Promise Belied

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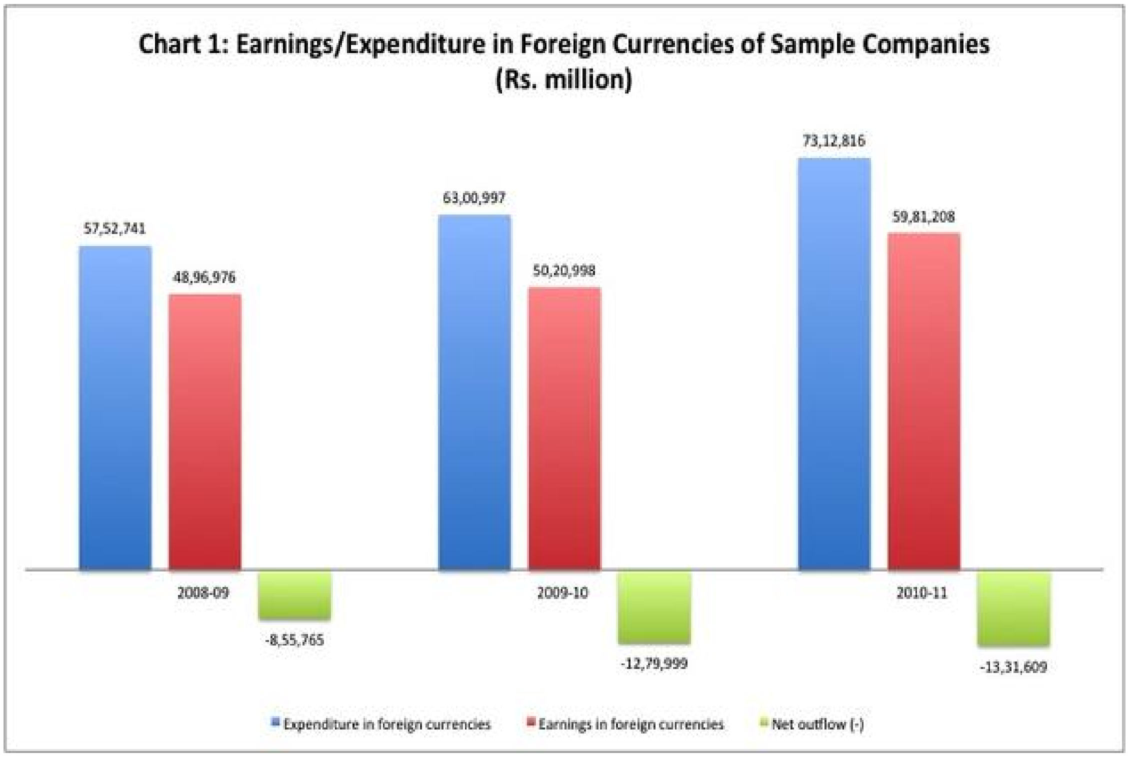
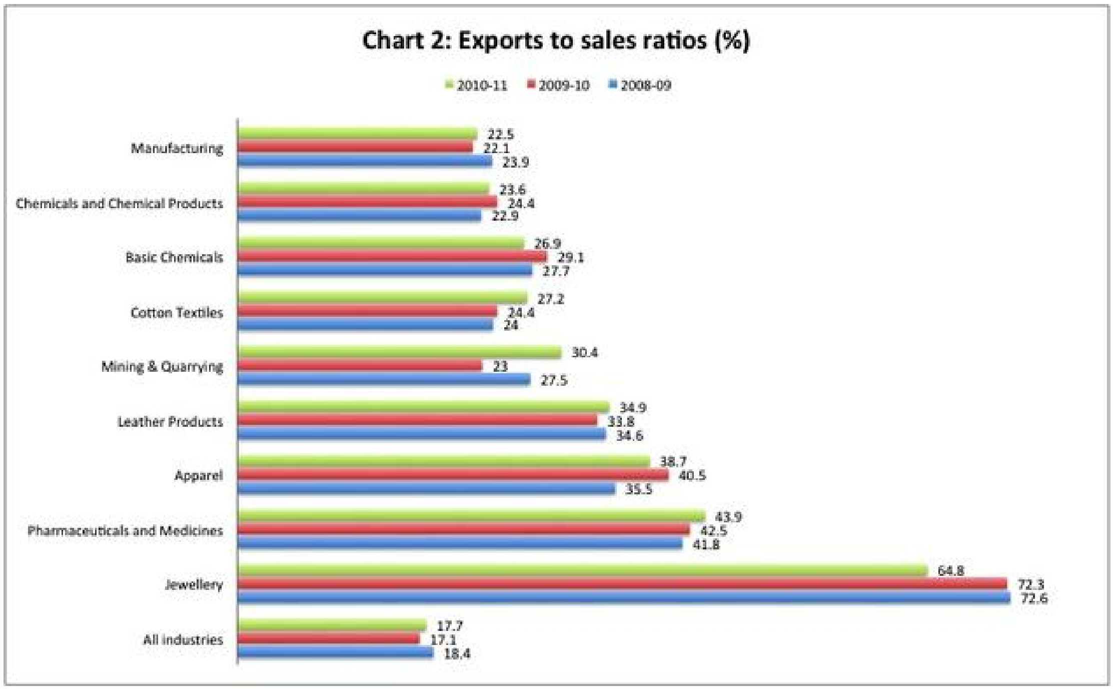
Liberalisation was expected to change the foreign exchange earning and spending behaviour of India's corporate sector. Once subjected to international competition after the removal of quantitative restrictions and the reduction of tariffs on imports, Indian firms were expected to restructure themselves to be internationally competitive. In addition, the relaxation of regulations on foreign direct investment in the context of liberalised trade was expected to attract relocative foreign capital. Foreign firms seeking to exploit India's competitive advantages in specific sectors would, it was argued, use India as a site for world market production and relocate globally oriented production facilities to the country.

As a consequence of these developments firms were expected to become more export oriented, resulting in the foreign exchange earning of the corporate sector exceeding foreign exchange spending. Because of this projected positive balance of payments effect, liberalisation was presented as a means to reduce the external vulnerability of a country that had for long relied to a significant extent on imports of capital equipment and inputs to produce for the domestic market. Unfortunately, ignoring the special case of the IT and IT-enabled services sectors this does not seem to have occurred.

The Reserve Bank of India has just released its regular survey of the finances of select public limited companies for the year 2010-11, covering a sample of 3,485 companies, and providing information on their aggregate foreign exchange expenditure and earnings. The data show that on the average, during 2008-09 to 2010-11, out of 38 industry categories (including 30 under manufacturing) only 10 were exporting more than a fifth of their output or had an export to sales ratio exceeding 20 per cent. On the other hand, all industry categories were expending foreign exchange under one head or another varying from imports of raw materials to payments of dividends to foreign investors. In the event, in all three years the aggregate foreign exchange balance of the sample companies was negative and rising (Chart 1).



One creditable feature is the fact that the 2,242 firms (out of the sample of 3.485) that were engaged in manufacturing had together recorded on average an export to sales ratio exceeding 20 per cent. Does this indicate that liberalisation is indeed making the manufacturing sector more export oriented? A look at the disaggregated data suggests that this is not true (Chart 2). Among the 10 industries with export to sales ratios higher than 20 per cent, which because of their larger sales and higher export orientation deliver the creditable aggregate record, are three groups of industries. One is the extractive Mining and Quarrying sector that was an exporter even under the earlier import-substituting growth regime. A second set of industries consists of those engaged in "traditional" manufactures, such as textiles, leather and jewellery, in which India has always had a competitive edge in trade, well before liberalisation. And finally there are a small set of more modern manufactures consisting essentially of pharmaceuticals and chemical products of different kinds.



Thus, if at all post-liberalisation restructuring and expansion has made a substantial difference to the export capacity of the large corporate sector, it would apply only to the last of the sectors mentioned. However, the evidence is clear that this is not true of pharmaceuticals and medicines, where India's strength lies in generics and off-patent products rather than products developed and controlled either by restructured Indian firms or foreign invested firms. And that strength too is the result of the pre-liberalisation policy of granting only process, and not product, patents. That allowed domestic firms to develop the capability of synthesising patented drugs through alternative process routes and offering them at a much cheaper price in the market. It is that capability that continues to be exploited after the introduction of product patents in 2005, with focus on drugs going off patent.

Despite the introduction of product patents, rather than invest in new capacities and use India as a base for world-market production, foreign firms after liberalisation decided to deal with the competition from Indian firms in the generics market by acquiring some of the big players. Thus Japanese company Daiichi Sankyo acquired India's largest drug producer, Ranbaxy, for $4.6 billion, U.S.-based Abbott Laboratories acquired Piramal Health Care for $3.7 billion and US generic manufacturer Mylan Inc acquired Matrix Laboratories. While these companies may use the acquired facilities to sustain and expand exports as more drugs go off patent, there are fears that they may reduce production in India to provide space for newer and higher-priced, patented formulations produced by the parent with similar therapeutic effects.

In sum, there is little evidence coming from the RBI's sample of medium and large public limited companies that points to an increase in the export earning capacity of the corporate sector. On the other hand, the liberalisation of imports and foreign investment rules and the larger presence of foreign firms must have increased the propensity to import of the corporate sector. That explains the negative balance of payments outcome. The promise of positive net foreign exchange earnings based on which liberalisation was partly justified has clearly been belied.

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