Investment Policy in India

– An Agenda for Action

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– An Agenda for Action

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LIST OF ABBREVIATIONS

AGOA	-	African Growth Opportunity Act
CUTS	-	Consumer Unity & Trust Society
DFID	-	Department for International Development
EPZ	-	Export Processing Zone
FDI	-	Foreign Direct Investment
FIPB	-	Foreign Investment Promotion Board
FIPL	-	Foreign Investment Promotion Law
GDP	-	Gross Domestic Product
IIA	-	International Investment Agreement
IFD	-	Investment for Development
MNE	-	Multi National Enterprise
NIE	-	Newly Industrialised Economy
NRG	-	National Reference Group
SEZ	-	Special Economic Zones
SOE	-	State-Owned Enterprise
SSI	-	Small Scale Industry
UNCTAD	-	United Nations Conference on Trade and Development
UNIDO	-	United Nations Industrial Development Organisation

PREFACE

As per the UNCTAD World Investment Report 2003, in 2002 global foreign direct investment (FDI) flows fell for second year in a row albeit unevenly. India is one of the few countries, which experienced an increase in FDI inflows in 2002. However, compared to the other Asian giant China, India's inflows are minuscule. This despite the fact that since the economic liberalisation in 1991, India has been opening up sectors – previously reserved for public and domestic private investors-to foreign investors and taken other measures to facilitate higher FDI. The country needs to reorient its policies, improve their implementation and revamp the regulatory structure to improve the situation.

For the purpose of developing strategies to increase FDI flows to the country, the Government of India constituted a Steering Group on FDI under the chairmanship of Mr. N. K. Singh. The Group, which came out with its report in 2002, recommends a range of policy implementation and regulatory measures for the Central as well as state governments. It advocated a change of strategy towards FDI, more vigorous marketing of the country as an investment destination and reforms in specific sectors for facilitating higher FDI.

We hope that the present booklet would add to the FDI debate. This booklet, published under the Investment for Development (IFD) project, is an attempt to analyse India's FDI trends and policies, and suggest actions points for governments, civil society and inter-governmental organisations. It also summarises discussions of national seminars and results of a survey of civil society perceptions of India regarding FDI conducted under the IFD project. Further, it suggests policy measures to attract higher FDI and maximise benefits from it. This booklet is one of the seven published under the project.

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September, 2003 **Pradeep S. Mehta**
Jaipur Secretary General

CHAPTER-1

Introduction

The Need for Foreign Direct Investment (FDI)

Most developing countries now welcome Foreign Direct Investment (FDI) as an important tool for stimulating economic growth through technology transfer and efficiency improvement. Developing countries have always felt that their investment needs are far greater than what can be realised through domestic savings. As a result, most of the countries have opened up to foreign savings to meet their investment needs. There is also an increasing concern among developing countries on the productivity of investment.

Earlier, India showed a preference for official/private debt flows over foreign private capital in the form of FDI. Moreover, a section of its population wished to build strong national champions, as they feared that FDI would erode sovereignty and culture. Till 1980s, FDI constituted a small portion in external capital flows in comparison to official/private debt flows.

The global debt crisis of 1980s made developing economies realise the dangers of debt finance. One distinct disadvantage of debt finance is that it creates fixed debt-servicing obligations. During the debt crisis, even when the borrowing agency was a private entity, the government often had to come to its rescue in order to maintain the credibility of the country.

The situation has changed since 1990s: debt flows (to developing countries) have virtually stagnated, while FDI flows have increased five-fold from $36bn in 1991 to $78bn in 2000. Today, FDI flows to developing countries are greater than debt flows. The growing volume of global FDI, the stagnating volume of debt flows, the servicing aspect of debt finance and potential technology spillover from FDI — all have contributed to the current policy shift of the developing countries towards FDI. Besides, the success stories of export-led growth led by FDI in the newly industrialised economies (NIEs) have encouraged the developing economies to take a positive view of FDI.

In the immediate post-World War period, most developing countries pursued a policy of investment-led growth. The emphasis, however, was on increasing the investment rate and not on the productivity of investment. To their dismay, many developing economies found that higher investment (which represents a sacrifice of current consumption) does not necessarily lead to higher growth, as many were faced with declining investment productivity. Developing countries compete with each other to attract FDI. As a result, the investment regimes in different countries have been liberalised.

Restrictions on the entry and operations of foreign branches and affiliates have been considerably reduced or eliminated. Investors are increasingly allowed to freely transfer their profits and capital, while guarantees of non-expropriation and free transfer of funds is now a common feature. Also, settlement of investment disputes through arbitration is increasingly accepted. Overall, the investment environment has become much more facilitative to higher FDI flows.

The extent, to which FDI contributes to a host economy, depends on a number of macro-economic and policy factors. Benefits of FDI may vary depending on these factors and existing productivity levels in the economy. Thus, FDI may generate growth and development in some sectors, while having neutral or negative effects in others.

The government can enhance the benefits of FDI through a policy framework that creates development incentives for firms. Competition policy, efficient sectoral regulatory policies, and taxation policies, among others, are likely to increase benefits of FDI. Policies focusing on building domestic capabilities through education and training are also extremely important for encouraging technological upgrading and entrepreneurship.

The Investment for Development Project

In the light of the importance of FDI in the framework of developing countries, the "Investment for Development" project endeavours to study the investment regimes of selected developing/transition economies and build capacity on investment policy. The emphasis is on co-operation between countries, and within and between regions of the world, sharing information and experience, and engendering joint initiatives.

This two-year project, launched in September 2001, is being conducted by the Consumer Unity & Trust Society (CUTS), India, in collaboration with the United Nations Conference on Trade and Development (UNCTAD) and is supported by the Department for International Development (DFID), UK. The project involves fact-finding and advocacy work on investment regimes in seven developing and transition economies, namely, Bangladesh, Brazil, Hungary, India, South Africa, Tanzania and Zambia. National Council of Applied Economic Research or NCAER (New Delhi) is working with CUTS as the partner organisation in India for this project.

National Reference Group (NRG) Meetings

It is important to concentrate on domestic issues to achieve the goals of the project. Equally important is to take account of the concerns and fears of different stakeholder groups, *e.g.* consumers, workers, and investors. Similarly, it is important to examine the international issues affecting investment environment in developing countries. This includes addressing the concerns of developing countries regarding the World Trade Organisation's (WTO) agenda.

Therefore, a National Reference Group (NRG) was formed in each of the selected developing countries of the IFD project, in general, and India, in particular, to provide a sounding board and quality check on the research outputs. To be specific, the NRG was expected to monitor the quality and content of research outputs generated, create a sounding board, which could be used for advocacy on foreign investment regimes in these countries, discuss international investment agreements (IIAs) and investment issues at the WTO, and deliberate on strategies to be adopted by developing countries at international forums and attract attention to the project at a national level.

In India, the NRG constituted the following groups of people:
- Parliamentarians and/or politicians;
- Officials from key national and sub-national government/ministries, namely, trade, industry, commerce, finance etc;
- Government agencies and other quasi-governmental bodies relevant to investment issues, *viz.* investment promotion agencies;
- Business representatives, *e.g.* chambers of commerce;
- Civil society organisations with an interest in economic issues;
- Academics and other experts, especially economists and lawyers; and
- Media.
- Trade Unions

Highlights of the Report

The present paper, "Investment Policy in India - An Agenda for Action", has been prepared as part of the IFD project to suggest action points and recommendations for policy changes in India. The report contains highlights of discussions in the NRG meetings, background and analyses of key areas of the debate on FDI and prioritised policy recommendations emerging from the project research and the meetings.

The paper contains policy advocacy points on FDI for civil society, governments and inter-governmental organisations. It will be distributed widely in the country among policy makers, civil society organisations and business groups.

Organisation of the Report

This paper comprises six sections, 'Introduction' being the first one. Section two deals with investment policy, performance and perceptions in India; section three is a summary of the NRG meetings, while sections four, five and six contain actions/recommendations for the government, civil society and inter-governmental organisations, respectively.

CHAPTER-2

Investment Policy, Performance and Perceptions in India

The Current Situation

In the recent past, India, if not completely hostile, was not very receptive to foreign private capital. The situation, however, has changed. It appears that the Government of India is trying hard to attract FDI now. However, FDI inflows to India (as a share of GDP) have been much more modest than many other developing countries. In fact, India's glaring failure warrants introspection.

On paper, the current policies with regard to inward FDI flow in India can be argued to be very liberal. For example, post-entry, foreign firms are generally provided national treatment. The differential treatment is limited to a few entry rules spelling out the proportion of equity that a foreign firm can hold in an Indian registered company or business. There are a few sectors, which are banned (like, lotteries & gaming and legal services) and some sectors with limits on foreign equity proportion.

Over the years, sectoral caps on foreign equity participation have been relaxed. Till now, there has not been any reduction in the limit of foreign equity participation for any industry. The procedural route has now been made simpler and non-discriminatory. There exist sector-specific incentives, but they are also accorded to domestic investors. To a large extent, incentives have been made transparent and rule-based.

Problems Faced by Investors

Investment climate in India, however, is less than satisfactory, as reflected by the huge difference between the approved and actual inflows of FDI. Although on paper, the regime is liberal, the system does not work, as it is supposed to because of delays, complexities, obfuscation, overlapping jurisdictions and endless requests for more information, which frustrate the foreign investors. To be specific, the delays faced by foreign investors are not at the stage of FDI approval *per se*, but at the state level — as projects reach the crucial implementation stage.

Investors find bureaucracy and red-tapism in India one of the most discouraging factors. Actual investment is only about 50 percent of FDI approvals. Furthermore, the investors feel that environmental clearances and legal work are too time-consuming.

Out of the three stages of a project, namely general approval, clearance and implementation, the second one is the most oppressive for investors. The difference in the central and state governments' treatment of foreign investors can undermine FDI promotion efforts of the central government. The federal structure of India, where many of the clearance authorities are the state governments, leads to procedural delays.

Bureaucracy is also non-cooperative in extending the infrastructural facilities to any project that is being set up. It is important to note that the weak credibility of regulatory systems, and multiple and conflicting roles of agencies and government can have a more adverse impact on new FDI investors than on domestic investors. This happens, because domestic investors are better informed about the working of the present system.

India's Performance in Attracting FDI

Of late, India has done well in attracting FDI flows. But the general opinion of the stakeholders (*i.e.* foreign and domestic investors and civil society) is that given her size, there is significant scope for increasing FDI flows. The sectors that have received most of the FDI flows are IT, automobile sector, chemicals and power. Although FDI flows have definitely contributed positively in terms of domestic export growth, employment and technology spillovers in the IT and automobile sectors, the same is not true of the power sector where the experience can be described as a failure.

Perceptions of FDI

In order to know civil society's perception of the investment environment in India, a primary survey was conducted through structured questionnaire through e-mail all over India during February 2002 and January 2003. The survey questionnaire was designed to elicit information on contribution of FDI on development and sector-wise distribution of FDI, apart from the impact of FDI on various parameters relating to economy, technology, policies, etc.

Most civil society representatives agree that FDI brings in valuable new technologies, management techniques, improves the access to world markets and increases the competitiveness of the economy. It is generally believed that local firms would gain from the spillover effect with the entry of multinational enterprises (MNEs). Indeed, our surveys of local firms have revealed that they are now more inclined to adopt new management techniques, new technologies and improve quality.

The consensus opinion of civil society representatives is that India is losing out as an attractive destination of FDI in comparison to other countries due to bureaucracy and a non-transparent regulatory environment leading to bureaucratic hassles and corruption. The policy framework needs to be re-oriented in terms of transparency and simplified bureaucratic procedures. The present state of infrastructural facilities, thus, is a stumbling block for increasing the FDI flow.

All the stakeholders seem to be positively inclined towards FDI flows, especially, the local firms, which are most likely to face competition from foreign investors. Moreover, the stakeholders also want the government to take a pro-active stand to maximise the benefits from FDI flows.

CHAPTER-3

Stakeholders' Views on FDI

Three National Reference Group (NRG) meetings were held in each of the IFD project countries to discuss investment policies, performance and perceptions in India, other relevant aspects relating to FDI and issues relating to WTO in the meetings. Given below are the summarised principal issues that emerged from these three meetings.

FDI and Development

Developing countries have undertaken substantial policy changes over the last 10-15 years and many of these changes have come about due to changes in the perception of FDI. These policies, in turn, affect FDI flows.

It is now agreed upon that not only does the quantity of FDI matter, but the quality matters as well. Civil society is now, in general, positively inclined towards FDI. Different regions have different experiences with FDI. The strongest effects—both positive and negative—have been felt in the Latin American countries. The capacity constraints in dealing with foreign investors are particularly felt in the least-developed countries (LDCs). On the other hand, countries in transition economies have had peculiar experiences with FDI and privatisation, as there was no local entrepreneur – following, planned economic system.

Developing countries expect to benefit from FDI mainly in two ways: 1) increase in overall capital and 2) improvements in technology. However, the situations differ between countries. For example, in China, which is the leading FDI recipient, most foreign capital goes back into purchasing US bonds. Benefits of FDI are not so much about an increase in overall capacity, as about the benefits occurring at the firm level. Such benefits include increased competition and increased intra-firm trade.

FDI Flows: The Experience of India

To date, the level of FDI inflow into India has been too low to have any positive or negative impact. Therefore, the focus should be on means to increase the domestic investment, with FDI supplementing India's need for capital. However, in some crucial priority sectors, where domestic investment is not forthcoming, FDI is very much needed to relieve capital constraints. Since FDI has started to flow into India significantly only in the last five-six years, India has had little time to assimilate the technology that has flown in with FDI — within four to five years, India has had to absorb a range of new technology, which has been very difficult. As a result, technology is still outdated. It would be wrong on our part to blame FDI for this.

One of the main reasons for the absence of visible impact of FDI in India is the departure of many foreign investors midway in the project-implementation stage as a result of excessive/bad governance. Therefore, the NRG opines, the interference from the government should be reduced. Software and automobile sectors are good examples of minimum interference from the government, resulting in large FDI flows and few departures. The consensus opinion of the NRG members is that red-tapism has to be reduced at any cost to make India an FDI-attracting country.

Foreign and Indian investors have negative perceptions about doing business in India. Bureaucratic delays, inconsistent and unpredictable standards, cumbersome documentation, lack of sectoral policies in some infrastructure sectors have retarded FDI flows to India. Further, transaction costs in India are high. This obviously acts as a barrier for new investments. One needs to initiate measures to put a check on this.

FDI Flows: The Experience of a Few Other Countries

Bangladesh

Despite liberalisation, FDI was not large in Bangladesh in the 1990s. Mainly, the gas and energy sectors have attracted all the FDIs. In the past, civil society in the country did not appreciate the potential benefits of FDI. Now the general opinion in Bangladesh, including that of local investors, is more favourable towards FDI. Generally, people feel that some sectors should be out of bounds for FDI. Many of the problems to facilitate higher FDI, such as bureaucracy, law and order situation and poor infrastructure, are not specific to FDI but apply equally to all investors. The small size of the Bangladeshi market is, however, detrimental to FDI flows.

Kenya

Kenya lost the kind of FDI, which it used to receive earlier to its neighbours, or South Africa during the last five-six years. However, following the change in government, foreign investors are expected to return to Kenya. A new Foreign Investment Protection Act (FIPA) has been drafted, but its enactment is taking time. The public perception of FDI has taken a severe beating recently in a wellpublicised case involving a Canadian mining firm. The firm was to set up a mining operation on the Kenyan coast, but ran into all kinds of problems. There were land disputes as well as serious environmental damages associated with the operation, which led to civil society protests and court intervention. Kenya's experience with Export Processing Zones (EPZ's) has not been very good.

The existence of EPZs essentially means that there are two sets of rules, one for exporters and one for others. The main reason, for which foreign investors have been interested in investing in Kenyan EPZs, is to take advantage of the low labour standards, and preferential market access to the US markets under the African Growth Opportunity Act (AGOA). However, the prevalence of low labour standards has now led to severe strikes.

Concerns of Civil Society Regarding FDI

The NRG is not unanimous about benefits of globalisation — some have argued that it would affect the poor more adversely. Some are also of the opinion that FDI affects domestic capital adversely because the rate of return on domestic capital falls when FDI flows in. So, as foreign investment rises, domestic investment falls. In this context, developing countries, in general, and India, in particular, should encourage foreign investment in small volumes, which energise the domestic industries, but do not harm them.

Some NRG members are of the opinion that the domestic capital formation has been declining in the recent years despite high domestic savings rate. Some believe that FDI is leading to outflow of funds from the country. FDI has mainly gone into buying out companies, into equity and into buying of shares. The members unanimously agree that bad governance is the crux of the issue and that unless it is tackled effectively, the situation will not improve.

Benefits of FDI do not reach all the people in the country. To date, FDI has come only in big cities. There has been a positive impact of FDI on IT and telecom, which are utilised by affluent people, but not on power, which is used by everybody. So far, there has been little flow into agriculture or rural industries. However, it was pointed out that there is very little FDI in agriculture, because it is not required there. Change of rules in this respect is needed.

Civil society perceives that FDI brings in technology, efficient management techniques and also improves competitiveness and access to the world markets. Overall, civil society considers FDI as desirable. The NRG has argued for support to local firms for upgrading technology. The NRG members also feel that better competition, regulation and reforms in labour legislation are required. There are conflicts, as, on one hand, they want more freedom for themselves and, on the other, they want to impose restrictions.

Concerns on Mergers & Acquisitions (M&As)

Since mid-1990s, there has been a decline in FDI approvals and actual inflows to India. In China also, there has been a difference between FDI approvals and actual inflows, but the fructification rate as well as the rate of decline in FDI approvals is found to be much lower in India. The analysis of the determinants of FDI fructification has showed that there is no direct relationship between the rate of fructification and the size of the firm. That is, while the probability of contract failure declines with size, beyond a certain level, size of the local firm might reduce the probability of FDI fructification.

This suggests that there is a prevalence of FDI with a view to take-over the local firm and non-fructification of the approved FDI, because large local firms resist takeover moves. Given the fact that FDI inflows in the form of M&As are likely to have an adverse impact on the overall growth and development and such inflows undermine the fructification rate, there appears to be the need for appropriate change in our policy framework to discourage FDI investments involving M&As.

Define/Prioritise Objectives Regarding Competition Policy

There is an important role for competition policy in the development context. It promotes growth of markets. It affects access to goods and services. It relates to business and practices. Business practices are, to some extent, determined culturally. Competition policy, the NRG argues, has to consider this angle and determine how exactly the government should intervene in the market place.

The Government of India has now formulated a new competition bill and a new body, called Competition Commission of India, which will shortly start functioning, according to the terms of reference of the new bill. However, the NRG opines that there are shortcomings in the new bill. The proposed administrative structure of the new Competition Commission of India does not give much hope that it would be an efficient implementation body.

Role of Indian State Owned Enterprises (SOEs)

SOEs are dominant actors in the Indian market. Privatisation or disinvestment of SOEs has not been smooth. Foreign bidders are not allowed to bid for all SOEs and, at times, it is difficult to find big enough local investors, who can buy one of these enterprises. However, it is low interest of foreign investors rather than restriction on foreign investors' participation in SOEs, which led to slow privatisation. The lack of interest from foreign investors might be an indication of overpricing of SOEs.

There is a general consensus that the Indian SOEs are not run optimally. However, there is a disagreement within the NRG about the process of restructuring and whether or not foreign investors should be let in. There is, indeed, a need for post-privatisation regulation, though doubts have been raised about the state's capacity to regulate, when it could not run the SOEs.

Success Story of FDI: Telecom Sector

The NRG noted that telecom is the only sector that has been witnessing true liberalisation. Though gradually, and still with distortions, it is bestowing consumer benefits and attracting massive domestic and foreign investment, it is also the only sector that is spurring domestic indigenous products and world-class enterprises, enabling introduction of electronic governance, commerce, education and promoting impressive growth of software exports.

It has also witnessed corporatisation (*e.g.* Bharat Sanchar) and disinvestment (Hindustan Telephones Limited, Videsh Sanchar Nigam Limited, Mahanagar Telephone Nigam Limited), necessitating frequent changes in policy and law.

Constraints in Physical Infrastructure

Infrastructure is the basic underlying framework of facilities, through which goods and services are provided to the public. Unless the state of infrastructure improves in India, the country cannot attract FDI in a big way.

To overcome the constraints in financing infrastructure, India has turned towards FDI since the early 1990s. However, the amount of FDI flow in the infrastructural sector has been very small. Among the infrastructure sectors, only telecom has made the desired progress in the country.

Creation of an Enabling Framework in the Infrastructure Sector

The role of private and foreign investments in infrastructure has been debated. The foreign investment policy has nothing special about investment in infrastructure. We have not been able to promote domestic private investment in this sector. The conditions that facilitate private investment would attract investment regardless of origin. Creating conditions for private investment in infrastructure requires viability of business propositions. Collectivity of potential revenues is crucial here. There has to be a fair and transparent regulatory regime. The subsidy mechanisms also need to be transparent.

A good legal framework, the NRG considers, is a prime condition for attracting FDI in infrastructure sectors, because these investments are huge and involve long gestation periods. Another important requirement is good governance, since such investments tend to have a long gestation and payback periods, and hence, are more susceptible to political and ideological vagaries. It is equally important to ensure the long-term continuity of policies and to establish a regulatory mechanism for healthy development and monitoring of projects.

The emphasis should be on new forms of partnerships, like contracting out or management contracts, private financing of public facilities, leasing, joint ventures, build-operate-transfer (BOT) schemes and privatisation. The multilateral agencies can play a crucial role here. For instance, United Nations Industrial Development Organisation (UNIDO) can play a role here by creating an enabling environment for the fruition of such a business, through policy advice, guidelines and capability building. These could include the establishment of the basic legal framework for private financing of infrastructure (PFI) projects, preparation of a standard concession agreement, establishment of procurement rules and procedures, bidding documents and bid evaluation.

Constraints in Social Infrastructure

Social infrastructure includes human resources, which includes organisational skills, technical expertise, educational levels, health and social services. There is a need to improve the state of social infrastructure if India has to attract FDI in a big way. India stands way behind China, or the East Asian countries, in this respect.

Shortcomings in Regulatory Reforms

The debate in the NRG meetings centres around the need for regulatory reform for increasing the pace of FDI flow to India. The broad emerging view in the discussion is that reservation in the small-scale industry (SSI), rigidity in labour laws, weak bankruptcy laws, weak infrastructure, cumbersome procedures, existing cap on foreign equity holding, absence of strategic sales of public utilities to foreign companies and, above all, high transaction costs, have all contributed towards lower-than-expected FDI inflows to India.

Need for Legal and Judicial Reforms

The role of regulatory reforms in enhancing FDI is limited, but a quite significant one. Regulatory reforms mean "changes that improve regulatory quality — enhancing performance, bringing about cost effectiveness, scrapping/building of a new regulatory regime and improving processes for making regulation". Therefore, in view of this definition, there seems a need to examine every aspect of regulation.

Multilateral Agreements and India

So far, India has performed well on the issues of commodity trade at the WTO. But the NRG is of the opinion that the country lacks clear policy or direction on issues of investment. The principal reason for this could be a dearth of proper analyses on different clauses of WTO agreements and their implications for India. Everyone agrees on the need for understanding the different clauses of WTO. It is also equally important to comprehend the investment issues properly.

The European Union (EU) is supporting the launch of negotiations for a Multilateral Framework for Investment (MFI) at the WTO due to political considerations. There are differences among several countries of the EU in this regard. It is usually argued if a handful of OECD countries could not reach a consensus on an agreement at the OECD, it would be even more difficult to reach a pact involving many more countries.

Need for Encouraging NRI Participation

It was also noted that the probability of FDI fructification increases if the cases involve non-resident Indians' (NRIs) participation. This underlines the need for tapping the NRIs for promoting FDI inflow. In this regard, India needs to draw lessons from the Chinese experiment, wherein there was a series of policy initiatives, specifically meant to attract the overseas Chinese residents. Another important finding relates to the role of experience of the local firm in influencing FDI fructification. The result tends to suggest that the probability of FDI fructification increases with prior experience of the local firms in dealing with the foreign firms.

CHAPTER-4

Agenda for Action - Government

Create an Enabling Environment

The Government can enhance the domestic investment environment by adopting several steps, such as reducing business cost in India, reorienting the policy framework in terms of transparency, simplifying bureaucratic procedures, establishing a regulatory mechanism for healthy development and monitoring of projects, and establishing an institutional base for attracting and regulating investments.

A Foreign Investment Promotion Law (FIPL), incorporating and integrating aspects relevant to promotion of FDI, should be passed. Besides, exit policy for labour laws should be reduced and bankruptcy laws should be strengthened. Last but not the least, database of FDI should be improved.

Put Emphasis on Infrastructure Sector

A special area, on which the government should concentrate, is the infrastructure sector. The government should establish a good transparent regulatory framework to facilitate investment in infrastructure. The states in India should also be encouraged to endorse special investment laws pertaining to infrastructure for the purpose of expediting investment in this sector. Domestic policy reforms are also required in the power sector, urban infrastructure and the real estate. There is a need to expedite de-control/de-licensing to promote both domestic and foreign private investments.

Concentrate on Sectoral FDI

There is a need to concentrate on specific sectors: the broad approach should be one of targeting specific companies in specific sectors. Sectoral FDI caps should be reduced to the minimum and entry barriers should be eliminated. Reservations for the small-scale industry (SSI) should be removed. The existing SEZs should be developed as one of the competitive destinations for export-related global FDI, by simplifying applicable laws, rules and administrative procedures and reducing red-tape levels.

A lot of delays take place at the state level. To expedite FDI proposals, Foreign Investment Promotion Board (FIPB) should be encouraged to give initial central-level approvals where possible.

CHAPTER-5

Agenda for Action - Civil Society

Work Closely with Government

Civil society has to work closely with the government and, wherever possible, make direct or indirect policy intervention. Civil society should try to reduce bureaucratic interference and the regulatory environment for eliminating bureaucratic hassles and corruption to make India an attractive destination for FDI. The role of discretionary power of the government should be reduced, wherever possible, infrastructural facilities should be enhanced, environmental, labour, sectoral and intellectual property rights should be strengthened, and delays in environmental clearances and legal work should be curtailed.

Build Awareness and Stimulate Debate on Investment

There is also a need to raise awareness, stimulate national debate and build capacity of civil society on investment issues. Civil society should be made aware of certain issues, *e.g.* the need to have easier exit policy/rules for firms. There are conflicting views among civil society. On the one hand, civil society wants a more liberal policy regime and, on the other, it wants to impose restrictions on foreign investors in terms of job creation, technology/skill transfer, export commitments etc.

CHAPTER-6

Agenda for Action - Inter-Governmental Organisations

Co-operation on Privatisation

Inter-governmental Organisations (IGOs) can play a crucial role in helping out the Indian government in privatisation and facilitating new forms of partnerships, like contracting out or management contracts, private financing of public facilities, leasing, enter into joint ventures and launch build-operate-transfer (BOT) schemes in infrastructure sectors. IGOs can also enhance micro-level expertise in drafting good investment policies and disseminate database for effective policy analysis.

A Role for UNIDO

The United Nations Industrial Development Organisation (UNIDO) can play an important role in creating an enabling environment for the fruition of such a business through policy advice, guidelines and capability building. This includes establishment of the basic legal framework for Private Financing of Infrastructure (PFI) projects, preparation of a standard concession agreement, establishment of procurement rules and procedures and bidding documents and bid evaluation.

Address the Concerns of Developing Countries on WTO Issues

IGOs should address the concerns of developing countries regarding the WTO agenda and discuss the strategies that could be adopted by them, and argue the merits and demerits of an International Investment Agreement (IIA) at the WTO.

CHAPTER-7

Conclusion

By and large, civil society is positively oriented towards FDI. However, the civil society representatives have certain specific concerns related to FDIs' contribution to the economy. These concerns are reflected in its orientation towards having some constraints in the functioning of FDI firms. Civil society has to take the lead in raising awareness and building capacity on investment issues. It has to work closely with the government and, wherever possible, make direct or indirect intervention.

The government should provide an enabling environment for better and more efficient economic activity. This would stimulate FDI as well as domestic investment. The enabling environment includes (1) education, (2) infrastructure, (3) good governance and (4) information dissemination.

There is a definite role for IGOs in investment facilitation in developing countries. Civil society, governments of developing countries and IGOs would gain by interacting closely with each other.

ANNEXURE

Summary of NRG Discussions

One of the most important activities of the IFD project was the formation of a National Reference Group (NRG) in each project country to provide a sounding board and quality check on the research outputs. The main purpose of the NRG meetings was to attract attention to the project at a national level.

First NRG Meeting

January 12, 2002, Jaipur, India

The participants felt that the objective of the government in liberalising the FDI regimes could be examined vis-à-vis exports, technology transfer and employment. The extent to which rigid labour laws, weak infrastructure, caps on foreign equity holding, high transaction costs and slow pace of economic reforms have contributed to the poor FDI performance could also be assessed. In this context, the phenomenon of withdrawal of investment and failed investment could be looked into. Some participants opined that FDI should not be viewed as the only tool for poverty alleviation and generating employment, and that FDI flows may not rise even after improving administrative procedures.

The participants discussed appropriate policies to facilitate FDI and methods of formulating and implementing FDI policies. A strong domestic competition policy and radical improvements in domestic governance with appropriate and strong institutions must be developed with a healthy infrastructure sector and macroeconomic stability.

FDI should be thought of in the global context, and whether or not it benefits majority of the people. In this context, the case for encouraging Foreign Institutional Investors as against Transnational Corporations (TNCs) was also discussed. A view was expressed that FDI is needed in the short run to provide a spurt in the growth rate but in the long run repatriation in profits result in outflow of capital. The consensus on this point was that foreign investment should not be seen differently from domestic investment: they are two sides of the same coin and that investment in appropriate sectors would lead to faster and sustainable development. A case in point was the huge requirement in the infrastructure sector.

On investment in the WTO context, the general opinion was that there are no problems with the WTO regime but many had reservations regarding an agreement on investment. It was pointed out that the developed countries should not be allowed to push their agenda through an IIA.

Some scepticism was expressed as to why an IIA at the WTO would facilitate higher FDI inflows. It was pointed out that some countries, including the developing ones had signed many bilateral investment treaties with the provisions that were being discussed in the WTO context, but the same countries were opposing it at that level. The major objection was with the proposed provision of pre-established rights, which many developing countries including India were not willing to accept. It was opined that the developing countries should demand an agreement on the Movement of Natural Persons too, if they were to sign an IIA.

It was also discussed that India had done well on the issues of commodity trade at the WTO, but lacked clear policy or direction on issues of investment. One of the reasons for this state of affairs could be that the number of studies conducted in India on WTO issues are not many and so there is a dearth of proper analysis on different clauses of WTO agreements and their implications for India. Developing countries must realise that the WTO has to be understood properly and in the era of globalisation they have to welcome FDI and thus understand the investment issues properly and comprehensively.

Second NRG Meeting

June 09, 2002, Chennai, India

The discussions started with deliberations on the continuous decline in government savings and investment. The stability achieved has been at the cost of lower public investment in infrastructure. India has been facing severe resource constraints in financing infrastructure due to lack of government financial resources and decline in concessional aid. One of the differences between pre and post reform period in India is that efficiency of investment has come into focus.

It was felt, in the meeting that, services such as drinking water, roads etc having public-good characteristics could be provided by the private sector in a competitive environment. However, competition is a double-edged sword. It can promote efficiency but can also be devastating if not regulated properly. This brings into focus the role of regulators to provide a level playing field.

The major sectors that attracted FDI inflows in India in 2001-02 were telecom, power, oil and refinery, electricity equipment (including computer software), transportation and services sector. It was noted that telecom is the only sector that is witnessing true liberalisation and though halting and still with some distortions, bestowing consumer benefits and attracting domestic as well as foreign investment. The success in this sector has not been reflected in other sectors. The ongoing discussion on FDI in 'silicon chips' versus 'potato chips' needs to be considered in the perspective of the sectors in which the country is trying to attract FDI.

A good legal framework and good governance are prime conditions for attracting foreign direct investors (especially in infrastructure) because of the magnitude of investments.

Analysis of the determinants of FDI fructification showed that there is a relationship between the rate of fructification and the size of the firm. FDI by way of mergers and acquisitions often did not fructify because the large local firms resist the take over. It was also noted that the FDI fructification rate increases if the cases involve non-resident Indian participation.

The multilateral agencies could play a crucial role in FDI for creation of an enabling environment through policy advice and capacity building.

Third NRG Meeting

March 13, 2003, New Delhi, India

Referring to the overall documentation of the project including surveys, it was analysed that the project countries had undertaken substantial FDI policy changes over the last 10-15 years. Many of these changes have come about due to changes in the perception of FDI. From the civil society surveys, it was seen that there was a general positive attitude towards FDI, though there were a few areas of concern.

The meeting looked closely at the Indian State Owned Enterprises (SOE's) that are dominant actors in the market The civil society's perception of their role is important. Foreign bidders are not allowed to bid for all SOEs and at times it is difficult to find big enough local investors. Sometimes, foreign investors do not evince enough interest, maybe because they feel that the SOEs are overpriced. There was a general consensus that Indian SOEs are not run optimally. The way forward for restructuring has not really been found.

The Tanzanian delegate said that before privatisation of the telecom sector, telephones were a luxury but now that there are three companies, the situation has eased considerably. However, when these companies collude, the customers suffer. The Tanzanian civil society generally feels positive towards FDI but had some reservations on the environmental impact of FDI.

The Indian situation was compared with Bangladesh, where the negative attitude for FDI was usually sector-specific. It was also felt that despite liberalisation some problems such as bureaucracy, law and order and infrastructure inhibited FDI inflows. The not-so-good image of Bangladesh was also perceived as a reason for poor progress.

After the presentation of the advocacy points, the main point of discussion was, distinguishing between the need for development to attract FDI and the need of FDI for the sake of development. An enabling FDI regime might in fact simply be the other side of the coin for making FDI work for development. It was also noted that the country might need liberal policies to attract FDI. Regulation is required to make FDI count for development.

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