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1, BUSINESS, INDIA, OPINION

INDIA’S NEXT GOVERNMENT CAN BOOST THE ECONOMY – OPED

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India's next government with a decisive mandate will have a great opportunity to unlock the full potential of the economy. This potential has been stifled by an inappropriate policy framework, bloated subsidies, poor quality of governance, and corruption. Substantive dialogue between government and business on policies had virtually stalled. There are numerous short and long term reforms that can get the economy on a plus 10 percent growth path.

One of the key areas for reform is Foreign Direct Investment(FDI) policy, which is riddled with restrictions that have lost their relevance. The sectoral FDI limits of 26 percent, 51 percent and 74 percent in various sectors and other restrictions were intended to ensure that various degrees of control remain with the Indian partner under Indian company law. The line Ministries felt that these restrictions were needed to protect Indian companies especially public sector undertakings (PSUs) from unfair competition. In the process, growth of various sectors has been hampered, competition was limited, and consumers ended up paying higher prices for lower quality products and services. This also adversely affected global competitiveness of Indian producers

The undue focus on equity as the main instrument of control over an enterprise overlooks the fact that control can also be exercised by restrictions on technology, exports, etc on the part of the foreign partner. Such restrictive business practices could deprive the Indian joint venture the ability to compete in the global marketplace. For example a major Indian producer of solar water heaters was forced to accept restriction on exports only to South Asia as a condition for technical collaboration with a foreign partner.

The Competition Commission of India (CCI) has been set up to deal with abuse of market power and restrictive business practices. It affords the opportunity for the public to lodge complaints and go through a quasi judicial process and get relief. Therefore it does not make sense for line Ministries to frame policy that would limit the entry and growth of business activity in their sectors. This includes caps on FDI and other business restrictions placed on foreign investment.

Similarly, a number of independent regulatory bodies have been set up in various sectors. These have developed considerable expertise in ensuring healthy and balanced development of their economic areas. They afford means of dealing with complaints, providing relief, and ensuring a level playing field.

FDI inflows into India have remained relatively stagnant in recent years fluctuating between $21-35 billion annually since 2007 according to Indian official data. UNCTAD estimated the FDI inflows in 2013 to be $28 billion for India, well below other developing areas such as China ($ 127 bn), Russia ($ 94 bn), British Virgin Islands ($ 92 bn), Hong Kong ($72 bn), Brazil ($63 bn), Singapore ($ 56 bn) and Mexico ($ 38 bn). This shows that great opportunities exist for India to increase FDI further, and a target of around $50 billion should be considered reasonable.

The quality of FDI is important. FDI which leads to new "greenfield" projects and activities, would add value, bring in technology, create jobs and income, should be welcomed without limits. On the other hand, if FDI results only in acquisition of existing enterprises but does not lead to business expansion, and reduces competition, it would not help the economy.

The FIPB examines these and other issues before granting approvals. These are sometimes hedged in with conditions imposed by line Ministries often devised by officials with little business or technical experience. Such conditions can severely restrict the business freedom and the profitability of the joint venture. A rule based rather than an ad hoc approach would improve transparency and predictability for investors and the public. Ministries which run PSUs in their sector face a conflict between making impartial assessments and protecting their business interest in PSUs. The impression still is that India views FDI as a reluctant necessity and a source of tainted money. In fact FDI should be seen as a vote of confidence in India.

Besides FDI through financial transfers, FDI in kind, through inputs of high technology and capital equipment for a joint venture should also be readily allowed as is the case in countries like South Korea and China. This would encourage companies to transfer high tech operations to India.

Some sectors need to be opened up to FDI. Up to 100 percent FDI should be allowed in defence industry. India today imports over 75percent of defence equipment from abroad. It makes sense to allow foreign companies to set up defence industries in India. This could not only meet India's needs, but also enable India to become a global supplier of products and components. The defence PSUs would be motivated to improve their management, products, and quality due to competition, foreign collaborations and in house research.

Another sector is nuclear power industry, with huge future requirements. Opening up this sector to FDI will bring in technology, human resource development, fuel supply security, and capital which are badly needed. India cannot implement its ambitious nuclear power programme with only domestic capital.

The other important factor is the overall business environment facing the potential investor. Negative factors include unduly complicated and lengthy processes for setting up a business, unreasonable and unpredictable taxation, difficulties in access to land and utilities (especially for manufacturing ventures), poor logistics and financial facilities, burdensome labour laws, and corruption in official agencies, etc. Overall India's ranking of 132 in ease of doing business needs improvement, being far behind Singapore (1), China (91) and South Korea (9). If India's business environment can be made more investor friendly and simplified, there can be a big jump in investment both domestic and foreign in the economy.

The tax burden on business in India is an important factor on investing in India. The corporate tax rate in India (34 percent) is high compared to the Asian average (22 percent), or countries like China (25 percent) and Singapore (17 percent). Compliance with unnecessarily complicated processes and unpredictability adds to the burden. A hostile tax regime discourages investors and even Indian companies may move their operations abroad. Taxation should be considered not just an instrument of revenue generation for the government, but an instrument of economic policy.

There are some concerns about security issues when foreign entities are involved in business operations in India. These can be addressed by requiring security guidelines for all sensitive sectors (including defence), including clearances for key personnel for all entities (including domestic ones) operating in sensitive sectors. Other countries have such security procedures for business entities.

India's major attraction is its large domestic market, relatively low personnel costs, and good geolocation as an export hub. In the auto sector, these advantages have been leveraged with the help of pro-business policies with the result that from being a producer of only a few low quality products, India has become a major global player in the auto sector. Such progress is possible in other sectors if supportive policies can be put in place.

The next government has the opportunity to step up India's growth. It should take steps to open up the economy to FDI, revitalize the business environment, work more closely with business, boost investor confidence, rationalize taxes and subsidies, and move towards more transparent and automatic government processes.

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