ISAS Insights
No. 621– 11 June 2020

Attracting Foreign Investment into India: Key Initiatives by the Government

Vinod Rai

Summary

As a possible fall out of the COVID-19 pandemic crisis, India has the opportunity to attract foreign direct investment inflows from large companies seeking to diversify their investment to mitigate risks. It has set up an empowered group of secretaries to engage in conversation with these companies and provide all possible facilities to them to ensure ease of setting up business. In addition, some incentive schemes have been announced in sectors where the government feels India has an advantage such as mobiles, electronics and medical equipment. However, mere incentives may not be sufficient to attract these investors. It will require a whole ecosystem which is facilitative and not overbearing.

China had, over the years, become the most preferred destination for international companies to set up shop and supply their products to global markets. The excellent infrastructure, abundance of cheap and professional labour, ease of doing business facilities, a strong business ecosystem, low taxes, not-so-strict regulatory compliances and competitive currency practices are the main reasons for the attraction towards China. As a consequence, China became the largest recipient of foreign direct investment (FDI) in Asia.[1]

However, with the outbreak of the COVID-19 pandemic from Wuhan and the increased concerns, largely emerging from the United States (US) and countries in Europe, that the virus may have been a bio-weapon, a large number of multinational companies have begun to entertain thoughts of diversifying their production sources. In fact, this is not the first time that such a thought has occurred in the minds of these companies. There was an indication that South Korean firms were engaged in talks with Indian companies to relocate some of their production sources to India. The added concern, which has been very prominently highlighted with China having locked down its production, export and shipping facilities, is the risk of facing disruption in the supply chain, with one hiccup in that country. Several large conglomerates have realised the risk of being so totally dependent for manufacturing activities on a single country. It is this awareness which has prompted them to expand the geographic spread of their facilities. This concern had begun gaining ground in the protracted China-US tariff discussions which had introduced jitters in the mind of companies which had large facilities in China.

India offers an attractive option to these companies. It is believed that nearly 1,000 companies are engaged in the process of exploring multiple alternative locations and that 300 of these are in talks with Indian companies. If this is really true, the Indian government needs to proactively create an environment such that the thought of India as a supply chain

[1] World Investment Report, 2019, https://unctad.org/en/Pages/DIAE/World%20Investment%20Report/World_Investment_Report.aspx#:~:text=. Accessed on 9 June 2020.

partner becomes attractive to these companies. No doubt, this will require the creation of world class manufacturing ecosystem, supplemented by trained and highly-skilled manpower. The ecosystem should encourage innovation and protect intellectual property. These factors, combined with cheap and reliable labour, helped China attain a leading position. In the realisation that mere geo-political considerations will not attract companies to India, the government seems to have embarked on a major mission to make available all feasible policy options to attract FDI inflows into the country and help large companies, presently based in China, to diversify their sources of production to mitigate their risks.

On 3 June 2020, the Indian government announced the creation of an empowered group of secretaries, headed by the cabinet secretary, and a Project Development Cell (PDC) in the ministries/departments with a view to attracting investments to the country. Its objectives include bringing synergies and ensuring timely clearances from different departments and ministries to attract increased investments into India and provide investment support and facilitation to global investors and to facilitate investments of top investors in a targeted manner and to usher policy stability and consistency in the overall investment environment. The PDCs, located in each economic ministry, have been set up for the development of investible projects in coordination between the central and state governments. The PDC will be tasked to conceptualise, strategise, implement and disseminate details with respect to investible projects.

The PDC is aimed at creating projects with all approvals, making land available for allocation with the complete detailed project reports for adoption/investment by investors and to identify issues that need to be resolved in order to attract and finalise the investments. The government's objective, besides making India an investor-friendly destination, is to ramp up production across product lines and help to serve big markets in the US, the European Union, China and elsewhere, thereby making India a large player in the global value chain. The setting up of the committee comes after the government made certain changes in its FDI policy which restricts direct investments from China and other neighbouring countries. The changes were introduced to curb opportunistic takeovers or acquisition of Indian companies, mainly unlisted. With this amendment, the government merely proposes to introduce a screening process. However, a large number of companies such as Paytm, Snapdeal, Ola, Swiggy, Zomato and Big Basket, which have fairly substantial Chinese investment, have been concerned about this provision. This concern has to be seen in context of the fact that more than 234 funding deals have been done with Chinese investor participation in the period 2014-19.[2]

The efforts of the government to incentivise domestic and foreign investments in sectors where Indian conditions appear to have an advantage, such as smart phones, electronics, medical devises, textiles and synthetic fibers, have been identified. The government has announced three schemes to boost domestic and foreign investment to create a manufacturing hub in India for electronics and smart phones. In one of the largest incentive schemes to boost the production of mobile phones and their components in India, the

[2] "#TheInc42Show: What Can Govt Do To Incentivise Investments Amid FDI Restrictions?", *dailyhunt*, 26 April 2020, https://m.dailyhunt.in/news/india/english/inc42-epaper-inc/theinc42show+what+can+govt+do+to+incentivise+investments+amid+fdi+restrictions-newsid-n180765532. Accessed on 9 June 2020.

government has announced a production linked incentive package of nearly ₹420 billion (S$8.75 billion) to be disbursed over five years. This involves an incentive of four to six per cent on incremental sales of goods manufactured locally for a period of five years. The major beneficiaries of this scheme among the foreign producers would be companies selling high end devices such as iPhone producer Apple, Galaxy and Note series by Samsung. Among the domestic producers would be players like Karbonn, Micromax and Lava.

Due to the minimum price restriction of US$200 (S$278) of the product for eligibility, companies such as Oppo, Vivo and maybe even Samsung would not be eligible for the incentive as their products are priced below US$200 (S$278). This scheme will be operational from 1 August 2020. The scheme has been devised to overcome the disadvantage of 8.5to 11 per cent that the sector manufacturing electronics hardware faces vis-à-vis other producers in countries such as Vietnam and China. This is largely due to the inadequacy of infrastructure, domestic supply chain and logistics, high cost of capital, lack of uninterrupted supply of power and limitations of design and research and design facilities.

The government has also announced another scheme – Scheme for Promotion of Manufacturing of Electronic Components and Semiconductors – which will also be launched on 1 August 2020. This is to develop a supply chain which is essential for the manufacturing of electronic products with higher domestic value addition. The scheme will help offset the disability for domestic manufacturing of electric components and semi-conductors. The attempt is to strengthen the electronics manufacturing ecosystem in the country by providing a financial incentive of 25 per cent on capital expenditure for the identified list of electronic items that comprise downstream value chain of electronic products. The scheme is applicable to investments in new units and expansion of capacity or modernization and diversification of existing units.

Yet another attractive proposition approved by the government is the Modified Electronic Manufacturing Clusters (EMC 2.0) Scheme to develop world class infrastructure, along with common facilities and amenities through the Electronic Manufacturing Clusters, to help create a hub for mobile and component manufacturing. It is hoped that these EMCs will help in the growth of the electronic system design and manufacturing sector, create an ecosystem for the development of entrepreneurs and drive innovation by attracting investment in the sector and thereby creating employment.

Additionally, two important factors to convert the opportunity into an advantage are the easy and early availability of land and a consistent and flexible policy on labour. Land is a state subject and states like Karnataka have already put in place policy amendments which permit corporates to directly negotiate with and purchase land from farmers. The states have begun to prepare their land inventory and the central government aggregates these and offers them to potential buyers. Similarly, amendments to existing labour laws are being proposed to introduce certain degree of flexibility in hiring of labour. On the whole, the government is working on strategic implementation of an integrated approach that will eventually bring about synergies between ministries/departments of the central and state governments in investment and related incentive policies.

To help in the ease of doing business, the government is also seeking to reclassify certain offences under the financial sector laws as civil offences rather than criminal so as to improve the ease of doing business. It is expected that the reclassification will decrease the burden on businesses and inspire confidence among investors. The nature of default will then be evaluated in terms of the action being an act of omission (inadvertent) or an act of commission (pre-mediated default). The proposal is to re-look at provisions which are merely procedural in nature and do not impact public interest or national security. The defaults that are under consideration of government are bounced cheques which entailed imprisonment up to two years or taking of public deposits. The government is seeking to decriminalise four sections of the Reserve Bank of India Act in this regard. This is a move which will be welcomed by the industry and investors who feel that, whilst a heavy penalty in terms of monetary fine is in order, criminalisation is an avoidable dampener to businesses.

Another sector which offers an excellent opportunity for India is higher education. As part of his election campaign commitment, US President Donald Trump has banned the entry of citizens from six Muslim-majority Organisation of Islamic Cooperation-member countries into the US. The countries are Chad, Libya, Syria, Yemen, Somalia and Iran. This ban was contested and has been upheld in the US Supreme Court, thus giving finality to it. Besides the adverse impact it will have on the inflow of tourists from these countries, it will also indirectly impact the enrollment of students in American universities. It is estimated that about 22,000 students from these countries are presently enrolled in the US. India has a fairly sizeable proportion of foreign students joining its universities and higher educational institutions. The numbers are growing with students from Afghanistan, Sudan, Iran and the United Arab Emirates leading the pack. With the changes introduced in FDI and registrations of educational institutions in the private sector, there has been an improvement in the overall standards of education. This indicates the potential that India has to offer as an alternative educational preference for foreign students by ensuring even better standards of teaching and other related infrastructure. The government should develop a strategy to attract overseas students especially as China may be a less attractive destination for a while. Facilities and the quality of education in private technical institutions find easy acceptability for jobs and higher learning in the US, indicating to the potential that this sector offers.

A step in the direction of an indigenous industry seeking to substitute Chinese equipment has been taken in the field of solar equipment. Adani Green Energy, a large Indian private conglomerate, has won a major tender to set up 8GW of manufacturing linked solar energy projects with an investment of 45,000 crore (S$9.72 billion). It is learnt that the group is in negotiation with potential equity and strategic partners for latest technology solar equipment manufacturing. Presently, Chinese solar equipment has a 90-per cent share in the Indian market. The new facility will reduce the dependence on Chinese facilities to negligible levels. To provide an initial stimulus to such ventures, while the government may not be able to give cash incentives, assistance could be provided by policy interventions such as anti-dumping duty or customs duty on imports.

The capacity of the government to attract investment in the country cannot be determined merely by the schemes, incentives and other tax related attractions that it can offer. It will determined by a holistic ecosystem that the government machinery, both in the centre and the states, will be able to offer so that the 'ease of doing business' is noticeable at the ground level. There has to be a facilitative and 'hand holding' approach in the states where these units will be established and the local bureaucracy should not become a stumbling block. The main issues involving the local bureaucracy which delay clearances are the approval of licenses, early land acquisition, power connections, environmental clearances, bank loan applications and easy registration to employ contract labour. Facilitation officials need to be mandated to ensure that new investors are provided all the guidance and assistance to set up their facility in a time bound manner. The government should put a premium on timeliness for such activities and fix accountability where any lackadaisical approach is observed.

The Indian government will have to be cognisant of the fact that there are other countries in the Asian region seeking to attract companies that are likely to be moving out of China. Malaysia, the Philippines, Indonesia and Vietnam are equally attractive destinations and have indeed been able to successfully induce large corporates to set base there. Hence, it is a comprehensive set of policy options which will have to be coordinated for synergistic action between the state and central governments. The Indian government has to contend with a contraction in the economy as a consequence of which tax collections will decline. The fiscal policy space available to the government is very limited. It is time to ensure a consistent and predictable policy environment. Unpredictable and rapidly changing norms in respect of taxation, trade and investment deter longtime investors. The high cost of manufacturing and myriad regulatory approvals are a huge deterrent. The government needs to announce measures which will be guaranteed for at least 10 years so as to enable corporates to take decisions in an atmosphere of certainty rather than face an uncertain future.

. . . . .

Mr Vinod Rai is a Distinguished Visiting Research Fellow at the Institute of South Asian Studies (ISAS), an autonomous research institute at the National University of Singapore (NUS). He is a former Comptroller and Auditor General of India. He can be contacted atisasvr@nus.edu.sg. The author bears full responsibility for the facts cited and opinions expressed in this paper.