Half-hearted FDI reform

Dismantling the FIPB is the first step on the road to rationalising the FDI regime. It must be complemented with a single comprehensive law governing capital inflows in India, which includes doing away with the approval system

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Finance Minister Arun Jaitley in his Budget speech promised that the Foreign Investment Promotion Board (FIPB) would be phased out in 2017-18, and the road map for this would be unveiled during the current financial year. This is a laudable step towards simplifying the regulatory regime governing foreign direct investment (FDI). FDI inflows in India may be under the automatic route or the approval route. In the latter case, the FDI inflow is subject to prior approval from the central government. Administratively, the approval may flow from a ministry or department of the central government. The FIPB is an inter-ministerial body to facilitate single-window clearance for such proposals. Soon after the Budget speech, Commerce Minister Nirmala Sitharaman stated ("Ministries, regulators can decide fate of FDI proposals: Sitharaman", *Business Standard*, February 7, 2017) that while the FIPB might be dispensed with, the approval regime would continue with sectoral departments or regulators being in charge of granting approvals to FDI inflows under the approval route. If this is true, then dismantling the FIPB without simultaneously abolishing the approval route, will be counterproductive.

First, dismantling the FIPB without simultaneously dispensing with the "approval route" is problematic from an ease-of-doing-business perspective. It will end up increasing the costs associated with the approval process, as it will require investors and the Indian investee firms to deal with multiple touch-points in the bureaucratic administration at the Centre.

Let's take a hypothetical example of Hudson News, an American group that operates news distribution stands and retail outlets at airports and railway stations. It also publishes its own in-house material. If Hudson News proposes to set up operations in India, it will require to obtain the approval of the central government as both FDI in print media and FDI in multi-brand retail are under the approval route. Hudson News will have to approach the Ministry of Information and Broadcasting for approval to set up its print media operations in India. It will have to separately approach the Department of Industrial Policy and Promotion in the Ministry of Commerce and Industry for approval of its retail operations. In the absence of the FIPB, it will not have the ease of dealing with a single inter-ministerial body that will process the back-end interface with the different governmental departments and ministries involved. Top this with the different application processes mandated by each governmental department or ministry, and the scale of the problem multiplies.

Second, the concept of the approval route runs afoul of the "minimum government" rule that this government has been promising citizens since May 2014. Under the current regulatory regime governing FDI inflows, about 15 sectors are under the approval route. These sectors range from print media and content broadcasting to multi-brand retail. If there are conditions for the FDI inflows other than caps, these conditions are specifically listed in the annual FDI policy issued by the Ministry of Commerce and Industry. For example, the conditions for investment in the civil aviation sector are specifically listed in the Consolidated FDI Policy document. Similarly, the "other conditions" for FDI in private sector banking are specifically listed. The approval route is a relic of the time when India was new to foreign trade and capital. The listing of restrictions and conditions in the policy obviates the need for approval by sectoral regulators and governmental departments.

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Third, retaining the approval route mechanism indicates that despite our relatively good experience with liberalisation of capital inflows, we rely on centrally planning the economy. The approval mechanism creates artificial entry barriers between two applicants who satisfy the conditions listed in the policy. It makes the system vulnerable to regulatory discretion and induces unpredictability. The practice of seeking approvals and exemptions from conditions, engenders ad-hocism and cronyism. This has adverse implications for the administration of an impartial and rule of law-driven regulatory regime governing capital controls.

Fourth, the approval route is a regressive policy tool in an economy the size and scale of India. The approval route does not only apply to specific sectors, but also to specific contractual arrangements. For example, where a non-resident invests in brownfield pharma and contractually imposes a non-compete provision on the Indian joint venture partner, the provision requires the approval of the central government. Competition issues are governed under the sector-neutral Competition Act, and protectionist controls through mandating approvals for contractual arrangements do not augur well for an economy that is competing for foreign capital. Similarly, there is no rationale for mandating the approval route for FDI flows in the print media, especially in the age of the internet and a globalised world where information flows are virtually seamless.

In developed countries, regulations mandate an approval process for capital inflows from foreigners, where there are national security considerations. Leaving aside the timing of full capital account convertibility, we should similarly re-calibrate our laws governing inflows. The design of a simple and clear law governing capital flows is codified in the Indian Financial Code, the draft law prepared by the Financial Sector Legislative Reforms Commission (2013). Without touching upon the issue of capital account convertibility, it outlines the objectives with which capital flows may be restricted. It leaves scope for an approval process only where the capital inflow has implications for national security or during emergencies. In the latter case, the requirement to obtain approval is necessarily temporary and must be preceded by reasons.

Dismantling the FIPB is the first step on the road to rationalising our FDI regime. This step must be complemented with a single comprehensive law governing capital inflows in India. It must do away with relics of the past, including an approval-based system for capital inflows, which belie the extent to which India is already integrated with the global economy.

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