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“For Private Gain-Sacrificing FDI’

by S L Rao

The current account deficit in the balance of payments has been at record levels. It has improved a little, but the precipitate decline of the Rupee, now at over Rs 60 to the U.S. dollar, spells doom for many companies and for India’s foreign debt. The same borrowings are now much more in Rupee value. Balance sheets will show much higher debt in Rupees and much higher interest payments in rupees.

This current account deficit is due to excessive imports, declining exports, not matched by growth in net earnings on foreign investments or on cash transfers. Our major imports are oil, coal and gold. The Rupee values of these are now much more, because of the decline in the Rupee’s external value. It could be made up by foreign institutional and foreign direct investment. The former has been coming but is now withdrawing to the safety of the dollar in the USA. The latter has been and remains weak.

The situation is accompanied by and is a result of the sharp falls in growth, inflation continuing for over two years, declining investment and high government deficits. Poor growth is related to poor investment. Investment is sluggish. High interest rates and the declining foreign exchange value of the Rupee are two reasons. The deficit has been somewhat reduced by cuts in expenditures, and on oil and gas subsidies, and improved tax collection. But massive social welfare expenditures, with the promise of more because of the Food Security Bill, keep the deficit at high levels. Inflation will therefore continue. Social welfare expenditures are stolen to a substantial extent by politicians and bureaucrats, (estimates are by over 50%). They do not also benefit many of the poor and deserving.

Land acquisition delays, slow environmental and forest clearances, absence of time bound bureaucratic clearances, honest investigative practices, slow Court judgments, to name a few, have kept away investment. These are known. Many committees and GOMs keep discussing remedies, but there is no improvement.

Nationalized coal mining has been inefficient and unable to dig as much coal out as is possible. Exports are depressed due to the sluggish world economy and the scams that have affected major commodity exports like iron ore. The suspicions (now proven by Ranbaxy and Wockhardt) about falsification of trial results will affect pharmaceutical exports.

Rising foreign investment could restore the balance of payments and stimulate the economy. Rising domestic investment (both private and public) would be an economic stimulus to growth. But there is strangely, more domestic investment going overseas than is invested in India. This is because of all the impediments listed earlier.

Foreign investment is not as confident about India as it was some years ago. That is not only because of the deteriorating macro economic factors (deficit, inflation, current account deficit, high interest rates, etc). The innumerable procedures before the many clearances are given, the enormous amount of time wasted in these procedures, the cost of these delays in unused human and financial resources, uncertain tax rules, retrospective tax demands, have combined to make foreign investors wary of investing in India.

RBI categorizes foreign investment into direct and portfolio investments. Direct investment is in equity or debt and recently has been redefined to include foreigners holding above 10% in any venture. Portfolio investment is in debt, securities through the FII route, up to 10% of the securities traded in both primary and secondary capital markets including shares, debentures, warrants, and units of mutual funds, government securities and derivative instruments. Between 2000-01 and 2011-12, direct investment rose from $ 3270 million to $ 22006 million; and portfolio investment from $ 2590 million to $ 17171. Our dependence on the latter is high. They are volatile. Their seesawing inflows and outflows have made for frequent rises and falls in the stock market and Rupee exchange rates.

India compares poorly with China which has had consistent GDP growth, low inflation, current account surplus, superlative infrastructure and foreign direct investment. China has grown primarily because it was such an attractive destination for foreign direct investment. Low wages, productive labour, practically non-existent labour legislation, made it a great manufacturing destination. From mere assemblers China has moved over the years to becoming important manufacturers of basic industrial goods. It had no restrictions on technology imports or0 royalties. Like India, a significant amount was money belonging to non-residents. It is sent illegally (havala) abroad and brought back as foreign investment. But China also had investments from Japan, Korea, Europe and the USA.

India actively encourages round tripping of Indian funds by treating investments from countries like Mauritius to their tax laws (no capital gains tax). For years, technology

imports were controlled, royalty's low, bureaucratic approvals were many and time wasting.

Implicit policy was to encourage institutional portfolio investments and as institutional investments, external commercial borrowings and NRI remittances. Foreign direct investment was more into buying existing businesses, not building new factories.

India needs massive foreign investment especially in infrastructure (roads, power, ports, railways, airports, etc). The UPA government has promoted FDI in insurance, pension funds, multi-brand retail, etc, but the conditions imposed, changing rules, taxation uncertainties, and regulatory frameworks, have prevented much investment.

Decades of hostility to private investment, private profit, and foreign investment continue. Society believes essential services (water, electricity, road transport, etc), must be free or cross-subsidized by suppliers. This has led to unbridled increases in deficits of state owned enterprises in infrastructure.

India has stimulated foreign institutional investment into equities, debt, and other financial instruments. FII is liked by politicians and bureaucrats and businessmen. It has helped black money and its laundering. A genuine forensic investigation will show that much of the present FII to India is really Indian money coming back by these routes.

Similarly, 'participatory notes', enable Indians to send funds anonymously through overseas banks. Genuine FII has been hurt by the downturn in the European economies and

the preference of investors for the safety of the dollar for investment.

We can become an important FDI destination and build a current account surplus, like China. But we should remove all restrictions on foreign investment including defence industries. There should be no cap, nor compulsion to have local investment participation. Clearances must be simplified and speeded. Taxation should be stable, clear, and consistent. The bureaucracy and individual officers should be made responsible and accountable for time bound clearances. Land acquisition should be made easier even if it requires an ordinance in the absence of legislation. Present legislative changes will not help. Inflation should be controlled and for this government deficits must come down. Pruning of much misspending and theft of wasteful social welfare and other expenditures must be done.

These policies should have been introduced in our years of high growth, low inflation, low current account and fiscal deficits. Today, government has no alternative but to get foreign money into our reserves by any means. But we should have a blueprint of what must be done when our situation allows it, to increase FDI significantly in foreign investment into India.

The biggest stumbling block is the unspoken conspiracy between politicians, bureaucrats and businessmen, to encourage portfolio investment through many avenues.

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