CHAPTER VI

Implications for Policy

A virtual sea change has taken place in the economic policy framework in India since July 1991. Radical liberalisation has been ushered to make the Indian economy progressively market oriented and integrate it with the emerging global economic structure. The government of India announced a series of measures designed to attract foreign investment in large volumes. In response to the New Economic Policy, FDI approvals increased from Rs. 5.3 billion in 1991 to Rs. 595.4 billion in 1995 (Table V, Chapter I). But the actual inflow of FDI has been quite less than the FDI approvals. Table VII of chapter I clearly shows that ratio of actual FDI inflows to FDI approvals was 66% in 1991. In succeeding years, upto 1995, this ratio was just in the range in 17 to 21%. This large gap between the approved and actual FDI indicates that expectations of foreign investors have not been matched with new policy changes. The purpose of this chapter is, to identify the drawbacks or shortcomings in the policy which have hindred the flow of FDI in India, and to suggest measures to make the policy in tune with the determinants of FDI. The present study suggests the following implications for FDI policy in general and at the sectoral level, to increase FDI inflow in India.

6.1 POLICY IMPLICATIONS IN GENERAL

The general policy implications towards FDI have been described under the following 15 sub-heads.

6.1.1 Need for Policy Transparency

FDI in India has been allowed through three routes. Automatic approval upto 51% foreign equity has been granted through RBI route for priority sector industries (Appendix 4). FDI approvals for more than 51% equity and in sectors not concerned with automatic approvals are cleared by FIPB and SIA. Table V of chapter I shows that percentage of approvals (Number) in the period from August 91 to December 1995, has been 17.5% through SIA, 23.77% through RBI and 58.73% through FIPB. Percentage of amount of FDI approved during this period has been 2.57%, 4.46% and 92.97% through SIA, RBI and FIPB respectively. This reveals that large chunk of FDI approvals is through FIPB route which lacks transparency. 66% sample firms reported that policy procedures are not clear.

Bureaucratic delays and widespread corruption in India are found to be the most powerful barrier to FDI inflow in India. Almost all the respondents replied that they experienced buraucratic problems in India. Bureaucratic delays and wide spread corruption were reported moderately high significant deterrents of FDI inflows in India. (See Para (i), (ii) of 4.5 and Fig. 4.24 and 4.25 in Chapter IV). There is bureaucratisation at the Centre and at the State levels which discourages the flow of international direct investment in India. Despite the liberalisation measures taken by the government, bureaucratic and procedural bottlenecks were compelling the foreign investors to look at other options. The present mechanism does not

promote the post reform policies, it is too much time consuming to the extent that any serious investor usually would not be left with any other option but to opt out of the project. Many projects involve massive funds and each day's delay reflects in the over run to the cost-estimates. Investors cannot bear up with prolonged uncertainty of 'yes' or 'No'. Also dealing with large number of different agencies/departments for getting innumerable permissions, clearances is a frustrating experience. There is no internal co-ordination among these agencies. This increases the cost and creates a fertile field for corruption.

It is very important to bring in more **transparency** in the foreign investment policy in order to improve the inflow of FDI. If there is transparency, the foreign investor knows exactly where he stands. There should be transparent and consistent guidelines for FIPB clearances. There should be greater clarity in policy guidelines in different sectors. All the procedures should be simplified, made investor friendly and be not time consuming. Apart from realignment of these procedures, it also requires a change in the mind set of implementators of these procedures.

There should be better **implementation mechanism** for liberalised policies. Despite all the libearlisation measures in India, one thing is very clear, the recognition that the time has value has still not permeated the minds of planners and government decision makers. One may not require industrial licensing in Delhi, but all kinds of knots still have to be untied just about everywhere one goes. Steps should be taken to curb the corruption in the country.

After having got the approval from the centre, an overseas investor has to get an additional 30 or 40 approvals at the state. Most of the respondent companies have pointed out the problem of excessive paper work involved in getting approvals. So there is need for faster clearances at the state level. There is need for greater liberalisation in the working of State governments. After all, factories have to be set up in the states. Investors have to operate in the states.

There should be uniformity in laws for foreign investment. The government should prepare a set of guidelines for the foreign investors which should be common for the centre and the states.

While we have a much better judicial system than what China has, still it takes a much longer time to decide judicially and this is quite discouraging for foreign investors. So there is need for quick mechanism to settle disputes. Many respondent firms pointed out that Indian laws are vague and can be interpreted differently by different persons. So laws should also be made clear. If relevant changes in the law which are in tune with the policies do not simultaneously take place, the policies, however, worthy they may be and whatever guarantee of stability or continuity may be attached to it; it would in all probability never achieve the desired results. The laws and regulations carried over from the world war time and even the emergency period of the seventies, need to be carefully reviewed, eliminated or amended to fit the post reform context.

There should be a comprehensive policy instead of the present case by case approval in industries not covered in the automatic approval list.

6.1.2 Need for More Privatisation

In the new economic policy, many areas which were hitherto reserved for the public sector have been opened up for investments by the private sector. The policy of disinvestment of shares in public sector companies involved in the key telecom and petroleum sectors has been highly appreciated by many overseas investors who recognize the tremendous potential of those industries once wholly owned by state. A well planned disinvestment programme offers enormous economic benefits. It has the potential to release substantial flows of capital for investment in infrastructure projects, it encourages competition by opening up markets to other players, it enables significant efficiency improvements and above all, fosters the right environment for new enterprises and job creation. India is less well travelled down the road of disinvestment compared with European countries. There is need to have more disinvestment in public sector units.

Real privataisation means that one should be able to change the management of those companies and bring in new technology and new capital so that companies which are a burden on the state can perform better.

6.1.3 Overcoming of Procedural Bottlenecks of Customs and Trade

In the new economic policy, 100% foreign equity has been permitted in 100% export oriented units subject to certain conditions (See page 131 of Chapter III). Tax holiday for 5 years has also been granted to EOUS. But this fiscal incentive has not been reported to be quite highly significant determinant of FDI. Respondent companies have mentioned about procedural bottlenecks of customs and trade which act as barrier to the flow of FDI in export processing zones. Exporters and importers tell horrible stories about harassment, wooden bureaucracy, incompetence, corruption and pointless paper work*58. Dozens of signatures are still needed to export a garment consignment. The government has earned much applause for cutting tariffs, keeping a competitive exchange rate and making somewhat easier for exporters. But it has not done nearly enough to reform system and procedures to ensure that importing and exporting is free of hassless, harassment and corruption. All sorts of conditions and wide discretion with individual officers impose heavy costs on the economy. Importers and exporters often pay bribes to import goods. Paper work needs to become simpler. Fewer documents and forms to fill will streamline procedure and cut into opportunities for rent seeking through obfuscation and delay.

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*58 The Economic Times. April 25, 1997.

6.1.4 Need for Further Reduction in Import Tariffs

In the new policy, imports have been liberalised but still they are not upto the expectations of foreign investors. The average tariff rate in India is quite high. 74% of the sample firms reported that high import tariffs act as a disincentive for FDI inflow in India. High import tariffs have been revealed as the 5th most important obstacle to the flow of international direct investment in India. Significance of this factor is found to be highest in other Asian countries based firms, in textiles industry and in minority foreign owned firms.

Import norms in India are not yet fully in line with other nations. So import duties should be reduced to match the world standards. Exporters must have access to duty free imports if we want that FDI should increase in the export processing zones. Import duties on components and raw materials which are not available in India should be declined further so that the cost of production falls and goods can be offered at cheaper rates.

6.1.5 Need for Exit Policy

Pro Labour Laws in India and lack of exit policy have emerged as the 4th most powerful barrier to the flow of international direct investment in India. This deterrent is revealed to be of the greatest significance for Germany and USA based firms and for metallurgy and computer sectors.

So an **exit policy** for labour is essential for attracting strong capital inflows from Japan, Germany and USA based firms. Overseas businessmen want to avoid complex legal procedures if factories need to be closed. Exit policy must be implemented at the earliest and work force should be made more disciplined and dedicated. **The establishment of an efficient** system of labour dispute settlement should be given high priority in India.

6.1.6 Entry of Foreign Capital

In the present policy FDI has been allowed in all the sectors but there is need to have a selective approach to the entry of foreign capital and MNCs. Foreign capital should come into infrastructure and areas where technological gaps exist. Capital inflows should commensurate with the needs of the economy. In the present study, **Infrastructure bottle-necks** are revealed to be the 2nd most important hinderance in the way of FDI inflow in India. This deterrent got an average score of 2.71 . Power problems, non-satisfactory condition of railways and roads, lack of proper port facilities, inadequate telecommunication system and non-satisfactory condition of water supply and sewerage system together are a stumbling block in the flow of international direct investment in India (See Table XXXIV & Fig.4.26 - 4.30; Chapter IV).

The present availability of infrastructure in different areas are far inadequate and inefficient than what is

desired. Without adequate infrastructure, productivity gains will remain marginal and private capital will flow to other reforming countries where quality of living and range of amenities are substantially better. Poor infra-structure is discouraging the flow of FDI in export processing zones. Many important international companies engaged in export oriented production decided not to undertake production in India because of poor port facilities here. FDI should be encouraged in areas like energy and power generation and transmission, all types of communication and transport services and infrastructure, e.g., manufacture and setting up telecommunication equipment, construction of roads, bridges, express ways, toll roads, shipping and ports, etc.

We need to have **proper polices in infrastructure** in order to encourage foreign investment in this area. In the power sector, the processes for central and state clearances are too cumbersome and must be streamlined, preferably through the establishment of a single window clearance agency. Fiscal incentives and other facilities should be provided to overseas investors to make investments in the infrastructure sector. Ports and telecommunication system must be modernised. Infrastructure development must be given top priority in the plans.

In order to attract **international bidding**, for example, India's procurements for major infrastructure projects and other government purchases must be conducted in a manner consistent with internationally accepted practices.

6.1.7 Equity Norms

In the new economic policy equity participation is not linked to the net inflow of foreign investment. Equity can come in the form of kind (equipment etc.) The present study has found that determinants do not change significantly on the basis of ownership structure (See Chapter IV & V). So to ensure that foreign ventures do not lead to excess flow of foreign exchange, foreign equity ownership should be linked to net foreign investment inflows. Hundred per cent foreign ownership may be allowed in cases of 100 per cent export oriented units. Those with a lower commitment should have a lower foreign component of foreign equity. Of course, a number of industries in the infrastructure sector should be exempted from this rule as infrastructure industries are net forex spenders.

6.1.8 Need to Reduce the Tax Rate

According to the present investigation, **high corporate tax rate, high income tax and excise tax** rank 3rd among the most significant irritants to FDI inflow in India. The degree of significance of high corporate tax rate discouring the flow of FDI, is highest for Germany based firms, for textiles industry and for fully owned subsidiaries. High income tax and excise duty are considered of the greatest significance for USA based firms and for metallurgy sector. **Tax rates** should be brought down to increase the flow of international direct investment in India. India should redesign its tax system so that

quality levels at competitive prices can be produced in India. For converging FDI and for speedy industralisation of the country, the government of India should exempt tax on know-how and reduce the rate on tax of dividend remittances.

6.1.9 Need for Reduction in the Rate of Interest

High rate of interest in India is the 5th most significant variable having negative impact on FDI inflow in India. The importance of this hindrance is shown to be highest for Germany based firms and for transport sector.

There is need for **lower interest rates,** easy availability of credit from banks and financial institutions. A more rapid pace of infrastructure development would be facilitated by a reduction in the cost of capital.

6.1.10 Need for More Bilateral and Multilateral Agreements

In the present work, bilateral agreements have been revealed to be an important variable having positive impact on FDI inflow in India. This factor got an average score of 2.49. The signing of MIGA has been reported to be a quite significant determinant affecting the FDI inflow in India (See Fig. 4.8 & 4.9; Chapter IV). India should enter into more bilateral agreements with different source countries as these agreements increase the confidence of the investors in the host country and they are encouraged to undertake FDI in different areas.

6.1.11 Consistent Rules and Philosophies

Political risk in India ranks 6th among the major deterrents to the FDI inflow in India (Table XXXIII; Chapter IV). Political risk is considered to be of the greatest importance by Germany based firms, by computers industry, by fully owned subsidiaries (Fig. 4.35; Chapter IV). No foreign investor would like to invest in such a country where political instability becomes the order of the day. Hence, Indian government should provide a clean and good environment to attract foreign investment in the country. For attracting large investments, it is important that the set of rules and the philosophies behind them remain constant.

6.1.12 Need for More Publicity of the New FDI Policy

For hike in FDI there is need for more publicity. Foreign investor should be in a position to know the exact investment opportunities in India. Timely and appropriate information is absolutely needed.

6.1.13 Need for Freedom for Capital Convertibility

Factors grouped under foreign exchange regulation act (Current A/c convertibility of rupee, unified exchange rate, devaluation of rupee, and depreciation of rupee in the foreign exchange market) have been reported as significant determinants of FDI inflow in India (See Table XLIII and Fig. 5.15 to 5.18 ;

Chapter V). Respondent firms pointed out that there should be capital account convertibility of rupee. There is a need for greater freedom, particularly, freedom for capital convertibility. There is a need to integrate the markets in India, including the financial markets, much more closely with the global markets. Foreign investors need greater freedom to invest in India; and they need to know that they can readily realise all or part of their investments if the need arises.

6.1.14 Coordination of Different Policies

There is need for coherence between different policy areas including investment, trade, technology and competition and also between initiatives at the bilateral, regional and multilateral levels, guided by the principle of non-discrimination . **Indian Economic Policies** should be in harmony with the international development in the field of trade, industry and finance.

6.1.15 Dynamic FDI policy

Determinants keep on changing from time to time according to the changing economic scenario at the global level, at the home country as well as at the host country level. So FDI policy should be dynamic in character. There should be some monitoring mechanism to provide built in flexibility in the FDI policy.

6.2 POLICY IMPLICATIONS FOR DIFFERENT SECTORS

There is a need for different FDI policies in different sectors. This study clearly indicates that motives and determinants vary from sector to sector and from country to country. One factor is the most significant in one sector while it is completely non-significant in the other sector. So a uniform approach towards FDI in all the sectors would do no good. There is need to have different FDI policies in different sectors as discussed below.

6.2.1 Policy Implications for the Power Sector

No doubt in the present policy, the government has welcomed foreign investment in the power sector and FDI approvals in this sector including fuels were 27.01% of the total FDI approved in the period (1991-95) (Table XVIII of Chapter III), the actual inflow in this sector has been only 2.91% of the total actual inflows and actual/approval ratio has been approximately 5.6%. This indicates shortcomings of the policy in this sector. While the centre has the right to clear and approve power projects; those involving an investment of more than Rs. 25 crore, the onus of signing the finer details like the **Power Purchase Agreement (PPA)** rests with the state.[*59] Changes in the government at the states and inherent opposing views resulted in projects being scrutinised all over again.

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*59 The Economic Times, Nov.15 ,1996

Precious time is lost while the political parties try to gain as much mileage out of maligning the previous government. The other major problem is the poor financial viability of the State Electricity Boards (SEBs) who are the buyers of power. The investors are unsure whether they will be able to recover their money. The gross cross subsidisation of the agriculture sector by the SEBs is another point that is a cause for concern to the investors since it has direct consequence on their financial efficiency. Most of the developers are now finding it more profitable and easy to seek out other third world countries like Indonesia, Malaysia and Thailand. **The initial clearances take at least 3 to 4 years here, in Thailand for example, the final closure is reached within a year.**

In the international system, the promoters complete for the tariff but are left free with the details of the project, making them fast and efficient. Power plants need enormous project work and higher risks than a simple investment. India has to compete for foreign investment with the profits available in other countries for power projects.

The changed government at the state should not disown the commitments of a previous government. Competitive bidding procedures and substantive requirements vary between states and require unification and standardisation. In competitive bidding, the SEBs must prepackage the projects by first securing all project clearances. Policy procedures should be changed in such a manner that there is no delay in the start of

the project after getting approval. Steps must be taken to ensure that investors gain from their investment in this sectors.

6.2.2 Policy Implications for the Telecommunications

There is a large gap between approvals and actual investment in this sector. (See Table XVIII and XX). In the period from 1991 to 95, the telecommunication sector accounted for 8.14% of the total approvals while in actual inflows of FDI, this sector accounted for just 0.02% of the total actual FDI inflows. Investors want that licensing should be scrapped in this sector. There is need for more tariff reductions. Telephone manufacturers complain about the tendering process of Department of Telecommunications (DoT). The order is rationed out amongst the various contending parties with the lowest bidder getting about 30%.[*60] This tendering process militates against the aim of foreign investors to make India a major manufacturing base for telecom equipment. So if India is to become a manufacturing base,DoT's rationing practice must be abandoned in favour of "winner takes all" with the lowest bidder being awarded the entire orders. This would enable the manufacturing company to enjoy the economies of scale.

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*60 The Economic Times, March 24, 1997.

6.2.3 Policy Implications for Chemicals & Pharmaceuticals

Weak Intellectual Property Regime has been found to be the 7th main deterrents to FDI inflow in India (See Table XXXIII, Chapter IV). Its importance is greatest in Germany and USA based firms and in chemicals and pharmaceuticals and computers industries which involve high research and development costs (Fig.4.36 & 4.37). **Many MNCs in the pharmaceutical sector are not making investments in India due to non-existence of product patent and short-duration of the process patent.**

There is a need to bring Indian laws governing the intellectural property rights to the international standards in order to attract more FDI inflow in sectors like chemicals & pharmaceuticals, software , science and technology. Intellectual property regime must be strengthened in order to attract FDI in the above factors.

6.2.4 Policy Implications for Food Processing Industries

The new economic policy has permitted mergers and take over of the existing firms. This factor has been reported to an important variable affecting FDI inflow in India. In food processing sector, many international firms have taken over existing Indian firms (like Cocacola). In such cases FDI merely replaces Indian investment without the attendant benefits of technology upgradation and higher level of economic activity. Due to mergers and acquisitions there is high market concentra-

tion in this sector - allowing restrictive or anti-competitive practices to appear. To avoid such malpractices, the government should adopt policies to maintain healthy competition at national and international level.

6.2.5 Policy Implications for Computers Industry

In order to encourage more FDI in this sector, there is need for more training facilities which allow the students to train on latest machines. Software training institutes, preferably affiliated to international institutes should be established. Steps must be taken by the government to encourage exports from this sector.

Developing countries are vying with each other to attract FDI. Time and tide do not wait for anybody. International community is not waiting in queue to invest in India. Many countries are rolling out red carpet for FDI. Foreign investors would not come to India unless they find it profitable to do business in India. So to promote FDI, policies have to be changed for India to emerge as a favoured investment destination. FDI, has to be raised but while doing so, the interests of consumers, workers and domestic entrepreneurs should not be overlooked.