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Role Of FDI in Infrastructural Development Of India

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ABSTRACT

This study analyses the role of foreign direct investment (FDI) in the infrastructural development of India and investigates the development path of the various sectors of India. FDI plays an important role in the development process of a country. It has potential for making a contribution to the development through the transfer of financial resources, technology and innovative and improved management techniques along with raising productivity. Developing countries like India need substantial foreign inflows to achieve the required investment to accelerate economic growth and development. It can act as a catalyst for domestic industrial development. Further, it helps in speeding up economic activity and brings with it other scarce productive factors such as technical knowhow and managerial experience, which are equally essential for economic development.

Keywords:

Introduction:
India's rise in recent years is a most prominent development in the world economy. India has re-emerged as one of the fastest growing economies in the world. India's growth, particularly in manufacturing and services, has boosted the sentiments, both within country and abroad. With an upsurge in investment and robust macroeconomic fundamentals, the future outlook for India is distinctly unbeatable.

India, while stepping up public investment in infrastructure, has been actively engaged in involving private sector to meet the growing demand. The demand for infrastructure investment during the 11th Five Year Plan (2007-2012) has been estimated to be US$ 492.5 billion (Planning Commission, 2007). To meet this growing demand, Government of India has planned to raise the investment in infrastructure from the present 4.7 percent of GDP to around 7.5 to 8 percent of GDP in the 11th Five Year Plan.

INFRASTRUCTURE INVESTMENTS REQUIREMENT IN INDIA
India is expected to grow at an average 9 percent per annum in next few years. Accompanying this growth will be an increase in demand for infrastructure services. The infrastructure investment has increased in the past few years, driven by government initiatives and private participation, but that need to be escalated in coming years. The Government of India expects that 22-25 percent of the investment (of US$ 384 billion) required is to come from private sector (Government of India, 2007). According to the Committee on Infrastructure, headed by the Indian Prime Minister, these investments are to be achieved through a combination of public investment, public-private-partnerships (PPPs) and exclusive private investments, wherever feasible. To sum up, the Indian infrastructure space has gained much importance in the past few years, and provides immense opportunities for growth and development.

Therefore, it is clear that there is substantial infrastructure needs in infrastructure sector in India, which, in other words, also offers large investment opportunities. Many of the new investments (such as gas pipelines) seem to be viable on commercial terms and should be suitable for partnership with private investors. For many other infrastructure investments also Public-Private–Partnership (PPP) is emerging as the preferred instrument, where the private sector gets its normal financial rates of return while the public sector partner provides concessional funding based on the long-term direct and indirect benefits to the economy.

GOVERNMENT POLICY ON INFRASTRUCTURE DEVELOPMENT: PUBLIC – PRIVATE PARTNERSHIP
Government is actively pursuing PPPs to bridge the infrastructure deficit in the country. Several initiatives have been taken during the last three years to promote PPPs in sectors like power, ports, highways, airports, tourism and urban infrastructure. Under the overall guidance of the Committee of Infrastructure headed by the Prime Minister, the PPP programme has been finalized and the implementation of the various schemes is being closely monitored by the constituent Ministries/Departments under this programme.

Indian experience shows that competition and PPPs can help in improving infrastructure. The opening of the telecoms sector is a case in point. Opening up the sector has led to massive investments and expansion in supply coupled with improvement in quality. The target of 15 percent tele-density set for the year 2010 was realized in 2007. Further, the cost of service today is lower than that in any other country in the world. Similarly, competition in the aviation sector has resulted in the creation of new capacities and much greater choice for travelers. The annual growth in air traffic has been in excess of 20 percent and fares have dropped significantly. Even in the road sector, PPPs have demonstrated their efficacy wherever they have been used such as on the Jaipur-Kishengarh highway.

THE ROLE OF FDI IN INFRASTRUCTURE
The economic model followed by India after independence

relied on import substitution and selective foreign capital inflow, both through portfolio investment and the Foreign Direct Investment (FDI) route. This changed radically with the liberalization measures post-1990.

Both portfolio and Foreign Direct Investment were not only allowed but also actively encouraged. The Foreign Investment Promotion Board (FIPB) was created to approve FDI proposals speedily and in most sectors, particularly infrastructure. The Reserve Bank of India gives automatic approvals for investments. During the decade of the nineties, the 'ceilings' on FDI in different sectors were progressively raised. From 2001, 100 per cent foreign investments were allowed in several industrial sectors. Currently, 100 per cent Foreign Direct Investment is allowed in almost all the infrastructure sectors.

The role of Foreign Direct Investment in an economy goes beyond simply easing financial constraints. FDI inflows are associated with multiple benefits such as technology transfer, market access and organizational skills. Consequently, there is an increasing and intense competition between countries to maximize the quantity of FDI inflows. Any successful policy for attracting FDI has to keep this competitive scenario in mind.

The Benefits of FDI Inflows can be broadly identified as:

Bridging the financial gap between the quantum of funds needed to sustain a level of growth and the domestic availability of funds.

Technology transfer coupled with knowledge diffusion that leads to improvement in productivity It can thus fasten the rate of technological progress through a 'contagion' effect that permeates domestic firm.

FDI Inflows in India - Sectoral Analysis of Top 10 Sectors
Sector-wise FDI Inflows in India from April 2010-Dec 2010
Table 2 Sector–wise FDI Inflows (Rupees in Crores)

Sector	2007-08 (April-March)	2008-09 (April-March)	2009-10 (April-March)	2010-11 (for April '10)	Cumulative Inflows (April '00 - April '10)	% age to Total Inflows (In terms of US$)
Services Sector (financial & non-financial)	26,589	28,411	20,958	1,581	106,992	21 %
Computer Software & Hardware	5,623	7,329	4,350	765	44,611	9 %
Telecommunications (radio paging, cellular mobile, basic telephone services)	5,103	11,727	12,338	1,914	42,620	8 %
Housing & Real Estate	8,749	12,621	13,586	246	37,615	7 %
Construction Activities (including roads & highways)	6,989	8,792	13,544	345	36,066	7 %
Power	3,875	4,382	6,908	547	21,466	4 %
Automobile Industry	2,697	5,212	5,609	187	20,864	4 %
Metallurgical Industries	4,686	4,157	1,935	404	13,845	3 %
Petroleum & Natural Gas	5,729	1,931	1,328	522	12,026	2 %
Chemicals (other than fertilizers)	920	3,427	1,707	115	11,300	2 %

Modes of Foreign Direct Investment in India
FDI can enter India through two possible channels:

- The automatic route under which companies receiving Foreign Direct Investment need to inform the Reserve Bank of India within 30 days of receipt of funds and issuance of shares to the foreign investor
- For sectors that are not covered under the automatic route, prior approval is needed from the Foreign Investment Promotion Board (FIPB)

Other determinants of FDI in Infrastructure
While a liberal 'entry' policy can go a long way in encouraging foreign investments in infrastructure, the willingness to invest in infrastructure projects has been restrained by a number of constraints across a number of economies. Thus, any successful strategy of attracting Foreign Direct Investment into these sectors will have to deal with these issues directly. These are:

• Subsidized prices: In most developing countries, infrastructure services are priced below the cost of supply. Subsidies may be hidden as increasing arrears to the banking system or outstanding payments to State agencies (like State Electricity Boards). This undermines the financial viability of projects.

• Mixed signals from different constituencies: Many diverse groups with varying levels of influence on Government policy have a stake in the policy that affects private infrastructure operations. Consumers benefitting from subsidized prices may resent price increases associated with privatization. Managers and employees of public utilities are understandably concerned about their jobs. This often influences policy related to private infrastructure and affects the investment environment.

FDI Norms in Infrastructure Sectors
Automatic clearance for foreign investment (not requiring the approval of the FIPB) was first introduced for infrastructure sectors like power and roads

• Loss of authority: Governments are often reluctant to abdicate control over key sectors of the economy particularly where foreign ownership is involved. Most Governments do not have a strong record of regulating private industries because the public sector has been so dominant. This often results in rules prohibiting private entry into certain sectors, imposing limits on foreign ownership.

• Misunderstanding regarding what private involvement can offer and what investors require:

Although private sector involvement does offer extra financing and the willingness to manage some risks (construction and operation risks), they are unwilling to bear risks that they cannot control (policy or regulatory risk).

GOVERNMENT POLICY FOR INVITING PRIVATE AND FOREIGN INVESTMENT
To encourage foreign funds flow into the infrastructure sector, the Financing Ministry has allowed Foreign Institutional Investors (FIIs) also to invest in unlisted companies. This was aimed at helping infrastructure companies as they would not be in a position to list their shares in the initial phase. FIIs now deploy 100 per cent of their funds in corporate debt. However, the Ministry has not dispensed with the 20 percent withholding tax on such investment as per the suggestions of the IIR report.

Speaking at the World Infrastructure Forum, John Taylor, Director, Infrastructure, Energy and Financial Sector Department, ADB, emphasized that the "counter guarantee" scheme was designed to cover specific risks including "discriminatory government action of various kinds, non-delivery of inputs or non-payment for output by State-owned entities, availability of essential public services, changes in the agreed regulatory framework or tax regime, provision of essential complementary infrastructure, compensation or delays caused by government action or political uncertainty, transfer risks, foreign currency availability and convertibility."

In a bid to make the core sector attractive for FDI, the Cabinet Committee on Foreign Investment (CCFI) has modified the 49 percent cap on foreign equity in the infrastructure sector to render fund mobilization easier. This major policy decision which will indirectly raise the foreign equity investment in infrastructure sector to well over 51 per cent if a domestic partner fails to meet his commitment from internal sources, including borrowing, should help the large industrial houses. The new mechanism is designed to overcome the constraints for foreign equity cap in the infrastructure sector. Under the norms, companies operating in the sector can bring in equity through the mechanism of an investing company for the purpose of making investment in a licensee company and the service sector where there is a prescribed foreign equity cap.

CONCLUSION:
Provision of quality and efficient infrastructure services is essential to realize the full potential of the emerging Indian economy. Indian government's first priority is therefore rising to the challenge of maintaining and managing high growth through investment in infrastructure sector, among others. To

sustain 9 percent growth, the Government of India has estimated that an investment of over US$ 492.5 billion during the 11th Five Year Plan (2007-2012) is required. Therefore, there is substantial infrastructure needs in infrastructure sector in India, which, in other words, also offers large investment opportunities. Public-Private–Partnership (PPP) is emerging as the preferred instrument, where the private sector gets its normal financial rates of return while the public sector partner provides concessional funding based on the long-term direct and indirect benefits to the economy. New instruments such as Viability Gap Funding (VGF) through a special purpose vehicle (SPV) set up recently by the Government of India to fund mega infrastructure projects may be relevant for other Asian countries as well. The cross-border infrastructure component is an important determinant of regional integration. If countries are not inter-linked each other through improved transportation network, regional integration process will not move ahead at a desired pace. In India, development of cross-border infrastructure, especially transportation linkages and energy pipelines with neighboring countries is underway and expected to contribute to the regional integration in Asia by reducing transportation costs and facilitating intra-regional trade and services. Nevertheless, there are many challenges. It is important for India to enhance its overland connectivity with East Asia in order to effectively facilitate the Asian regional integration.

India's rising growth trajectory requires rapidly expanding infrastructure facilities to support it. The Government recognizes the fact that domestic resources alone may not be adequate to sustain the required expansion in infrastructure. Thus, it has followed a strategy to create incentives for Foreign Direct Investment. India, today, has an extremely liberal regime for FDI in terms of entry norms. International experience shows that there can potentially be a number of other barriers to the willingness to invest in infrastructure projects. The Government has taken systematic initiatives to address these problems largely through comprehensive reforms in sectors like power and telecommunications. The combination of domestic private foreign investment and multilateral investments is likely to propel India's economic growth momentum in future.

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