FDI – Making it Count for India Next Decade

Anuradha Ganesh*

E-mail: ashram.ganu@gmail.com

What is FDI

Foreign Direct Investment refers to investments made by foreign nationals in a country with the intention of gaining an interest in the said country. FDI is defined by International Monetary Fund (IMF) and Organization for Economic Cooperation and Development (OECD) as a category of cross border investment made by a resident in one economy (the direct investor) with the objective of establishing a 'lasting interest' in an enterprise (the direct investment enterprise) that is resident in an economy other than that of the direct investor. In the Indian context, 'FDI' means investment by a non resident in a company incorporated in India. Foreign Direct Investment in India is regulated under the Foreign Exchange Management Act (FEMA). "Foreign Direct Investment" is not defined under FEMA or under the Government policy. However it appears only as a head note of Schedule 1 to Notification No. FEMA 20/RB dt. 03.05.2000 (cited as Notification No. 20). In common parlance any investment which is not a portfolio investment is described as direct investment.

Therefore, any investment made in accordance with Schedule 1 can be treated as a foreign direct investment or FDI. There are two types of FDI: inward and outward. Investments into a country are inward FDI whereas investments made from the country and into other countries are

* Mulund College of Commerce, Mulund, Maharashtra, Mumbai.

ISSN 2348–0661 Print

Annual Research Journal of Symbiosis Centre for Management Studies, Pune
Vol. 1, Januray 2013 – January 2014, pp. 29–40

outward FDI. The resulting net investment is nothing but *net* FDI *inflow* (positive or negative).

FDI Across the Globe

There is a popular belief in developing economies that developed nations are only investors and therefore, FDI is received by developing nations. This is far from the reality. The United States happens to be the world's largest recipient of FDI. The primary reason for the same is that the U.S. has a fundamentally open economy and has very minimal barriers to foreign direct investment. U.S. FDI totaled $194 billion in 2010. 84% of FDI in the U.S. in 2010 came from or through eight countries: Switzerland, the United Kingdom, Japan, France, Germany, Luxembourg, the Netherlands, and Canada. Research indicates that foreigners hold greater shares of their investment portfolios in the United States if their own countries have less developed financial markets, an effect whose magnitude decreases with income per capita. Countries with fewer capital controls and greater trade with the United States also invest more in U.S. equity and bond markets.

President Barack Obama has said, "In a global economy, the United States faces increasing competition for the jobs and industries of the future. Taking steps to ensure that we remain the destination of choice for investors around the world will help us win that competition and bring prosperity to our people."

FDI in China

Also known as RFDI (renminbi Foreign Direct Investment), FDI in China has increased considerably over the last decade, reaching $59.1 billion in the first six months of 2012, making China the largest recipient of foreign direct investment and topping theUnited States which had $57.4 billion of FDI during the same period."

Foreign Direct Investment in India – The Story So Far

The evolution of Indian FDI can broadly be divided into three phases classified on the basis of the initiatives taken to induce foreign investments into the Indian economy:

The first phase, between 1969 and 1991, was marked by the coming into force of the Monopolies and Restrictive Trade Practices Commission (MRTP) in 1969, which imposed restrictions on the size of operations, pricing of products and services of foreign companies. The Foreign Exchange Regulation Act (FERA), enacted in 1973, limited the extent of foreign equity to 40% in the sectors where FDI was permitted, although this limit could be raised to 74% under certain circumstances.

The second phase, between 1991 and 2000, witnessed the liberalisation of the FDI policy, as part of the Government's economic reforms program. In 1991, as per the 'Statement on Industrial Policy', FDI was allowed under the automatic route, up to 51%,in 35 high priority industries. Foreign technical collaboration was also placed under the automatic route, subject to specified limits. In 1996, the automatic approval route for FDI was expanded, from 35 to 111 industries, under four distinct categories (Part A – up to 50%, Part B – up to 51%, Part C – up to 74%, and Part D – up to 100%). A Foreign Investment Promotion Board (FIPB) was constituted to consider cases under the government route.

The third phase, beginning 2000 and till date, has reflected the increasing globalisation of the Indian economy.In the year 2000, a paradigm shift occurred, wherein, except for a negative list, all the remaining activities were placed under the automatic route. Caps were gradually raised in a number of sectors/activities. Some of the initiatives that were taken during this period were that the insurance and defence sectors were opened up subject to a cap of 26%. The cap for telecom services was increased from 49% to 74%, FDI was allowed up to 51% in single brand retail. The year 2010 saw the continuation of the rationalisation process and all existing regulations on FDI were consolidated into a single document for ease of reference. There has been further relaxations and liberalisation more recently, in September 2012, in retail and other sectors.

Starting from a baseline of less than $1 billion in 1990, a recent UNCTAD survey projected India as the second most important FDI destination (after China) for transnational corporations during 2010–2012. As per the data, the sectors that attracted higher inflows were services, telecommunication, construction activities and computer software and hardware. Mauritius, Singapore, US and UK were among the leading sources of FDI. More recently, in September 2012, the GOI has allowed

FDI in aviation up to 49%, in the broadcast sector upto 74%, in multi-brand retail up to 51%, and in single brand retail up to 100%. The choice of allowing FDI in multi-brand retail up to 51% has been left to each state, given the huge political controversy the decision has witnessed. In the supply chain sector, the government of India had already approved 100% FDI for developing cold chain.

The question is not whether FDI is required but how do we attract the right amounts to the right sectors – an assessment of India's capital needs in key sectors.

India's $ 2 trillion economy has been growing at about 7% per annum over the last 3 years, although it has slowed down over the last year on the back of continued global uncertainty. However, focused efforts to attract higher levels of investment are required if India wants to achieve the interlinked goals of consistently over 8% p.a. GDP growth, faster manufacturing growth, greater employment and better infrastructure. It will require multiple interventions from the government and support agencies to create an attractive investment climate and raise investment levels so as to meet both the investment goals as well as the GDP growth targets.

In this context, let us examine a few key sectors, viz., infrastructure (including Power and Roads), Education and Health Care (these are essentially less sensitive in nature but are yet ones that need to grow and develop significantly to sustain economic growth and assure a decent standard of living for India's ever increasing population) and the investments that will be needed over the next few years to sustain a high rate of economic growth.

Infrastructure

Sector Facts

India has

- The fifth largest electricity generation capacity in the world
- 454 airports and airstrips
- The fourth largest rail network in the world

The Index of Eight core industries—crude oil, petroleum refinery products, coal, electricity, cement, steel, fertilizers and natural gas—having a combined weight of 37.90 percent in the Index of Industrial Production (IIP) stood at 139.5 in September 2012, according to data released by the Union Ministry of Commerce and Industry. During April-September 2012-13, the cumulative growth rate of the Core industries was 3.2 percent. The infrastructure sector accounts for 26.7 percent of India's industrial output.

The Planning Commission has projected that investment in infrastructure would almost double at US$ 1,025 billion in the Twelfth Five Year Plan (2012-17), compared to US$ 514 billion in the Eleventh Plan. Of the US$ 1,025 billion, 50 percent is expected to come from private sector, whose investment has been 36 percent in the Eleventh Plan.

According to investment banking company Goldman Sachs, India's infrastructure sector will require US$ 1.7 trillion investment in the next 10-years. Further, India needs to spend US$ 1.2 trillion by 2030 to meet the projected demand of its cities, according to a McKinsey Global Institute Report.

Power

Sector Facts

- FDI flows into power during April-August 2012 stood at US$ 315 million, according to the Department of Industrial Policy and Promotion (DIPP)
- The sector witnessed FDI inflows of US$ 1,652 million during April-March 2011-12, according to DIPP

The power sector, ranked sixth among the leading sectors of the Indian economy, has attracted US$ 4.6 billion in Foreign Direct Investment (FDI) since 2000, according to the Ministry of Commerce and Industry's Department of Industrial Policy & Promotion (DIPP). FDI in petroleum and natural gas totalled US$ 2.7 billion for the period, getting the ninth rank in foreign investment.

Effective and investment friendly policy roadmaps designed by the Government of India are increasing the liberalization of the nation's economy, especially in the energy sector. Initiatives include ambitious five-year plans for increasing installed electricity infrastructure, the New Exploration and Licensing Policy for increasing the production of oil and gas, and the nuclear sector's recent embrace of international companies to provide equipment and related services.

In recent years availability of power in India has both increased and improved but demand has consistently outstripped supply and substantial energy and peak shortages prevailed in 2009-10. This reinforces the fact that investments required in this sector need to be both huge as well as timely, so as to narrow down the gap between the demand and supply position.

Roads

Sector Facts

- The length of various categories of roads is: National Highways – 70,934 km, State Highways – 1,54,522 km, Major District Roads & Other District Roads – 25,77,396 km, Rural Roads – 14,33,577 km
- National Highways comprise only 1.7 percent of total road network of the country, but carry about 40 percent of the road traffic.
- Foreign direct investment (FDI) received in construction development (including roads and highways) sector from April 2000 to August 2012 stood at US$ 21,340 million, according to Department of Industrial Policy and Promotion (DIPP) statistics

India has about 4.2 million kilometres of road network, which is the second largest in the world. About 65 percent of freight and 85 percent passenger traffic is carried by the roads.

Further, the Government will undertake the up-gradation of around 3,700 km of national highways (NHs) under the National Highways Interconnectivity Improvement Project (NHIIP) at a cost of about US$ 4.26 billion. According to official ministry sources, this project, to be executed by the Ministry of Road Transport and Highways, would involve double laning of single-lane highways in eight states in the next three years. Currently, about 30 percent of the total NH network is still single-laned, 53 percent double-laned and 17 percent four/six/eight-laned. NHAI has completed 99.2 percent of construction work on the Golden Quadrilateral (GQ). Out of total length of 5,846 km of GQ project, 4 laning of 5,799 km has been completed.

Recently, the Yamuna Expressway, India's longest elevated highway, had been opened to traffic, slashing travel time between Delhi and Agra by almost half. Developing and upgrading India's roads will play a key role in building connectivity, faster turnaround times, and improve efficiency in transportation and in the manufacturing and services sectors, as the economy marches ahead.

Education

Sector Facts

- FDI inflows in the education sector during stood at US$ 660.93 million during April 2000-September 2012, according to the Department of Industrial Policy and Promotion (DIPP).
- According to the 2011 census, the total literacy rate in India is 74.04 percent. The female literacy rate is 65.46 percent and male literacy rate is 82.14 percent
- The country has 40 central universities, 45 technical institutes, 13 management institutes, 4 information technology institute, 6 science and research institute, 3 planning and architecture institutes, and 4 training institutions, according to the Ministry of Human Resource Development (HRD) Annual Report 2011-12

The education sector in India is evolving, led by the emergence of new niche sectors like vocational training, finishing schools, child-skill enhancement and e-learning, among others. The Indian education system, considered as one of the largest in the world, is divided into two major parts viz core and non-core businesses. While, schools and higher education form the core group, the non-core business consists of pre-schools, vocational training and coaching classes.

The higher education sector is expected to register a CAGR of 12 percent from 2008 to reach a size of US$ 31.47 billion, according to report released by Deloitte Touche Tohmatsu India titled 'Indian Higher

Education Sector: Opportunities aplenty, growth unlimited!'

The education sector in India is also considered as one of the major areas for investments as the entire education system is going through a process of overhaul, according to a report 'Emerging Opportunities for Private and Foreign Participants in Higher Education' by PricewaterhouseCoopers (PwC). The private education sector is estimated to reach US$ 115 billion by 2018, according to consulting firm Technopak.

Health Care

Sector Facts

- FDI inflow in hospital and diagnostic centres was US$ 1.4 billion during April 2000 and September 2012, according to the latest Department of Industrial Policy & Promotion (DIPP) data
- FDI inflow in medical and surgical appliances stood at US$ 570.2 million during the same period, according to the latest DIPP data

The Indian healthcare sector is expected to reach US$ 100 billion by 2015, growing at around 20 percent a year, according to rating agency Fitch. Some of the major factors driving the growth in the sector include increasing population, growing lifestyle related health issues, cheaper costs for treatment, thrust in medical tourism, improving health insurance penetration, increasing disposable income, government initiatives and focus on Public Private Partnership (PPP) models.

Further, the Indian pharmaceutical market is also set to witness medium-term growth.

Meanwhile, the Government of India has decided to increase health expenditure to 2.5 percent of gross domestic product (GDP) by the end of the Twelfth Five Year Plan (2012-17), from the existing 1.4 percent. Prime Minister, Dr Manmohan Singh also emphasised the need for increased outlay to health sector during the Twelfth Five Year Plan.

FDI Experience of Other World Economies – A Case Study with Specific Reference to China

Let us now examine how other emerging economies, including China, have approached FDI and how does India compare vis-à-vis these nations.

Comparison on FDI Policy – Key Sectors

Key Sector	*India*	*China*	*Indonesia*	*Singapore*	*Phillipines*
Real estate	Not permitted for <100 acres	100% on lease	100% on lease	100%	100% on lease
Retail trade	Single brand 100% Multi-brand 51%	100%	100%	100%	100%
Banking	74%	20% (increase at later stage up to 62% possible)	100%	100%	60%

* Most countries require the setting up of a local entity (WOS or JV) for property rights.

Source: US Commercial Service website, EDB, MIDA, Country websites.

For FDI, India is More Liberal But China is More Positive

Although there are imbalances between India's FDI policy and that of China, on an overall basis, India allows FDI in more sectors as compared to China. Also, India allows higher levels of foreign direct investment in many sectors as compared to China but our neighbour has been more successful when it comes to attracting FDI. A striking feature of China's FDI regime is its focus on agriculture and basic raw materials.

A number measures to improve India's investment environment invariably make slow progress due to a lack of sufficient consensus for immediate reforms. Here's a snapshot of how India measures up versus China on certain parameters:

Sectors in which India Permits a Higher FDI Cap

Key Sector	*India*	*China*
Mining, Oil and gas	100%	75%
Telecom	74%	49%

Banking	74%	62%
Media (print)	26%	0%
Electricity	100%	85%
Health Care	100%	85%

It is somewhat easier to set up business in India

	India	*China*
Days taken to start a foreign business	46	99
Ease of establishment index (0-min; 100-max)	76	64

But accessing land is easier in China

	India	*China*
Time to lease private land (days)	90	59
Time to lease public land (days)	295	129

And disputes are resolved faster in China

Arbitrating commercial disputes:

	India	*China*
Judicial assistance index (0-min; 100-max)	53	60

Way Forward on FDI – A Few Suggestions

Learning from the China story on FDI, the need of the hour is to create the right environment for attracting FDI in key sectors that require huge investments. We have certain inherent advantages like a detailed and well set legal system (an area where China lags behind although it is faster when it comes to disputes resolution) and we need to capitalise on the same by creating a consistent policy and a level playing field that will attract foreign investors.

We can consider suggestions that can be implemented immediately and ones that can take shape in the medium term:

- Immediate action – Sector specific initiatives to increase investment/ FDI especially in the non-strategic/less sensitive sectors
- Medium term plan – Make India a competitive destination for Investment through a stable and efficient regime of taxation, labour laws and adequate infrastructure.

Non Strategic Sectors where FDI Norms can be Relaxed

- Retail (the current announcements are discretionary at the state level)
- Real Estate and Construction
- Banking
- Tourism

Core Sectors which Need Investments to Sustain India's Economic Growth

- Power
- Infrastructure
- Education

Medium Term Recommendations

The need here is to make India an attractive and competitive destination for investments. This can be achieved only through investor friendly and stable policies. Some of the areas that need focus includes:

Corporate Tax Rates – uniform tax rates in the range of 25% to 30%.

Customs/Import Duties – up to 10% (0% within ASEAN and on reciprocal basis).

Labour Laws – not archaic and draconian but one that protects labour while achieving productivity and flexibility.

Independent Regulators – that ensures speed, transparency and a level playing field for all.

Legal System – speed of decisions and clarity in interpretation.

The creation of National Thrust Areas – where the Government removes all impediments and provides special incentives for a pre-determined time period in order to achieve a specified growth. These may include Tourism, Power and Energy, Education, Agro-processing, supply chain and Infrastructure.

Key factors driving Indian investment opportunities from an investor perspective include improved macro-economic fundamentals, increased ability to pay for infrastructure services, progress towards full cost recovery with use of efficient subsidies (the UID initiative can become a powerful tool here), gradually improving access to both foreign and domestic capital, gradually improving access to long term financing, fiscal incentives (such as tax rebates) and increasing clarity in policy and regulatory frameworks.

References

Various articles pertaining to FDI in the press, media and on Wikipedia.

Investment Strategy for India (finmin.nic.in).

Various articles published by the Overseas Indian facilitation centre (OIFC).

Getting China and India right (Anil K Gupta and Haiyan Wang).

Various Reports published by the Dept of Industrial Policy & Promotion.

McKinsey Global Institute Report.

'Indian Higher Education Sector: Opportunities aplenty, growth unlimited!' (Deloitte Touche).

Emerging Opportunities for Private and Foreign Participants in Higher Education' - PricewaterhouseCoopers (PwC).