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Management

STRATEGY TO ENHANCE FOREIGN DIRECT INVESTMENT IN INFRASTRUCTURE SECTOR IN INDIA

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ABSTRACT

There is an urgent need to develop new and maintain existing physical infrastructure in India and large investments are needed to do this. At present, Government of India and State Governments are mostly investing for development and maintenance of infrastructure and foreign direct investment in the sector is limited. This has resulted in unsatisfactory condition of existing infrastructure in the country. Foreign direct investment in infrastructure sector in India will be useful as it will bring in modern technologies and fund and create employment opportunities. But, there are impediments in receiving more FDI in infrastructure sector in India. In the paper, the author has highlighted such impediments and suggested measures to address them.

INTRODUCTION AND CONTEXT

Foreign direct investment (FDI) is owning and controlling business enterprise in one country by an entity based in another country. This can be done by establishing new offices and factories, mergers and acquisitions, participating in overseas projects with investment opportunities, reinvesting profits earned from overseas operations, intra company loans, etc. FDI helps in improved economic growth and development in the host countries. It offers number of benefits like introduction of new technology, innovative products, opportunities of employment, introduction of new skills, etc. Therefore, there is global competition to attract FDI. Foreign direct investment has played a significant role in development of Indian economy. India has attracted high FDI in some sectors such as services, telecommunication, construction development, computer software and hardware and automobile sectors. But, India needs more FDI in future to overhaul its infrastructure sector. There are impediments in attracting more FDI to India in infrastructure sector and these impediments need to be removed.

TREND OF FDI IN INFRASTRUCTURE SECTOR IN INDIA

Infrastructure sector is a key driver of Indian economy and FDI in the sector has increased over past years. At present, 100% FDI under the automatic route is permitted in the construction development sector, which includes development of townships, residential or commercial premises including infrastructure in them. FDI in India in construction development sector is US$ 25.66 billion during the period from April 2000 to March 2020, which is 5.46% of total FDI in the same period. During this period, infrastructure construction sector attracted FDI of US$16.847 billion, which is about 3.58% of total FDI. As per an estimate, India requires investment worth Rs. 50 Trillion in infrastructure sector by year 2022 for sustainable development in the country. Present **status of FDI and need of investments in some of the infrastructure sub sectors in India are as below:**

I) Roads

India has one of the largest road networks in the world and road transport caters to 80% of passenger traffic and 65% of freight traffic in India. The annual growth of use of road network in India is expected to be over 12% for passenger traffic and over 15% for cargo traffic. It is estimated that around US$ 27 billion plus private investment was required over FY12-FY17 to improve road infrastructure in India. FDI in development of road sector in India is less. One of the reasons of low FDI in road sector is unsuccessful trend of PPP projects in the sector.

ii) Power

Foreign direct investment in power generation in India from conventional sources (coal, natural gas, oil) and non-conventional sources (wind and solar) has improved over the years. India's ranking in World Bank's "Ease of Doing Business – Getting Electricity" sub-ranking has significantly improved from 137 in year 2014 to 24 in year 2018. The power sector including non conventional energy sector attracted FDI of US$24.212 billion since April 2000 until March 2019. This amounts to about 5.15% of total FDI inflows in to India.

iii) Urban Infrastructure

About 30% of Indian population lives in urban areas. Urbanization in India is expected to grow at an astonishing rate of 38%. Therefore, over the next 20 years, it is estimated that US$ 650 billion investment is required in urban infrastructure. Out of this, about 45% is required for development of urban roads. Till date, FDI in urban infrastructure sector in India is not significant. With the recent effort of Governments to develop 100 smart cities in India, there has been some improvement of FDI in development of information and communication technologies in the sector.

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iv) Airports

India has 454 airports, out of which around 90 are open for commercial services and 16 are designated as international airports. Delhi and Mumbai are the busiest airports in India. There is an urgent need to improve current airport infrastructure in the country. The Indian Government has projected that an investment of around US$ 12 billion in the next five years will be needed in the sector and 75% of the investment envisaged in the next five years is expected to be contributed by private sector. FDI inflows to India's air transport sector reached about US$ 2.751 billion between April 2000 and March 2020. The government has allowed 100% FDI in scheduled air transport services, regional air transport services and domestic scheduled passenger airlines.

v) Railways

Indian Railways has the world's fourth largest rail network comprising 115,000 km of track length with a route length of 65,000 km and 7,500 stations. There is an estimated annual railway traffic growth of 4% to 5%. Indian Railways is also the world's second largest employer with a workforce of 1.5 million. The government has focused on attracting investment in railway infrastructure by making investor-friendly policies. Currently, 100% FDI under the automatic route is permitted in railway infrastructure, which includes manufacture and maintenance of rolling stock (coaches and locomotives) and mass rapid transport systems (metros). FDI inflows into railways related components from April 2000 to March 2020 is about US$ 1.107 Billion, which is 0.24% of total FDI in the same period.

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vi) Ports:

India is a large maritime country in the world with a coastline of about 7,517 kms. In India, about 95 per cent of trading by volume and 70 per cent by value is done through maritime transport. India has 12 major and 205 notified minor and intermediate ports. Thus, Indian ports and shipping industry is playing a vital role in sustaining growth in the country's trade and commerce. Government of India has allowed Foreign Direct Investment (FDI) of up to 100 per cent under the automatic route for port and harbour construction and maintenance projects. Current capacity of major ports in India is 745 million matric tonnes. India's existing ports infrastructure is not sufficient to handle the increased loads. There are capacity constraints with a level of containerization of 25%, whereas global average containerization level is 60% to 70%. Further, Indian ports face huge congestion and average time for clearing import-export cargo is about 19 days. FDI inflows into port sector from April 2000 to March 2020 is US$ 1.637 Billion, which is about 0.35% of total FDI in India.

vii) Telecommunication:
India is currently the world's second-largest telecommunications market with a subscriber base of 1.20 billion and has registered strong growth in the last decade. In 2019, India surpassed USA to become the second largest market in terms of number of mobile app downloads. India ranks as the world's second largest market in terms of total internet users. India is also the world's second largest telecommunications market. There have been much investment and development in the sector. FDI inflows into telecommunication sector from April 2000 to March 2020 is about US$ 37.271 Billion, which is 7.93% of total FDI in the same period.

IDENTIFIED IMPEDIMENTS FOR FDI IN INFRASTRUCTURE SECTOR IN INDIA

The identified impediments for FDI in infrastructure sector India are as below:

I) Stringent Labor Laws: Large firms in India are not allowed to retrench or layoff any workers or close down without the permission of the state governments. These laws protect the workers and at the same time hamper any attempt to restructure business. To retrench unnecessary workers, firms need approval from both employees and state governments, which is difficult. In some occasions, trade unions extort large fund from companies through voluntary retirement schemes.

ii) Corruption: Corruption is rampant many public service offices in India. Corruption in combination with legal hurdles, lack of institutional reforms and inefficient bureaucratic decision-making process, is scarring foreign investors.

iii) Lack of decision making by state governments: The reform process of liberalizing the economy is mainly done by Government of India. State Governments are not much involved in reform process due to political reasons.

iv) High corporate tax rates: Corporate tax rate in many countries is about 15 to 30 percent. But, in India, tax rate is much higher for foreign companies. High corporate tax rate is definitely a major disincentive to foreign corporate investment in India.

v) Lack of Financing Facilities: In India, financing facilities in Infrastructure projects is very limited. Corporate Bond market is not active and banks are not keen in lending to infrastructure sector.

vi) Political instability: Political instability in India has adversely affected direct inflow of FDI to India as it raises concern for safety and constant return on investment.

vii) Ease of Doing Business: Foreign companies look into the World Bank's ranking in Ease of Doing Business. Although, there is improvement in ranking of India, it is not enough to attract more FDI.

viii) High Pollution: India has become one of the most polluted countries with regard to air and water pollution. The state of sanitation and drainage facilities is precarious. During heavy rains, metro cities like Chennai, Kolkata, Mumbai and Delhi are flooded. Potential foreign investors are scared of such situation in India.

INITIATIVES TAKEN UP BY GOVERNMENT TO INCREASE FDI IN INFRASTRUCTURE SECTOR

Government of India has taken many initiatives in recent years such as relaxing FDI norms across several infrastructure sectors. Government has put in place a liberal and transparent policy for Foreign Direct Investment, wherein most of the sectors are open to FDI under the automatic route. Some features of present policy of Government in FDI are:

i) Abolition of the Foreign Investment Promotion Board (FIPB) and the introduction of the 'Foreign Investment Facilitation Portal' (FIFP), an administrative body to facilitate FDI applicants.
ii) The FDI Policy 2017 defines and lists sector-specific administrative ministry and department as 'Competent Authorities' empowered to grant government approval for FDI.
iii) Introduction of 'Standard Operating Procedure (SOP) to process FDI proposals: The DIPP has also issued the SOP, which sets out a detailed procedure and timeline for applications as well as the list of 'competent authorities' for processing government approvals for FDI in India.
iv) 100% FDI in asset reconstruction companies through the automatic route. Construction development sector is eligible for 100 % FDI under the automatic route.
v) Ministry of Finance has proposed that 100 percent FDI will be allowed in railways-related infrastructure. In March 2020, government permitted non-resident Indians (NRIs) to acquire up to 100 per cent stake in Air India.
vi) In August 2019, government permitted 100 per cent FDI under the automatic route in coal mining for open sale as well as in developing allied infrastructure like washeries.
vii) No government approval will be required for FDI up to an extent of 100 per cent in Real Estate Broking Services.

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REQUIRED ADDITIONAL EFFORTS

There is need to create a right environment in India for attracting FDI in infrastructure sector. The growth of others sectors of the economy is mostly dependent of the growth and investments in infrastructure sector and which in turn demands high requirement of FDI in the sector. The following positive steps need to be taken by government to increase FDI in infrastructure sector:

i) Improvement in the business environment: There is an urgent need to improve business environment in India, which can help in expediting business processes and remove hurdles in doing business by foreign investors. The measures to improve business environment need to be identified by conducting adequate research. In such research activities, foreign investors, national and international academia need to be involved. Based on finding of research, suitable legislations and administrative orders can be issues by central and state governments.

ii) Single Window System: A single window system can reduce the slow process and make the life easy, comfortable and better for any entrepreneur including a foreign entrepreneur. The current start up time required for all the major projects is more than a year. This can be reduced only by single window system without diluting the process and rules.

iii) Reduction of Air and Water Pollution in all Major Cities in India: There is an urgent need to improve air and water pollution and quality of life in major cities in India. Officials of many foreign industries are unwilling to visit and stay in Indian cities due to poor air and water quality and other social amenities. Governments will have to take necessary measures to improve quality of life of inhabitants in Indian cities.

iv) Financing Facility for Infrastructure Projects: Overall duration of infrastructure projects is between 10 and 30 years. Also, firms need large amounts of capital and long-term plans to get involved in it. Governments in India often invite private firms to fund half of the infrastructural needs of the country through public-private partnerships projects. Foreign investors are not willing to invest in such projects because of uncertain policy atmosphere. Land acquisition is unusually difficult in cities. Inflation is high in India. All these make it almost impossible for foreign firms to invest in infrastructure projects. For greater foreign investment to happen, change of existing situation is required.

v) Developing a strong legal and regulatory framework: To ensure FDI participation in infrastructure sector, a strong legal and regulatory framework needs to be developed in India. Due to significant capital requirements, a long investment time line and fixed nature of assets, foreign infrastructural investments require a better and stable policy framework supported by rule of law.

vi) Need to Develop Strategic Infrastructure Plans: Identification of important infrastructural projects is an important responsibility of Central and State Governments. Commercial viability of the project is an important consideration. At the same time, cost sharing can allowed to ensure construction of less profitable projects of public benefits. Long term planning of infrastructure projects can increase possibility FDI in the projects.

vii) Reduction of Risks in Infrastructure Projects: As mentioned above, there is a need to create a pipeline of commercially attractive projects with possibility of private involvement. Once that is done, preparatory steps need to be taken Government to reduce the risks to foreign investors. Completing necessary feasibility studies on environmental, economical and social impacts can reduce the risks to the foreign investor to a greater extend and improve the confidence of foreign investors in investing. A competitive and transparent bidding process without favoritism can also be useful to foreign investors.

viii) Capacity Building to Regulate FDI: For management of FDI in infrastructure sector, understanding of economic, financial, legal, and political aspects of the infrastructural sector is needed. Officials of existing Government Departments and agencies need capacity building and training to face the challenges and undertake the responsibility.

Disclaimer: The findings and conclusions presented in the paper are personal opinion of the author.