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Pull out all the stops on FDI

BHASKAR BALAKRISHNAN

Too many strings attached to foreign investment in retail

There can be no 'defence' for the current curbs.

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The government's current review of foreign direct investment (FDI) policy is timely, and urgently needed to revive the flagging economy. FDI policy must boost growth, especially of high-tech sectors, to make India globally competitive.

Restrictions on FDI should be minimal, and treatment of foreign investors should be on par with their domestic counterparts, except for reasons of national security. India's FDI policy is still riddled with unnecessary restrictions, mostly seeking to protect Indian business from FDI-led competition. In a globalising world, such protection is self-defeating; it can neither encourage global competitiveness nor meet the growing expectations of consumers.

FDI inflows into India have increased, but are still far below their true potential. Emerging economies such as China, Brazil and Russia are doing much better. India will have to compete with other economies to attract FDI. While FDI has recently been allowed for multi-brand retail, it is subject to many restrictions that seek to protect small retailers and do not encourage them to upgrade their services.

Frequent assessment

FDI policy sets caps on investment in different sectors. In many sectors 100 per cent FDI is allowed, but there are caps of 74 per cent, 49 per cent, and 24 per cent. The intention of fixing such limits is to restrict the degree of management control of the foreign investor over the joint venture. Ministries advocate these limits to protect their PSUs from competition — a clear conflict of interest with their role in promoting the healthy and balanced growth of a sector.

FDI can be for setting up new businesses (greenfield projects) or for investing in existing businesses (brownfield projects), including mergers and acquisitions (M&A). The former is highly desirable as it contributes to growth, technology advancement, jobs and competitiveness. The latter may result in diminished competition and loss of jobs — a risk that must be safeguarded against. Such assessments should be made by regulatory bodies such as the Competition Commission.

For greenfield projects that bring in high technology, sectoral caps should be done away with and 100 per cent FDI should be allowed. In other cases, sectoral caps should only be set to prevent unfair competition or restrictive business practices, especially where FDI is used for mergers and acquisitions.

Our policy focuses on FDI through financial transfers. However, FDI can also be in kind, through inputs of high technology and capital equipment for a joint venture. FDI in kind should be permitted, especially for high-tech industries, as is the case in South Korea and China. This would encourage companies and high tech entrepreneurs to set up high tech operations to India.

Some sectors badly need opening up. There is a good case for allowing 100 per cent FDI in Defence industries. India imports over 75 per cent of its Defence equipment. It makes sense to allow foreign companies to set up Defence industries in India that could not only meet the country's needs but also enable it to become a supplier of products and components, as has been the case with the auto industry.

Another sector that requires huge investments and technology is nuclear power. Opening up this sector to FDI will bring in foreign partners with investment, technology and fuel supply assurances. It is better if the foreign partner becomes an investor, rather than remain a mere supplier of equipment, as a stakeholder can contribute better to making the plant work efficiently. In addition to FDI, a partner can bring in the best international practices for plant safety and security. India cannot implement its ambitious nuclear power programme with just domestic capital.

Security concerns

There are some valid concerns about national security when foreign entities are involved. This should be dealt with by listing out the sensitive business areas. Security guidelines need to be notified for such activities, covering personnel and physical assets. These should then be strictly applied to all entities carrying out listed sensitive business activities, even if no FDI is involved.

Focusing exclusively on foreign management control via FDI can leave many loopholes in security. Moreover, the security clearance process has to be periodically repeated as personnel and business operations may keep changing. For example, the US government has uniform and elaborate security procedures for all entities that do business with it.

Besides FDI, policy action is needed on business facilitation and taxation to stimulate investment. The business environment needs to be simplified and made more investor-friendly, so that FDI intentions are converted into actual business without delays.

Even if comprehensive, FDI policy reform cannot be carried out in isolation and without reference to reforms in other areas, as these contribute jointly to the investor's perception of the economy. We need to consider reforms in the tax system to make our investment climate competitive with those of other emerging economies.

The feasibility of reducing the capital gains tax (20 per cent) needs consideration, with deep cuts especially for high-tech greenfield projects. Corporate tax at present compares unfavourably with the Asian average of 22 per cent. A reduction here would certainly stimulate investment and the capital market, boosting the economy. Tax reductions for hi-tech greenfield projects would also give sectors such as infrastructure a leg up.

(The author is a former Ambassador of India. He has participated in the FIPB, FIIA, and has worked for UNIDO.)

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