THE HINDU Business Line

Resistance to FDI a hangover of the past

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Experience shows that large retail operators have not crowded out small businesses.

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The recent Cabinet decision to allow up to 51 per cent FDI in multi-brand retail and 100 per cent in single brand retail, subject to certain conditions, is a welcome step in cleaning up India's FDI regime and making it more in tune with the country's needs. Our FDI policy has moved hesitantly away from the licence raj mentality of protection against imagined foreign devils towards a more open and competitive environment. But much more needs to be done to free FDI policy and practice from the hangovers of the past.

In the licence-permit raj, business was subject to heavy state controls, and those who managed to operate the system got licences to operate in a highly protected environment, free from competition for their products and services. The state-controlled enterprises fattened in this environment. The hapless consumers had to put up with shoddy goods, high prices and poor services. A glaring example was the automobile sector, where consumers had to wait years to get a new car which was an outdated product.

The 1991 wave of reforms were a big leap forward in releasing the economy from the shackles of the past, though partial and undertaken under crisis conditions. FDI policy was part of this package, opening up various sectors of the economy to foreign participation. There was opposition to these changes from the Left. But the results are there for all to see — improved rates of growth, more competitive Indian industry, a world-class IT sector, more diversified exports, jump in FDI, better quality products in the markets, fall in appeal of imported products, and India's emergence as a global economic powerhouse.

FDI policy is hedged in with various restrictions. In each sector, the line Ministries' main concern was to protect their PSUs from competition. FDI policy remains sector-specific, reflecting the way this policy is fashioned. Sector-specific complicated limits and conditions on FDI proliferated, as line ministries sought to hedge in and restrict business operations of entities with FDI. The notorious Press Note 18 (abolished in 2005) was one example of an inefficient attempt to protect domestic partners. In a few sensitive sectors, the bogey of security was raised to block FDI.

Revisting the caps

Thus, our FDI policy today is riddled with caps of varying degrees, related to sectors and sub-sectors of business activity. The financial sector shows this particularly clearly. The foreign investor needs a specialist to navigate these shoals. The caps of 26, 51, and 74 per cent arise from our corporate structures, related to the decision-making power of the foreign partner to veto, control, and veto override, respectively. With changes in company laws, these caps may need to be revisited.

The Foreign Investment Promotion Board (FIPB) considers FDI proposals that do not come under the automatic route. Even so, many applicants seek FIPB approval as the applicability of the automatic route may not be entirely clear. In the Board, quite often, line ministries oppose or restrict proposals simply because they may lead to competition or impact on the prospects of PSUs under their control.

The healthy and balanced development of the sector is not promoted. With the setting up of independent regulators in many sectors, the conflict of interest between ministries engaging in business via PSUs and regulating the sector has

been removed to some extent. Regulatory agencies could set limits to FDI, if necessary. This would lead to healthy competition.

A vexed issue

Another issue is the question of FDI in kind rather than in cash. The foreign partner may contribute with technology, equipment, or know-how in return for equity. Indian FDI policy is rather inflexible and only financial flows count towards FDI. It is for the business partners to develop the most suitable form of business collaboration, whether it involves financial stake, technology or equipment, or a mix.

The issue of FDI in retailing has been a vexed one. Large retail businesses might put out small shopkeepers, it is argued. But this issue arises, irrespective of whether the large retailer has FDI or not. Large retailers offer economies of scale, can expand markets, introduce products, create jobs and, with backward integration, can yield better value for small suppliers and help them upgrade quality, and give consumers more choices. Experience shows that large retail operators have not crowded out small businesses. The recent decision to allow more FDI in retailing will provide new opportunities and benefits. However, there should be healthy competition between large domestic retailers and those with FDI. Imposing socially-desirable conditionalities only on large retailers with FDI will result in unfair competition.

Security concerns

Security is also an issue whenever a sensitive project is involved. Threats to security can arise from foreign as well as domestic entities. Therefore, it would be better to address security concerns by requiring appropriate clearances for all entities involved in a sensitive sector or activity. Trying to address security by putting limits on FDI or by country origin of FDI will not be effective. The FDI policy should be based on economic needs of the sector and delinked with the security issue, which should be handled separately.

For example, given India's ambitious nuclear power programme, it is appropriate to consider allowing FDI and private sector participation in this sector as has been done in many countries.

(The author is a former Ambassador of India and has been a member of the Foreign Investment Promotion Board.)

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