

Investment

ENCOURAGING GREATER INTERNATIONAL INVESTMENT IN INDIA

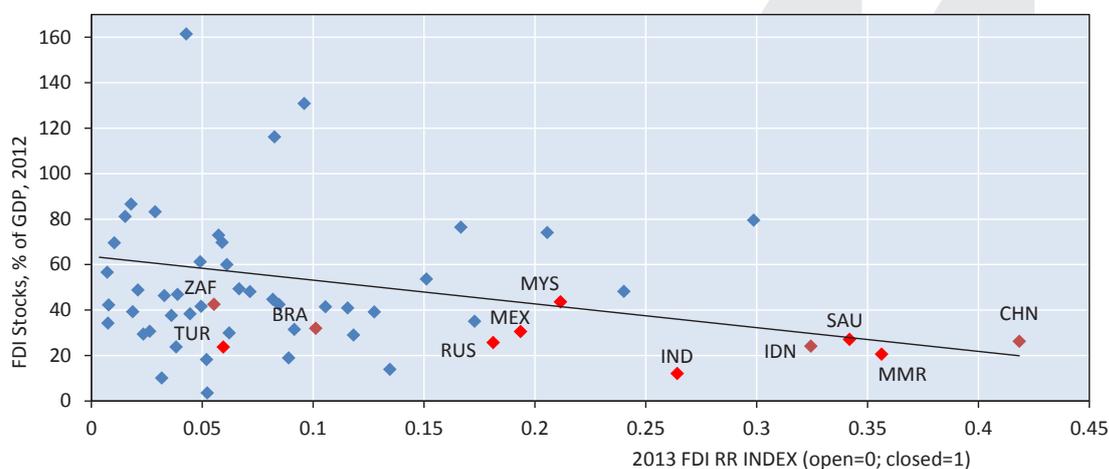
- ▶ FDI stocks in India remain modest, particularly given its market potential.
- ▶ India has made great strides in reducing FDI restrictions over the past 15 years. Nonetheless, the remaining restrictions are considerable.
- ▶ Restrictions are concentrated in the services sector, with negative repercussions on overall competitiveness.
- ▶ India suffers from frequent and unpredictable policy changes, regulatory uncertainty at state levels, and delays in land acquisition.
- ▶ Broader reforms of the business environment are required to enhance predictability, transparency and fairness.
- ▶ MNEs offer another channel of integration into the global economy. Responsible business conduct, as embodied in global standards and practices, can help minimise risks and maximise returns from international expansion.

What's the issue?

India is regularly mentioned as one of the top global destinations for international investment, but it ranks outside the top 10 recipients worldwide. FDI statistics are notoriously volatile, but a decline has been visible in recent years. International multinationals cite factors such as retrospective tax legislation and rulings, strict labour laws, slow decision-making at the sub-national level, and poor infrastructure.

In addition, in India statutory restrictions in areas such as equity investment, screening and approval requirements, appointment of foreign key personnel, and other operations (such as limits on the purchase of land or on repatriation of profits and capital) are burdensome for foreign investors. Their pervasiveness – as measured by the OECD FDI Regulatory Restrictiveness Index – is a burden on the national economy (see Figure).

Regulatory restrictions matter for attracting FDI



Sources: OECD and UNCTAD statistics.

Why is this important for India?

India's sluggish growth rate is partly due to the poor dynamism of the manufacturing sector and lack of success in participating in international production networks. Multinational enterprises create (usually well-paid) jobs, generate complementarities with local firms, diffuse more advanced technology and management practices, contribute to the trade balance, improve competition conditions, and generate further real income gains if they spur positive externalities, for example raising productivity in other firms.

At India's current stage of development, achieving all these potential results would be crucial for inclusive growth. Improving the business environment would make it possible for India to attract a major proportion of FDI inflows into manufacturing, as China, Malaysia and Thailand have been able to achieve.

An environment conducive to investment and innovation would benefit Indian firms and make it possible to upgrade and pursue appropriate internationalisation strategies. India also became the first country in the world to mandate responsible business conduct by requiring companies to spend 2% of their net profits on projects related to social development.

What should policymakers do?

- ▶ Ease foreign equity restrictions in sectors such as aviation, insurance and multi-brand retail trade.
- ▶ Accelerate approval of necessary norms and local procurement provisions by state governments.
- ▶ Guarantee investors with advance tax rulings.
- ▶ Revise certain provisions of the Land Acquisition Act that impose unnecessary burdens on PPP and private projects (for example, clauses on the Social Impact Assessment study and on the threshold for consent requirement).



Further reading

Kalinova, B., Palerm, A. and Thomsen, S. (2010), "OECD's FDI Restrictiveness Index: 2010 Update", *OECD Working Papers on International Investment* No. 2010/03, OECD Publishing. <http://dx.doi.org/10.1787/5km91p02zj7g-en>

OECD (2010), *Investment Policy Review – India*, OECD Publishing. <http://www.oecd.org/india/india-investmentpolicyreview-oecd.htm>

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OECD/WTO (2013), *Trade in Value Added (TIVA) Indicators – India*. http://www.oecd.org/sti/ind/TIVA_INDIA_MAY_2013.pdf

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