



**REPORT
OF
THE COMMITTEE
TO
EXAMINE PRINCIPLES OF A POSSIBLE SHIFT
FROM PHYSICAL TO FINANCIAL CONTROLS**

1985

M. Narasimham
Chairman

**COMMITTEE TO EXAMINE THE PRINCIPLES
OF A POSSIBLE SHIFT FROM PHYSICAL
TO FINANCIAL CONTROLS**

New Delhi, the 25th January, 1985.

Dear Mr. Finance Minister,

I have pleasure in submitting the first report of the Committee to examine the principles of a possible shift from physical to financial controls. This report covers the area of industrial licensing and related M.R.T.P. aspects where the Committee has identified some broad principles of possible reform. In a subsequent report the Committee will deal with other administrative controls such as capital issues control, approval for capital goods imports, approval for foreign collaboration and exchange control.

Yours sincerely,

Sd/-

(M. Narasimham)

REPORT ON INDUSTRIAL LICENSING AND RELATED MRTP ASPECTS

INTRODUCTION

We were appointed as a Committee to examine the question of a possible shift from physical to financial controls and the principles which should govern such a shift. The terms of reference of the committee are thus extensive. However, in this report we address ourselves to the question of industrial licensing as, in our view, it is this set of controls that has had the most far reaching impact on investment and growth in our industrial economy. We will be dealing in a subsequent report with other areas of administrative controls such as capital issues control, approvals of import of capital goods, approvals for foreign collaboration and exchange controls.

2. The present system of industrial licensing was devised in the Fifties in the light of the Industrial Policy Resolutions and within the framework of the Industries Development and Regulation Act (IDRA). The main object of licensing was, accordingly, (to promote industrialisation on the basis of effective utilisation of resources and in accordance with national priorities.) Other important concerns were (to reduce foreign dominance, increase indigenous industrial capacity, encourage small scale industry, bring about greater regional dispersal, prevent concentration of economic power and promote and expand the public sector so as to control the commanding heights of the economy.)

3. Over the past thirty years, there has been considerable success in achieving these objectives. Aggregate industrial output has increased five-fold since Independence. Even allowing for deficiencies in data, there is evidence to show that industrial output has grown at a compound rate of 6 per cent per annum in the last three decades as compared to barely 2 per cent in the preceding fifty years. Dependence on imports in critical sectors has been substantially reduced and the public sector's presence in the industrial structure has increased in a big way. Small scale and decentralised industry has also shown impressive expansion and its contribution to total recorded industrial output is now as much as 40 per cent.

4. Indian industry has also made impressive strides in the range and sophistication of output manufacture. The weight of capital goods in industrial production went up from less than 5 per cent in the mid-Fifties to nearly 16 per cent in 1970. Basic and capital goods industries taken together now account for as much as 50 per cent of the total value added in industrial production. Engineering goods which had

a negligible share in India's total exports at the time of Independence now account for over 10 per cent. The proportion of imported machinery and transport equipment to gross domestic fixed capital formation in machinery and equipment has come down from about 40 per cent in the Fifties to less than 15 per cent now.

5. While considerable progress has thus been made in Indian industry since Independence and we now have a reasonably well diversified industrial structure, the development of our industrial economy has exacted a heavy price in terms of a high cost structure and insufficient attention to quality of products. The high cost structure, in turn, may be ascribed to an element of technological obsolescence as well as the market conditions in which Indian industry has operated. Though the strategy of import substitution had and continues to have validity in the context of our objective of self-reliance, the manner in which the strategy has been implemented has led to this result. Indian industry has been insulated also from internal competition, because of, among other reasons, the operation of a wide array of controls on investment and production as a result of which those fortunate to have been licensed to invest and produce have pre-empted a share of the market by virtue of administrative action rather than economic competitiveness. The overall result has been that the rate of industrial growth has been adversely affected and employment opportunities in the industrial sector have not expanded sufficiently. India could not also take advantage of the tremendous expansion which took place in world trade in the Sixties and Seventies with the result that our share in world exports, which already was very small has declined further. Actual growth in industrial investment and production has, over the years, also failed to meet the Plan targets and has led to continuing shortages in several critical areas, especially wage goods. The existing licensing system has also not ensured efficient resource use in our industrial economy since in the protected market conditions an industry could be financially viable even though it is not economically viable in the overall national context. There is therefore a widely shared view that the actual performance of the industrial sector has fallen short of the potential and this has given rise to a feeling that the entire framework of industrial policy needs review and reform.

6. What lends urgency to such a review is that a system of detailed and physical control of all and every aspect of industrial activity such as is in vogue in our country has inherent limitations in dealing with the complex industrial structure that we now have and the multiplicity of objectives that prevail in our conditions. In the current situation where technology has reached a high degree of sophistication and is advancing rapidly, decisions regarding industrial investment have to be quick and based on upto date information. Experience in this country, as elsewhere, has shown that administrative controls do not respond quickly enough to such changing needs.

The Committee's approach

7. It is against this background that the Committee has viewed its task. In addressing itself to its terms of reference, the Committee examined whether regulations in the form of physical controls can be replaced by indicative signals and instruments so that an environment can be created in which economic agents can take their decisions regarding investment and production in response to the signals provided to the economy. Such signals can come from the operation of the market, the priorities set out in the Plan documents and incentives and disincentives as embodied in policy instruments such as monetary and credit policy, fiscal policy and trade policy.

8. In a developing economy like ours there can be no two opinions about the need for and relevance of planning. We also recognise that in the sphere of industry a measure of regulation of investment and production (is necessary to fulfil broader socio-economic objectives, promote the efficient use of resources, help in widening and deepening the base of entrepreneurship, bring about more balanced regional growth of industry, expand employment opportunities and prevent the emergence of, and gain some control over, monopolies. It was this perception which led to Government intervention through expansion of the public sector and through various regulations designed to channelise the use of investible resources in the industrial sector according to Plan priorities. A measure of regulation of industrial investment and production is therefore clearly necessary but we believe the methods and instruments of such regulation require to be re-examined.) In quite a few areas the original objectives have been lost sight of and various restrictions imposed through administrative action adding needlessly to the complexity of the regulations and adversely affecting growth.

9. The Committee has taken note of the moves towards liberalisation of the present system in recent years. This process has to be carried further. However, it is necessary to do this in a systematic and well-thought out manner, so that the instruments are used purposively and serve the objectives in view more efficiently.

10. The Committee has considered the question whether the present functions of regulating investment and production could be transferred from the concerned administrative ministries to public financial institutions. We are not convinced that a mere transfer of this authority to financial institutions to sanction investment would be an improvement over the present situation. If the system is one where there is an excessive and even exclusive reliance on the exercise of discretion in individual cases, it makes little difference whether the discretion is exercised by Government officials or by executives of financial institutions. On the contrary, it may be preferable to retain such control with the Government departments. The objective should, in our view, be to move away from discretionary controls towards

a system which would operate under a set of well understood rules without the necessity of intervention in individual cases. The important point, therefore, is to limit the area of discretion and to give more scope to decision-making by concerned economic agents.

A NEW FRAMEWORK FOR LICENSING AND MRTP CONTROL:

Industrial Licensing

11. The Committee examined the three possible directions in which reforms could be contemplated. These are:

- (i) Improving the operation of the licensing system by simplifying the procedures and making them more rule-based and less discretionary.
- (ii) Limiting the area of licensing e.g. by delicensing certain industries.
- (iii) Substituting licensing controls by financial instruments such as fiscal and credit measures.

12. The Committee is of the view that there is scope for reform in each of these directions. Simplification of procedures must be regarded as a necessary and continuing process. As regards the question of limiting the area of licensing, the Committee noted that one way of achieving this is to raise the exemption limit in terms of investment prescribed for the operation of the IDRA. The Committee is of the view that this is neither necessary nor would it make much practical difference. The present cutoff point of Rs.5 crores was fixed only recently and no change in this is called for at this stage. What is needed is an industry-wise approach so that the instrument of licensing is made applicable to a well defined area and certain industries are freed from the requirement of individual licensing on a case by case basis.

13. The objective of limiting the scope of physical controls envisaged under the IDRA could be brought about by "delicensing" some of the industries which are currently under the purview of licensing. Industries which would be delicensed should be open for free entry by any unit, other than an MRTP or FERA company, without the requirement of a licence. This would imply that there would be a list of industries for which no licence would be required. Only registration would be obligatory. An alternative approach could be to have a list of industries for which a licence would be required leaving all other industries out of the scope of licensing, subject only to the requirement of registration.

14. The Committee considered the merits and drawbacks of the two alternatives of having a positive (i.e. delicensed) list or a negative list, that is a list of industries which would require a licence. One view was that a "negative" list would be preferable as it would leave the residuary items out of the scope of licensing and thus provide incentives for innovation and growth of new industries which would be difficult to identify for inclusion in a positive (delicensed) list. Such a change to a

system of licensing by exception would be logical but also far reaching. However, on practical and administrative considerations, we feel that it would be difficult to go over to such a system at the present time. We accordingly suggest that limiting the area of licensing should operate in the following manner. Industries to be delicensed will be notified under Section 29B of the IDRA. As mentioned earlier, units going into industries which would be delicensed in this way would be required only to register for purposes of statistical information regarding production, investment, etc. Unlike under a system of automatic licensing, "delicensing" contemplated by the Committee would dispense with the requirement of a licence altogether for delicensed industries.

15. The Committee identified the following criteria for industries to be delicensed.

- (i) Industries producing items which are allowed to be imported freely;
- (ii) Industries in which there is prima facie need for creating capacity;
- (iii) Industries in which technology is changing fast and especially those coming within the category of producer goods and the energy sector i.e. industries having critical implications for economic growth;
- (iv) Items of mass consumption; and
- (v) Items which have high export possibilities.

16. Criterion (i) would serve to ensure that items which are freely imported would qualify for free entry by domestic producers also. It is not rational to seek to regulate administratively investment catering to domestic production of items while permitting their imports freely. At present, items which are freely allowed to be imported are put on the OGL. The Committee noted that there is a certain measure of stability in the list of capital goods included under OGL. We recommend that investment designed to enter into domestic production of capital goods that are now on the OGL should be delicensed straightaway. In the case of others, (i.e. non-capital goods items) those which have been on the OGL for three years should be delicensed unless there are good reasons to the contrary.

17. Criterion (ii) would help to expand the supply of those commodities for which there is a large gap between supply and demand including the requirement for exports and where the capacity installed is clearly inadequate in relation to the targets envisaged in the Plans. This is an area where the Planning Commission is in the best position to provide an indication from time to time. Since targets in the Plans are laid down for critical items, this criterion would help to achieve better the Plan targets within the time frame contemplated in the Plans.

18. Delicensing of producer goods industries and industries with rapidly changing technology would be needed to impart the much needed dynamism in our industrial sector. Areas which come readily to mind in this context are new energy sources and industrial electronics.

19. As for mass consumption goods, selective delicensing of these industries is necessary to ensure supply of wage goods in larger quantities at cheaper prices. We are aware that this item includes a number of traditional industries like textiles. A certain degree of control would have to be retained for some of these industries in view of their large employment content as in the case of handlooms. This has to be kept in view while identifying industries for delicensing. Sugar is another example of an industry where for historical and other reasons, a measure of regulation of entry would need to be continued.

20. The Committee also considered the role of licensing in respect of those industries which will continue to be under the purview of licensing control. The Committee strongly feels that the adoption of proper criteria for issue of licences is necessary for improving the efficiency of such industries and to help make them competitive in terms of quality and price. For this purpose, the Committee suggests that the following criteria inter alia be adopted for issue of industrial licences:

- (i) New investments should be at levels of capacity which are economic at international prices. This is particularly necessary in sectors, such as chemicals and other intermediates, where scale economies are crucial in determining costs and prices. Our past experience has been that many plants have been sanctioned at levels of capacity, which are profitable at domestic prices because of high tariffs, but which are uncompetitive otherwise. This has led to a high cost structure which has affected export performance as well as expansion of domestic demand for industrial products;
- (ii) Import substitution activities, where net foreign exchange savings are small but domestic resource costs are high, should not be encouraged. There are several instances where domestic manufacturing, based on imports of components etc., does not save much foreign exchange. At the same time the domestic resource costs of saving foreign exchange are several times the official exchange rate. Such high cost import substitution is neither in the interest of industrial end-users nor of the economy in general.
- (iii) Licensed capacity should be defined in broad terms so that sufficient flexibility is available to the manufacturer for changing his product-mix in line with changes in the demand situation and technological environment.

21. There has been a welcome improvement in the Government's approach to licensing in the recent past and the criteria mentioned above are also being increasingly applied. For example, decisions have been taken to redefine licensing capacity in broad terms (i.e. broad-banding). The Licensing Committee may be asked to evolve appropriate operational rules so that the criteria we have suggested above can be applied consistently in considering all applications.

Review of Reservation for Small Scale Units

22. One important element in our industrial policy is represented by the policy of [reservation of certain industries for exclusive production in the small scale] sector. The list of items reserved for the small scale sector currently runs to over 800 industries. The [reservation of specific industrial products] for the small scale

sector in this manner has the effect of restricting investment, growth and production in certain areas. While we recognise the necessity for specific measures to protect small scale industrial investment and growth, we do not believe that this is best attained through a policy of physical reservation as it has been our experience that the policy of reservation has adversely affected the efficiency of investment, increased the cost structure of production in these sectors and has not ensured maintenance of quality standards. In the process, a large number of articles both of mass consumption and consumer durables have been reserved for the small scale sector, neglecting the economies of scale. This has gone against the other determinants of policy of providing wage goods at low prices and of expanding opportunities for gainful employment. Reservation for the small scale sector should be made more selective and based on criteria such as scale neutralities, employment potential and quality standards.

23. As for the instrument of protection, our preference would be to protect and encourage the small scale and decentralised sector through the provision of infrastructure and support facilities like supply of inputs, marketing and technical assistance etc., rather than through a policy of reservation.

24. Application of the criteria indicated above will result in the dereservation of a number of industries. The process of dereservation would however have to be gradual so as to avoid undue hardship.

Regulations to Control Monopolies

25. One of the major elements in the exercise of discretionary regulation is the operation of the MRTP Act. We recognise the need to continue with a measure of control on monopolies. Market dominance today constitutes a major determinant of the existence of monopoly conditions in an industry. This should continue to be so.

26. The MRTP legislation at present also provides for registration of industrial undertakings if their assets are Rs.20 crores and above. This level was fixed in 1969 and, taking into account the increase in prices and the growth in the industrial base, we believe it would be both desirable and realistic to raise this figure to at least Rs.75 crores. This should be reviewed as and when necessary. The Committee was informed that 1321 undertakings stood registered under the MRTP Act as at the end of 1983, the latest year for which statistics relating to their assets were available. The revision in the asset level proposed by us will bring down the number of undertakings registered under the Act from 1321, as of 1983, to 942. Correspondingly, the number of single large undertakings/monopoly houses covered by the MRTP Act will also come down from 184 to 82. It is relevant to note that even with the proposed reduction in the coverage of the MRTP Act in terms of number of undertakings/monopoly houses, the volume of assets which would go outside the purview of the MRTP Act will be less than 1/5th of the total assets of Rs.25884 crores covered under the MRTP Act as on 31.12.1983.

27. The Committee also feels that the MRTP Act should be used as a positive instrument and should seek to attract investment effectively into priority areas instead of merely functioning as a form of negative control on large houses. At present, there is a limited list of industries notified under section 22A of the MRTP Act, where the MRTP undertakings can invest without the requirement of an MRTP clearance. We recommend that this list may be suitably enlarged to include industries satisfying some well defined criteria viz. requirement of large investment and involvement of high technology and high risk.

Towards non-specific, non-discretionary controls

28. The Committee believes that the recommendations made in the preceding paragraphs would have the effect of significantly [reducing the area of discretionary controls over industrial investment] This will help to limit the area of physical control but [it is equally necessary that physical controls are replaced by non-specific and less discretionary fiscal and monetary instruments] We believe greater use should be made of the excise duty structure and tariff policy to protect either specific industries or industrial sectors such as the small-scale sector and also to discourage or even prevent the flow of resources into low priority industries. Preferential credit facilities in terms of interest rates, maturity periods, non-stipulation of convertibility clause, relaxation of promoters' contribution norms, etc., can also be considered as measures to redirect investment into preferred industrial sectors, or backward or no-industry areas. While we advocate a more meaningful application of financial instruments we would also like to sound a note of caution against overburdening the administration of the fiscal and credit systems by excessively detailed specification of incentives and disincentives.

(M. Narasimham)
CHAIRMAN

(Y.K. Alagh)

(M.Datta Chaudhuri)

(I.S. Gulati)

(Bimal Jalan)

(S.S. Nadkarni)

(M.R.B. Punja)

(K.V. Ramanathan)

(C. Rangarajan)

(A. Sengupta)

(.S.S. Sidhu)

(C.G. Somiah)

(A. Bagchi)
Member Secretary

New Delhi
January 24, 1985.

[Dr. Y.K. Alagh is out of the country. Dr. I.S.Gulati and Dr.C. Rangarajan could not sign the report but they agree with the recommendations]

ANNEXURE-I

TERMS OF REFERENCE OF THE COMMITTEE

- (a) To examine the principles involved in a possible shift in using the banking and investment financing systems for achieving socially desirable results in this respect in our policy from physical controls to financial controls with a view to streamlining the control system and improving its efficiency, and
- (b) Any other matter which may be relevant to the consideration of (a).

ANNEXURE-II

LIST OF MEMBERS

1.	Shri M. Narasimham, Principal, Administrative Staff College, Hyderabad.	:	Chairman
2.	Dr. Y.K. Alagh, Chairman, Bureau of Industrial Costs & Prices, New Delhi.	:	Member
3.	Prof. M. Datta Chaudhuri Delhi School of Economics, University of Delhi, Delhi.	:	Member
4.	Prof. I.S. Gulati, Centre for Development Studies, Trivandrum.	:	Member
5.	Dr. Bimal Jalan, Special Secretary & Chief Economic Adviser Ministry of Finance, New Delhi.	:	Member
6.	Shri S.S. Nadkarni, Chairman & Managing Director, Industrial Credit & Investment Corporation of India Limited, Bombay.	:	Member
7.	Shri M.R.B. Punja, Chairman, Industrial Development Bank of India, Bombay.	:	Member
8.	Shri K.V. Ramanathan, Secretary, Planning Commission, New Delhi.	:	Member
9.	Dr. C. Rangarajan, Deputy Governor, Reserve Bank of India, Bombay.	:	Member
10.	Dr. A. Sengupta, Special Secretary to the Prime Minister, New Delhi.	:	Member
11.	Dr. S.S. Sidhu, Secretary, Department of Industrial Development, Ministry of Industry, New Delhi.	:	Member
12.	Shri C.G. Somiah, Secretary, Department of Company Affairs, Ministry of Law, Justice & Company Affairs, New Delhi.	:	Member
13.	Dr. A. Bagchi, Officer on Special Duty, Department of Economic Affairs, Ministry of Finance, New Delhi.	:	Member-Secretary

FINAL REPORT

April 1985

**M.NARASIMHAM
CHAIRMAN**

**COMMITTEE TO EXAMINE THE PRINCIPLES
OF A POSSIBLE SHIFT FROM PHYSICAL
TO FINANCIAL CONTROLS**

New Delhi, the 17th April, 1985.

Dear Mr. Finance Minister,

I have pleasure in submitting the second and Final Report of the Committee to Examine the Principles of a Possible Shift from Physical to Financial Controls.

We have, after due deliberation, kept this report brief as we did with our first report on industrial licensing and have confined our attention to policy recommendations. We intend to put out later an annexure to the report which would contain the results of our review and analysis of the issues involved. These reviews and analysis served as a background to the recommendations we have made.

The other members of the Committee and I would like to place on record our deep sense of appreciation of the contribution made by our Member-Secretary Dr. A. Bagchi to the discussion and the drafting of the Report. He brought to bear on his work his considerable knowledge of the issues we were asked to consider. We would also like to place on record our appreciation of the assistance we received from Shri R. Nangia and the painstaking work done by our Secretariat. Services rendered by Shri Rakesh Kumar and Shri K.R. Phanda deserve special mention. The Secretariat for Industrial Approvals and the Department of Company Affairs extended their full cooperation and provided all necessary information. To the IDBI, ICICI and the staff of the Economic Division of the Department of Economic Affairs who provided considerable secretarial and logistic support we owe a special word of thanks.

Yours sincerely,

Sd/-

(M. Narasimham)

FINAL REPORT

The Committee had submitted a report in January this year indicating its basic approach and rationale and covering the areas of industrial licensing and related MRTTP aspects. In this second and final report we give our views and recommendations regarding four other important areas of administrative controls viz., control over capital goods imports, foreign collaboration approval, capital issues control and exchange control.)

Capital Goods Imports

2. India has during the last quarter century built up an impressive base for manufacturing a wide variety of capital goods. As a result, the country has attained a degree of self-reliance in this important area which is high by any reckoning and remarkably so for a developing country. The various studies and surveys conducted in recent years on the performance of the domestic capital goods industries reveal that in several lines they are efficient. Many of the units can produce at reasonable cost, in terms of domestic resources, products of good quality. Some of the Indian manufacturers of capital goods are in fact doing well in foreign markets where the competition from established suppliers from industrialised countries is severe.

3. Notwithstanding this, the general picture is one where the growth of our capital goods industry has taken place largely within a highly restrictive and protected environment which is reflected in high prices, in indifferent quality, and often in dated technology. The performance of several Indian firms producing capital goods has thus lagged behind their counterparts in advanced countries or even the newly industrialising countries in important respects viz., technology, quality and ability to fabricate equipment according to the specification of customers as well as provision of after-sales service. In the production of a number of capital goods we are not efficient in terms of domestic resource cost. Part of the inefficiency of the capital goods sector is attributable to the protective environment created through physical quantitative controls.

4. Restriction on import of capital goods is primarily intended to protect the domestic capital goods industries. There is no question that protection has, in our condition, a strong rationale, but in the case of capital goods protection through quantitative restrictions creates problems of its own. This is mainly because capital goods are highly heterogeneous; no two producers supply identical equipment. In the face of such quality variations it is very difficult to administer a regime of quantitative restrictions rationally. Any attempt to administer quantitative restrictions with respect to highly heterogeneous commodities such as capital goods could

introduce distortions in the domestic economy whose magnitude is difficult to determine. Since these distortions are introduced through producer goods they have a more lasting and damaging impact on the entire industrial structure. We are, therefore, of the view that going by the logic of rational choice, price-based control on the import of capital goods is superior to quantity-based controls. We accordingly recommend that as a general principle the system of regulation of capital goods import through quantitative restrictions should be replaced by tariff.

5. However, switching over from quantitative restrictions to tariff protection at one go may cause widespread disruptions in the domestic capital goods industry. It is, therefore, necessary to evolve a policy for a structured adjustment process. For this purpose it is necessary to distinguish between industries or products in which we have an advantage and those in which no such advantage exists. Studies show there is a wide range of products which have come of age and can face competition. These can be put on tariff without any difficulty and the tariff level need not be high. It would however be necessary to identify such products carefully and a process of trial and error may have to be gone through to put them on tariff. But there are a few industries in which, for historical reasons, we have been operating rather inefficiently behind a protective wall, and these may not be able to survive international competition even with reasonable tariff protection. In the case of these industries, a prudent policy would be to put them on notice that quantitative restrictions would be replaced by tariff over a phased period, but in the interim retain quantitative restrictions in order to determine the required tariff structure and other measures necessary for making them efficient producers over time.

6. We can identify another group of capital goods producing units which can survive without very high tariff protection provided they are freed from the impact of negative protection. The most obvious example of such negative protection is where the cost of raw materials and intermediates, which constitute the inputs for these capital goods industries, are well above international prices due to remediable factors. This type of negative protection could arise from domestic taxes, pricing and industrial policies. In their case, if quantitative restriction is to be replaced by tariff it would be necessary to take care of the negative protection they are subject to now. These industries and also industries which are of crucial importance to the economy may be put on tariff and the tariff level lowered gradually as and when their handicaps by way of negative protection through high prices of inputs are removed. With the gradual move towards a more competitive regime, it should be possible to remove the handicaps of capital goods producers arising from high prices of essential inputs like steel and replace the quantitative restrictions with reasonable tariff. For industries which can be taken off quantitative restrictions and put on tariff, but may not be able to withstand the change immediately, we may have to provide a high level of protection initially but it should be understood that such

high tariffs would be a transitional measure and the level brought down over a stipulated period to reasonable levels. For others which are efficient and in a position to face international competition, the level of duty should not exceed a nominal rate of say, 25 per cent.

7. For strategic and defence related industries quantitative restrictions may have to remain, so that the country acquires domestic capacity for production.

8. Apprehensions have sometimes been expressed that a change-over from quantitative restrictions to tariff may affect revenue. This cannot be the case unless quantitative restrictions are replaced by prohibitively high tariff. In fact, with the level of imports remaining unchanged, any switch to tariffs should lead to a revenue gain.

9. Arguments are some times put forward against replacement of quantitative restrictions by tariff on the ground that this will lead to price rise by raising the cost of capital. This too would ordinarily not happen if the tariff replacing the quantitative restrictions mops up the economic rent which the licensed capital goods importers enjoyed.

10. However, in the case of non-competitive imports, tariff certainly would raise the cost of capital in the user industries. There are many persuasive arguments why indirect taxes (tariff or excise) should not be levied on intermediate and capital goods. Hence we recommend that tariff on non-competitive imports should not be substantial. There may be a case for retaining some duty on imports of such capital goods to correct the distortion which may result from labour-saving nature of capital goods produced in advanced countries. "Non-competitive" in this context should be interpreted to include those which the country is unlikely to produce in the near future. However, what is non-competitive today may become competitive in the future. Therefore, the argument for protective tariff may be extended to industries where domestic production possibility is likely to come up in the near future. Units going into production of new product or products in which the country had no capability earlier would need high level of protection initially but the protection should be strictly time bound and be phased down.

11. In sum, we believe that as a general rule the protection to be given to capital goods industries should be through tariff but that the transition to a system of tariff must be phased depending on the character of the particular capital goods industry. Accordingly, we recommend:

- (i) In future, new industries should ordinarily be given protection through tariffs, except in special circumstances;
- (ii) All existing industries should be divided into three categories:
 - (a) those which can go immediately on to a tariff regime, assuming that the maximum tariff rate does not go beyond say, 150 per cent;

- (b) those which can come under category (a) above with suitable changes in the duties on Intermediate inputs; and
- (c) those which would remain under quantitative restrictions for the present.

Foreign Collaboration

12. The policy with regard to foreign collaboration and foreign investment is best viewed in the context of policies concerned with the import and induction of foreign technology into the country. It is no longer necessary in all cases that foreign technology should come along with foreign investment as the finance and technology package is "unbundled". Foreign collaboration and investment are concerned in the main with transfer of technology and know-how and also the philosophy of design or what is sometime referred to as the know-why of the technology. This covers the area of disembodied technology, or to vary the metaphor, technological software as distinct from technological hardware represented by capital goods imports. We have dealt already with the subject of capital goods imports policy and in this section confine our review and recommendations to policies with respect to foreign investment and foreign technical collaboration.

13. It is recognised that a major factor underlying the inefficiency and high cost structure of Indian industry is the slow pace of technological progress. Continuous upgradation of technology which is crucial to growth and industrialisation, has not come about in many areas, either through import of foreign technology or indigenous development and adaptation of whatever has been imported or both. Foreign technology import may have been constrained partly by policies regulating foreign investment and technical collaboration and partly because of internal market structure (lack of competition), as well as international factors like reluctance of the dominant foreign firms to share their technology with importers in developing countries.

14. While our aim has been and should be, as far as possible, to foster our capability to adapt and develop technology on our own, which a totally unrestrained flow of foreign technology may hinder, there is no way of keeping pace with the tremendous progress which is taking place in science and technology without a satisfactory arrangement for ensuring the flow of recent technology from abroad. Therefore, import of technology has to be provided for in important areas and in a manner which will help indigenous capabilities to develop and adapt in greater measure than has taken place so far. It is with these objectives in view that we review the policies in regard to foreign investment and foreign technical collaboration.

15. As regards foreign investment policy, we see no reason to suggest any change either in the content of the policy or for that matter in the procedures pertaining to foreign investment approvals. Our policy with regard to foreign investment is rightly selective. Once a foreign investment is allowed into the country in terms of FERA, the treatment of the concerned enterprise is rightly totally non-

discriminatory and the same regulations or concessions that apply to Indian Industry apply also to those units which have foreign investment in them according to the provisions of the FERA. Foreign investment, in turn, is allowed only where we feel that the technology is not likely to be available otherwise and, furthermore, is restricted to areas where the technology is highly sophisticated or where there is scope for export expansion. The policy has worked well and we do not see any need to suggest any changes in this regard. The present procedures also do not, in our view, call for much change, especially in the light of the recent move towards liberalising the procedures by enhancing the threshold of cases for reference to the Cabinet Committee on Economic Affairs.

16. It is, however, in the areas of foreign technical collaboration and the system governing its approvals that we believe there is considerable scope for relaxation without any sacrifice of the basic objectives of our policy. At present foreign technical collaboration proposals have to be submitted to the Foreign Investment Board (FIB) through the Secretariat for Industrial Approvals. The applications are reviewed by a Technical Evaluation Committee (TEC) whose recommendations are then placed before the Foreign Investment Board. In examining the proposals, the TEC in turn pays attention to the indigenous angle, the small-scale angle, and the need to avoid repetitive import of technology. Though the process of examination of proposals leading to their consideration by FIB has been streamlined and the time shortened, there are still avoidable delays. The FIB itself follows norms relating to the fixation of lumpsum and royalty payments, the latter in turn varying, depending upon whether the products are meant for domestic or export sales. It is also our observation that in the majority of cases, foreign collaboration proposals are approved as long as they are within the parameters relating to lumpsum and royalty payments. Thus in the last three years, out of a total of 1752 proposals submitted to SIA as many as 1228 (or 70% of the total number of applications) were cleared, and 430 rejected by FIB. A further 92 applications were disposed of by administrative Ministries under powers delegated to them.

17. We have given careful consideration to the present system and procedures and believe that the objectives in view can be obtained through simplification of the procedures. We thus feel that there is no need for prior reference of proposals to the FIB as long as they conform to the stipulated guidelines in relation to lumpsum payments and royalty payments, and as long as lumpsum payments in any single proposal does not exceed Rs. 50 lakhs and royalty payments in any year do not exceed Rs. 20 lakhs. Where the estimated lumpsum/royalty payments exceed these limits, prior reference and approval would continue to be required as at present.

18. Furthermore, we believe that in the system we envisage, where the lumpsum/royalty payments are within the stipulated guidelines and within the threshold

limits mentioned above, they should be taken on record by the concerned administrative ministry and deemed to have become effective as soon as the concerned administrative ministry notifies that it has been taken on record. We would suggest that the concerned administrative ministries should periodically publish the particulars of collaborations taken on record. The administrative ministries, would doubtless keep the Reserve Bank of India and Ministry of Finance informed. At the same time, in order to help promote proper absorption and adaptation of imported technology and to give a fillip to indigenous R&D and development of indigenous technology, all proposals, including those not requiring prior approval, should contain plans for proposed R&D activity so that the import of technology would not be at the expense of development of indigenous technology. Proposals involving payments aggregating to relatively small amounts need not be subjected to this requirement.

19. In suggesting these changes we believe that Government should also notify a list of industries such as certain kinds of light consumer goods industries, where technological superiority cannot be established but brand name loyalty provides market power to well-known international producers. Foreign technical collaboration should not be permitted in such industries under normal circumstances. If any proposal for foreign technical collaboration in this normally banned list is made, it would have to be referred to the FIB, which would need to make the acceptance of the proposal an exception with adequate reasons. For instance, we could conceive that such an exception could be made in respect of items with export potential and where suitable export obligation is provided for the appropriately enforced.

20. As a measure of promoting indigenous technology we believe that under normal circumstances no renewal or extension of the original period of foreign collaboration should be allowed. Any proposal for renewal should be examined in the light of the progress made by the concern in building up an adequate domestic R&D effort as indicated in the plan filed at the time of initial submission to which we have made a reference above. Companies which are shown to have been able to absorb, assimilate and further develop imported technology to meet domestic requirements could be encouraged to have access to later foreign technology (and, contrarywise, those who fail to do so would not be allowed continuing access to foreign technology).

21. We have also given consideration to the problem of repetitive import of technology by permitting more than one firm to import the same technology. Even allowing for an element of product differentiation there can be no gainsaying that there is a repetitive element in foreign technology collaborations which have been approved, for example, in the light commercial vehicle industry. However, we also see that what might be, at first sight, considered to be repetitive technology imports, helps prevent emergence of monopoly or oligopoly condition and is justified as long as this is not carried to the extreme of free import of such technology. This is all the more necessary in respect of low priority areas.

22. Export commitments are an important element in many collaborations. Our experience with regard to export obligations is, in general, that these have rarely been well formulated or enforced and have remained obligations on paper. Sometimes failure to comply with obligations has entailed a rupee penalty on the companies which have defaulted. This has not proved a sufficient deterrent. We, therefore, suggest that consideration be given to enforcing effective sanctions in this regard. This could conceivably take the form of stipulating that non-fulfilment of earlier export obligations would be taken into account whenever fresh proposals for foreign collaboration involving either the Indian company or the foreign collaborator are considered.

23. The Committee thus believes that the various measures taken of late to liberalise controls on industrial investment and production, including the delicensing of certain industries and the move towards a less restrictive trade regime, would increase competition from both within and also from the international sector, and provide a strong impetus to Indian industries for technological upgradation - both in respect of production processes and products. The Committee's recommendations with respect to the policy on foreign collaboration approval are aimed at encouraging this process further.

Capital Issues Control

24. First introduced as a war-time measure in 1943, capital issues control has more recently been employed for regulating the capital structure of public limited companies, bonus issues, foreign capital participation in Indian companies, and capital reorganisations, mergers and amalgamations. The main objectives underlying the control are regulating the flow of investment in the organised sector into desired areas, protecting the investment of the public, particularly small investors, preventing domination of the capital market by a few large houses and regulating the financial structure of companies. For this purpose, detailed guidelines have been issued by the Controller of Capital Issues (CCI) indicating the acceptable pattern and structure of capital. Guidelines for issue of bonus shares have also been issued and these are revised from time to time. Approval is not required by private companies, banking and insurance companies, Government companies (provided no portion of the issue is for the general public) and public limited companies, if the capital issued in a year does not exceed Rs. 1 crore.

25. The Committee felt that the operation of the capital issues control has been largely satisfactory and the disposal of applications also fairly quick. The administrative department has successfully handled the growing volume of capital issues, which have increased to almost Rs.2,000 crores from less than Rs.100 crores only a few years ago. By the end of the 7th Five Year Plan, it is expected that the capital market would be in a position to generate funds of Rs.5,000 to Rs.7,000 crores.

26. Since 1947, when the Capital Issues (Control) Act came into operation, a number of changes in the policy environment have taken place. The IDRA was

enacted in 1956 and the scheme of financing new projects is by and large looked into by financial institutions. Proposals involving foreign collaboration are now approved by the Foreign Investment Board, while MRTP and aspects of investment which form a part of the prospectus are now looked after by the Department of Company Affairs. In view of these developments, the role of capital issues control has been considerably reduced. It is in this context that the Committee considered whether there is any need for continuing with capital issues control at all and, if so, whether some alternative method of control was called for.

27. We are of the view that total abolition of control over capital issues may not be desirable in view of the need to protect small and uninformed or inexperienced investors, as well as to ensure healthy growth of the corporate sector and the capital market.

28. We also considered whether the present functions could be taken over by the financial institutions. As no large-sized project can be financed without assistance from financial institutions, it could be argued that the task of overseeing the soundness of the capital structure of a company intending to go to the market for capital is better entrusted to the financial institutions. One view was that with clearcut guidelines, the financial institutions should be able to administer the checks necessary to ensure that the guidelines are adhered to in the matter of capital issues. On detailed consideration of the matter, however, we felt that the role of financial institutions lies primarily in ensuring the financial viability of projects. There could also be a conflict of interest situation where some public financial institutions have an interest as investors in a concern. On these and related considerations, we feel it does not seem necessary or desirable to transfer the function of looking after capital issues to public financial institutions.

29. As mentioned earlier, there has been a tremendous growth in capital issues in recent years and correspondingly in the market for securities and in the number of investors. The proliferation of stock exchanges and the larger role envisaged for them in raising corporate resources, requires the continuing confidence of investors in the proper functioning of the stock and capital markets. As certain recent events have shown there are lacunae under the present system in several areas of the functioning of stock exchanges, relating, inter alia, to aspects such as insider trading, rights of minority and small shareholders in case of take-overs. We, therefore, recommend that it would be desirable to set up an independent statutory, regulatory body, clothed with adequate powers and similar in broad scope to the Securities and Exchanges Commission of the USA to safeguard the interests of the investing public.* The main function of such a Commission will be regulatory and in

* Shri Nadkarni is a member of another Committee on Stock Exchange set up by Government where this matter is being considered and hence wished not to express any views on this recommendation.

three areas viz., regulation of stock exchanges, mergers and take-overs and share registration. This will be a quasi-judicial body to regulate the functioning of the capital market in these areas, while the function of overseeing the enforcement of regulations regarding capital issues will remain with CCI. This will enable the CCI to perform the promotional role in developing the capital market, as at present.

30. We also feel that in order to liberalise the capital market further, and keeping in view the growing size of the new issues market, the exemption limit for obtaining prior approval for issue of capital may be raised in the first instance to Rs. 3 crores in any year from the existing threshold of Rs. 1 crore.

Exchange Control

31. Exchange control is administered by the Reserve Bank of India in accordance with the general policy laid down by Government in consultation with the RBI. The important areas which are regulated by Exchange Control include (a) all dealings in foreign exchange and maintenance of balances at foreign centres; (b) procedure for realisation of proceeds of exports; (c) payments to non-residents; (d) transfer of securities between residents and non-residents; (e) foreign travel; and (f) trading, commercial and industrial activities in India of foreign firms and companies (including branches of foreign firms and companies) and foreign nationals.

32. The Reserve Bank does not deal in foreign exchange directly with the public. The day-to-day business of buying and selling foreign exchange is handled by the Foreign Exchange Departments of Commercial Banks. The RBI has licensed certain scheduled commercial/cooperative banks to deal in foreign exchange, known as authorised dealers.

33. An Expert Committee was set up in 1982 under the Chairmanship of Shri M.S. Patwardhan to review the Exchange Control Regulations and procedures relating to exports and imports and suggest measures for simplification. The Committee made a number of recommendations on a wide range of topics which have been accepted by RBI for implementation. As a result of the Committee's recommendations, additional or new powers have been delegated by Reserve Bank to Authorised Dealers in order that exporters and importers are able to obtain necessary services in the area of foreign exchange and exchange control from their own bankers as far as possible instead of having to approach the RBI for various types of approvals.

34. Replies received in response to the Committee's Questionnaire show that the system of Exchange Control needs further procedural reform. We understand that a Group has been set up recently under the Chairmanship of Shri A. Ghosh, Deputy Governor, Reserve Bank of India, to go into the question of further reform of Exchange Control Regulations. In view of this, we would not like to go into the details of the working of foreign exchange regulations. However, there is reason to

think that the present procedures are in many cases needlessly onerous and there is considerable scope for delegation. Specifically, we would recommend the following for the consideration of the Government:

- (i) In cases where Government approval has already been obtained for foreign loans, investment or technical collaboration, there should be no need to go to the RBI for remittances of interest dividends or royalties so long as there is no deviation either from the contractual agreement or from the accepted guidelines;
- (ii) Greater degree of delegation of authority may be allowed in release of foreign exchange for purposes of education, health etc., and
- (iii) Under the foreign travel scheme, at present, a visitor is allowed US \$500 once in two years. The scheme may be modified to the extent that a visitor may be allowed US \$ 250 in a year subject to a maximum of US \$ 1000 at a time for a block of four years.

35. We do not recommend any liberalisation at this stage in the content of foreign exchange control, as distinct from procedural reform as we believe the balance of payments situation of the country is entering a difficult phase. Any liberalisation in the content of control may appropriately be considered as the situation with regard to external payments eases

Concluding Remarks

36. The Committee was set up to examine the possibility of shifting our regulatory system away from physical controls to financial or fiscal controls. After careful examination, the Committee has recommended that in a fairly wide area of production and trade the present system of quantitative controls (e.g. licensing of investment and imports) should be replaced by indirect controls (viz., taxes and subsidies). One of the important reasons why our regulatory system is in need of reform is that the licensing system has tended to obstruct the play of competitive forces in our industrial economy by creating innumerable barriers to entry. The Committee feels that in the current phase of our industrial development, a greater measure of competition within the domestic economy and greater exposure to international competition are important in order to develop cost and quality consciousness among our industrial producers.

37. However, it is important to remember that the logic of the reform goes far beyond the mere replacement of one set of controls by another. Over the years, our industrial producers have got used to having their markets almost fully protected by licensing rules covering investment and import trade. A meaningful reform designed to introduce some measure of competition must necessarily help the efficient firms and hurt the inefficient ones. The success of this reform will, therefore, crucially depend on the extent to which the necessary adjustments in the institutional and organisational structure can take place in an orderly fashion. Hence the overall policy environment must be consistent with the supportive of the desired changes in

our industrial organisation. There are three areas which are of particular significance in this context:

- (i) An industrial economy is an interdependent structure through input-output linkages. Profitability in any line of production depends not only on the controls affecting it directly, but also on those affecting other industries which have interindustrial linkages with it. Therefore, the system of indirect taxes (excise, tariff etc.) and subsidies have to be mutually consistent in any system of indirect taxation.
- (ii) The real justification for introducing a greater measure of competition is that it will make for efficiency by penalising inefficient firms and rewarding the efficient ones. Hence some bankruptcies, closures and lay-offs will perhaps be an unavoidable component of any system promoting greater competition. Therefore, if one arm of policy is to promote competitive conditions, while another part tries to bail out inefficient and sick units, then the reforms proposed cannot be effective. Some compromises in certain situations may be unavoidable in any democratic society and the possible gains in efficiency may have to be sacrificed or deferred for other economic and social considerations. Nonetheless, the overall thrust of economic policies should be the elimination of wasteful use of resources.
- (iii) An essential aspect of competition in a modern industrial economy is managerial competition, which implies, among other things, take-overs and mergers. The operation of the overall mechanism governing take-overs and mergers and the discharge by the financial institutions of their functions in this regard, should be guided primarily by objectives of efficiency.

(M. Narasimham)
Chairman

(Y. K. Alagh)

(M. S. Ahluwalia)

(M. Datta Chaudhuri)

(I. S. Gulati)

(Bimal Jalan)

(S. S. Nadkarni)

(M. R. B. Punja)

(K. V. Ramanathan)

(C. Rangarajan)

(C. G. Somiah)

(S. D. Srivastava)

(A. Bagchi)
Member-Secretary

LIST OF MEMBERS

- | | | |
|-----|---|----------|
| 1. | Shri M.Narasimham,
Principal,
Administrative Staff College of India,
Hyderabad. | Chairman |
| 2. | Dr.Y.K.Alagh,
Chairman,
Bureau of Industrial Costs & Prices,
New Delhi. | Member |
| 3. | Shri M.S.Ahluwalia,*
Additional Secretary to the
Prime Minister,
New Delhi. | Member |
| 4. | Prof. M.Datta Chaudhuri,
Delhi School of Economics,
University of Delhi,
Delhi. | Member |
| 5. | Prof. I.S.Gulati,
Centre for Development Studies,
Trivandrum. | Member |
| 6. | Dr. Bimal Jalan,
Secretary (Banking) and
Chief Economic Adviser,
Ministry of Finance,
New Delhi. | Member |
| 7. | Shri S.S.Nadkarni,
Chairman & Managing Director,
Industrial Credit and Investment
Corporation of India Limited,
Bombay. | Member |
| 8. | Shri M.R.B.Punja,
Chairman,
Industrial Development Bank of India,
Bombay. | Member |
| 9. | Shri K.V.Ramanathan,
Member-Secretary,
Planning Commission,
New Delhi. | Member |
| 10. | Dr. C.Rangarajan,
Deputy Governor,
Reserve Bank of India,
Bombay. | Member |
| 11. | Shri C.G.Somiah,
Secretary,
Department of Company Affairs,
Ministry of Industry and Company Affairs,
New Delhi. | Member |

12. S.D.Srivastava,+
Secretary,
Department of Industrial Development,
Ministry of Industry and Company Affairs,
New Delhi.

Member

13. Dr. A.Bagchi,
Officer on Special Duty,
Department of Economic Affairs,
Ministry of Finance,
New Delhi.

Member-Secretary

* Vice Dr. A.K.Sengupta

+ Vice Dr. S.S.Sidhu