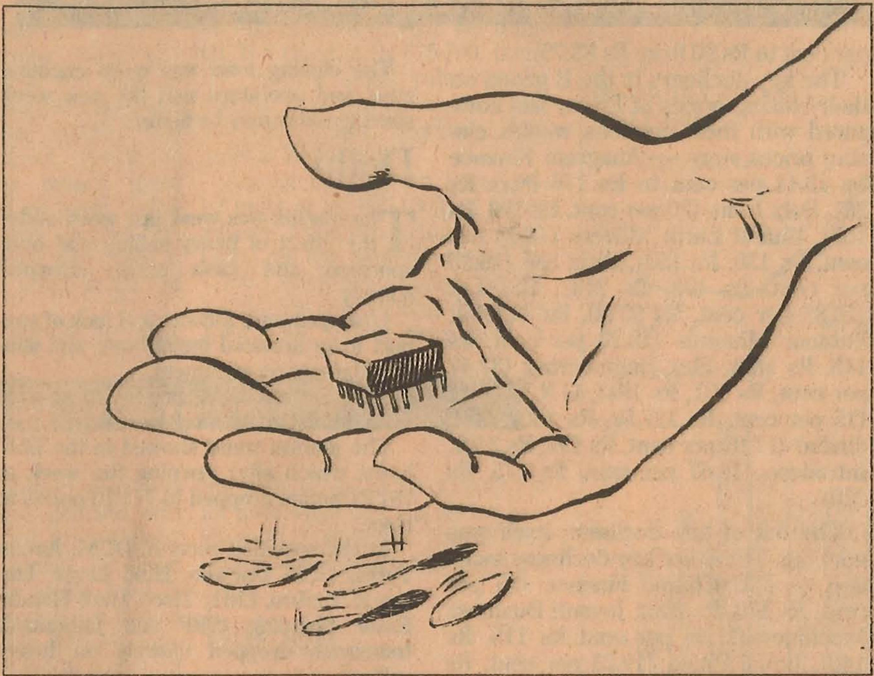
Chip off the old block?

The BJP's call for curbing foreign investment in consumer goods harks of the licence-raj, says ***Bharat Ramaswami***

Illustration by R PRASAD



The Bhartiya Janata Party (BJP) has once again put forward its reservations on foreign investment. Now that the BJP controls the economically powerful states of Gujarat and Maharashtra, its views demand serious attention. At its meeting in Goa, the members of its national executive agreed on a policy resolution which calls for restrictions on foreign investment in the consumer goods sector.

To illustrate the party's view, Dr Murli Manohar Joshi explained that while India needs foreign investments in "high-tech" industries like computer chips, the country should turn away foreign interest in "low-tech" industries like potato chips.

The notion that economic policies should differentiate between consumer goods and others is an old one. The pre-1991 governments singled out consumer goods for special attention. Under the old regime of industrial licensing, investment in consumer goods was not something to be encouraged. Approvals were granted, but grudgingly and to a select few. Foreign investment was restricted by disallowing majority stake and forced dilution of equity in favour of Indian owners.

Indeed, Hindustan Lever escaped this fate only by pointing to its investments in bio-technology and its exports. The other leg of these policies was the emphasis on investments in areas regarded as important to the nation. Export obligations, promises of "high" technology, and investment in the core sectors were some of the criteria used to define importance.

To achieve the right balance of investment between the priority sectors and the consumer goods sector, the government used controls through licensing of capacities of domestic firms and preventing entry of foreign enterprises. However, by discouraging competition and by supporting inefficient firms and their army of liaison agents in ministries, these policies generated tremendous waste. The idea that the state can achieve an optimal composition of investment between priority and non priority areas gradually lost its appeal and is now discredited.

Today, due to the huge costs it imposed on the economy, industrial licensing is no more. Domestic investments are free to go into any sector. Regulations on foreign investments are also a lot less stringent. Many foreign firms, with brand names well known to Indian consumers, have either entered the market or are planning to do so. From the point of view of industrial policy, therefore, computer chips are no longer all that different from potato chips.

The economic policy resolution of the BJP differs from this outlook. Like past policies, the BJP seeks a different policy for consumer goods. The logic of past policies required, however, that restrictions on fresh investments in consumer goods be applied to both domestic and foreign investors. Although, in practice, entry into consumer goods was probably easier for domestic firms.

Where the BJP's position differs is that its economic policies would apply restriction on consumer goods investment to foreign firms alone. It is in this sense that computer chips and potato chips are pretty much the same as long as they are produced by domestic firms. However, if produced by foreign firms, these two commodities are different and therefore deserve different policies.

The view that we should not allow foreign investment in consumer goods may not be limited to the supporters of BJP alone. For instance, the sale of brandnames such as Thumps-Up and Gold-Spot to the Coca-Cola company was received with much regret and a surprising sense of loss by many, including commentators positioned at the left end of the political spectrum. The paradox here is that if Indians are genuinely attached to Thumps-Up and other brands developed locally, it would be stupid, in terms of business, for the owners of these brands, even if foreign, to extinguish such goodwill.

The BJP stand raises the important question about why we should care about foreign investment at all. According to its policy, domestic firms are not to be constrained in entering consumer goods and nor are existing firms in this sector to be regulated with respect to capacity expansion. It, therefore, seems that the BJP does not share the reservations of earlier policies about discouraging the production of consumer goods.

What is not kosher, however, are consumer goods produced by foreign firms. The view seems to be that foreign investment is desirable when it brings new technology and/or funds to projects (like in the power sector) that have problems in attracting domestic financing. Since consumer goods are "low-tech" and they can attract sufficient domestic investment, foreign investment in this sector is redundant.

The problem with this is that it takes an incomplete view of foreign investment and economic growth. Whatever be India's strategy for development, economic growth depends on the success of that strategy in maintaining a steady increase in the productivity of resources. New technology, whether generated indigenously or brought from outside, is important for this purpose.

However, productivity does not depend on technology alone. Productivity can also be increased by changes in the way production is organised. Access to such ideas is also important. Furthermore, even with the state of the art technology, a firm will not use resources efficiently if sufficient penalties for such complacency are lacking.

From the point of view of economic growth, foreign investment is attractive because it keeps the economy open to new ideas which lead to new products as well as to new ways of doing old things. The ideas include, of course, technological improvements but are not limited to them. For instance, the contribution of Maruti's vendor development policies towards refashioning the automotive components industry in India has been widely acknowledged. More generally, Japanese investments have been instrumental in creating awareness of their management styles and organisations. They have inspired Indian firms to adopt methods of quality which delegate responsibility and authority to workers. These ideas are not necessarily specific to a particular technology or sector. Nonetheless, they produce tangible increase in productivity.

Once India's accept that productivity depends on new ideas, whether relating to technology or matters relating to organisations, it is clear that a distinction between so called "high-tech" and "low-tech" industries is not a sound basis for policy. In addition, distinction will be a hard one to administer. Impressions to the contrary, marketing potato chips involves the use of new techniques in packaging and preservation, the benefits of which accrue to the entire food processing industry.

The example of packaged potato chips also points to the role that foreign investment may sometimes play in market development. Till Pepsi came on the scene, no Indian firm thought it worthwhile to market branded potato chips on a large scale. Pepsi's advertising and sales promotion created a market for this product which made entry and expansion profitable for Indian concerns. Today, Kelloggs, which is promoting breakfast cereals for the Indian diet is in exactly the same position. If successful, its efforts will have created a new market in inducing entry by Indian rivals. If unsuccessful, the costs of the efforts are borne by Kelloggs alone and not by any of the prospective Indian entrants.

Like new ideas, market development is also a public good, the chief characteristic of which is that the benefits of supplying the good are received not just by the supplier alone, other producers within the industry and in related sectors also take advantage. Government, which ought to be concerned about social benefits, should be careful not to make policies which reduce the supply of public goods from private suppliers.

Besides diffusing new ideas and creating new markets, foreign investment provides the incentives for domestic firms to be efficient, which also makes them competitive internationally. On the other hand, preventing foreign investment in consumer goods restrict competition and consumers are worse off as a result. In addition, domestic funds that would be invested elsewhere are attracted to this sector. There might of course, be specific instances, where the gains from foreign investment fail to materialise.

But does that justify a blanket ban on foreign investment in the consumer goods sector, which might deprive us of the best in management, organisation, technology and marketing? Faced with such objections, one response, which often finds favour with governments when it comes to implementation, might be the promise of a case-by-case approach. However, our experience of the last forty odd years of discretionary controls can only lead us to view such policies with nothing but the deepest misgivings.

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