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TIME TO SHOW INVESTORS – INDIA MEANS BUSINESS

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Economic Rationale of FDI

Foreign Direct Investment (FDI) to India has been regarded as an important component of capital flows to supplement investible resources, to access advanced technologies for importing production know-how and for promoting exports. Being the more stable component of capital flows compared to Foreign Institutional Investor/portfolio investment and external commercial borrowings, it is admittedly the preferred means to finance the current account deficit. To achieve eight percent growth India must generate FDI rather than FII. In actual fact India attracted USD Twenty eight billion FDI in 2013 against USD Twenty four billion in 2012 shows a report of United Nations Conference on Trade and Development. Its position, as per the World Investment Report, 2014 slipped to fourth from second as the most attractive FDI destination after China in 2008 – 2010.

Factors that made India attractive not long back

Even as recently as last year, The United Nations Conference on Trade and Development (UNCTAD) in its World Investment Report 2013 had published the finding that India was one of the most attractive investment destinations as it had one of the largest markets even though growth had slowed down to 5% per annum. It had a pool of talented manpower and favourable demographics. An expanding middle class with rising urban and rural incomes were a key factor in attracting foreign investment. The services sector was likely to grow along with new sectors like aviation, defence and insurance. Even flows to the manufacturing sector were expected to increase as a number of countries including Japan and Korea were set to establish industry specific industrial zones in the Delhi-Mumbai Industrial Corridor. A major part of the FDI inflow has gone into telecommunication, automotive, construction and computer software and hardware sectors. A 2014 World Bank study ranks India as the World's third largest economy in terms of its GDP after USA and China. State wide FDI flows into Maharashtra, Delhi, Karnataka, Gujrat and Tamil Nadu accounted for more than 75 percent of the aggregate inflows during 2000 - 12 . These States offered better infrastructural facilities and favourable business environment and an aggressive Government strategy to woo foreign investors. These States acted as enclaves to exert a disproportionate pull compared to the rest of India to secure FDI despite troubles in the world economy and the global slowdown.

Factors adversely impacting FDI

However, despite all its well-known advantages, why have foreign investors suddenly turned wary of investing in India? A Business Chambers' review confirms the slow-down of inflows- its study of factors across major EMEs indicates that the recent investment climate in India has become increasingly difficult and perhaps is beginning to depress investor sentiment. Many of the Latin American and Asian countries saw a rebound in 2010, but due to a growing negative perception, FDI flows to India, which had reduced during 2009, continued to be modest during 2010 and 2012-13. Several factors have recently had a huge negative impact on the flow of FDI and the more significant ones are discussed below.

Delay in Implementation of Projects & Environmental Clearances

To the extent implementation of a project is delayed, it adds to its cost and competitiveness and may even make it economically unviable. Anecdotal evidence suggests that procedural delays affect the cross border flows of investible funds. Infrastructure projects in India carry significant risks associated with meeting government regulation, environment norms and legal requirements; inadequate user charges; and execution and construction risks. Industry surveys suggest that environment clearances, land acquisition and rehabilitation are the key issues that delayed large investment projects in the steel industry.

Bureaucratic hurdles

The time consuming systems and procedures to be complied with, the bureaucratic layers to be dealt with and the multiple bodies from which clearances are to be obtained - all add up substantially to the transaction costs involved and take up a lot of management time thus making it an issue of serious concern for the investors.

Solution: There is a report by reputed Indian Economists on Putting India Back on Track. The measures suggested to simplify and reduce the regulations which stifle entrepreneurship must be seriously implemented within a time frame of two years.

Retrospective Tax Amendments

The Vodafone related amendment to the Income Tax Act in 2012 has done a huge damage to India's prospects for foreign investment. MNCs and investors have publicly declared that this one move alone has dealt a severe blow to the credibility of India as a country of predictable and stable policies.

Solution: The government must send out a strong and credible message that Retrospective Amendments will be repealed to restore the Supreme Court ruling in the Vodafone case and such amendments will be avoided in future. This alone will restore the faith of business and the investor community in the policy environment and tax regime of India.

Tax Disputes and outrageous demands

Litigation in tax cases involves astronomical sums in both direct and indirect taxes. As on June 2013 rupees 4.82 lakh crores are locked up in direct tax disputes and Rupee 1 lakh crore indirect tax disputes. The number of disputes pending before Commissioner Appeals, ITAT/CESTAT, HC's and SC are staggering. Both Indirect Tax and Direct Tax Departments go in appeal to HC's and SC for cases of Rupees 10 Lakhs and 25 Lakhs respectively. In transfer pricing cases alone tax demands involve Rupees Sixty thousand crores on adjusted income amounting to Rupees Two lakh crores to the income of the India entity of foreign companies.

Solution: Two things need to be done to cut down the volume of disputes. First the generation of demands must be curbed by getting C A G /Audit on board to settle paras in the Commissionerates. Secondly, after a critical analysis and review of the present level / volume, the demands must be cut down by a commission of three officers.

Corruption and Difficulty of doing business in India

According to the World Bank report India ranks 132 out of 185 countries in “Ease of Doing Business”. This is one area that strangulates businesses and acts as a major impediment to establishing start-ups, and is crying for reform of rules and regulations. To add to this is the rampant and all pervasive corruption in government departments which also adds to the cost of doing business in India.

Solution: It is no secret that the revenue department is in need of a drastic overhaul to restore integrity and impartiality as also the confidence to decide without fear or favour among its officers. The administrative measures to reform the ills of India's tax department are highlighted in Dr Parthasarthi Shome's Report on Tax Administration Reform Commission. The government already has a readymade set of recommendations on the table which need to be implemented as soon as possible. Implementation is the need of the hour.

Open up the FDI Policy & Implement Fast

The recent Budget has liberalised the FDI Policy by raising the current limits in the remaining sectors like Urban Construction, Insurance, Defence & even E-Commerce. The ceilings have been raised to 49% to begin with. All that India needs is to ensure that the raising of the current limits on foreign investment is done in a calibrated manner in these sectors and that transfer of technology in defence production is secured through Government of India's understanding with foreign governments which control and regulate the issue of defence technology. The policy on multi brand retail may be kept in abeyance till such time as the economy revives and industrial growth generates employment. Perhaps the domestic retail sector still needs time to organise itself to meet foreign competition. Once India is back on the path of growth and jobs in the manufacturing sector begin to raise income levels and the SME sectors becomes stronger, may be the country will be ready to look more positively at the multi brand retail issue. To conclude, it is implementation alone that will revive the economy whether through FDI or through the domestic investment cycle and the solutions highlighted in this note will gradually encourage foreign investors. Currently, investors are poised on the threshold on the basis of expectations. Hopefully, market expectations will be buoyed up with Budget announcement on July 10, 2014.

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