FOREIGN DIRECT INVESTMENT IN INFRASTRUCTURE SECTOR – INDIAN SCENARIO

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Abstract:
Infrastructure is the basic physical and organizational structures needed for the operations of a society or enterprise or the services and facilities necessary for an economy to function. It can be generally defined as the set of interconnected structural elements that provide support for the development of the economy. The foreign investment in infrastructure remains dim even though Government of India promotes foreign capital and creating an investor friendly environment. Lack of infrastructure adversely affects in growth of other sectors also. This paper discuss the infrastructure deficiency of India, the foreign direct investment in infrastructure sector and the actions which the authorities can take while planning to bridge the infrastructural gap.

Introduction:
Infrastructure an important item in judging a country’s or region’s development. Infrastructure sector covers hard infrastructure and soft infrastructure. Hard infrastructure includes transport infrastructure, energy infrastructure, water management infrastructure, communication infrastructure, solid waste management, earth monitoring and measurement networks. Governance infrastructure, economic infrastructure, social infrastructure, cultural, sports and recreational infrastructure comes under the soft infrastructure. Before 1700, infrastructural sector covered only roads and canals. Railways and telegraph services are included in the category from 1700 to 1870. Electricity, water distribution and sewers and subways are added to the sector after 1870. Since 1920 communication facilities and technology infrastructure is considered as the prime additions to the sector.

Literature Review
Rudra Prakash Pradhan, ICFAI Journal of Financial Economics. Jun2008, Vol. 6 Issue 2 - The paper investigates the determinants of Foreign Direct Investment (FDI) in India, with particular reference to infrastructure. Covering the period from 1970 to 2004, the empirical investigation confirmed that infrastructure has a significant negative impact on FDI inflows in India. This is mostly due to stagnant infrastructure investment in the economy. On the contrary, FDI inflows are positively determined by trade openness in the country. The paper suggests that to make our economic policy more effective towards increasing inflows of FDI, a successful FDI policy must be well-integrated with the policy of globalization and infrastructural development

Tien Quang Tran, ASEAN Economic Bulletin. Apr2009, Vol. 26 Issue 1 - Through examining trends and patterns of foreign direct investment (FDI) in Vietnam over the twenty years of reform (1986-2008), this paper found a big increase in registered FDI recently. This is not in accordance with the increase in actual capital disbursement because of low absorptive capacity of the economy in terms of poor infrastructure, restricted and unstable policy, and weak competitive capacity of domestic firms. Moreover, newly massive flows of FDI brought an explosion to infrastructure development in the form of office buildings,
hotels, industrial zones, resident parks and ports. This could help to improve the situation of infrastructure because it has not kept pace with the rapid economic growth over the past decade and are considered as major constraints in attracting more FDI.

**Indian Scenario**

Reserve Bank of India has defined infrastructure sector as¹:

i. Power
ii. Telecommunications
iii. Railways
iv. Roads including bridges
v. Sea port and air port
vi. Industrial parks
vii. Urban infrastructure (water supply, sanitation and sewage projects)
viii. Mining, exploration and refining, and
ix. Cold storage and cold room facility, including for farm level pre-cooling for preservation or storage of agricultural and allied produce, marine products and meat.

The Index of Eight core industries—crude oil, petroleum refinery products, coal, electricity, cement, steel, fertilizers and natural gas—having a combined weight of 37.90 per cent in the Index of Industrial Production (IIP) stood at 139.5 in September 2012, according to data released by the Union Ministry of Commerce and Industry. During April-September 2012-13, the cumulative growth rate of the Core industries was 3.2 per cent. The infrastructure sector accounts for 26.7 per cent of India's industrial output. The Planning Commission has projected that investment in infrastructure would almost double at US$ 1,025 billion in the Twelfth Five Year Plan (2012-17), compared to US$ 514 billion in the Eleventh Plan. Of the US$ 1,025 billion, 50 per cent is expected to come from private sector, whose investment has been 36 per cent in the Eleventh Plan.

According to investment banking company Goldman Sachs, India's infrastructure sector will require US$ 1.7 trillion investment in the next 10-years. With a view to streamlining and simplifying the appraisal and approval process for public private partnership (PPP) projects, a Public Private Partnership Appraisal Committee (PPPAC) has been constituted under the chairmanship of Secretary, Department of Economic Affairs and Secretaries of Planning Commission, Department of Expenditure, Department of Legal Affairs and the concerned Administrative Department as its members. The project proposals are appraised by the Planning Commission and approved by the PPPAC. Further, India needs to spend US$ 1.7 trillion by 2030 to meet the projected demand of its cities, according to a McKinsey Global Institute Report.

Foreign Direct Investment (FDI) in infrastructural sector to be viewed in this context. India’s infrastructure funding has fallen well short of its economic growth. Lack of infrastructure is adversely affecting the growth of secondary sector and the percentage share in GDP is showing a decline. This is making the economy over dependent on service sector and forcing as to increase our imports.

¹ RBI Master Circular No.12/2012-13 dated July 02, 2012
Majority of the new projects coming up in the infrastructure is of PPP model i.e indirectly the expense is paid by the public. Not many private players are in a position to invest in trillions of dollars in infrastructural projects. This in turn makes PPP projects not enough to meet the country’s immediate requirements. India has already emerged as one of fast growing developing economies of the world. The matured financial market has already invited Foreign Institutional Investors. Our stock markets are already one of the favored destinations of foreign players. This has to be used as a base for inviting FDI in India.

The trend towards greater reliance on the private sector has also seen a growing role for FDI in infrastructure. FDI made up 28% of the total infrastructure investment in developing countries during 1996 – 2008\(^2\). Moreover they have the greater capacity to mobilize financial resource to meet the huge capital requirements of major infrastructural projects. Opening the infrastructure sector also increases the pool of potential investors, allowing governments to secure higher prices for infrastructural assets.

**FDI Investments in Indian Infrastructure:**

FDI investment in infrastructural sector is welcomed by the Government of India. India is more viewed as a financial market. Majority of FDI investments happened in the financial services sector. The growth rate of the economy, working and earning population and financial literacy helped in increasing the FDI base in financial services sector. Other sectors including infrastructure was not in the limelight till now. The recent policy changes has favourably affected retailing and educational sector and many players has already expressed their interest in investing in India

Infrastructure in India is viewed as a tough sector to invest. India needs an investment of US$ 1.7 trillion\(^3\) in infrastructure. Only then the country would be able to meet the requirements based on the expected GDP growth. Private- Public Partnerships (PPP) are gaining importance with PPP airport projects at Bangalore, Delhi, Hyderabad and Mumbai and also in power and port sectors. Among the PPP projects only the power sector is on track, achieving 100 % of planned capacity, the airport sector is at 75% and road sectors at 50% including National Highway Development Programme that has achieved only 10% of the planned capacity\(^4\)

This is followed by the low foreign investments in the infrastructure. One of the main reasons for unattractive inflow to infrastructure is the regulatory environment. As a system we need a clear, stable legal framework for promoting investment in infrastructure. Once we move from State Investments to Transnational Corporations (TNC) we need a legal framework which would meet the international benchmarks. The investor will be always concerned of the clarity of the legal frame work. Policy changes in short run and delay in taking decisions in policy matters has adversely affected the foreign inflow in infrastructure.

Lack of strategic planning in the sector also affected the foreign inflow. Many countries have a very clear plan of the infrastructural requirements of the next 10 years and will be having a strategy to route the money to various divisions based on requirement. In developed nations

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\(^2\) UNCTAD, 2010 b  
\(^3\) Goldman Sachs Report, 2012  
\(^4\) Planning Commission of India, Eleventh Plan Targets and Achievement
infrastructural sector is viewed as whole and planning is done. But in India each division is considered separately.

Even though India is blessed with abundant labour, the management in infrastructure projects is viewed in a different angle. Political influence, labour unrest, hostile measures of acquiring land etc. are viewed negatively by international media. This is creating some sort of resistance for a foreign player to invest in infrastructure. The delay in completion of projects due to these factors is keeping the money blocked for a longer period. Majority of players wish to be an FII in infrastructure and reality sector than and FDI.

Among the developing economies, India is considered to be one of the countries where the project completion time is very high\(^5\). We are not having a single window system (except in a few cases where it’s more of a state subject). This makes the process too complicated and time consuming. The lack of co-ordination and integration between various Government departments worsen the situation. An infrastructure project which requires approvals for ‘n’ number of departments from the starting stage to the completion stage, the investor is forced to comply with the demands of the consultants and bureaucracy.

Political environment in India is also a reason for low foreign investment in infrastructural sector. India is having elections every 5 years, and majority of state have new ministry every 5 years. There are many instances where the policy and process of one ministry is diagonally opposite to the next ministry. There are even instances where some projects are cancelled, modified and fresh tenders orders and given. This is creating a policy dilemma and increases the risk of the foreign player.

**Future Requirements:**

The growth of others sectors of the economy is now dependent of the growth and investments in infrastructure and which in turn demands the requirement of FDI in the sector. Opening up of retail sector, matured financial services and software sectors, growing educational, reality, pharmaceutical and hospitality sectors provided wide opportunity for growth of the economy. This will become a reality only if all the others sectors can be supported with the basic infrastructure. The following steps from the government can make the infrastructure more lucrative for foreign participation:

1. Developing a strong legal and regulatory framework: Ideally, this is the requirement in the foundation stage itself (before inviting for FDI participation). Significant capital requirements, a long investment time line and the fixed nature of assets make infrastructural investments unique. Beyond the existence of commercial opportunities in the host country markets, foreign infrastructural investments require a transparent and stable policy framework underpinned by the rule of law. Before committing funds to projects, companies consider whether laws and contracts are likely to be properly enforced; rights and responsibilities are well defined. Moving from a state owned system to a TNC requires significant adjustments to the policy framework.

2. Capacity and skills to regulate FDI: Inviting TNC’s to deliver infrastructural services often puts more pressure on public authorities than a State-sponsored plan.
Understanding the legal, economic, financial and political aspects of the infrastructural sector is necessary to perform demanding planning, negotiation and regulatory functions. The existing Government agencies and Departments must be equipped to meet the challenge and undertake the responsibility.

3. Develop a strategic infrastructure plan identifying key needs: The identification of priority infrastructural projects should be informed by the Government’s socio-economic development objective. The commercial viability of the project is always an important consideration, but cost sharing can also be used to ensure the construction of less profitable projects based on requirement and public interest. Long term planning by the Government allows it to better co-ordinate infrastructural developments and optimize the FDI impact.

4. Open the bidding stage to as many investors as possible: It is better to have a competitive bidding or auctioning process. A highly competitive bidding stage maximizes the benefits accruing to the infrastructural users in specific and the economy as a whole also. It’s important that the process is transparent and favoritism to be avoided.

5. Create a pipeline for pre-assumed, commercially attractive projects that can be actively promoted: After an infrastructural project is identified as eligible for private involvement, there are a number of preparatory steps that the government can take to reduce the risk which the foreign investor is facing particularly in the case of green field investments. Completing necessary feasibility study on environmental and social impacts will reduce the risk of the foreign investor to a greater extend and improve the confidence in investing.

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

7. Mitigating political and regulatory risk: Change in ministry can make the project riskier for the investor. Entering in to bilateral agreements with foreign countries having the clause protecting the terms of the contact can be a morale booster. Yet, the Government should remain cautious to avoid unlimited liability and obligations.

8. Monitoring and Follow up in the project implementation stage: Private investments in infrastructure are typically characterized by complex terms and conditions between the investor and government. Positive outcomes depends on government’s efforts to monitor the project’s progress and enforcing the agreement with the infrastructural investor which demands the creation of an independent body with powers to negotiate and enforce the terms. High level reviews are another way of ensuring the project completion as per the terms specified in the contract.
Conclusion:

The Eleventh Five Year Plan emphasized the need for removing infrastructural bottlenecks for the sustained growth. It, therefore, proposed an investment of US$ 500 billion in infrastructure through a mix of public and private sectors to reduce deficits identified in the infrastructure sector. FDI in the sector can improve the standard of living, generate employment opportunities, makes others sectors more effective and ultimately results in economic growth and prosperity. A transparent, clear and accessible regulatory system supported by a state run independent monitoring system for project implementation can help in attracting FDI and meeting infrastructure requirements.

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