India and the improving Ease of Doing Business: the allure of being the Chinese alternative – Part II

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Political Economy of India and its Growth Story

India set out a path to open up its economy to the world with Liberalisation, Privatisation and Globalisation in 1991, a watershed moment in its development and emergence as an economy to reckon with in the following years. Being the largest Democracy in the world, coupled with strategic challenges in its backyard, India has been regularly challenged by a slew of political, economic and security challenges. However, the consistent growth, projection of politico-economic stability, as well as the creation of a conducive environment for investors' has only pushed the country to being one of the most preferred attractions for multinational corporations to ensure returns on their invested capital in recent times.

With the recent advancement in the Ease of Doing Business (EoDB) rankings, the Indian economy is likely to witness further accelerated growth in the near term, especially in the face of global perception regarding a better investor climate. However, the most important question regarding sustained challenges for the inflow of foreign direct investment is the political willingness for foreign investment amid the federating units of the country. Given the vote-bank politics that characterises the contemporary Indian political system, it is significant to understand if India's federal structure has been and will be a challenge for drawing investors into the country.

Secondly, keeping in mind the different political structures at play at the centre and the state-level, coupled with the incumbent government's attempt to consolidate power in order to implement economic reforms, the assessments will focus on the government attempts to centralise the inflow of FDI and the potential possibilities in such a scenario for the EoDB. With that being said, one of the germane questions with regard to the positive perception of India's growth story has been regarding the possibility of sustained growth based on all economic indices. Although India has been growing at a steady pace of 5-7 percent over the last decade or so, one of the critical questions that has been raised has been the broad departure in the rate of Gross Domestic Product and the Per Capita Income in the country. In such a scenario, it is important to understand whether the EoDB and the country's overall growth rate are actually reflective of percolating growth or are just emblematic of increasing income inequality in the country?

Despite questions regarding the comprehensive nature of growth in the country, India's advancement in the EoDB rankings has led to the all-important question of whether India can replace China as the world's manufacturing hub. Particularly keeping in mind the positive aspects of India's growth story at this moment, the question becomes an all-too relevant one that also ties itself to India emerging to be among the top three economies in the next two decades. The report will be an attempt to qualitatively assess these questions in light of the political challenges and the potential measures that may be adopted to circumvent them.

Foreign Direct Investment in India: the Role of India's Federal Political Structure

The Indian Democracy is characterised by its federal democratic structure, wherein both the Central and state governments have a hold over the income generated by the state. However, based on Constitutional provisions, many issues regarding foreign investments in a state ultimately are a prerogative of the state governments, a factor that has perceivably continued to impede the Central government's aims for the country. This has particularly been the case when opposition political parties have ruled particular states when a particular coalition has been in power at the Centre.

India is divided into 29 states, 7 Union Territories and the National Capital Region (NCR). India's history is replete with instances of centre-state discord over the implementation of policies that were viewed as detrimental for the local populace by the state government and the centre superseding the state government's concerns or vice versa. However, in recent times, the Centre has adopted measures in a bid to promote healthy competition among the federal units, promoting states to directly conduct forums and interactions with foreign investors to ensure FDI inflow. This does not negate the fact that the Central government has ostensibly been in support of development initiatives in certain states than in others. Moreover, these factors remain influenced by apprehensions among the local population regarding land acquisition, rehabilitation and reallocation, impact on the environment, employment opportunities or loss of livelihood etc. In that regard, understanding FDI in regard to the country's federal structure assumes significance.

PM Modi with top US investors including Google CEO Sundar Pichai and Apple CEO Tim Cook during his June 2017 visit to the US

Implementation Scorecard for Business Reforms

S.NO.	STATE	SCORE (%)
1	TELANGANA	62.10
2	HARYANA	54.03
3	CHHATTISGARH	48.12
4	ODISHA	46.77
5	WEST BENGAL	46.51
6	GUJARAT	45.70
7	MAHARASHTRA	43.28
8	ASSAM	43.01
9	KARNATAKA	40.05
10	JHARKHAND	39.52

How does FDI Work in India?

Past research on the dynamics of FDI and Centre-State relations have indicated that states with affiliated governments to that of the Centre tend to receive more FDI than opposition-controlled states or those ruled by coalition partners. The exception to this rule being when the party ruling at the Centre holds the majority of Parliamentary seats in the state, despite being ruled by an opposition party. Secondly, states ruled by opposition parties, but having a considerable negotiation power with the Centre with regard to political gains, have traditionally received higher levels of FDI. Thus, this highlights the overall political permutations and combinations involved in the attraction of FDI into states.

Under the current government, one of the most significant initiatives with regard to drawing foreign investments has been the establishment of the Department of Industrial Policy and Promotion. In a bid to boost FDI inflow, the Central government in June 2017 dissolved the Foreign Investment Promotion Board that was working under the Ministry of Finance. In that sense, the 15 sectors wherein prior government approval is required for FDI are now directly referred to the relevant central ministries and the DIPP. This was envisaged in a bid to accelerate the approval process for the establishment of businesses and for expedited FDI inflow; however, given the central government's stranglehold over the process, the issue of party politics and relations between a particular state and the Centre plays a significant role in the calculations of the investor.

Some instances wherein tenuous Centre-State relations have costed mega-FDI projects in India can be seen in regard to Maharashtra and Odisha. Odisha has been a state ruled by a regional party called as the Biju Janata Dal since 2000, a party that has refrained itself from the ruling coalitions of either the United Progressive Alliance or the incumbent National Democratic Alliance. Odisha is a state replete with natural resources, although it remains one of the most economically backward states in the country. In 2005, multinational corporations POSCO and Vedanta signed a MoU with the state government to invest in the state in the aluminium and mining sector. However, during the UPA rule until 2014, the Odisha government routinely accused the Central government of attempting to stall the investment projects in the state under the garb of tribal rights and environmental protection. The situation has, incidentally, remained stagnant under the incumbent BJP-led NDA coalition at the centre. Notably, due to these companies' withdrawing their projects or incurring heavy losses, the state has dipped to being one of the least investor-friendly destinations in the country from being among the top-ranking states

Keeping this in mind, it is clear that inter-governmental strife and partisan politics play an important role in deciding the political risk for investments. However, a significant question is that although the ruling BJp is discerningly successful in consolidating power across the country at this time, can this centre-state strife continue if the government seeks to establish the country as a manufacturing powerhouse in the next decade?

STATEMENT ON SECTOR-WISE FDI EQUITY INFLOWS FROM APRIL 2000 TO JUNE 2017

S.NO.	SECTOR	Amount of FDI Inflows		%age of Total Inflows
		(In Rs crore)	(In US$ million)	
1	SERVICES SECTOR*	328,701.98	61,359.43	17.92
2	COMPUTER SOFTWARE & HARDWARE	145,269.36	25,985.07	7.59
3	CONSTRUCTION DEVELOPMENT	116,254.60	24,543.84	7.17
4	TELECOMMUNICATIONS	130,728.99	24,033.74	7.02
5	AUTOMOBLIE INDUSTRY	96,831.50	17,389.89	5.08
6	DURGS & PHARMACEUTICALS	77,631.05	14,987.84	4.38
7	TRADING	89,512.52	14,979.45	4.37
8	CHEMICALS (OTHER THAN FERTILIZERS)	73,332.72	13,972.40	4.08
9	POWER	61,225.75	11,765.82	3.44
10	HOTEL & TOURISM	58,001.15	10,477.29	3.06

Government Efforts to Centralise FDI regime for EoDB

While the incumbent BJP-led coalition is likely to use the FDI lure to gain regional political party support in the long-run, it is liable that investors are likely to be inclined toward states either ruled by BJP at the state level or at least affiliated parties. This is likely to be the case as the state leadership's aims and attempts to sustain foreign investments in their territory would likely align with the Centre's regulations and agency-requirements. In such a scenario, state governments would likely want to affiliate itself or at least project its approval of the central government's measures with regard to drawing investments. However, one of the most important aspects to be considered in this scenario is that these state governments, especially if ruled by a regional party, may not be inclined to do so in the event of an upcoming election year.

With that in mind, inter-governmental relations would remain a significant dynamic impacting FDI inflow with regard to states. The example of BJP-ruled Maharashtra being among the top attractive destinations for foreign investors is a case in point. Given the fact that the EoDB rankings was likely a shot in the arm for the Modi government, the Centre is likely to use it as a leverage for state government to fall in line with regard to industrial regulations, especially as the PM is particularly seen as the face of development for the country.

SHARE OF TOP INVESTING COUNTRIES FDI EQUITY INFLOWS (Financial years)

S.NO.	COUNTRY	Cumulative Inflows (April, 00-June, 17)	%age to Total Inflows (in terms of US $)
1	MAURITIUS	607,177 (114,931)	34%
2	SINGAPORE	334,445 (57,600)	17%
3	JAPAN	145,159 (26,125)	8%
4	U.K.	126,449 (24,731)	7%
5	NETHERLANDS	120,931 (21,266)	6%
6	U.S.A.	114,788 (20,983)	6%
7	GERMANY	57,186 (10,496)	3%
8	CYPRUS	47,518 (9,279)	3%
9	FRANCE	31,270 (5,824)	2%
10	UAE	26,577 (4,765)	1%
TOTAL FDI INFLOWS FROM ALL COUNTRIES*		1,854,642 (342,520)	

Future trends: India the next China for the Manufacturing sector?

According to data from the Department of Industrial Policy and Promotion, FDI equity inflows into India has had its largest share in the services sector of India, accounting for approximately 18 percent of the total FDI inflows in the country. The services sector accounts for approximately 60 percent of the country's Gross Domestic Product (GDP) and is one of the fastest growing sectors of the country driving FDI inflows into the country across the Telecom, drugs and pharmaceuticals, and hospitality and tourism industry. For an import-driven economy at this moment that is attempting to make its available demographic productive, this growth and boost to the services sector appears to be a positive indication. However, with an expanding demographic with increased consumer spending ability, the question arises as to if India can capitalise on this factor to make the most of its consumer market.

Asia has traditionally been a manufacturing hub for the world. Following the Second World War, Japan rose from the war's devastating consequences by being the manufacturing centre for the world, a position that was replaced by the Asian tigers (Hong Kong, Taiwan, Singapore, and South Korea) and subsequently by China. With China attempting to shift from an export driven economy to one where it focuses on domestic consumption and a potentially booming market, can India take the position that would be left void by Asia's largest economy? One of the scepticisms with regard to this question has been of the growing reliance on technology and its impact on the manufacturing sector. With Artificial Intelligence and technological developments gradually replacing the need for more manual control over manufacturing, India needs to develop measures to deal with its largely unskilled booming young demographic while creating employment opportunities as well as balancing out the probability of being a manufacturing economy and capitalising on its consumer market as the country emerges to be a middle-income economy in the next few years.

With all that being said, while the question of India being the next China is consistently presented as India emerges as one of the most reliant Democratic economies in the Asia-Pacific, it remains to be seen if India is able to capitalise on its new-found reputation. While the EoDB rankings are likely to continue to boost investor confidence with regard to the country in the coming years, in turn, leading to further advancement in the EoDB in the country, the country's political willingness to ensure a conducive environment for investments while eliminating inter-governmental differences remain significant.

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