1960-61. It was 111.9 million dollars in 1960.<sup>19</sup> In recent years it has been at the rate of 100 to 120 million dollars per year.<sup>20</sup>

Considering the actual needs of India for private foreign capital, the net inflow is inadequate. The outline of the Indian Third Five-Year Plan indicates the actual need of foreign private capital to successfully carry out envisaged economic plans. The total requirement for foreign capital is approximately 5.7 billion dollars.<sup>21</sup>

Out of this total 5.7 billion dollars, Lewis feels that approximately 945 million dollars should come through private channels.<sup>22</sup> To achieve the various targets of the Third Five-Year Plan, India thus needs a minimum of 189 million dollars per year from private sources, while the present inflow of such capital has been only 100 to 120

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<sup>18</sup>S. Kannappan and E. Burgess, loc. cit.

<sup>19</sup>India News, December 12, 1962, loc. cit.

<sup>20</sup>G. L. Mehta, loc. cit.

<sup>21</sup>Third Five-Year Plan: A Draft Outline, Government of India Printing Press, New Delhi, India, 1961.

<sup>22</sup>John Lewis, Quiet Crisis in India, The Brookings Institution, Washington, D.C., 1962, p. 217.

million dollars per year. In recent years, due to the Chinese invasion and shortages of foreign exchange, the actual need of foreign private investment is estimated to be some 300 million dollars a year. A high government official recently said,

We have the need and scope for \$300 million worth of outside investment yearly, [three times the current rate]. . . . The government, in fact, would like to corral some \$300 million of United States investments alone over the next 24 months.<sup>23</sup>

To increase the inflow of foreign private investment, the Indian government has made certain policy adjustments. These include:

1. Greater willingness to grant majority control to foreign manufacturers.
2. Continued payment of profit and technical assistance remittances in dollars despite the tight reserves situation.
3. Abolition of various wealth and excess dividends taxes and of the compulsory deposit scheme.
4. Transferring industries formerly reserved for the public sector to private investment.<sup>24</sup>

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<sup>23</sup>Wall Street Journal, New York, July 22, 1964, p. 1.

<sup>24</sup>Investment and Licensing Opportunities in Thirty-Seven Countries, Business International, New York, 1961, p. 111.

These changes in policies, however, have failed to produce the desired increase in the inflow of foreign private investment into India. The findings of previous researchers in this field of inquiry are quite inadequate in providing guidelines for policy changes which will help to increase foreign investment in India. This research therefore, was undertaken to fill the gap in our understanding of specific obstacles and impediments to foreign investment in India. To guide this research the following two hypotheses were formulated.

#### Guiding Hypotheses

1. Environmental factors have differential effects on the inflow of foreign private capital into India. Social, political, and economic stability are, in varying degrees, directly related to the inflow of foreign capital into the lesser-developed countries.
2. If social, political, and economic stability are found neutral to the inflow of foreign capital into India, then such Indian government policies as industrial and foreign investment policies, taxation policy, exchange control, import policies, and governmental apparatus of decision-making should explain the lesser inflow of foreign capital into India.

To test these hypotheses and to achieve the main purpose of the study, the following factors are investigated.

1. The socio-economic and political conditions in India.
2. Indian policies affecting foreign private

investment and particularly policies which appear to be retarding such investment in India.

In analyzing these factors both the factual data and the subjective evaluation of this data by foreign investors in India will be presented. However, an outline of the research design used for collecting data for the study precedes the analysis of these factors.

## CHAPTER II

### THE RESEARCH DESIGN

#### Basic Assumptions

The ultimate aim of this study is to utilize the potential of foreign private investment in promoting economic development in the lesser-developed countries. In recent years much has been written on the subject of economic development of underdeveloped countries. Indeed, this subject has become the intellectual battle ground for the political scientist, the economist, the sociologist, and the anthropologist. Each of these specialists, in process, has contributed considerably toward solving various socio-economic and political problems encountered in developing these nations economically and industrially. Both theoretical and applied researchers in this field of inquiry have been motivated by three basic convictions:

1. That the disparity in stages of economic development and in rates of growth between nations is not a 'natural' condition.
2. That in order to bridge this gap, industrially advanced countries can and must help these lesser-developed countries.



3. That to accelerate the industrialization of these countries, not only substantial amounts of foreign capital--both private and public--but advanced managerial and technical know-how from the industrialized countries will be necessary.<sup>1</sup>

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<sup>1</sup>See (a) W. W. Rostow, The Stages of Economic Growth, Cambridge University Press, Boston, Mass., 1960.

(b) John P. Lewis, Quiet Crisis in India, The Brookings Institution, Washington, D.C., December, 1962.

(c) Raymond F. Mikesell, "America's Economic Responsibility as a Great Power," American Economic Review, Vol. 50, 1960, pp. 258-270.

(d) Jack N. Behrman, "Promoting Free World Economic Development Through Direct Investment," American Economic Review, Supp. 1960, pp. 271-281. See also his "Foreign Licensing, Investment and United States Economic Policy," The Patent, Trademark, and Copyright Journal of Research and Education, Vol. 4, Summer, 1960, pp. 153-172.

(e) J. N. Behrman, "Licensing Abroad of American Held Patents, Trademarks, and Techniques," The Patent, Trademark, and Copyright Journal of Research and Education, Vol. I, 1957, pp. 145-158. See also various issues of the same journal since the Fall of 1959.

(f) Charles A. Myers, Labor Problems in the Industrialization of India, Harvard University Press, 1958.

(g) George Rosen, Industrial Change in India, Glencoe, Illinois, The Free Press, 1958.

(h) C. McMillan and R. Gonzalez, International Enterprise in a Developing Economy, Bureau of Business and Economic Research, Michigan State University, East Lansing, Michigan, 1964.

The present researcher accepts the above convictions and, in addition, accepts the following premises:

1. That the role of private foreign capital and its advanced managerial and technical know-how is significant in promoting rapid economic development in India.
2. That the potential role of private foreign capital in promoting the economic development in India has not been fully utilized.

#### Research Methodology

The following research steps were undertaken to test the hypotheses and achieve the purposes described in Chapter I.

1. Documentary research in the United States and India.
2. Questionnaire survey of 188 American companies investing in India.
3. Personal interviews with top executives of:  
(a) American companies in the United States and India and (b) British and Indian companies in India.

Each of these research steps is described below.

### Documentary Research

During the period of January, 1963, through November, 1963, extensive library work was done to gather factual data concerning Indian socio-economic and political conditions and specific Indian policies affecting foreign private investment. Factual data of this nature were collected to compare and contrast the objective facts with the subjective evaluation of these factors by foreign investors. Foreign investment decisions--and for that matter any business decision--are being made both on the basis of factual data and subjective evaluation of these data. The questionnaire survey in the United States and personal interviews in the United States and in India were conducted to ascertain foreign investors' evaluation of the various factors in the Indian investment climate.

### Questionnaire Survey

To design an appropriate questionnaire and interview guide, ten executives of American companies and three executives of the Indian Investment Center were interviewed in September, 1963. Following these interviews, a preliminary questionnaire was prepared and pre-tested on six American executives and five academicians. As a result of this pre-testing, selection of items to be included in the final questionnaire was determined. It became clear that the questionnaire should solicit information to ascertain:

(1) factors or policies influencing investment decisions of foreign investors in India, (2) attitudes of foreign investors toward Indian policies affecting foreign investment decisions, and (3) various problems and difficulties encountered by foreign investors in their initial negotiations with Indian government officials.

The revised questionnaire was distributed to American companies during November and December, 1963.

### The Questionnaire Sample

Some 188 United States companies either investing or contemplating investment in India were sent the questionnaire. Out of the 188 American companies, 29 companies returned this questionnaire saying either that they were not in a position to complete this questionnaire or that it was against the company policies to fill out such a questionnaire. Of the remaining 159 companies, a total of 101 companies filled out and returned the questionnaire, thus giving us 63.52 per cent of questionnaire returns. There are about 178 United States firms operating in India at the present time.<sup>2</sup> Thus the sample size for the questionnaire was 89.4 per cent of the total United States companies in India,

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<sup>2</sup>"Investment Factors in India," Overseas Business Reports, United States Department of Commerce, December, 1962, p. 2.

while the actual response constituted 56.7 per cent of this total.

Of the 101 United States companies responding to the questionnaire survey, some 74 have investments in India, 6 were only licensors, and the remaining 21 companies were contemplating investment in India. The following table shows the distribution of these companies by principal type of activity.

TABLE 1  
COMPANIES SURVEYED BY QUESTIONNAIRE

Type of Principal Activity	Number of Companies
Chemical and pharmaceutical . . . . .	22
Machine tools and spare parts . . . . .	21
Non-electrical heavy machinery . . . . .	17
Electrical machinery . . . . .	8
Engineering and management consultants . . .	7
Petroleum refining . . . . .	3
Rubber . . . . .	3
Banking . . . . .	4
Trading . . . . .	3
Automobile . . . . .	4
All other industries . . . . .	9
Total	101

Personal Interviews in the United States and India

Executives were selected for interviews from different types of industries. During the interviews, executives were asked to express their viewpoints on Indian socio-economic and political environments. They also were asked questions concerning factors influencing investment decisions, their attitudes toward such factors, and their experience with Indian investment.

Interview Sample

The following groups of executives were interviewed.

<u>Group</u>	<u>Total Number</u>
Indian industrialists in India . . . . .	12
Indian government officials . . . . .	8
Indian economists in India . . . . .	6
American executives in the United States (vice-president level) . . . . .	22
American executives in India (top level) . . . . .	13
American advisers to government of India . . . . .	3
British advisers to government of India . . . . .	2
British executives in India (top level) . . . . .	<u>16</u>
Total	82

The samples of the questionnaire used and the guide for the interview questions are given in the appendix.

TABLE 2  
COMPANIES SURVEYED BY INTERVIEW

Type of Principal Activity	American Executives in U.S.A.	American Executives in India	British Executives in India	Indian Ind. in India
Chemical and pharmaceutical	5	4	4	3
Machine tools and spare parts	4	3	4	3
Non-electrical machinery	4	3	3	4
Electrical machinery	2	1	1	1
Engineering and management consultants	5	-	-	-
Rubber	-	1	1	-
Banking	2	1	2	1
Trading	-	-	1	-
Automobile	-	-	-	-
Total	22	13	16	12

#### Rationale Behind the Choice of Sample

Although this research was conducted both in the United States and in India, major field work was done in the United States. The time and financial restraints made this choice inevitable, but the following economic considerations also justified this choice.

In recent years the net inflow of United States private capital has been more than half of the total inflow of net foreign capital into India. In 1959, the net inflow of American private capital was 69.04 per cent of the total foreign private capital inflow into India. It was 15.96 million dollars as compared with 3.15 million dollars from the United Kingdom and 7.14 million dollars from all other countries.<sup>3</sup> Yet the total private investment from the United States is relatively insignificant. The limited participation of the United States private investment in India can be seen from the following statistics. In 1962, total United States private investment was 188 million dollars, which is less than 4 per cent of the net annual global outflow from the United States.<sup>4</sup> This is less than a fifth of United States business investments in relatively tiny Mexico.<sup>5</sup> Thus there is great potential in increasing the United States private investment in India. The Indian government is aware of the small share of the United States private investment in India, and this awareness is manifested in her various efforts to increase such investment in India.

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<sup>3</sup>Indian News, op. cit., p. 4.

<sup>4</sup>United States Department of Commerce, United States Direct Foreign Investments and Earnings Ratios, 1959-62, Washington, D.C., 1963, p. 4.

<sup>5</sup>Wall Street Journal, July 27, 1964, p. 1.



### Scope of the Study

The main purpose of this research is to ascertain specific obstacles and impediments to foreign private investment in India. More specifically, the research attempts to ascertain obstacles and impediments that are inherent in Indian governmental policies. The aim is to pinpoint shortcomings in these policies which, if removed, could result in increasing inflow of foreign capital into India. It must be admitted, however, that a host of factors may restrict investment of some foreign companies in India. Barlow and Wender, for example, found that many companies do not invest in foreign countries because of:

- a. Lack of interest or knowledge on the part of the top executive.
- b. The company does little exporting and therefore has not been brought into contact with the foreign situation.
- c. The products made by the company are so specialized that foreign countries do not provide a large enough market.
- d. Inadequate management, technical personnel and money needed to invest in foreign countries.<sup>6</sup>

These and other business reasons may be important factors preventing investment of some foreign companies in India, but it is beyond the scope of this research to investigate such factors.

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<sup>6</sup>Barlow and Wender, op. cit., pp. 192-193.

Secondly, the study is conducted with particular reference to private foreign investment with or without partnership with Indian companies. In recent years, however, many foreign companies have collaborated with the Indian government, and this practice may increase in years to come. This research has not attempted to investigate the problems and difficulties encountered by foreign companies in this type of collaboration.

Again, it must be admitted that there is a dynamic milieu of factors that influence investment decisions of foreign investors in India. We cannot fully investigate all these factors. Our attempt is simply to investigate the factors that seem quite obvious and logical. It is hoped, however, that knowledge of these obvious factors retarding foreign investment in India will provide guidelines in making policy changes for attracting foreign investments in India.

We shall now proceed to analyze these factors. First, in Chapter III, we shall analyze Indian socio-economic and political conditions and then, in Chapter IV, we shall discuss various Indian policies affecting foreign investment in India.

### CHAPTER III

#### SOCIO-ECONOMIC AND POLITICAL CONDITIONS IN INDIA

##### Introduction

The decision to invest or not to invest in any foreign country depends upon many complex factors. However, it is safe to assume that capital seeks profitable investment, whether domestic or foreign. In other words, investment is based on the expectation of future profits. The private investor, besides seeking profits, looks for the security of his invested capital. The security of capital, in turn, depends upon social, economic, and political conditions in the host country. Such social strifes as prolonged and/or frequent strikes, excessive labor troubles, and social disorder endangering private property tend to discourage investment, particularly from foreign countries. Also, rampant inflation, a stagnant economy, and an unstable government are discouraging elements in the investment climate. Many researchers in the field of international investment have clearly shown that such socio-economic and political instability in foreign countries has retarded greater inflow of United States private investment in those countries.

In this chapter, therefore, attempts have been made to analyze socio-economic and political environments, along with market potential and profitability of foreign venture in India.

### Indian Economy

#### Indian Planning: Historical Perspective

India is, perhaps, the first country in the world which has tried to undertake economic planning in a comprehensive way at the national level and under a democratic structure. Earlier, planned economic development had been associated with a regimented and highly centralized political system, but India has tried to follow the middle path by combining economic planning with democracy.

Although the National Planning Commission was set up by the government of India in March, 1950, valuable work had been done by Indian national leaders in regard to the planned economic development of the country even before the advent of political freedom in August, 1947. Under the chairmanship of the late Prime Minister Nehru, the Indian National Congress (the present ruling party) had set up a National Planning Committee in 1938. This committee produced a series of social and economic studies which formed the broad basis for a more organized planning effort after independence. Mahatma Gandhi regarded political freedom a

means to the attainment of economic and social objectives for raising the masses from poverty, hunger, and unemployment. His program of socio-economic reconstruction of the countryside constitutes the very foundation of the present community development movement in India.

The First Five-Year Plan:  
1951-1956

In 1951, India embarked on formal economic planning. During the decade from 1951 to 1961, India successfully completed two Five-Year Plans. At the present time, India is in the third year of her Third Five-Year Plan.

The First Five-Year Plan (1951-1956) was largely a preliminary effort emphasizing agriculture, irrigation, power, communication, and transportation. The plan took over several projects which had been worked out earlier and integrated them into a well-knit scheme of economic and social development, embracing every part of the country. Through its emphasis on agriculture, irrigation, power, and transportation, the plan aimed at creating the base for more rapid economic and industrial development in the future.

Total investment during the First Five-Year Plan was slightly over seven billion dollars, of which 3.27 billion dollars was invested by the public sector, that is, the Indian government.<sup>1</sup> The bulk of industrial investment was

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<sup>1</sup>Subbiah Kannappan and Eugene W. Burgess, op. cit., p. 9.

by the private sector.

On the whole, the targets set under the First Plan were exceeded. National income increased by 18 per cent, while the target was only 12 per cent.<sup>2</sup> Per capita income, in real terms, rose about 10 per cent.<sup>3</sup> The agricultural output index went up from 95.6 in 1950-51 to 116.9 for 1955-56.<sup>4</sup> The index of industrial production rose from 100 in 1951 to 132.6 in 1956.<sup>5</sup> The rate of savings was increased to 7 per cent of the national income in 1955-56 as against the target of 6.75 per cent.<sup>6</sup>

The Second Five-Year Plan:  
1956-1961

In contrast to the preliminary nature of the First Five-Year Plan, the Second Five-Year Plan was designed to industrialize the nation at a rapid speed. The higher growth rate in population (2 per cent per year instead of the 1.2 per cent estimated under the First Five-Year Plan) necessitated a significant shift in objectives. Thus the objectives of the Second Five-Year Plan were:

1. A 25 per cent increase in national income during 1956-1961.

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<sup>2</sup>Ibid.

<sup>3</sup>Ibid.

<sup>4</sup>Ibid.

<sup>5</sup>Ibid.

<sup>6</sup>Ibid.

2. Rapid industrialization of the country with emphasis on basic and heavy industries.
3. A large expansion of employment opportunities.
4. Reduction of disparities in income and wealth and in concentration of economic power.<sup>7</sup>

In the Second Five-Year Plan, expenditures shifted in favor of capital-intensive investments in heavy industry and of social and economic overhead capital. Due to these reasons, the public sector investment was higher than that of the private sector. Originally, the Second Plan aimed at total public expenditures of ten billion dollars and total private investment of five billion dollars.<sup>8</sup> The course of the Second Five-Year Plan was not altogether free from ups and downs. Such natural causes as floods and failure of monsoons, coupled with deficiencies in implementation, the Suez crisis, and other international developments presented difficulties for the successful implementation of the envisaged plan.

Moreover, due to reduced exports and increased costs of imports, India's foreign reserves declined rapidly. In 1956, they fell 23 per cent and, in 1957, another 34 per

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<sup>7</sup>Second Five-Year Plan, Government of India Printing Press, New Delhi, India, 1956, pp. 24-25.

<sup>8</sup>Ibid.

cent.<sup>9</sup> Increased foreign aid reduced the pressure on the exchange situation, but despite this assistance, it seemed clear that the Second Plan's goals were too high. This was realized by the Indian government, and the Plan targets for the public sector outlays were cut down to 46 billion rupees or about 9.7 billion dollars.<sup>10</sup>

Thus the performance of the Second Five-Year Plan did not measure up to expectations. The net national output at current prices went up from about 21 billion dollars in 1955-56 to over 26.5 billion dollars in 1958-59.<sup>11</sup> The index of industrial output went up from 132.6 in 1956 to 151.1 in 1959.<sup>12</sup> The agricultural output lagged significantly behind, and the national income increased by 20 per cent against a target of 25 per cent.<sup>13</sup>

However, taking the decade as a whole, the picture is one of over-all progress. Basic facilities like irrigation, power, and transportation, which are essential for agricultural and industrial development, were greatly expanded. Valuable mineral deposits, which feed small and

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<sup>9</sup>Sir Donald MacDougall, "India's Balance of Payment," Economic Weekly, Bombay, India, April 22-29, 1961, p. 675.

<sup>10</sup>Kannappan and Burgess, op. cit., p. 11.

<sup>11</sup>Ibid.

<sup>12</sup>Ibid.

<sup>13</sup>Ibid.



large industries, were discovered. During the 1951-61 decade the national income increased in real terms by 42 per cent, and per capita income by 17 per cent, despite the 20 per cent increase in population.<sup>14</sup> Industrial production approximately doubled during this period.<sup>15</sup> Agricultural production rose by 40 per cent.<sup>16</sup> Electric power generation tripled.<sup>17</sup> The rate of investment of national income more than doubled.<sup>18</sup> Total annual new investment in 1960-61 was three times that in 1950-51.<sup>19</sup> The economic progress made during the decade of 1951-61 is summarized in Table 3.

The Third Five-Year Plan:  
1961-1966

The achievements of the Second Five-Year Plan seem to indicate that the Plan was too ambitious. Indian planners became a target of excessive criticism from both foreign and domestic "experts." They were advised by these "experts" to plan less and give a free hand to private enterprise to do the job of economic development. However, population growth (2 per cent per year) was greater than expected (1.5 per cent per year) and made it more difficult for the Indian

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<sup>14</sup>Investing in India, Basic Facts of the Indian Economy, Indian Investment Center, New Delhi, India, p. 64.

<sup>15</sup>Ibid.

<sup>16</sup>Ibid.

<sup>17</sup>Ibid.

<sup>18</sup>Ibid.

<sup>19</sup>Ibid.

TABLE 3  
GROWTH OF THE INDIAN ECONOMY SINCE 1950-51

	1950-51	1955-56	1960-61*	1965-66**
<sup>+</sup> National income (Rs. 100 million)	1,024	1,213	1,420	1,900
<sup>+</sup> Per capita income (Rs)	267	255	327	385
Population (million)	361	397	438	492
Production:				
Agricultural (year ended June 1950=100)	96	117	139	176
Foodgrains (million tons)	52¶	66¶	79	100
Industrial (1950-51=100)	100	139	194 (94)	329 (70)
Electricity capacity (million kw.)	≈2.3	≈3.4	5.7 (148)	12.7 (123)

\*Estimates: Figures in brackets in this column show percentage increase over 1950-51.

\*\*Figures in brackets in this column show percentage increase over 1960-61.

<sup>+</sup>At 1960-61 prices.

≈Figures relate to calendar years 1950 and 1955.

¶Adjusted for changes in statistical coverage and methods of estimation

Source: Investing in India: Basic Facts of the Indian Economy, Indian Investment Center, New Delhi, India, 1962, p. 64.

TABLE 3--Continued

	1950-51	1955-56	1960-61*	1965-66**
Community development:				
Blocks (no.)	-----	1,069	3,110	5,223
Villages covered ('000s)	-----	106	368	550 (49)
Population served (million)	-----	69	204	359 (76)
Transport:				
Railway: freight carried (million tons)	92	114	154	245
Surfaced roads ( '000 miles)	98	122	144 (48)	169 (17)
Commercial vehicles on roads ('000s)	116	166	210 (81)	365 (74)
Shipping ('000 GRT)	390	480	900 (131)	1,090 (21)
Education:				
School students (million)	23.5	31.3	43.5 (85)	63.9 (47)
Health:				
Hospital beds ('000s)	113	125	186 (65)	240 (29)
Doctors ('000s)	56	65	70 (25)	81 (16)
Consumption per capita:				
Food (calories per day)	1,800	1,950	2,100	2,300
Cloth (yards per annum)	9.2	15.5	15.5 (68)	17.2 (11)

\*Estimates: Figures in brackets in this column show percentage increase over 1950-51.

\*\*Figures in brackets in this column show percentage increase over 1960-61.

government to achieve targeted economic growth. Yet, instead of turning back, Indian planners accepted the challenge. Consequently, the Third Five-Year Plan is much bigger in size and bolder in conception than the first two Five-Year Plans. The main objectives of the Third Five-Year Plan are:

1. To secure an increase in national income of over 5 per cent per annum.
2. To achieve self-sufficiency in food grains and increase agricultural production to meet the requirements of domestic industry and exports.
3. To expand basic industries like steel, chemicals, fuel and power, and machine tools.
4. To utilize to the fullest possible extent the manpower resources of the country and to insure a substantial expansion in employment opportunities.
5. To establish progressively greater equality of opportunity and to bring about reduction in disparities in income and wealth and more even distribution of economic power.<sup>20</sup>

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<sup>20</sup>Third Five-Year Plan: A Draft Outline, Government of India Printing Press, New Delhi, India, 1961, pp. 31-54.

The total outlay for the Third Five-Year Plan is expected to be 24.78 billion dollars.<sup>21</sup> A description of the over-all investment targets of the Third Five-Year Plan by different sectors is given in Table 4.

Indian Economy: (1961-1963)  
Conditions and Prospects

The Indian economy experienced many setbacks between 1961 and 1963. Much of the slower rate of growth during the first year of the Third Plan can be attributed to the rephrasing of the Second Plan after 1958-59 because of the foreign exchange shortage and slower progress in the implementation of programs. The Indian economy suffered a further setback due to the Chinese invasion in October and November, 1962. An over-all picture of the state of the Indian economy during 1960-63 can be obtained from Table 5. Following is a brief summary of the state of the Indian economy during 1960-63.

National Income

The national income declined from an annual growth rate of 7.1 per cent in 1960-61 to 2.2 per cent in 1961-62.<sup>22</sup>

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<sup>21</sup>Ibid.

<sup>22</sup>Indian Economy 1961-1963: (Conditions and Prospects), National Council of Applied Economic Research, New Delhi, India, 1963, p. 10.

TABLE 4  
PUBLIC AND PRIVATE SECTOR INVESTMENT

	Second Plan Estimates	Third Plan Targets
	(Rs. million)	
Agriculture & community development . .	8,350	14,600
Public sector . . . . .	2,100	6,600
Private sector . . . . .	6,250	8,000
Irrigation (major and medium) . . . . .	4,200	6,500
Public sector . . . . .	4,200	6,500
Private sector . . . . .	**	**
Power . . . . .	4,850	10,620
Public sector . . . . .	4,450	10,120
Private sector . . . . .	400	500
Village & small industries . . . . .	2,650	4,250
Public sector . . . . .	900	1,500
Private sector . . . . .	1,750	2,750
Organised industries & mining . . . . .	15,450	25,700
Public sector . . . . .	8,700	15,200
Private sector . . . . .	6,750*	10,500*
Transport & communications . . . . .	14,100	17,360
Public sector . . . . .	12,750	14,860
Private sector . . . . .	1,350	2,500
Social services & miscellaneous . . . . .	12,900	16,970
Public sector . . . . .	3,400	6,220
Private sector . . . . .	9,500	10,750
Inventories . . . . .	5,000	8,000
Public sector . . . . .	Nil	2,000
Private sector . . . . .	5,000	6,000
Total investments . . . . .	67,500	104,000
Public sector . . . . .	36,500	63,000
Private sector . . . . .	31,000‡	41,000‡

\*\*Included under agriculture and community development.

\*Excluding expenditure on replacement and modernisation.

‡Excluding transfers of Rs. 2,000 million from public to private sector.

Source: Investing in India: Basic Facts of the Indian Economy,  
Indian Investment Center, New Delhi, India, 1962,  
p. 66.

TABLE 5  
KEY ECONOMIC INDICATORS

Sl. No.	Item	Year		
		1960-61	1961-62	1962-63
1.	Annual growth of national income (per cent)	+7.1	+2.2	N.A.*
2.	Annual increase in the index of agricultural output with 1950-51 as base (per cent)	+8.9	+0.0	N.A.*
3.	Annual increase in the index of industrial production with 1956 as base (per cent)	+10.0	+7.2	+7.1 <sup>a</sup>
4.	(a) Annual increase/decrease in imports (per cent)	+16.7	-7.4	-1.5 <sup>b</sup>
	(b) Annual increase in exports (per cent)	+0.4	+3.1	+5.7
	(c) Balance of trade (+) surplus, (-) deficit (Rs. crores)	-471.80	-310.50	-225.60 <sup>c</sup>
5.	Percentage rise in the index of wholesale prices with 1952-56 as base	+6.7	+0.2	+2.2 <sup>d</sup>
6.	Annual increase in money supply (per cent)	+5.5	+6.1	+3.4 <sup>e</sup>

<sup>a</sup>Percentage change refers to the period January-October, 1962 over January-October, 1961.

<sup>b</sup>Refers to the period April-September, 1962 over April-September, 1961.

<sup>c</sup>Refers to April-September, 1962.

<sup>d</sup>Refers to April 1962 to January 1963.

<sup>e</sup>Percentage change refers to the period January 25, 1963 over March 31, 1962.

\*N.A.--not available.

TABLE 5--Continued

Sl. No.	Item	Year		
		1960-61	1961-62	1962-63
7.	Overall budget surplus or deficit of government of India (Rs. crores)	+48.0	-134.0	-119.0
8.	Annual increase in the index of electricity generated with 1950-51 as base (per cent)	+13.1	+12.6	N.A.*
9.	Annual increase in the index of traffic--railway--goods originating with 1950-51 as base (per cent)	+6.6	+2.8	+10.5 <sup>f</sup>
10.	Annual increase in the number of applicants on live register of employment exchanges (per cent)	+13.0	+14.1	+29.8

<sup>f</sup>Percentage change refers to the period April-November, 1962, over April-November, 1961.

\*N.A.--not available.

Source: Indian Economy 1961-63, National Council of Applied Economic Research, New Delhi, India, 1964, p. 101.

It witnessed an increase of 2.4 per cent in 1962-63 over 1961-62.<sup>23</sup> Thus, three-fourths of the Plan still remains to be achieved within three-fifths of the allotted time. In other words, the national income will have to rise at a much faster rate, viz., 7 per cent in each of the following years,

<sup>23</sup>Ibid., p. 11.



to achieve the Plan target.<sup>24</sup>

A 7 per cent cumulative rate of growth will clearly mean a higher rate of growth in each sector of the economy than has been achieved in the past two years. Broadly, the required cumulative rates may have to be nearly 5 per cent in agriculture and allied activities, 14 per cent in industry, and 6 per cent in the tertiary sector.<sup>25</sup> These annual rates are undoubtedly higher than those envisaged in the Plan because the deficiency of growth in the national income during the first two years of the Third Plan must be made up in the remaining parts of the Plan period.

#### Industrial Output: (1961-1963)

The general index of industrial production (base: 1951 = 100) for 1961 was 180.9 as compared to 169.7 in 1960.<sup>26</sup> It increased by 6.6 per cent in 1961 as compared to an 11.6 per cent increase in 1960 and an 8.9 per cent increase in 1959.<sup>27</sup> This poor performance in 1961 can largely be attributed to the shortage of power, transportation, foreign exchange, raw material, and spare parts.<sup>28</sup>

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<sup>24</sup>Ibid.

<sup>26</sup>Ibid., p. 32.

<sup>28</sup>Ibid.

<sup>25</sup>Ibid.

<sup>27</sup>Ibid., p. 33.

A mere recital of increased industrial production in the form of indices, especially if the base is low, is bound to give an exaggerated picture of the industrial growth over a period of time. It is true that such indices provide a rough yardstick for measuring industrial progress at different points of time, but they do not provide a correct appraisal of industrial development.

A correct appraisal of industrial development over a period of time can be done only by measuring the impact of such development on the economy as a whole.

#### Effect of Increased Industrial Production on Income

The national income of India rose from 102,400 million rupees in 1950-51 to 121,300 million rupees in 1955-56, and to 145,000 million rupees in 1960-61.<sup>29</sup> The contribution of the industries and mining sectors to these total figures is quoted in Table 6.

Since the industrial sector of the economy has been increasing its contribution to the national income, it may be concluded that there has been some progress in the country, although it may not be considered as spectacular as is often claimed. In fact, the progress is only modest, because

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<sup>29</sup>Third Five-Year Plan, Government of India Printing Press, New Delhi, India, 1961; quoted from Indian Economy, 1961-63, op. cit., p. 35.

the increase in the index of percentage contribution was only 14.5 per cent over the ten-year period of 1951-61, while the general industrial output index increased from 100 in 1951 to 181 in 1961.<sup>30</sup>

TABLE 6  
EFFECTS OF INCREASED INDUSTRIAL PRODUCTION  
ON NATIONAL INCOME

(One croes = 10 million rupees)  
(In croes at current prices)

Industry	1950-51	1955-56	1960-61
Mining	70	100	160
Large-scale industry	550	780	1,320
Small-scale industry	910	970	1,120
Total	1,530	1,850	2,600
Per cent of national income	16.1	18.5	18.4
Index of per cent contribution	100.0	115.0	114.5

Source: Estimates of national income 1948-49 to 1961-62, Central Statistical Organization, New Delhi, India, quoted from Indian Economy, 1961-63, National Council of Applied Economic Research, New Delhi, India, 1963, p. 35.

<sup>30</sup>Ibid., p. 36.

Another important facet of industrial growth is its impact on employment. The picture is not very bright on this score either. The percentage of labor employed by major groups of industries indicates that increases in direct employment arising out of industrial growth do not fall in line with the high figures quoted for industrial output indices. After ten years of government planning, industries employed only 4.6 per cent of the population in 1960-61.<sup>31</sup> Thus, the progress achieved in the industrial sector does not appear to have made any great impact on employment.

Yet there is a brighter aspect to India's industrial program and its organization. This is the extraordinary growth of and diversity in industrialization in the country over the last twelve years. Industry has been diversified by a wide range of manufactures, both in the heavy basic industries and in the field of consumer goods. Advanced manufacturing techniques have been imported, and there is a solid and massive foundation for further industrial expansion. All this growth in economic power and resources has greatly strengthened the economy.

An important landmark in the history of India's industrialization is the debut of some products of the engineering industries during the Second Plan period. Most important were: industrial boilers, cranes, precision

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<sup>31</sup>Ibid., p. 37.

instruments, road rollers, tractors, aircraft, and welding electrodes.<sup>32</sup> There is no doubt that some of the achievements in the industrial sectors had far-reaching consequences, especially in the manufacture of such items as bicycles, sewing machines, telephones, electrical goods, and textile and sugar machinery. However, advances in these industries failed to affect the general conditions of the population, as they did not radically alter the structure of the economy. In addition, the industries which will eventually change the structure of the economy have failed to reach target production levels. These industries include: iron and steel, fertilizers, industrial machinery, heavy castings and forgings, newsprint, raw films, chemical pulp, soda ash, caustic soda, dyestuffs, and cement.<sup>33</sup> Several causes contributed to the below-target performance of these vital industries. The most significant among these were:

1. Shortage of foreign exchange, especially hard currencies.
2. Lack of proper technical and managerial know-how.
3. Inadequacies in designing and executing projects.
4. Shortage of fuel and power.
5. Transportation bottlenecks.<sup>34</sup>

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<sup>32</sup>Ibid., p. 34.

<sup>33</sup>Ibid.

<sup>34</sup>Ibid.

Perhaps the shortage of foreign exchange is the single most important factor responsible for hindering Indian economic development. The deteriorating balance of payment position can easily be visualized from the following statistics:

	Balance of Payments on Current Account (In millions of rupees)			
	<u>1951-52</u>	<u>1955-56</u>	<u>1960-61</u>	<u>1961-62</u>
Total exports (f.o.b.)	7,301	6,402	6,319	6,620
Total imports (c.i.f.)	9,629	7,614	10,880	10,386
Trade Balance	-2,328	-1,212	-4,561	-3,766

Source: Investing in India: Basic Facts of the Indian Economy, Indian Investment Center, New Delhi, India, 1963, p. 75.

The trade deficit increased in 1961-62 to 3,766 million rupees as compared to 2,328 million rupees in 1951-52. Preliminary figures released for July and August, 1963, showed a total trade deficit of 88 million dollars for these months alone.<sup>35</sup> Foreign exchange reserves declined from 1,566.6 million dollars in 1956 to 256 million dollars in 1961.<sup>36</sup> Thus, one can say that the impact of economic

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<sup>35</sup>United States Department of Commerce, International Commerce, January 13, 1964, p. 17.

<sup>36</sup>Ibid.

development has been the most severe on India's balance of payments and exchange reserves because of the larger imports necessitated by the growing economy.

As the Council for Applied Economic Research has stated:

Foreign exchange will be one of the crucial factors determining many facets of the growth of the Indian economy in the decade that we are passing. India will need vast amounts of foreign exchange both for defense preparation and for strengthening the industrial base of the economy.<sup>37</sup>

The shortage of foreign exchange and below-target performance of some sectors in the economy are discouraging to Indian planners. However, these factors in themselves do not restrict the opportunities for foreign investors in India. These shortages point up the vast unexplored market situation in India. If there were no shortages and bottlenecks and if the Indian market was saturated, then probably foreign investors would not have been welcomed so eagerly in India. In spite of these setbacks in the Indian economy, one can say that India has made considerable progress in the economic sphere. This vote of confidence in India's economic growth was expressed by many executives interviewed in United States and India. For example, Mr. J. R. Galloway, the leader of the United States Business Delegation to India, recently said,

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<sup>37</sup>Indian Economy, 1961-63, op. cit., p. 96.

In the light of significant strides which the Indian economy has already made in recent years, with the political and financial stability which has stemmed from democratic government, with the vast potential market which India's large and industrious population represents, India should offer an outstanding opportunity for business enterprise.<sup>38</sup>

Mr. Franklin D. Roosevelt, Jr., United States Undersecretary of Commerce, said, "The economic progress of India has been mighty. Its potential for the future is also mighty."<sup>39</sup>

### Social and Political Conditions in India

A foreign private investor not only expects a higher rate of return from his investment abroad, but he also looks for the security of his invested capital. The security of his capital depends upon social and political conditions in the host country. Therefore, such social strifes as prolonged strikes, excessive labor troubles, and riots are discouraging to both foreign and domestic private investors. Such political troubles as revolutions, overthrow of ruling authorities, and military coups are also discouraging to private investors.

As we have seen in Chapter I, most of the previous

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<sup>38</sup>Quoted from India News, Embassy of India, Washington, D.C., June 26, 1964, p. 4.

<sup>39</sup>Ibid.



researchers mentioned social and political instability as important factors limiting United States private investment in the underdeveloped countries. These factors therefore have been analyzed below.

Since her political independence in August, 1947, India has been fortunate in having stable government, at both the state and federal levels. While most of the developing countries in the Far East, Middle East, Africa, and Latin America have been victims of revolutions against ruling authorities and have experienced military coups, India has had no such governmental overthrow or military coup.

At the social level, India has not experienced such problems as prolonged and/or frequent strikes and rioting endangering private property. Respect for the private property is firmly rooted in the heart and mind of every Indian. Besides, India has made considerable progress at social and educational levels. This can easily be seen from the following.

Today in India the life expectancy is forty-two years as compared to twenty-seven years in 1947. Mr. Chester Bowles, the United States Ambassador to India, commenting on India's socio-economic progress, had this to say: "India has freedom of speech, freedom of religion, freedom of press and a private enterprise sector that has been chalking up sizeable

gains."<sup>40</sup>

There has been rapid advance in education, especially in technical education and various other fields. The number of students in schools has increased by 85 per cent, and the number of students getting a technical education has increased by more than three times since 1947. The number of hospital beds has grown by 65 per cent and the number of practicing doctors by 25 per cent in the last fifteen years.<sup>41</sup> Where there was only 10 per cent literacy fifteen years ago, now 60 per cent of all Indian children under twelve go to school.<sup>42</sup>

The progress in education, health, agriculture, and agricultural services can be seen from Table 7. However, these figures understate the full extent of India's changing conditions and growth. Statistics cannot give full meaning to the human revolution that is quietly, yet perceptibly, taking place in the country. After centuries of passive acceptance, millions of villagers all over India are taking part in what is happening and are beginning to ask more of life and of the future.

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<sup>40</sup>Chester Bowles, 'On India's Progress,' a speech given at the University of Texas, April 26, 1963; quoted from India News, Washington, D.C., 1963, p. 3.

<sup>41</sup>Third Five-Year Plan: A Draft Outline, op. cit., p. 54.

<sup>42</sup>Ibid.

TABLE 7

## PROGRESS IN EDUCATION, HEALTH, AGRICULTURE, AND AGRICULTURAL SERVICES IN INDIA (1950-65)

	Unit	1950-51	1960-61	1965-66 Targets	Percentage 1960 vs. 1950	Increase 1965 vs. 1960
<b>EDUCATION</b>						
Students in school	Millions	23.5	61.1	64.8	75	58
Age group in schools,						
6-11 years	Percentage	43.0	60.0	80.0	40	33
11-14 years	Percentage	13.0	23.0	30.0	77	30
14-17 years	Percentage	5.0	12.0	15.0	140	25
Engineer and technol- ogy school intake	Number	4,119	13,165	18,500	220	41
Agricultural school intake	Number	1,060	4,500	6,000	325	33
<b>HEALTH</b>						
Institutions, hospitals, and dispensaries	Thousands	8.6	12.6	14.6	47	16
Family planning centers	Number		1,797	8,197		356
Registered doctors	Thousands	59	84	103	42	23
<b>AGRICULTURAL PRODUCTION</b>						
Food grains	Million tons	52.2	75.0	100-105	44	33.40
Cotton	Million bales	2.9	5.4	7.2	86	33
Sugar cane-gur	Million tons	5.6	7.2	9-9.2	29	25.28
Oil seeds	Million bales	5.1	7.2	9.2-9.5	41	28.32
Milk	Billion lbs.	11.6	15.0	17.3	29	15
<b>AGRICULTURAL SERVICES</b>						
Net total area irrigated	Million acres	51.5	70.0	90.0	36	29
Nitrogenous fertilizers consumed	'000 tons of N	55	360	1,000	855	178

Source: India, Business International Indian Roundtable, Business International, New York, 1961, p. 7.

Foreign Executives' Views on  
Indian Socio-Economic and  
Political Environments

Yet another way to ascertain the level of confidence in India's socio-economic and political environment is to ask foreign investors in India for their opinions. During the research interviews in the United States and India, 54 executives expressed their views on Indian socio-economic and political environment as described below.

Of the 54 respondents, 17 (31.5 per cent) said that the Indian socio-economic environment was very encouraging for their investment. Twenty-nine (53.7 per cent) said it was good enough for encouraging foreign private investment. Only one respondent said that the Indian socio-economic conditions were distressing and discouraging to private foreign investment.

In respect to the political situation in India, of the 54 respondents, 25.9 per cent said that the Indian political situation was very stable. Another 57.4 per cent said that it was stable enough to encourage foreign private investment, while only 7.4 per cent said that it was unstable. In summary, one can say that the majority of foreign investors in India and the Indian businessmen have confidence in the Indian socio-economic and political stability. The detailed summary of the executives' views on Indian socio-economic and political conditions is given in Tables 8 and 9.

TABLE 8

Views on Indian Socio-Economic Environment  
(Interview Analysis)

Executive	Very Encouraging		All Right		Distressing		No Comment		No Answer		Total	
	No. Percent	No. Percent	Good Enough	No. Percent	No. Percent	No. Percent	No. Percent	No. Percent	No. Percent	No. Percent	No. Percent	No. Percent
American Executives in United States	6	75.0	2	25.0							8	100.0
American Executives in India	4	30.8	8	61.5					1	7.7	13	100.0
British Executives in India	4	24.0	6	37.5		2	12.5		4	25.0	16	100.0
Indian Industrialists	2	16.7	9	75.0	1	8.3					12	100.0
United States Consulting Firms	1	20.0	4	80.0							5	100.0
Total	17	31.5	29	53.7	1	1.9	2	3.7	5	9.2	54	100.0

TABLE 9  
VIEWS ON THE POLITICAL SITUATION IN INDIA  
(Interview Analysis)

Executive	Very Stable		Stable Enough		Comparable*		Do Not Trust		No Answer		Total	
	No. Percent	No. Percent	No. Percent	No. Percent	No. Percent	No. Percent	No. Percent	No. Percent	No. Percent	No. Percent	No. Percent	No. Percent
American Executives in United States	5	62.5	3	37.5							8	100.0
American Executives in India	2	15.4	6	46.2	3	23.0	1	7.7	1	7.7	13	100.0
British Executives in India	4	25.0	8	50.0	1	6.2	3	18.8			16	100.0
Indian Industrialists	2	16.7	10	83.3							12	100.0
United States Consulting Firms	1	20.0	4	80.0							5	100.0
Total	14	25.9	31	57.4	4	7.4	4	7.4	1	1.9	54	100.0

\*As stable as any other developed country.

### Indian Laws on Expropriation and Nationalization of Industries

The Indian constitution provides that no person shall be deprived of his property except for public purposes and with compensation provided. The Indian government on many occasions has stressed that it has no intention of nationalizing industries which are functioning efficiently in accordance with India's social aims. There have been relatively few cases of nationalization and all these took place before 1959. Major instances of nationalization were the takeover of life insurance companies; privately owned domestic airlines; and the Kolar gold mines. In all cases, the amount of compensation paid by the Indian government has been termed "adequate" in business circles.<sup>43</sup>

### Investment Guaranty Agreement

The investment guaranty agreement for the conversion of earnings and original capital into dollars was concluded in September, 1957. This agreement was amended in December, 1959, to include provisions for compensation to American investors in the event of expropriation. This agreement assures United States investors that, in the event of expropriation or lack of convertibility, they will be compensated by the International Cooperation Administration of the

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<sup>43</sup>United States Department of Commerce, "Investment Factors in India," op. cit., p. 15.

United States; thereafter it is left to the United States government to press its claim with the Indian government. In the last few years, the Indian government has been attempting to conclude similar investment treaties with foreign governments of Western Europe.

#### Market Potential and Investment Opportunities in India

India has 440 million people. She has determined to increase per capita income by 43 dollars in the next fifteen years. This means an increase of some 19 billion dollars in purchasing power. An income increase of even ten dollars per capita will give additional purchasing power worth approximately 4.4 billion dollars.<sup>44</sup>

Among others, the United States Department of Commerce and John Lewis have indicated the great market potential of India. For example, in 1961, the United States Department of Commerce report said: "the approved venture can reasonably expect to enjoy the comfort of a ready-made and eager market generally free from competitive influences."<sup>45</sup>

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<sup>44</sup>Gopala Menon, "Opportunities for United States Private Investment in India," News Letter, Indian Investment Center, New York, February 5, 1962, p. 3.

<sup>45</sup>United States Department of Commerce, Investment in India, Washington, D.C., 1961, p. 3.



Lewis, commenting on the Indian market potential, said, "the future Indian market has for some time been one of the world's most challenging."<sup>46</sup>

Most of the executives interviewed in the United States and in India were appreciative of the market potential of India. Mr. J. R. Galloway, the leader of United States Business Delegation which visited India in April, 1964, said, "India offers outstanding opportunities for the United States business enterprise."<sup>47</sup>

For specific investment opportunities, the government of India periodically publishes an illustrative list of industries where private foreign capital is needed. The most recent list includes the following industries where private foreign capital and know-how are welcome. These are: iron and steel castings and forgings; iron and steel pipes; special steels; non-ferrous metals and alloys; boilers and steam generating plants; equipment for transmission and distribution of electricity; furnaces; marine diesel engines; industrial machinery, including major items of specialized equipment used in specific industries; ball, roller and taper bearings; speed reduction units; machine tools; tractors, earth-moving and construction machinery;

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<sup>46</sup>John Lewis, op. cit., p. 216.

<sup>47</sup>India News, op. cit., p. 3.

plastic; industrial and scientific instruments; fertilizers; organic chemicals, fine chemicals and intermediates; industrial explosives; industrial gases; agricultural chemicals such as insecticides; dye-stuffs; drugs, including the production of basic intermediates; newsprint; and pulp.<sup>48</sup>

#### Profitability of Foreign Investment in India

Foreign private investors in India have been, and are, making good profits. For example, the average net profits after taxes of United States subsidiaries in India were 12 per cent in 1958. Union Carbide (60 per cent American owned) made a net profit after taxes of 26.4 per cent, and Indian Aluminum (65 per cent Canadian owned) made 23.3 per cent in 1959.<sup>49</sup> These compared very favorably with the net profits made by the same companies in the home countries. In 1959, Union Carbide made 11.21 per cent profit after taxes in the United States while Aluminum Company made only 4.78 per cent in Canada.<sup>50</sup>

Again in 1962, Union Carbide earned, after taxes,

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<sup>48</sup>"Investment Opportunities in India," India News, Washington, D.C., February 1, 1963, p. 8.

<sup>49</sup>Investing and Licensing Opportunities in the Thirty-Seven Countries, 1963, op. cit., p. 217.

<sup>50</sup>Calculated from Moody's Industrial Manual, New York, 1960, pp. 246 and 1640.

22.2 per cent of its net worth; Indian Aluminum, 18.5 per cent; Dunlop Rubber, 19.9 per cent; Esso, 12.2 per cent; and Caltax, 9.9 per cent.<sup>51</sup>

A United States Department of Commerce study shows that in 1962 the rate of earnings, after foreign taxation of American investments in manufacturing enterprises in India, was among the highest of any country in the world. On some 63 million dollars of these investments in India, United States companies received an earning ratio of 20.6 per cent. In 1961 the average earnings were 19.2 per cent.<sup>52</sup>

#### A Viewpoint of the Foreign Investors

The satisfactory profitability of Indian ventures also was confirmed in research interviews conducted in the United States and India. Out of the 54 respondents, some 44 respondents (81.4 per cent) were quite satisfied with their rate of return in India. Only two respondents (3.7 per cent) were not satisfied. Views expressed by the American and British executives and the Indian industrialists are given in Table 13.

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<sup>51</sup>Investing and Licensing Opportunities in the Thirty-Seven Countries, 1963, loc. cit.

<sup>52</sup>United States Department of Commerce, United States Private Investment Abroad, Washington, D.C., 1962.

TABLE 10

THE EARNINGS RATIO OF UNITED STATES MANUFACTURING  
COMPANIES IN THE FAR EAST IN 1962\*

Country	Investment (millions of dollars)	Earnings Ratio (Percent)
India	63	20.9
Indonesia	12	25.0
Japan	110	9.1
Philippines	89	18.0

TABLE 11

EARNINGS RATIO OF UNITED STATES MANUFACTURING  
COMPANIES IN EUROPEAN COUNTRIES IN 1962\*

Country	Investment (millions of dollars)	Earnings Ratio (Percent)
Belgium-Luxemburg	169	21.9
Denmark	21	38.1
France	460	6.3
Germany	747	20.2
Italy	187	7.5
Netherlands	95	5.3
Norway	23	13.0
Spain	29	13.8
Sweden	21	9.5
Switzerland	123	18.7
Turkey	3	33.3
United Kingdom	2,305	10.0
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INDIA	63	20.9

\* Source: United States Department of Commerce,  
United States Private Investment Abroad, Washington, D.C.,  
1962.

TABLE 12  
EARNINGS RATIO OF UNITED STATES COMPANIES IN  
LATIN AMERICAN COUNTRIES IN 1962\*

Country	Investment (millions of dollars)	Earnings Ratio (Percent)
Argentina	283	17.0
Brazil	543	7.9
Chili	27	11.9
Colombia	94	4.3
Mexico	414	6.8
Panama	12	16.7
Peru	37	13.5
Uruguay	22	18.2
Venezuela	196	6.1

\*Source: United States Department of Commerce,  
United States Private Investment Abroad, Washington, D.C.,  
1962.

TABLE 13  
EXPERIENCE WITH THE INDIAN INVESTMENT  
(Interview Analysis)

Executive	Very Satisfactory No. Percent	Satisfactory No. Percent	Not so Satisfactory No. Percent	No Answer No. Percent	Total No. Percent
American Executives in United States	7 87.5	1 12.5			8 100.0
American Executives in India	2 15.4	8 61.5	1 7.7	2 15.4	13 100.0
British Executives in India	3 18.7	9 56.3	1 6.3	3 18.7	16 100.0
Indian Industrial- ists	6 50.0	6 50.0			12 100.0
United States Con- sulting Firms	2 40.0			3 60.0	5 100.0
Total	20 37.0	24 44.4	2 3.7	8 14.9	54 100.0

### Price Stability in India

A high rate of return will not mean much if the price level rises abnormally. In any developing country where huge investment outlays are made, prices of selected commodities are bound to rise due to the natural lag of demand and supply. However, it is the general wholesale price level which needs to be stabilized.

The Indian rupee depreciated from an index of 100 in 1952 to 79 in 1962. This, however, is more favorable than in other developing and developed countries. During the decade of 1952-62, the United Kingdom's pound depreciated from an index of 100 in 1952 to 75 in 1962. France's franc depreciated from 100 in 1952 to 70 in 1962. West Germany's mark depreciated from 100 in 1952 to 86 in 1962, and in the United States the dollar fell from 100 to 88.<sup>53</sup>

The comparison of the Indian rupee with the currencies of the other developing countries shows an even brighter picture. This can be seen from Table 14.

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<sup>53</sup>"Currency Values Around the World Continue to Drop," International Management, McGraw-Hill, New York, November, 1963, p. 27.

TABLE 14  
WORLD MONEY VALUES

	Indexes of Value of Money			Annual Depreciation	
	1952	1961	1962	'52-'62*	'61-'62
Ceylon	100	95	94	0.6%	1.0%
Venezuela	100	93	93	0.7	-1.0
Guatemala	100	94	92	0.8	2.0
El Salvador	100	91	91	1.0	---
Canada	100	91	90	1.1	1.0
Philippines	100	94	89	1.1	5.4
Belgium	100	90	89	1.2	1.0
Ecuador	100	92	89	1.2	2.8
Switzerland	100	92	88	1.2	3.7
United States	100	89	88	1.3	1.0
Lebanon	100	89	87	1.4	1.9
Portugal	100	92	87	1.4	4.6
Germany	100	89	86	1.5	3.7
Italy	100	84	80	2.2	4.6
South Africa	100	81	80	2.2	1.0
Austria	100	84	79	2.3	5.4
India	100	82	79	2.3	3.6
Australia	100	79	79	2.4	---
Netherlands	100	81	78	2.4	3.7
Pakistan	100	78	78	2.5	---
Denmark	100	81	76	2.8	7.0
Ireland	100	79	75	2.8	4.6
Norway	100	79	75	2.9	5.4
United Kingdom	100	78	75	2.9	3.7
Sweden	100	77	74	3.0	4.5

\*Compounded annually.

Note: Depreciation computed from unrounded data. Value of money is measured by reciprocals of official cost-of-living or consumer price indexes.



TABLE 14--Continued

	Indexes of Value of Money			Annual Depreciation	
	1952	1961	1962	'52-'62*	'61-'62
New Zealand	100	76	73	3.1%	3.6%
Japan	100	77	72	3.2	5.9
France	100	73	70	3.5	4.2
Finland	100	72	69	3.6	3.6
Greece	100	66	66	4.0	---
Mexico	100	62	62	4.7	0.9
Spain	100	63	60	5.0	5.1
Iran	100	54	54	6.0	0.8
Peru	100	53	50	6.7	5.9
Colombia	100	51	50	6.8	2.4
Israel	100	51	46	7.5	9.0
China (Taiwan)	100	45	44	7.9	2.1
Turkey	100	41	39	8.9	4.2
Uruguay	100	23	21	14.6	9.2
Argentina	100	14	11	19.7	21.8
Brazil	100	13	9	21.5	33.8
Chile	100	6	6	25.0	12.1
Bolivia	100	1	1	35.2	5.3

\*Compounded annually.

Source: "Currency Values Around the World Continue to Drop,"  
International Management, McGraw Hill, New York,  
 November, 1963, p. 27.

### Summary

In this chapter we analyzed the socio-economic and political conditions in India. Previous research in the field of international investment problems has shown that socio-economic and political instability, fear of war and expropriation, and unfriendly attitude on the part of host governments toward foreign private investment tend to limit United States private investment in those countries. We had hypothesized, however, that such factors as socio-economic and political stability were neutral to the inflow of foreign private investment into India.

To test this hypothesis, we discussed both the factual data concerning Indian socio-economic and political conditions and evaluation of these conditions by foreign and domestic executives. We have seen that in spite of certain setbacks in India's economic growth, India has made considerable progress at various levels and has maintained both social and political stability. The viewpoints of foreign executives also tend to confirm our hypothesis that these basic factors are favorable in India.

Two other most important factors necessary to attract foreign investors, namely, market potential and profitability of foreign venture, also are favorable in India. This was confirmed by both factual statistics and personal viewpoints of foreign investors in India.

However, if such factors as socio-economic and political stability and profitable market are favorable in India, then the factors retarding foreign investment in India must be certain specific Indian policies. Our next target, therefore, is to examine the specific Indian policies retarding foreign investment in India. To investigate these specific policies, it is necessary to know two things:

1. What factors or policies are considered influential by business executives in making investment decisions with regard to India.
2. What is the nature of these policies and how do business executives view these policies.

Once we identify the important factors or Indian policies influencing investment decisions of foreign investors, we can proceed to examine the nature of these policies. And while analyzing these policies, the second hypothesis will be tested.

CHAPTER IV  
INDIAN GOVERNMENT POLICIES AND THE  
FOREIGN INVESTOR

Introduction

To test our second hypothesis concerning specific Indian policies retarding foreign private investment in India, we need to know:

1. Factors influencing foreign investment and the relative importance of such factors in investment decisions.
2. Attitudes of foreign executives concerning these factors or policies.

Factors influencing investment decisions and attitudes of foreign executives toward such factors or policies were ascertained through the questionnaire survey in the United States and personal interview in the United States and India.

In a questionnaire survey in the United States some 188 companies were asked to select from the following factors the five which they considered most influential in making investment decisions.

- a. Indian government's foreign investment policy
- b. Indian government's foreign exchange policy

- c. Market potential for your product in India
- d. Taxation in India
- e. Indian government's repatriation policy
- f. Indian government's remittance policy
- g. Indian industrial policy
- h. Indian labor laws
- i. Availability of skilled labor
- j. Availability of technical and administrative personnel
- k. Future profitability of your investment
- l. Political situation
- m. Social and economic situation
- n. Any others (please specify).

Factors Influencing Investment Decisions  
Of Foreign Investors in India

Results of the Questionnaire  
Survey

The survey showed that foreign investors in India considered future profitability and market potential as the two most important factors influencing their investment decisions concerning India.

The other five Indian policies influencing investment decisions of foreign investors in India are as below:

<u>Policy</u>	<u>Number of Respondents</u>	<u>Percent of Total Respondents*</u>
Indian industrial and foreign investment policies	71	70.3
Indian remittance policy	45	44.6
Indian foreign exchange policy	41	40.6
Taxation policy	37	36.6
Indian repatriation policy	36	35.7

\* Total respondents, 101. The percentages do not total 100 because respondents mentioned more than one factor.

The political situation as a factor influencing investment decisions was not considered as important as the above five policies. Only 31 respondents (30.7 per cent) mentioned this factor. We have seen in Chapter III that the majority of the executives interviewed, both in the United States and in India, expressed their confidence in the stability of the Indian political system.

Other factors, such as Indian socio-economic conditions, labor laws, availability of skilled workers and technical and administrative personnel were not of major importance in influencing investment decisions. However, as we shall see in the next section, some of these factors were important in influencing decisions concerning the expansion

programs. Table 15 summarizes the responses concerning factors influencing investment decisions.

TABLE 15  
FACTORS INFLUENCING INVESTMENT DECISIONS  
(Results of the questionnaire survey)  
(101 respondents)

Factors	Number of Respondents	Percent of Total Respondents*
Future profitability of venture	80	79.2
Market potential of product	76	74.2
Indian foreign investment policy and Indian industrial policy	71	70.3
Indian remittance policy	45	44.6
Indian foreign exchange policy	41	40.6
Taxation in India	37	36.6
Indian repatriation policy	36	35.7
Political situation	31	30.7
Social and economic environments in India	18	17.8
Availability of technical and administrative personnel	7	7.0
Indian labor laws	3	3.0
Availability of skilled labor	3	3.0
Miscellaneous	8	7.9

\*Percentages do not total 100 because respondents mentioned more than one factor.

### Interviews in the United States and India

Some 54 executives of the American and the British companies responded to questions concerning factors influential in making investment decisions. These executives were asked open-ended questions, and they were allowed to list as many factors as they thought important. This sample of executives included 22 American executives in the United States, 16 American executives in India, and 16 British executives in India. The interview responses concerning the factors influencing investment decisions are given in Table 16.

These responses may be interpreted as relating to expansion decisions rather than initial investment decisions because all the respondents were already operating in India and therefore had already made initial commitments. Accordingly, we will term these responses as indicative of factors or policies influencing expansion decisions.

As can be seen from Table 16, the six most important factors or policies affecting expansion decisions are: Indian industrial and foreign investment policies, taxation policy, market potential in India, political situation, and the availability of raw materials and capital goods in India.



TABLE 16  
 FACTORS INFLUENCING INVESTMENT DECISIONS  
 (An interview survey in the United States and India)  
 (54 respondents)

Policy	Number of Respondents	Percent of Total Respondents*
Indian industrial and foreign investment policies	30	55.5
Taxation in India	23	42.6
Market potential for our product	13	24.7
Political situation in India	12	22.2
Availability of raw material and capital goods	7	13.0
Various governmental controls	6	11.1
Availability of technical and administrative personnel in India	6	11.1
Fear of nationalization	5	9.3
Socio-economic conditions in India	2	3.7
Marketing facilities	1	1.9

\*Many executives mentioned more than one factor; therefore, the percentages do not sum 100.

Market potential, the profitability of foreign venture in India, and socio-economic and political conditions were investigated in Chapter III. We have seen that these factors were favorable in India. But we do not as yet know

much about the remaining policies influencing investment decisions. These policies are:

1. Indian industrial and foreign investment policies
2. Taxation policy
3. Foreign exchange control policy
4. Indian remittance and repatriation policies
5. Indian import policy.

To identify the specific policies retarding foreign investment in India, one should examine the nature of each of the above policies and the foreign executives' evaluations of these policies. The factual material concerning these policies, though descriptive in nature, is necessary to gain fuller perspective of the issues involved. Unless we know what the policies are, attitudes of executives toward such policies become meaningless. Presentation of factual material concerning the above policies enables comparison and contrast of the objective facts with foreign investors' subjective evaluations of these policies. If the objective facts and subjective evaluations concur, then one can establish, with some validity, the policies retarding foreign investment in India. If the facts and evaluations do not concur, then it will be interpreted as a sign of a communication breakdown between the Indian government and foreign investors.

The seven most important Indian policies affecting investment decisions are analyzed below.

### Indian Industrial Policy

The industrial policy of the government of India is guided mainly by the Industrial Policy Resolution of 1956 and the Industries Development and Regulation Act of 1951 as amended to date. The Industrial Policy of 1956 has roughly divided industries into three categories.

#### First Category

This category includes all such heavy and basic industries as arms and ammunition, atomic energy, iron and steel castings, heavy plant and machinery tools for basic industries, mineral oils, aircraft, telephones and telephone cables, and electricity. In this group of industries, only the state may begin new undertakings. However, existing private industries in this group have been allowed to expand. The state also may take private partners--local or foreign--if the "national interest" so requires. Private enterprise still may enter these fields if such entry is considered to be in the national interest. This group of industries also includes shipbuilding, rail transport, and mining of iron, manganese and copper ore, gypsum, gold, sulfur, coal and lignite, in which state monopolies already have been established.

### Second Category

The second category covers industries in which both the government and private enterprise may start new undertakings. Specific industries included in this category are: aluminum; ferro-alloys and steels; antibiotics; fertilizers; synthetic rubber; chemical pulp; sea and road transport; manufacture of drugs; dyestuff; and plastics.

### Third Category

The third category is a catch-all, which includes all remaining and undesignated industries. This includes all consumer goods industries. These industries are left open to private enterprise, but the government also may enter the field at any time. Theoretically, foreign companies may enter this field, but in practice many are excluded by the policy of protecting existing indigenous producers from the competition of foreign capital.

The application of this policy is guided by pragmatic consideration. Its basic rules are often disregarded and private enterprise is allowed to start new industries which otherwise are reserved for state ownership. For example, manufacture of pig iron, which was initially reserved for state ownership, is now open for private enterprise. Similarly, private enterprises have been allowed to manufacture jeeps and fertilizers and to process drugs.

A major factor in this more pragmatic attitude is the foreign exchange shortage, which is so great that India must conserve every penny of her foreign currency and confine state investment to the highest priority projects. Greater reliance is placed on the private sector and specifically on the foreign private investor that not only brings capital goods but also managerial and technical know-how for new projects in return for equity. Many of the Third Plan's public sector<sup>1</sup> industrial projects have been transferred to private firms.

#### Indian Private Foreign Investment Policy

There is no single formal document that can be cited as the embodiment of Indian private foreign investment policy. The Indian government's attitude toward private investment is mainly reflected in the Industrial Policy Resolution of 1956 and various high-level pronouncements made from time to time. The industrial policy statement of 1948 set the early pattern for foreign private investment in India. In this statement it was said that foreign industrial know-how should be sought, but effective controls of new enterprise should be in Indian hands except in unusual cases calculated to serve the national interest.

As early as 1949, the late Prime Minister Nehru welcomed the participation of foreign capital which would

conform with India's national requirements for economic progress. Fair and nondiscriminatory treatment was assured. The Indian government has an excellent record for not discriminating among Indian companies once they are in operation, whether or not they are owned wholly or partly by foreign firms. However, except in special cases, foreign investors may not set up a wholly owned firm as Indian investors may. Even the few existing wholly foreign-owned manufacturing companies in India are being urged to sell some of their equity to local interests.

The Industrial Policy Resolution of 1956 also inhibits the freedom of foreign manufacturers to establish majority owned subsidiaries. However, in recent years this rule of minority participation has been disregarded. For example, the English Electric Company, the Consolidated Pneumatic Tools Company (United Kingdom), Asahi Glass of Japan, and W. W. Sprague of the United Kingdom were allowed to own a majority share in their Indian operations.<sup>1</sup> Since 1957, some of the foreign companies which have been allowed to own a majority share are as follows: Parke Davis of the United States, Atlas Copco of Sweden,<sup>2</sup> Johnson and Johnson of the United States, Hoffman-LaRoche of Sweden, the Italian

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<sup>1</sup>India, Business International, op. cit., p. 18.

<sup>2</sup>Ibid.

Ceat Cromma, and Merck, Sharp and Dome Company of the United States.<sup>3</sup>

The Indian government normally will authorize a foreign majority position under the following conditions:

1. If the enterprise is in a field considered vital to Indian economic development, and which requires large capital investments or advanced technical know-how.
2. If the enterprise will result in the further training of Indians.
3. If the enterprise will improve India's foreign exchange position.
4. If the enterprise will develop new lines of production.
5. If the enterprise is in a field where the volume of domestic production is small and there is no expectation that it will increase rapidly.<sup>4</sup>

Thus, there is little about Indian private foreign investment policy that is rigid. The Indian government is guided by pragmatism. The one generalization that is true

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<sup>3</sup>Investing and Licensing Opportunities in Thirty-Seven Countries, op. cit., p. 111.

<sup>4</sup>Kannappan and Burgess, op. cit., p. 20.

about the acceptability of terms is that there is no generalization.<sup>5</sup> Each case will be different because of variations in products and the need for each, because of the corporate policy of the foreign investor, and because of the method in which the foreign investor approaches the Indian government and carries on negotiations.

Views of the Executives--Both  
Foreign and Domestic--Concerning  
These Policies

Questionnaire survey.--In the questionnaire survey in the United States, executives of some 188 United States companies were asked to indicate their views concerning the Indian industrial policy. Their views are summarized in Table 17.

It can be seen that only 1 per cent of the total number of respondents considers this policy very liberal. Another 1 per cent considers it liberal, while 34.6 per cent feels that it is reasonable. However, a much larger percentage of respondents (55.5 per cent) thought that it was either restrictive or very restrictive. An American executive expressed it in these words:

It is very restrictive. [It is] socialistic. . . . Restrictive . . . not only restrictive but cloaked in misinformation, lack of information and questionable procedures.

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<sup>5</sup>India, Business International, op. cit., p. 18.



TABLE 17  
VIEWS CONCERNING THE INDIAN INDUSTRIAL POLICY  
(Questionnaire Survey Analysis)

Views	Number of Respondents	Percent of Total Respondents
Very liberal	1	1.0
Liberal	1	1.0
Reasonable	35	34.6
Restrictive	42	41.6
Very restrictive	14	13.9
No answer	8	7.9
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Total	101	100.0

### Interviews Responses

During the research interviews, 54 executives were asked, in a slightly different form, to express their views concerning Indian industrial policy. This group of executives consisted of 13 American executives in the United States, 13 American executives in India, 16 British executives in India, and 12 Indian industrialists.

The views expressed by these executives concerning the Indian industrial and foreign investment policies are given in Tables 18 and 19, which follow.

TABLE 18

VIEW ON THE INDIAN INDUSTRIAL POLICY  
(Interview Analysis)

Executive	Attractive No.Percent	Flexible No.Percent	Restrictive No. Percent	Very Restrictive		No Answer No.Percent	Total No.Percent
				No. Percent	No. Percent		
American Exec- utives in United States	10	77.3	1	7.3	2	15.4	13 100.0
American Exec- utives in India	3	23.1	8	61.5	2	15.4	13 100.0
British Exec- utives in India	3	18.7	5	31.2	7	43.8	1 6.3
Indian Indus- trialists	3	25.0	3	25.0	5	41.7	1 8.3
Total	19	35.2	17	31.5	16	29.6	1 1.9
							1 1.8
							54 100.0

TABLE 19

VIEWS ON THE FOREIGN INVESTMENT POLICY  
(Interview Analysis)

	Attractive No.Percent	All Right No.Percent	Restrictive No. Percent	No Answer No. Percent	Often Changes No.Percent	Total No. Percent
American Exec- utives in United States	10 77.3	1 7.3	2 15.4			13 100.0
American Exec- utives in India	6 46.2	4 30.8	3 23.0			13 100.0
British Exec- utives in India	6 37.5	4 25.0	6 27.5			16 100.0
Indian Indus- trialists	3 25.0	2 16.7	5 41.7	1 8.3	1 8.3	12 100.0
Total	25 46.3	11 20.4	16 29.6	1 1.9	1 1.8	54 100.0

Interview responses are not strictly comparable with those of the questionnaire survey because the patterns of question asked and the answers received were not the same. It is interesting to note, however, the differences in viewpoints of the British, the American, and the Indian executives concerning these policies. It can be seen from Table 18 that only 15.4 per cent of the American executives interviewed in India as compared to 43.8 per cent of the British executives interviewed in India, felt that the Indian industrial policy was restrictive. This difference may be attributed to the fact that the British investors were used to 'softer' terms during the pre-independence era.

We also observed the wide differences in views of the American executives in the United States and the American executives in India. Some 77.3 per cent of the American executives interviewed in the United States, as compared to only 23.1 per cent of the American executives interviewed in India, felt that the Indian industrial policy was attractive.

These differences may be due to the fact that the American executives in the United States, who were at the vice-president level, were thinking of the Indian industrial policy in terms of what other countries had to offer, as compared to India, while the American executives in India were thinking of the Indian industrial policy in terms of operating restrictions imposed on them through this policy.

It also is interesting to note from Table 18 that a larger percentage (41.7 per cent) of the Indian industrialists interviewed in India, as compared to 15.4 per cent of the American executives, both in the United States and in India, felt that the Indian industrial policy was restrictive. This may be due to the fact that the Indian industrialists also had enjoyed a 'softer' policy during the pre-independence era. And this is why perhaps, the British executives felt the same as the Indian industrialists rather than as the American executive.

#### Concluding Remarks on Indian Industrial and Foreign Investment Policies

In summing up the discussion of the Indian industrial and foreign investment policies, three basic patterns seem to emerge:

1. That the Indian industrial and foreign investment policies are restrictive
2. That these policies are pragmatic and ever changing
3. That these policies do offer enough opportunities to foreign investors but are evaluated differently by the different groups of executives (British, American, and Indian executives).

Each of these patterns is quite evident from the views expressed by the executives in the United States and India. Some of these remarks are presented below.

An Indian industrialist and a member of the Congress Party (ruling party) expressed in these words: "Our policies are restrictive. . . . I have a feeling that the government is too much for public enterprise. . . . Private enterprise has not been given a free hand."

Yet another Indian industrialist had this to say: "Industrial policy is restrictive and our economy is protected . . . this hampers our economic growth."

A British executive, having investment in India for more than 50 years said, ". . . [Indian policies] are attractive. . . . Principles behind such policy may be good but its implementation is not."

The American executives, both in the United States and in India, were mild in their viewpoints concerning these policies. They were more favorably disposed than both the Indian and the British executives.

An experienced American executive in India said:

[Indian policies] are liberal and flexible. The United States investors have enough scope under the present policy. . . . It is not as strict as businessmen feel . . . and under the limitations of Indian government, it is the best policy and the foreign investors have enough scope to invest and expand in India.

However, all executives have shown much concern about the pragmatism in Indian policies. Most of these executives considered the pragmatism in policies as a sign of "unbalanced mind" of the Indian government. This can easily be seen from the following expressions.

An Oxford educated Indian executive said,

Changing our investment policy from time to time hurts us more and creates suspicion in the eyes of foreign investors. We should be very clear from the beginning about our policies.

The British executives were even more eloquent and critical in their views. One experienced British executive expressed his opinion this way: "No general guidelines for what will be approved and what won't. . . . Even Pakistan has general guidelines. . . . It is very frustrating for the foreign investor."

Yet another executive said:

Policies may be fair but government of India cannot make up its mind . . . and frequent changes in the policies create uncertainties in our mind and do not give us confidence to expand or grow. . . . Changing policies also creates frustration.

#### Indian Policies Concerning Majority Capital and Management Participation of Foreign Firms

Indian industrial and foreign investment policies inhibit the freedom of foreign firms to establish even a majority owned subsidiary. However, in recent years the government of India has allowed a number of foreign firms to own a majority share in their Indian collaborations.

This is granted in unusual cases where the Indian government feels that it is in the interests of the Indian economy. But as a general rule, foreign firms are allowed to come in India only as a minor partner.

However, many American companies preferred majority capital participation while comparatively few companies preferred majority American management in their Indian collaborations.

It can be seen from Table 20 that 50 per cent of the United States companies responding to the questionnaire survey in the United States desired majority capital participation while only 11.9 per cent wanted majority management participation in their Indian collaborations.

The American companies desire majority capital participation because they feel that in this way they could operate more efficiently in India. American and British executives were also concerned about the attitudes of Indian businessmen. They felt that the typical Indian businessman was short-sighted and interested in quick profits. As one American executive who had stayed in India for more than twenty years said:

The Indian investor attitude that whatever is produced will sell is also considered inherently dangerous . . . while this may be the case today, competition will be established in India, and without a strong selling organization the enterprise may flounder.



TABLE 20

PERCENT OF THE UNITED STATES CAPITAL AND MANAGEMENT  
PREFERRED IN INDIAN OPERATIONS  
(Results of the questionnaire survey in the United States)

	United States Capital		United States Management	
	Number	Percent	Number	Percent
100 percent	11	10.9	1	1.0
Majority	39	38.6	11	10.9
50 - 50	3	3.0	-	-
Minority	22	21.8	19	18.8
Nominal	12	11.9	43	42.6
None	7	6.9	18	17.8
No answer	7	6.9	9	8.9
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Total	101	100.0	101	100.0

### Indian Taxation Policy

The Indian taxation policy and its effects on investment--both domestic and foreign--has generated more heated discussions, publicity, and research than any other Indian policy affecting private investment. For example, the National Council of Applied Economic Research (a very reputable national research organization) saw fit to investigate the Indian taxation policy four times in seven years.<sup>6</sup>

Many authorities on the Indian economy and Indian planning considered this variable one of the most important factors limiting India's development. Indian policy-makers themselves have used this variable as a main device to stimulate private investment--both domestic and foreign--in India. Frequent changes made in the taxation policy tend to confirm this viewpoint.

We have seen above that this policy is one of the important factors influencing investment decisions of foreign investors in India. Previous researches of the National Industrial Conference Board and the United States Department of Commerce considered this policy one of the factors

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<sup>6</sup>National Council of Applied Economic Research, Taxation and Foreign Investment, 1957; Taxation and Foreign Investment, revised 1958; Taxation and Private Investment, 1962; Foreign Investor and Tax Reforms, 1964, New Delhi, India.

limiting American private investment in India. The nature of this policy and the views of foreign executives concerning this policy, therefore, are examined below.

### Indian Tax Structure<sup>7</sup>

Indian taxation policy impinges upon the private foreign investor in four different forms:

1. Personal taxation--income taxes
2. Taxation on company profits (corporate taxation)
3. Taxation on inter-corporate investment
4. Taxation on patent royalties.

### Personal Taxation--Income Taxes

Although most foreign investment comes from corporations abroad, personal taxes impinge upon foreign investment due to the fact that some foreign personnel always accompany investment from abroad. Also, India, like many other developing countries, is in short supply of trained technical and managerial personnel. Therefore, if foreign technical and administrative personnel consider personal taxation in India too much higher than other countries, they may decide to go somewhere else where take-home pay is higher. In this context, therefore, the incidence of personal taxation assumes

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<sup>7</sup>Basic information concerning various tax measures discussed here is taken from Foreign Investor and Tax Reforms, loc. cit.

special significance.

There are three components in the taxation of income: income tax, super-tax, and surcharge on both. The rate structure is built on the "slab" system--the rates increase progressively with a rise in each slab of income. Tax liability is calculated for each slab to arrive at the total. Income tax rises progressively from 3 per cent on the first slab of income to a maximum marginal rate of 24 per cent on incomes above 20,000 rupees (approximately 4,000 dollars). In addition, incomes beyond this limit are subject to a super-tax, rising from 8 per cent to a maximum of 47.5 per cent.

The tax system differentiates in favor of salaried incomes and other earned incomes by imposing a lower surcharge on earned incomes than on unearned income. The maximum marginal rate of these taxes is 81.6 per cent for salaried incomes and 83.4 per cent for other earned incomes. These maxima apply to incomes above 100,000 rupees. To get a clear prospective of the incidence of Indian taxation, the tax structures in other developing and the advanced countries should be investigated.

International Comparison of the  
Incidence of Income Taxes

In Table 21 the tax burdens in India are compared with those of four advanced countries, namely, the United States, the United Kingdom, Canada, and Japan.

TABLE 21

TAX AS PERCENTAGE OF EARNED INCOME--INDIA COMPARED  
WITH CERTAIN ADVANCED COUNTRIES  
(Married individual with two children)

Income (Rupees)	India	U.K.	U.S.A.	Canada	Japan
10,000	6.9	0.4	Nil	Nil	12.9
20,000	14.6	12.3	8.6	5.3	20.0
30,000	24.5	18.2	12.4	9.6	24.6
40,000	31.5	21.2	14.8	12.9	27.7
50,000	37.7	23.0	16.2	15.8	30.2
75,000	49.8	27.0	19.8	22.6	34.7
100,000	56.8	32.1	22.8	27.1	38.2
125,000	61.6	36.8	25.7	31.6	40.6
200,000	70.8	50.7	34.1	37.6	45.7
300,000	75.4	62.1	43.0	44.6	49.4

Note: (1) Based on unpublished data available to the NCAER.  
(2) For India and the U.K. the income-tax rates relate to the year 1963-64, while for the other countries they pertain to the year 1962.

Source: National Council of Applied Economic Research,  
Foreign Investor and Tax Reforms, New Delhi, India,  
1964, p. 7.

It can be seen that the effective rates of taxation are higher in India than in the United Kingdom, the United States, and Canada. The Japanese effective rates are higher than the Indian rates only up to an income level of 30,000 rupees. The Indian tax rates are higher than the Japanese rates from incomes of 40,000 rupees to 300,000 rupees.<sup>8</sup>

In Table 22 the tax incidence in India is compared with that of five developing countries, namely, Pakistan, Burma, Malaya, Ceylon, and Brazil. This table shows that for incomes up to 75,000 rupees the Indian income tax is higher than in these countries. However, beyond this income level, Ceylon's tax rates are higher than those of India.<sup>9</sup>

Thus, it may be concluded that the burden of income taxes in India is higher than in such important capital-exporting countries as the United States, the United Kingdom, and Canada in the range of incomes in which most of the salaries of foreign personnel lie (i.e., 30,000 rupees to 150,000 rupees). The rates also are higher than those in most developing countries which compete with India by offering alternative opportunities to foreign investment.

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<sup>8</sup>Foreign Investor and Tax Reforms, op. cit., pp. 3-6.

<sup>9</sup>Ibid.

TABLE 22  
TAX AS PERCENTAGE OF EARNED INCOME--INDIA COMPARED  
WITH CERTAIN DEVELOPING COUNTRIES

(Married individual with two children)

Income (Rupees)	India	Pakistan	Burma	Ceylon	Malaya	Brazil
10,000	6.9	5.5	5.8	3.3	1.2	Nil
20,000	14.6	11.6	13.3	9.9	3.8	Nil
30,000	24.5	17.4	22.0	16.5	6.9	Nil
40,000	31.5	23.3	28.6	23.1	9.8	Nil
50,000	37.7	29.8	33.9	29.2	11.9	5.6
75,000	49.8	42.8	43.5	41.3	15.3	8.2
100,000	56.8	50.9	50.2	74.5	19.6	10.8
125,000	61.6	55.7	54.8	76.8	23.6	12.7
150,000	66.1	58.9	59.3	78.3	26.4	15.4
200,000	70.8	62.9	65.0	80.2	29.8	19.6
300,000	75.4	66.9	72.7	82.2	33.2	26.6

- Notes: (1) Based on unpublished data available to the NCAER.  
 (2) The rates for India relate to the year 1963-64, while those for the other countries pertain to the year 1962.  
 (3) In Ceylon, a surtax is levied at 50 per cent on net income, at Rs. 47,000, and more. The net income is calculated after certain deductions like income tax, other personal taxes, and land tax, etc. Here, however, net income is calculated by deducting income-tax only.

Source: National Council of Applied Economic Research, Foreign Investors and Tax Reforms, New Delhi, India, 1964, p. 9.

### Taxes on Company Profits

Company taxation in India fundamentally has been recast in recent years. Under an old law, companies were forced to pay at least partial tax on behalf of the shareholders. The new scheme is based on the idea that incorporation confers upon the company an obligation to bear tax that is distinct from the tax liability of its shareholders. The basic tax on registered Indian companies is fixed at 50 per cent of profits. No credit is given to shareholders with respect to the taxes paid by the company. In Table 23 corporation taxes in India are compared with those of other developing countries.

### Corporate Taxation for Foreign Branches

The corporate tax rate on branches of foreign companies is fixed at 65 per cent of earnings. As shown in Table 24, Indian corporate taxation on foreign branches compares unfavorably with that of other advanced and developing countries.

### Super-Profit Tax

The Finance Act of 1963 introduced a super-profit tax in the context of the national emergency in order to mobilize resources for both defense and development programs. However, the new budget of 1964-65 has abolished this tax



TABLE 23  
COMPARATIVE RATES OF CORPORATE TAXATION IN  
DEVELOPING COUNTRIES\*

Country	Total (Percent of Profit)	Country	Total (Percent of Profit)
Australia	49.0	Nigeria	40.0
India	56.0*	Pakistan	49.8
India	67.0**	Philippines	46.8
Japan	50.0	Egypt	22.2
Malaya	40.0	Syria	36.0

\*For the companies producing products like coal, iron, steel, ferro-alloys and special steels, crude oil, etc.

\*\*For all other companies.

Source: India: Business International Roundtable Conference, Business International, New York, 1961, p. 43.

and introduced a new tax called sur-tax.<sup>11</sup> The incidence of the sur-tax is little less than the original super-profit tax.

The super-profit tax was found to operate as an inhibiting factor in the growth of the corporate sector. The rates of the super-profit tax were: 50 per cent in the case of profits from 6-10 per cent of net worth and 60 per cent

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<sup>11</sup>Information concerning the sur-tax and all other new tax measures discussed in the following sections is taken directly from the budget proposals of 1964-65 reported in Economic Times, Bombay, India, March 1, 1964, pp. 1-4.

TABLE 24  
CORPORATE TAX RATE ON FOREIGN BRANCHES

Advanced Countries	Tax Rate on Foreign Branches (Percent)	Developing Countries	Tax Rate on Foreign Branches (Percent)
Japan	49.00	Philippines	30.00
Australia	40.00	Malaya	40.00
United Kingdom	53.75	Peru	37.00
France	50.00	Colombia	40.00
Canada	51.5	India (New Budget) 1964-65	65.00

Source: National Council of Applied Economic Research, Foreign Investor and Tax Reforms, New Delhi, India, 1964, p. 28.

in case of profits above 10 per cent of net worth. The new sur-tax reduces the burden of tax from 50 per cent to 40 per cent and raises the exemption limit from 6 per cent to 10 per cent of the capital base. Under the super-profit tax, the capital base consisted of only the paid-up capital and reserves. However, under the sur-tax, the capital base includes paid-up capital, debentures, and reserves including development rebate and loans from financial institutions and banks. The sur-tax will be levied at a uniform rate of 40 per cent of the entire excess profits of the company as compared to the two-tier system of rates of 50 per cent of

the capital base and 60 per cent of the balance under the super-profits tax act.

Further, provision has been made for granting a rebate of 20 per cent of the sur-tax attributable to profits derived from the business of generation and distribution of electricity and/or the manufacture of any one of the articles pertaining to such basic industries as steel and iron.

New or small companies also are given some relief under this new sur-tax. Now the minimum statutory deduction has been fixed at 200,000 rupees (42,000 dollars) as compared to 100,000 rupees (21,000 dollars) under the super-profit tax act. Because of these features, there will be no liability to the sur-tax unless a company's profits, before tax, exceed 400,000 rupees (approximately 84,000 dollars) and higher than 20 per cent of its capital base, including reserves and loan capital.

#### Taxes on Intercompany Dividends

In addition to the basic income tax, super-tax, and sur-tax on corporate profits as discussed in the preceding sections, the foreign investor must pay taxes on the dividends received from India. Since foreign investment generally comes in the form of a two-tier structure--a company in a foreign country investing in another company in India, it attracts a double burden of taxes. (Whether it be a subsidiary or a minority shareholding in an Indian company,

there is income and super-tax on the profits of the Indian enterprise and, also, tax on the dividends income that flows to the investing companies abroad.)

During 1963-64, the tax rates on intercorporate dividends varied from 25 per cent to 50 per cent depending upon the company's date of registration in India. The foreign companies registered before April 1, 1959, paid higher taxes than new foreign companies in India. However, the new budget proposals announced on February 29, 1964, abolished this discrimination. Now all foreign companies in India will be taxed on their intercorporate dividends at a fixed rate of 25 per cent.

Still, the new rate of 25 per cent on intercorporate dividends compares very unfavorably with the tax provisions of other countries. In most other countries, dividends from domestic intercorporate investments are either completely exempt from taxes or have a much lower rate than India. Countries that do not impose any such tax are: the United Kingdom, Australia, New Zealand, Canada, Ceylon, Malaya, South American Republics, Belgium, Norway, Finland, Greece, and Japan.<sup>12</sup> Several countries exempt dividends if the recipient company participates substantially in the equity

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<sup>12</sup> Foreign Investor and Tax Reforms, op. cit., p. 32.

capital-- 25 per cent or more of the company distributing dividends. Such countries are: Austria, Holland, West Germany, and Switzerland. In the United States, the effective tax on domestic intercorporate investment is only 7.8 per cent. In France, it is 12.5 per cent when the investing company holds more than 20 per cent of the capital.<sup>13</sup>

The high incidence of tax on intercorporate dividends places India in a very unfavorable position compared with other countries. The total tax burden on the foreign subsidiary making 100 per cent dividend distribution is higher in India than in many advanced and developing countries. This is depicted in Table 25.

#### Taxes on Patent Royalties

India, like many other developing countries, needs to import technical and managerial know-how from the industrially advanced countries. In view of the great importance of technical know-how for industrial expansion, the trend toward foreign technical collaboration will continue to increase. However, to secure foreign technical collaboration, India should offer attractive returns to the collaborator. But the returns incurred from such technical collaboration depend upon two factors: (1) the rate of royalty which must have approval of the Indian government, and (2) the impact of Indian taxation on the gross royalty remittance.

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<sup>13</sup>Ibid.

TABLE 25  
TOTAL TAX-BURDEN ON SUBSIDIARY MAKING 100  
PER CENT DIVIDEND DISTRIBUTION

Country	Total Tax Burden (Percent)	Country	Total Tax Burden (Percent)
India	67.50	Canada	51.50
Japan	44.00	Venezuela	45.00
Australia	49.00	Peru	49.50
New Zealand	50.00	Colombia	43.60
United Kingdom	53.75	France	57.50
South Africa	35.25	Italy	38.00
Philippines	35.25	Netherlands	47.00
Malaya	40.00		

Source: National Council of Applied Economic Research, Foreign Investor and Tax Reforms, New Delhi, India, 1964, p. 33.

The royalty rate for straight licensing agreements approved by the Indian government varies from 2 per cent to 7.5 per cent on total sales. The Indian government will approve higher rates in some cases where technical know-how is of major importance in developing a particular industry. The tax rates on royalties transmitted ranged from 50 to 63 per cent. It was 63 per cent for agreements made before April 1, 1961 and 50 per cent for agreements made on or after

April 1, 1961.<sup>14</sup> New budget proposals of 1964-65 have made the tax rate uniform at 50 per cent.<sup>15</sup> However, even the new rate compares unfavorably with the rates in other countries. This can be seen from Table 26.

TABLE 26  
TAX ON ROYALTY PAYMENT TO NON-RESIDENTS

Country	Tax Rate (Percent)	Country	Tax Rate (Percent)
Argentina	19 (approx.)	INDIA	50
Australia	40	Italy	18
Brazil	28	Japan	15
Canada	15	South Africa	9
France	17 to 19.2	United States	30

Source: National Council of Applied Economic Research, Foreign Investor and Tax Reforms, New Delhi, India, 1964, p. 36.

#### Incentives and Tax-Reliefs Granted to New Foreign Investors in India

India offers many incentives to new business firms. Major tax relief is a 20 per cent development rebate (in the form of a deduction from taxable incomes) on the value of

<sup>14</sup>Ibid., p. 36.

<sup>15</sup>Economic Times, op. cit., p. 4.

new machinery or plant installed, provided it is not sold for eight years. Depreciation allowances are also very liberal in India. In addition to free depreciation allowances of up to 100 per cent of the value of assets, the development rebate enables companies to write off against taxable income a total of 120 per cent of the cost of plant and machinery.

New industrial undertakings or expansions of existing firms commencing operations before April 1, 1966, are eligible for five-year exemption from taxes (after the beginning of production) on income up to 6 per cent of capital employed. The new budget proposals of 1964-65 grant a further corporate taxation rebate of 10 per cent to companies in a select list of industries. This includes: aluminum, copper, steel, cement, fertilizers, paper and pulp, tractors, tea, coffee, and rubber.

#### Personal Tax Concession in India

The Indian income tax act provides a special "tax holiday" to foreign technicians and managerial personnel with respect to both income tax and super-tax. The tax holiday for these personnel is for a period of one year if the contract of service has not received government approval beforehand or for three years if the service contract has had prior approval of the government.



Foreign Executives' Viewpoints  
on Indian Taxation

In spite of such tax reliefs and exemptions, Indian taxes are still the highest in the world. Findings of the questionnaire survey in the United States and interviews in the United States and India confirm this statement. Of the total respondents of the questionnaire survey in the United States, 76.3 per cent felt that, compared to the United States, Indian taxes are much higher, while only 5 per cent said that it was lower compared to the United States. Many business executives were quite eloquent in expressing this viewpoint. An American executive commenting on taxes in India said, "One has the feeling that private enterprise is encouraged only for the purpose of developing the economy, and, as it becomes developed, the restrictions begin to eliminate the incentives."

An Indian industrialist had this to say, "Too high . . . it is a penalty for efficient firms . . . it encourages inefficiency."

Yet another American executive in India commented: "Too high . . . it is political in nature, . . . it is retarding development in India." He further added, "Many old companies are sore about this . . . and their soreness will be passed on to the small and new foreign companies . . . who will believe this."

Most of the executives interviewed in the United States and India considered Indian taxes prohibitive. It can be seen from Table 28 that 81.5 per cent of the executives interviewed considered Indian taxes very high as compared to many developing and developed countries. Factual analysis of the incidence of Indian taxes confirm this viewpoint. Most of the executives were particularly critical of the super-profit tax, the newly imposed sur-tax, and the dividends tax. Some of the views expressed by the executives in the United States and India are given below.

An American executive in the United States said: "The recent super-profits tax has elevated the effective tax rate to a position . . . which deters from the attractiveness of investment in India."

A British executive in India said, "the super-profit tax has killed all incentive of businessmen."

Another British executive in India, commenting upon the newly imposed sur-tax and the dividends tax, said, "It is bloody awful . . . these new measures did not improve the climate for investment."

A detailed summary of the views expressed by executives concerning Indian taxation is given in Tables 27 and 28. To summarize, it is quite evident that Indian taxation is much too high and is so considered by foreign investors in India. New tax measures introduced in March, 1964, have

failed to evoke favorable reactions from the business community.

TABLE 27  
VIEWS ON TAXATION IN INDIA  
(Results of the questionnaire survey in the United States)

Views	Number of Respondents	Percent of Total Respondents
a. Much higher compared to the United States	35	34.7
b. Higher compared to the United States	42	41.6
c. Same as in the United States	10	9.9
d. Lower compared to the United States	5	4.9
e. Much lower compared to the United States	--	----
f. No answer	9	8.9
Total	101	100.0

TABLE 28

VIEWS ON TAXATION IN INDIA  
(Interview Analysis)

Executive	Very High		High but Justifiable		No Answer		Total	
	Number	Percent	Number	Percent	Number	Percent	Number	Percent
American Executives in United States	5	62.5	1	12.5	2	25.0	8	100.0
American Executives in India	12	92.3	1	7.7			13	100.0
British Executives in India	16	100.0					16	100.0
Indian Industrialists	7	58.4	4	33.3	1	3.3	12	100.0
United States Consulting Firms	4	80.0			1	20.0	5	100.0
Total	44	81.5	6	11.1	4	7.4	54	100.0

Indian Remittance and Repatriation  
Policies

Remittance of accrued earnings and original capital and increments thereto have been approved generally on a fairly free basis. India's record in permitting the remittance of profits and original capital abroad has been good, and the government has not placed any limitation on the amount of earnings from any industrial investment. In business circles these policies are termed as highly satisfactory. For example, Business International, a United States consulting firm, had this to say: "Few countries in the world have maintained a record of prompt remittance that compare with India's despite the extreme shortage of foreign exchange that has faced the country during the past five years."<sup>16</sup>

As long as a collaboration agreement has received approval from the Ministry of Commerce and Industry, the Controller of Capital Issues, and the Reserve Bank, remittances stemming from the agreement are promptly made. Repatriation of approved capital investment is automatic. This includes the originally invested amount plus all re-invested profits and capital appreciation. Since 1958, however, the Indian government has required some prospective

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<sup>16</sup>India: Business International Indian Roundtable,  
op. cit., p. 17.

investors to agree not to repatriate their capital for ten years or so. This requirement is being made, apparently, only in the cases involving importation of those types of capital equipment which have a low priority under India's present import licensing policy.

In spite of impressive records and favorable evaluation of these policies by many United States management consultants and experienced foreign private investors, the consensus of opinion was not very favorable. This can easily be seen from the results obtained from the questionnaire survey in the United States.

Approximately one-half of the total number of respondents said that the Indian remittance policy was either restrictive or very restrictive. The other half, however, said that it was either liberal or reasonable. Similarly, about one-third of the total number of respondents said that the Indian repatriation policy was restrictive, while little more than one-half of the total respondents said that it was liberal. Table 29 reports the viewpoints of United States executives concerning these policies.

However, it must be pointed out that quite a few of the executives who considered these policies restrictive were referring to the problems and difficulties they might have encountered while negotiating collaboration terms with government officials. This is quite evident from the remarks made by some of the executives who considered these policies

restrictive. For example, one American executive said, "The Indian remittance policy is very restrictive as it is very difficult to get approval for a higher royalty rate for rendering technical services."

TABLE 29

Views of the United States Executives Concerning  
Indian Remittance and Repatriation Policies

Views	Remittance Policy		Repatriation Policy	
	Number	Percent of Total Respondents	Number	Percent of Total Respondents
Very liberal	1	1.0	2	2.0
Liberal	8	7.9	7	6.9
Reasonable	39	38.6	48	47.5
Restrictive	34	33.7	26	25.7
Very restrictive	11	10.9	7	6.9
No answer	8	7.9	11	10.9
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Total	101	100.0	101	100.0

Yet another American executive remarked, "Indian remittance policy is restrictive as it does take a long time to secure unqualified approval from the Indian government for higher royalty payment."

### Results of Interviews

The experienced foreign executives in the United States and in India, however, considered these policies quite liberal. Approximately two-thirds of the total executives interviewed in the United States and India were quite satisfied with these policies. The responses obtained concerning these policies are given in Tables 30 and 31.

In summary then, one can say that Indian remittance and repatriation policies are fairly liberal and are evaluated as such by experienced foreign investors in India. However, the results of the questionnaire survey show that about 50 per cent of the respondents considered the Indian remittance policy restrictive. The lack of proper communication between the Indian government and these respondents seems to be the problem in this case.



TABLE 30

IEWS OF THE UNITED STATES AND THE BRITISH EXECUTIVES  
CONCERNING INDIAN REPATRIATION POLICY

Executives	Very Liberal		Liberal		Reasonable		Restrictive		No Answer		Total	
	No.	Percent	No.	Percent	No.	Percent	No.	Percent	No.	Percent	No.	Percent
American Exec- utives in United States	7	87.5			1	12.5					8	100.0
United States Executive in India	6	46.2	6	46.2			1	7.6			13	100.0
British Exec- utives in India	3	18.7	7	43.8			1	6.2	5	31.3	16	100.0
United States Consulting Firms in United States	4	80.0	1	20.0							5	100.0
Total	20	47.6	14	33.3	1	2.4	2	4.8	5	11.9	42	100.0

TABLE 31

VIEWS OF THE UNITED STATES AND BRITISH EXECUTIVES  
CONCERNING INDIAN REMITTANCE POLICY

	Very Restrictive												Total	
	Very Liberal			Liberal			Reasonable			Restrictive				
	No.	Percent	No.	Percent	No.	Percent	No.	Percent	No.	Percent	No.	Percent	No.	Percent
United States Executives in United States	7	87.5			1	12.5							8	100.0
American Executives in India	8	61.5	3	23.1			1	7.7	1	7.7			13	100.0
British Executives in India	9	56.3	6	37.5	1	6.2							16	100.0
United States Consulting Firms in United States	4	80.0	1	20.0									5	100.0
Total	28	66.7	10	23.7	2	4.8	1	2.4	1	2.4			42	100.0

Indian Foreign Exchange and  
Import Policies

Under the Foreign Exchange Regulation Act of 1947, as amended to date, the central government and the Reserve Bank of India control and regulate transactions in foreign exchange and foreign securities in India, payments to persons in a foreign country, the export and import of currency and bullion or precious stones, and transfer of securities to non-residents. In practice, as far as importation of goods is concerned, the control is now chiefly in the hands of the chief controller of imports and exports, and the issue of an import license automatically entitles the licensee to obtain, on application, the required foreign exchange from the Reserve Bank of India.

The import policy for each fiscal year is announced in the month of April by the Minister of Commerce and Industry. In general, the import policy is very restrictive, and the government is determined not to permit unnecessary drawings on the very limited foreign exchange reserves. It is very difficult to get an import license for necessary spare parts and raw material. To earn much needed foreign exchange through exports, the issue of import licenses is tied to exports whether or not the goods are manufactured by the license receiver. Import licenses for capital goods, especially when substantial amounts of foreign exchange are

involved, are often limited to countries from which the Indian government has loans for such imports.

The shortage of foreign exchange has been responsible for the restrictive import policy, but the restrictive import policy in turn is responsible for hindering Indian development programs.

Many foreign investors in India considered the exchange policy very restrictive. For example, approximately two-thirds of the American executives responding to the questionnaire survey said that this policy was very restrictive.

However, as we saw in Chapter III, the Indian government does not have much choice in this respect. The Indian government, through its various export promotion schemes, is trying seriously to ease foreign exchange restrictions. One way to ease this problem is to attract more investors in India; to do so India must improve other factors over which she has more control, i.e., industrial and foreign investment policies, taxation, and the decision-making machinery of government.

The Indian Government's Apparatus  
of Decision-Making

One of the main obstacles to securing foreign private investment or collaboration is the slow and cumbersome working of the government control apparatus. The formidable array of forms to be executed and officials to be consulted greatly discourages both the domestic investor and the foreign investor or collaborator. One can easily visualize this difficulty by merely looking at the procedural formalities the foreign private investor has to go through to obtain approval of the Indian government. He must obtain:

1. An industrial license under the Industries Development and Regulation Act of 1951
2. Approval from the capital goods and foreign agreements committees
3. A consent for the issue of capital stock under the Capital Issue Act of 1947
4. A license to import capital equipment and machinery under the Imports and Exports (control) Act of 1947
5. An approval from the Reserve Bank under the Foreign Exchange Regulation Act of 1947
6. A certificate of incorporation under the Indian Companies Act of 1956.<sup>17</sup>

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<sup>17</sup>Investing and Licensing Opportunities in the Thirty-Seven Countries, 1962, op. cit., p. 112.

The net result of these excessive control measures is the creation of unnecessary red tape at all levels. And this irritates both the domestic and foreign investor. The latter, however, is more sensitive in that he always has the opportunity of going elsewhere to obtain quick approval for his investment. Foreign investors in India were quite critical of this slow-moving administrative machinery. For example, some 84.2 per cent of the total respondents of the questionnaire survey in the United States mentioned that red tape and slow decisions were the main obstacles they encountered while negotiating with Indian government officials. An even slightly larger percentage (87 per cent) of the executives interviewed in the United States and India mentioned these factors as main problems and impediments to investment in India. The summary of their views concerning problems and difficulties encountered in negotiation with the Indian government officials is given in Tables 32 and 33.

American executives in the United States were quite frank in expressing their viewpoints concerning the slow-moving administrative machinery of the Indian government. An American executive in United States said,

They [Indian government officials] are as slow as molasses in January. . . . We are in many countries, and India tops them all in red tape and time consumption. You can't move without innumerable trips to New Delhi.

TABLE 32  
 INITIAL DIFFICULTIES OF NEGOTIATIONS  
 (Results of the questionnaire survey in the United States)  
 (Total Respondents 101)

Difficulty	Number of Respondents	Percent of Total Respondents*
Red tape	53	52.5
Slow decisions	32	31.7
Lack of understanding	5	4.9
Lack of correct facts	1	1.0
Import restriction	6	5.9
Royalty rate agreement	4	3.9
Lack of co-ordination of different agencies	4	3.9
General restrictions	4	3.9

\*Many firms mentioned more than one factor and therefore the percentages do not add up to 100.

TABLE 33

PROBLEMS AND DIFFICULTIES IN THE INITIAL NEGOTIATIONS  
(Interview Analysis)

Executives	Total Respondents 54*					
	Red Tape		Indecision		Changing Policies	
	Number	Percent	Number	Percent	Number	Percent
American Executives in the United States	5				3	
American Executives in India	13		2		1	
British Executives in India	14				2	
Indian Industrialists	10				2	
United States Consulting Firms	5					
Total	47	87.0	2	3.7	1	1.8
					7	13.0

\*Some executives mentioned more than one factor and therefore the percentages do not add up to 100.



Another American executive in a desperate mood said, "Red tape has been fantastic. . . . We budget ten times the usual required executive time."

Some American executives thought it worth-while to forego investment opportunities in India rather than to "fight" the procedural battle. An American executive contemplating investment in India commented upon the red tape and slow decision apparatus of the Indian government:

". . . bureaucratic red tape and delays are particularly irritating, to the point that in certain cases we have foregone opportunities rather than fight through the procedural battle."

Many American executives also were quite concerned about the conflicts that exist among the different agencies of the Indian government. Conflicting objectives from agency to agency with no means to coordinate and resolve such conflicts result in delays.

Red tape and excessive governmental bureaucracy also are considered the main problems faced by businessmen operating in India. As can be seen from Table 34, out of 54 executives, 44 executives (81.4 per cent) mentioned red tape as the main operational problem.

To sum up, then, one can say that red tape, the slow decision-making apparatus of the Indian government, and excessive bureaucracy are the most discouraging elements of

TABLE 34

PROBLEMS OF OPERATING IN INDIA  
(Interview Analysis)

Executives	Total Respondents 54							
	Red Tape		Availability of Raw Materials		Availability of Technical Personnel		No Answer	
	Number	Percent	Number	Percent	Number	Percent	Number	Percent
American Executives in United States	5		2				1	
American Executives in India	11		4		2		1	
British Executives in India	15		1				1	
Indian Industrialists	8		2		2		1	
United States Consulting Firms	5							
Total	44	81.4	9	16.7	4	7.4	4	7.4

\*Some executives mentioned more than one factor and therefore the percentages do not add up to 100.

the Indian investment climate. Therefore, to attract foreign investment India must move to reduce red tape and bureaucracy.

### Summary

To test our second hypothesis concerning specific Indian policies retarding foreign private investment in India, we analyzed the seven Indian policies which were considered influential by foreign investors in making investment decisions with regard to India.

The findings of our empirical research support the following conclusions.

1. Indian industrial and foreign investment policies are considered restrictive by foreign investors in India. The application of these policies is guided by pragmatic considerations, but foreign investors in India look upon the pragmatic aspect with suspicion.

2. The Indian tax rate is much higher as compared to many developing and developed countries. The higher tax rate in India has become a negative factor in attracting foreign private investors. Within the tax structure, the super-profit tax and the newly imposed sur-tax and dividends tax are considered prohibitive.

3. The single most important factor retarding greater inflow of foreign investment in India is the red

tape and bureaucracy involved in the Indian government's approval of foreign investments.

4. Foreign exchange control and import policies are regarded as very restrictive and, also, seem to limit expansion programs of many existing units in India.

5. Indian remittance and repatriation policies are liberal, but general consensus of opinion concerning these policies is not very favorable. A lack of proper communication between the Indian government and foreign investors seems to be the problem here.

These findings thus support our second hypothesis, namely, that such government policies as industrial and foreign investment policies, taxation policy, exchange control and import policies and Indian government's apparatus of decision-making are responsible for retarding a greater inflow of foreign investment into India.

This concludes the detailed description of the conceptual framework, research design, and findings for the dissertation. In the concluding chapter the author will summarize the main findings of the research and will present conclusions and the implications of the study as he sees them.

## CHAPTER V

### SUMMARY AND CONCLUSIONS

The main purpose of this research was to investigate obstacles and impediments to foreign investment in India. Specifically, the research attempted to ascertain obstacles and impediments that are inherent in Indian government policies. The over-all aim was to pinpoint shortcomings in certain Indian policies which, if removed, could result in increasing the inflow of foreign capital into India.

The previous researches of Paley, Gray, the International Advisory Board, the National Industrial Conference Board, the United States Department of Commerce, and Barlow and Wender show that fear of war and expropriation, hostile attitudes of foreign governments toward private investment, and socio-economic and political instability were some of the important factors limiting United States private investment in the lesser developed countries.

On the basis of these findings, to guide this study and to achieve the purposes mentioned, two hypotheses were formulated.

1. Social, political, and economic stability are, to varying degree, positively related to the inflow of foreign private capital in lesser-developed countries.

2. However, if the socio-economic and political stability are neutral to this inflow into India, then such governmental policies as industrial and foreign investment policies, taxation, exchange control, import policies, and the Indian government's apparatus of decision-making should provide explanation for the lesser inflow of foreign private capital into India.

We attempted to test both of these hypotheses by documentary and empirical research. The findings of the study support both of these hypotheses. The main findings of the study are summarized below.

#### Summary of Findings

To test our first hypothesis we analyzed the socio-economic and political conditions in India. We have seen that in spite of certain setbacks in the Indian economy, India has made considerable progress at various levels. During 1951-61, the national income increased by 42 per cent and per capita income by 17 per cent. Industrial production in the country has increased by 100 per cent and agricultural production by 40 per cent. Basic facilities like irrigation, power, and transportation are greatly expanded. The rate of investment of national income has more than doubled since 1951. Industry has been diversified to a great extent, and a solid foundation is already laid for further industrial expansion.

At the social and educational levels, considerable

progress has been made in India. Life expectancy has increased to 42 years as compared to 27 years in 1947. Since 1951, the number of students in schools has increased by 85 per cent and the number of students getting technical education has increased by 300 per cent. The number of hospitals has increased by 47 per cent. At the political level, India has maintained a democratic government. The foreign investor in India is quite appreciative of all this progress and has expressed his confidence in the Indian socio-economic and political stability.

Two other most important factors necessary to attract foreign investors, namely, market potential and profitability of foreign venture, are very favorable in India. This was confirmed by both factual statistics and personal viewpoints of foreign investors in India.

#### Indian Policies Limiting Foreign Private Investment in India

To test our second hypothesis we analyzed several Indian policies affecting investment decisions of foreign investors in India. The findings of this analysis suggest that the following policies or factors are responsible for retarding greater inflow of foreign capital into India. These factors or policies are given in Table 35 in order of relative importance. The order (or rank) is based on two considerations: (1) the number of times foreign investors

mentioned such factors, and (2) the emphasis foreign investors put on such factors.

TABLE 35  
FACTORS LIMITING FOREIGN PRIVATE  
INVESTMENT IN INDIA

Rank Order	Factors
1	Red tape, slow decisions, and bureaucracy in the Indian government.
2	Indian foreign investment policy, (particularly uncertainties concerning what will and what will not be approved by the Indian government).
3	Taxation policy, particularly super-profit tax on companies during 1963-64 and presently the sur-tax and dividends tax.
4	Indian foreign exchange policy.
5	Indian import policy.
6	Indian policies concerning majority capital and management participation of foreign firms.

The relative importance of these factors in retarding investment in India is also confirmed by yet another finding of this research. In order to pinpoint the specific factors retarding investment in India, some 54 executives in the United States and India were asked to mention factors or policies which must be changed to induce them to



increase their investments in India. Their responses to this question are given below.

Of the 54 executives, 36 executives (66.7 per cent) said that, in order to attract investment, the Indian government must improve its administrative machinery and should get rid of excessive red tape. Some 34 executives (62.9 per cent) suggested that the Indian government should not oscillate in its policies, while 21 executives (38.9 per cent) suggested some changes in tax structure. Other factors mentioned by these executives are:

<u>Factor or Policy</u>	<u>Percent of Total Respondents</u>
Foreign exchange should be liberalized . . . . .	14.8
Consideration of economic size . . . . .	1.8
Repatriation policy . . . . .	1.8
Removal of excessive controls . . . . .	3.7
Availability of raw material and technical personnel . . . . .	5.5

It must be admitted, however, that the decision to invest or not to invest in any foreign country is quite complex and depends upon many factors. It is quite likely that many executives who mentioned the above Indian policies as restrictive may still go on investing in the presence of these restrictions. And yet some others may not invest at all, even if all the above obstacles are removed. The relative importance of the above factors in retarding foreign

investment in India therefore can be interpreted simply as below.

If the Indian government makes suggested changes in the factor listed as first in importance, then it is more likely that the rate of flow of foreign capital will be greater than if the policy changes were made in those factors considered second, third, fourth, etc., in importance.

The above six factors or policies retarding foreign investment in India were discussed and analyzed at great length in Chapter IV. Out of these six factors, the first three factors (namely red tape and excessive bureaucracy in the Indian government, the Indian foreign investment policy, and the taxation policy) seem to be more critical. We shall therefore summarize these factors and suggest some means to improve them.

#### Excessive Red Tape and Bureaucracy in the Indian Government

Many foreign investors were very critical concerning the length of time taken by the Indian government to approve their proposals. It is indeed no exaggeration when a foreign investor described the nature of red tape in the Indian government as "slow as molasses in January."

Most of these delays and difficulties arise due to the wide range of legislation which controls industry, particularly in obtaining:

1. Industrial licenses
2. Approval of terms of foreign collaboration agreements
3. Import licenses for raw materials and capital goods.

The Indian government has recently made several attempts to introduce expeditious procedures. For example, much of the red tape may be cut down by the new decision to issue "a letter of intent"<sup>1</sup> within a month from the date of receipt of an application to start an enterprise. This would enable the Indian industrialist to assure the potential foreign collaborator that the government would favorably consider their joint venture. This measure may alleviate some of the problems and difficulties of foreign investors in India, but much more needs to be done in the direction of procedural reforms. To decrease red tape and bureaucracy in decision-making, we should identify the main sources of red tape.

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<sup>1</sup>This was done under the recommendations of "Industries Development Procedures Committee" appointed by the Indian government in September, 1963 to examine various procedures of industrial licensing. See Foreign Investor and Tax Reforms, op. cit., p. vii.

### Sources of Red Tape

One of the most potent sources of delay is in the issue of import licenses. The procedure known as "screening for indigenous availability" is adopted for issue of an import license. This procedure requires applicants for import licenses to obtain a number of "refusal letters" from indigenous suppliers before they can be given the license. This procedure is very circuitous and time consuming, and it is doubtful whether the resultant saving in foreign exchange is worth the loss to the nation through delays in implementing new projects.

Another source of delay in obtaining foreign collaboration approval is in securing an industrial license, necessary under the Industries Development and Regulation Act of 1951. It is believed that the implementation of this act has created serious obstacles to industrial progress. The Indian Engineering Association's research<sup>2</sup> suggests that the present system of industrial licensing control has led to indecision or to arbitrary decisions and has provided unnecessary scope for the misuse of power. The Association therefore suggested removal of the present controls over

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<sup>2</sup>Report on Foreign Aid, Collaboration and Investment, Indian Engineering Association, Calcutta, India, January, 1964.

industrial licensing and recommended the liberalized method of issuing the industrial license.

Under the liberalized system recommended by the Association, the purpose of industrial licensing would be simply to register or record the intentions of the various parties proposing to set up new projects or to expand existing ones. This information therefore would still be available to the government for planning purposes. The advantages of this liberalized licensing procedure are:

1. Industrial projects would be implemented more speedily through the elimination of a major source of procedural delay.
2. An industry would become more efficient through the removal of artificial restrictions on competition and through the establishment of units of an economic size, resulting in lower prices, improved quality, and increased capacity to compete in export markets.
3. Unnecessary duplication of controls and multiplication of government decisions would be avoided, thus enabling both the administration and applicants for licenses to attend to other more important work.
4. The full potential demand of industry for raw materials, electric power, fuel, transport, etc., would be duly registered with the authorities concerned, thus enabling more realistic planning ahead for the expansion of vital sectors of the economy.
5. Industrial licenses would cease to be a marketable commodity, and current speculation or trafficking in licenses would be eliminated.<sup>3</sup>

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<sup>3</sup>Ibid., p. 20.

Some of the difficulties faced by the foreign investor or collaborator in India also arises from the division of responsibility among various government authorities for approving new projects. This may involve the foreign businessman in several trips from one ministry to another or between the central and state governments and may even give rise to disputes. It is therefore desirable to concentrate the various discussions and decisions relating to each project at one particular point as far as possible. One possibility here would be to give a greater measure of responsibility to the state governments to approve and promote industrial projects within their borders.

#### Indian Industrial and Foreign Investment Policies

These policies have been operating as inhibiting factors for the inflow of foreign investment into India. Many foreign executives termed these policies as restrictive.

The Indian government has been pragmatic in implementing these policies. But this pragmatism itself has become an inhibiting factor and is looked upon by the foreign executives as a sign of "imbalanced mind" of the Indian government.

Indian planners, however, always have taken pride in being flexible or pragmatic in their policy measures.

But if the pragmatism does create suspicion and uncertainties in the minds of private investors, then it indeed is time for the Indian planners to make up their minds about what they want in these policies. In particular, there is an urgent need for general guidelines concerning what will and what will not be approved by the Indian government.

There is also a need to spell out clearly the policies concerning three factors:

1. Rules on equity
2. Royalty payments
3. Payment for such intangible assets as research and development.

#### Indian Taxation Policy

The Indian taxes--both personal and corporate--are much higher compared to many industrially advanced and developing countries. Researchers of the National Council of Applied Economic Research<sup>4</sup> also have pointed out the high incidence of Indian tax measures and its adverse effects on private investment, saving, and economic growth.

The super-profit tax which was levied in 1963 was operating as a particularly inhibiting factor. Finance Minister Krishnamachari in his new budget proposals abolished

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<sup>4</sup>In particular see the two recent publications on this subject: (a) Taxation and Private Investment, 1961, and (b) Foreign Investor and Tax Reforms, 1964, loc. cit.

this tax and also reduced the incidence of intercorporate and personal taxes. However, he also introduced such new tax measures as sur-tax and dividends tax. Thus, the overall effect of these changes on the private investment climate is quite negligible.

From a purely tax point of view, India still remains an unattractive country for foreign investment. Thus, there is an urgent need for more effective tax incentives to private investors. There also is a need for long-term stability in the tax situation because the frequency of changes in structure of company taxation creates uncertainties in the minds of investors and perhaps has been the greatest single deterrent to a freer inflow of foreign capital into India.

### Implications

We may now ask: What is the significance of the findings of this research? The significance of the research findings lies in its contribution of our understanding of such internal factors as Indian foreign investment policy, taxation policy, and the decision-making apparatus of the Indian government in limiting foreign private investment in India.

The study attempted to demonstrate that the presence of such favorable factors as socio-economic and political stability and profitable market are not enough to attract



foreign private investment in the country. The underdeveloped countries needing and seeking such investment should also examine their policies limiting greater inflow of foreign private capital. This study, therefore, sets the stage for similar studies for other developing countries needing and seeking foreign private investments.

The ultimate aim of this research is to utilize the potential of foreign private capital in promoting economic development in underdeveloped countries. In this respect, knowledge of specific obstacles and impediments to such investment is indeed desirable. However, it is realized that the understanding of specific obstacles and impediments to such investment is only one facet toward utilizing the potential of foreign private capital in developing underdeveloped nations. To utilize the potential of this media we must also increase our understanding of the role and potential of foreign private capital itself. We know that the operation of foreign firms constitutes the most effective means for transferring advanced managerial and technical know-how into less-developed countries, but we know very little about how this happens.<sup>5</sup>

Further investigations in the following areas may therefore prove useful in this regard.

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<sup>5</sup>McMillan and Gonzalez, op. cit., p. 7.

### Suggested Areas for Additional Investigations

1. Study of the impact of foreign collaboration on improving managerial and technical performance of other domestic firms.

We know that the domestic partner has improved his managerial and technical performance by collaborating with foreign firms, but the effects of foreign collaboration are much wider in scope. Collaboration also improves the managerial and technical performance of other domestic firms. However, the full impact of foreign collaboration on domestic firms has largely remained unexplored. The National Planning Association<sup>6</sup> has done some useful work in this area, but its case studies of business performance abroad are limited in scope. More intensive case studies of domestic firms will be useful in increasing our understanding of the role and potential of foreign collaboration for improved managerial and technical performance in lesser developed countries.

2. Study of the role and potential of licensing arrangements in promoting economic development in the lesser developed nations.

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<sup>6</sup>The National Planning Association has sponsored several case studies of United States firms operating overseas. Among these, the most recent is Kannappan and Burgess, loc. cit.

It has been widely recognized that the licensing arrangement is the easiest medium for transferring managerial and technical know-how of the industrially advanced countries to the underdeveloped countries. Besides providing needed know-how, this type of arrangement helps to overcome the problems of trade barriers, exchange control, and shortage of dollars or other foreign currencies.

However, the potential of this media is not fully utilized. Many developing nations have some misgivings about the utility of such media. This is manifested in their refusal to pay adequate royalties for licensing agreements. Study of the role and potential of licensing agreements and various impediments to such arrangement, therefore, may prove useful in utilizing this medium in promoting economic development in underdeveloped countries.

### Main Conclusions

Within the limitation set forth in Chapter II (scope of the study), it has been found that red tape and excessive bureaucracy in the Indian government, pragmatism in foreign investment policy, and the high tax structure (particularly the sur-tax and the dividends tax) are the main obstacles to greater inflow of foreign private investment into India. The researches of the United States Department of Commerce and the National Industrial Conference Board did mention these

factors but they did not specify the relative importance of these factors in retarding investment in India. Therefore, the main contribution of this study lies in establishing the relative importance of these factors in retarding foreign investment in India. Besides, this study updates the findings of all other previous researchers in this field of inquiry.

## **APPENDIX I**

### **SOME ADDITIONAL FINDINGS**

### Some Additional Findings of the Study

The information collected through the questionnaire survey and personal interviews, besides supporting two hypotheses and achieving the main purposes of the study, has provided additional insights into the factors limiting foreign private investment in India. Some of these additional findings support our hypotheses, but they are not considered so crucial and hence were not reported in the main body of the dissertation.

#### Ranking of the Indian Investment Climate

In the questionnaire survey in the United States, representatives of some 188 American companies were asked to rank the Indian investment climate as compared to certain developed and developing countries. These countries were: Egypt, Pakistan, Japan, countries in the European Common Market, other West European countries, Brazil, and Argentina.

In this survey India was ranked lower than Japan and all European countries; she was ranked higher than Brazil, Argentina, Egypt, and Pakistan. Thus, among the developing countries, India is on top, but her investment climate is inferior as compared to the industrially advanced countries. The detailed result of this ranking is given in Table 36.

TABLE 36  
COMPARATIVE RANKING OF EIGHT COUNTRIES FOR  
THEIR FOREIGN INVESTMENT CLIMATE  
(Total Respondents 101)

Countries or Area	Ranking								No Answer
	1	2	3	4	5	6	7	8	
European Com- mon Market Countries	63.4	21.8	3.0	----	----	----	----	----	11.8
Other West European Countries	6.9	43.6	27.7	3.9	1.0	----	----	----	16.9
Japan	12.9	17.8	40.6	8.9	4.9	2.0	----	----	12.9
India	6.9	2.0	9.9	32.7	18.8	13.9	1.0	1.0	13.8
Brazil	1.0	1.0	----	3.0	19.8	12.9	19.8	21.8	20.7
Argentina	----	----	3.9	17.8	14.9	24.8	15.8	3.0	19.8
Pakistan	1.0	1.0	1.0	18.8	14.9	17.8	20.8	2.0	22.7
Egypt	----	----	----	1.0	3.0	10.9	12.9	47.5	24.7

This ranking tends to support the view that foreign investors regard Indian socio-economic and political stability superior to Egypt, Pakistan, Argentina, and Brazil (representatives of developing countries). But red tape, frequent changes made in foreign investment policy, and higher taxation in India make India's investment climate inferior to such developed nations as Japan, countries in the European Common Market, and other Western European countries where the

obstacles listed above are either non-existent or are less serious.

Differences Between Attitudes of  
American Executives and British  
Executives Toward Indian Policies

British executives have been investing in India since 1870, but investments of American firms are of recent origin. Americans have been investing in India since World War II and particularly since 1950. The difference in length of exposure to India's socio-economic and legal conditions causes speculation about possible corresponding differences in attitudes between these two groups toward Indian policies.

Within the limitation of sample size, the findings of this study suggest the following differences between British and American investors' attitudes.

1. The British investors were more critical toward Indian industrial and foreign investment policies than the American investors.
2. In general, American investors were more favorably disposed toward the various governmental controls and restrictions and the Indian investment climate.
3. The British executives and the Indian industrialists were similar in their viewpoints concerning the Indian investment climate and Indian policies.



However, among Indian government officials and Indian businessmen there is a widely held belief that "the British know India well" and "Americans are really foreigners and do not know much about India." This viewpoint is held due to the fact that the British Empire ruled India for more than 200 years. However, the findings of this research concerning the attitudes of the American and British executives do not support the above viewpoint. In fact, the findings indicate that 'knowing India well' is not a particular advantage in knowing the Indian investment climate or specific policies. Again, it indicates that, so far as the businessman is concerned, length of 'exposure' is neutral or negatively related to the viewpoints held by executives concerning Indian policies. Thus the practice of Indian government officials in taking for granted British investors in India and providing information only to American investors is questionable.

#### Uncommercial Attitude of the Indian Government

Many domestic and foreign business executives criticized the Indian government's attitude toward business and businessmen. They complained that Indian government officials were not commercially minded and could not appreciate the role of businessmen. American executives in particular were very critical in this respect. An executive of a

United States pharmaceutical firm said:

The Indian government seems to have the idea that business firms in America are like our government; that is, that we are willing to give them everything for nothing to speak of in return . . . also, some of the restrictions imposed are a bit ridiculous from a business standpoint and certainly would not induce us to sign a contract to work in India.

Yet another American executive expressed his opinion in these words:

As you must appreciate, United States business firms (unlike our government) are not in the habit of giving away information or valuable assets to anyone . . . unless there is an adequate return. There is a lack of appreciation [among Indian government officials] of the problems involved in starting an efficient manufacturing operation.

### Information Gaps

The information system concerning investment opportunities in India is far from adequate. Many foreign executives were concerned about the inadequacy of information concerning investment opportunities in India. They also complained about the lack of adequate statistics in India. During the research interviews in New York City, it was found that many top-level executives (director level) knew almost nothing about Indian investment opportunities. But still these same executives were responsible for making final decisions concerning their company's investment in foreign countries. For example, one American executive of a petroleum company said:

I know everything about India. . . . I know it has great potential and investment opportunities . . . but my director and chairman think that India is still a country of wild elephants and tigers.

Some of these problems of communication may be alleviated with the opening of an Investment Center in New Delhi with branch offices in New York and principal cities in Europe. But still much more needs to be done in this respect. There is an urgent need for some kind of communication channel between the top executives (director level) of foreign companies and the Indian government. The Monthly News Letter, currently published by the Indian Investment Center, is indeed a step in the right direction. In this newsletter, efforts should be made to introduce some articles by foreign executives in India telling of their successful experiences in India. This may prove effective in attracting more foreign investors to India.

## **APPENDIX II**

**COVER LETTER, SAMPLE QUESTIONNAIRE, AND  
SAMPLE INTERVIEW GUIDE**

Cover Letter

Michigan State University  
Graduate School of Business Administration  
Department of Management  
East Lansing, Michigan  
October 31, 1963

Mr. \_\_\_\_\_  
Vice President  
International Division  
\_\_\_\_\_ Corporation  
New York, New York

Dear Mr. \_\_\_\_\_:

We are undertaking a research project concerning the private foreign investment climate in India. This research is being sponsored and supported by the Graduate School of Business Administration, Michigan State University.

The purpose of this research is to contribute to our understanding of specific obstacles and impediments to private foreign investment in India. It will also seek to discern the nature of differences, if any, between the British and the American investors' attitudes toward the Indian investment climate. Knowledge of this character is largely lacking.

The research is being conducted in the United States and India.

The interest of your company in International Business makes your viewpoint on this subject very desirable. We would greatly appreciate your filling out the enclosed questionnaire. Needless to say, your replies will be held in strict confidence and no firm or person will be identified in published results. The enclosed questionnaire will take very little of your time, as most of the items can be answered by a check mark.

It is our hope that the findings of this research will be of value to both, the Indian government in future policy formulation and the U.S. firms operating or contemplating operations in India. Therefore, we would greatly appreciate your frank opinion and comments on the Indian investment climate and Indian policies affecting American investment in India.

A summary of the findings of this research will be made available to you. Thank you for your cooperation.

Sincerely yours,  
*Anant R. Neghandi*

Anant R. Neghandi  
Research Project Director

Enc.

## STUDY OF THE PRIVATE FOREIGN INVESTMENT CLIMATE IN INDIA

Graduate School of Business Administration

Michigan State University

---

Strictly Confidential

1. Does your company now have any investment or licensing arrangements in India? Please check:

Yes ☐No ☐

2. How long has your company had such arrangements in India? \_\_\_\_\_

3. From what sources does your company obtain information on specific investment opportunities in India? Please check:

- a) ☐ U.S. Dept. of Commerce
- b) ☐ Indian Investment Center
- c) ☐ Indian Ministry of Commerce and Industry
- d) ☐ Chamber of Commerce in India
- e) ☐ Chamber of Commerce in U.S.A.
- f) ☐ Chamber of Commerce in U.K.
- g) ☐ Trade Association in India
- h) ☐ Trade Association in U.S.A.
- i) ☐ Trade Association in U.K.
- j) ☐ Consulting Firms in India
- k) ☐ Consulting Firms in U.S.A.
- l) ☐ Consulting Firms in U.K.
- m) ☐ Any other sources \_\_\_\_\_, please specify \_\_\_\_\_

(We would find any comments you might have on the above questions very helpful. If you have any further remarks, please enter them on the back of this sheet.)

4. Please check 5 of the following factors which you consider to be the most important for making a decision to invest in India. (You may rank these five factors in numerical order if you wish so).

Information regarding:

- a) ☐ Indian Govt.'s Foreign Investment Policy
- b) ☐ Indian Govt.'s Foreign Exchange Policy
- c) ☐ Market Potential for your Product in India
- d) ☐ Taxation in India
- e) ☐ Indian Govt.'s Repatriation Policy
- f) ☐ Indian Govt.'s Remittance Policy
- g) ☐ Indian Industrial Policy
- h) ☐ Indian Labor Laws
- i) ☐ Availability of Skilled Labor
- j) ☐ Availability of Technical and Adm. Personnel
- k) ☐ Future profitability of your Investment
- l) ☐ Political situation
- m) ☐ Social and Economic situation
- n) ☐ Any others (please specify)

5. From what source(s) does your company obtain the necessary information concerning these five factors? Please comment. \_\_\_\_\_

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6. What type of information do you need which you are now not receiving from the available sources? Please comment. \_\_\_\_\_

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(We would find any comments you might have on the above questions very helpful. If you have any further remarks, please enter them on the back of this sheet.)

7. Please indicate your views regarding the following Indian Policies:

Please check, and if possible comment on your answer.

A. Indian Industrial Policy

- a) ☐ Very liberal or favorable
- b) ☐ Liberal or favorable
- c) ☐ Reasonable
- d) ☐ Restrictive
- e) ☐ Very restrictive

B. Indian Foreign Exchange Policy

- a) ☐ Very liberal or favorable
- b) ☐ Liberal or favorable
- c) ☐ Reasonable
- d) ☐ Restrictive
- e) ☐ Very restrictive

C. Corporation and other Business  
Taxes in India

- a) ☐ Much higher compared to the  
U.S.A.
- b) ☐ Higher compared to the U.S.A.
- c) ☐ Same as in the U.S.A.
- d) ☐ Lower compared to the U.S.A.
- e) ☐ Much lower as compared to the  
U.S.A.

D. Indian Government's Repatriation  
Policy

- a) ☐ Very liberal or favorable
- b) ☐ Liberal or favorable
- c) ☐ Reasonable
- d) ☐ Restrictive
- e) ☐ Very Restrictive

E. Indian Government's Remittance Policy

- a) ☐ Very liberal or favorable
- b) ☐ Liberal or favorable
- c) ☐ Reasonable
- d) ☐ Restrictive
- e) ☐ Very restrictive

8. What % of U.S. capital would you prefer to use in your Indian investment?

Please check and if possible, comment on your answer.

- ☐ 100% U.S. capital
- ☐ Majority U.S. capital
- ☐ Minority U.S. capital
- ☐ Nominal U.S. capital
- ☐ No U.S. capital

(We would find any comments you might have on the above questions very helpful. If you have any further remarks, please enter them on the back of this sheet.)



9. What % of U.S. Management Personnel would you prefer to use in your Indian operation? Please check and if possible, comment on your answer.

- ☐ 100% U.S. Management  
☐ Majority U.S. Management  
☐ Minority U.S. Management  
☐ Nominal U.S. Management  
☐ No U.S. Management

10. Please comment on the various problems and difficulties your company might have experienced in initial negotiations with Indian government officials or personnel of any other agencies. \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_

11. Of the following countries, which are, today, the most attractive as investment areas in your line of business, considering market opportunities socio-economic and political environments? (Please rank them letting 1 represent the most attractive country or area and 8 the least attractive.)

- a) ☐ Egypt  
b) ☐ Pakistan  
c) ☐ Japan  
d) ☐ Countries in European Common Market  
e) ☐ Other W. European countries  
f) ☐ India  
g) ☐ Brazil  
h) ☐ Argentina

Comments

Interview GuideStudy of the Private Foreign Investment  
Climate in IndiaGeneral Information

Name of Company:

Kind of Business:

Type of Investment in India:

Person Interviewed:

1. Company's experience with its Indian investment (e.g., satisfactory or otherwise).
2. Company's present moves in India (e.g., expanding, withdrawing, status quo).
3. Company's attitude toward Indian:
  - a) Industrial policy
  - b) Government planning
  - c) Foreign investment policy
  - d) Exchange control policy
  - e) Remittance policy
  - f) Repatriation policy
  - g) Social and economic situation
  - h) Political situation
  - i) Chinese aggression
  - j) Fear of communism
  - k) Indian (Nehru's) brand of socialism
  - l) Taxation

Effect of these on investment decisions:

4. Factors influencing investment decisions:

Most important:

Most critical:

5. Problems and difficulties encountered:

a) While operating in India:

b) During initial negotiation with government's officials:

6. Company's viewpoint toward Indian investment climate in general.
7. What factors or policies will have to be changed or modified in order to attract foreign private capital in greater amounts?
8. Company's experience with:
  - a) Indian partner
  - b) Indian executives
  - c) Indian labor
9. What benefits or advantages does your company expect and seek before favorably considering a new investment or licensing operation in:
  - a) Any foreign country \_\_\_\_\_
  - b) India \_\_\_\_\_
10. What major safeguards or conditions does your company require before it will favorably consider a specific investment proposal in India?
11. What are some of the factors or impediments that would rule out any consideration of investment in India?
12. Cost of preliminary investigation for investment opportunities in India?
 

Too high \_\_\_\_\_

Reasonable \_\_\_\_\_

Low \_\_\_\_\_
13. Role of U.S. government for encouraging U.S. investment in India.
 

What policies favorable \_\_\_\_\_

What policies unfavorable \_\_\_\_\_

Comments:

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