Takshashila Discussion Document

Attracting Large Investments in the Post COVID-19 World

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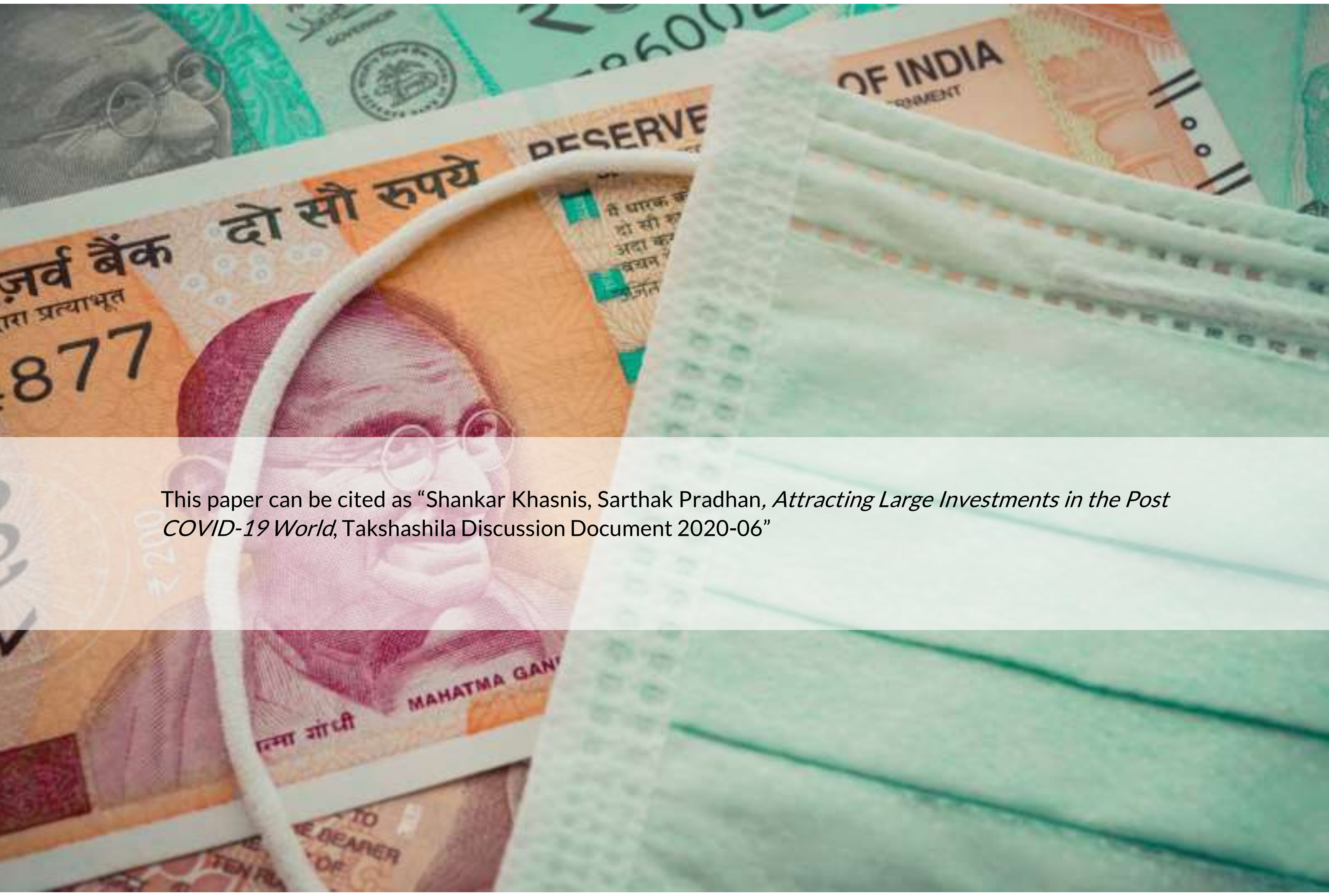

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Executive Summary

India must be prepared with a post-pandemic economic reconstruction plan to revive the different sectors of the economy. It is here that attracting large investments becomes important. To do that, India must address the traditional hurdles (low credibility as an investor-friendly destination, tedious land acquisition processes, and cumbersome regulations, poor infrastructure for large scale projects) and create enabling conditions.

For the above, we propose the following policy recommendations -

1) The national investment promotion and facilitation agency – "Invest India" should focus on the entire investment cycle. In addition to providing information, investors should also be assisted in structuring their financials, money movements, obtaining land, and other necessary statutory clearances. Operational and administrative services must also be extended to investors.
2) To prevent policy uncertainty and boost investor confidence, state governments must agree for international arbitration. Policy uncertainty can also be reduced if competitive federalism is used to let states bid for Request for Proposals (RFP) through the Ministry of Corporate Affairs.
3) To facilitate inward and outward movement of goods, India needs to invest in expanding its air and sea cargo facilities. Hinterland connectivity to these facilities needs to be ensured by constructing highways and railway networks. Warehousing infrastructure needs to be ramped up.
4) To provide a cost advantage in terms of raw materials, the Union government should incentivise the creation of global sourcing agencies. This cost advantage will also provide an edge in exports to manufacturers in India.
5) To ensure a healthy supply chain for large investments, MSMEs need to be provided with interventions like subsidised loans, tax waivers, grants for technology upgradation, and sector-specific infrastructure support.
6) To improve the quality of labour supply, newer models of skill development must be used with the private sector playing the leading role.
7) Sectors where India has the potential to be globally competitive need to be identified and 2-3 marquee investments established in each of these sectors. Sectors like textiles & garments, electronics manufacturing, auto components, medical devices, building materials, etc. hold potential.

Background

The COVID-19 pandemic has wreaked havoc all over the world. The degree of impact on an economy depends on the type of economy and its position in the global value chain. With the passage of time, different economies are developing strategies for dealing with the pandemic and for post-pandemic economic reconstruction.

To deal with the pandemic, India has used strong containment measures. At the time of writing, India has been under lockdown for more than 50 days. The unintended consequences of this are reduced economic activity, job losses, wage losses, etc. To get the economy running, an economic reconstruction plan is necessary. A part of this plan can be a strategy to attract large scale investments. These large investments by creating jobs, meeting the domestic needs, insulating India from domestic supply chain disruptions can pave the way for economic recovery. To ensure this, India needs to create conducive conditions for investments. It must address the challenges investors face while doing business. This document identifies these challenges and proposes policy recommendations to address the same.

This document has been divided into 3 parts. In the first part (Section A), we briefly explain the different hurdles in attracting large scale investments. In the second part (Section B), we explore different opportunities created by the COVID-19 pandemic to attract investments to India. Finally, in the third part (Section C), we suggest different measures to leverage the present opportunity to bring in large investors to India.

A. India faces severe hurdles in attracting large scale private investments

1. Low credibility as an investor friendly destination

At present, India has a portal for single window approval of FDI proposals, but it takes[1] at least 8-10 weeks for any such approvals to be granted. "Invest India" - India's national investment promotion and facilitation agency is primarily focused on providing information and marketing services. Investors also need assistance for structuring their financials, money movements, getting land banks and the necessary statutory clearances. Services like understanding investor requirements, providing ready-made packages of incentives, consulting & expediting applications are lacking at present. After-care services like operational services, administrative services are not part of the offerings.

Since investment is an irreversible forward-looking activity, future expectations from it play a critical role in the decision-making process. Despite this, policy flip flops have been more than frequent in the Indian context e.g. Andhra Government's termination[2] of Amravati development project with the Singapore consortium, imposition of retrospective taxes etc. Policy uncertainties lead to higher investment risks and dampen investments.

2. Tedious land acquisition processes and cumbersome regulations

Table 1 provides a comparative picture of the extent of regulatory hurdles faced by investors in India, China, and New Zealand.

	India	***China***	***New Zealand***
Setting up a business	18 days	9 days	0.5 days
Registration of property	10 procedures 49 days 7.4-8.1% of property value	4 procedures 9 days 4.6% of property value	2 procedures 3.5 days 0.1% of property value
Enforcement of contracts	1445 days	496 days	216 days

Table 1 Date Source: World Bank - Ease of Doing Business[3]

Apart from these regulatory bottlenecks, land acquisition is a major hurdle. Many states do not have[4] formal land allocation policies. Lack of digital records, frequent litigations, and restrictive laws on rezoning[5] of land make it difficult to acquire land. In the recent past there has been an exodus[6] of big-ticket projects because of hurdles in land acquisition e.g. POSCO in Odisha. Even projects like Delhi Mumbai Industrial Corridor, Mumbai-Ahmedabad Bullet Train are facing[7] similar challenges. Stalling rate of private sector projects remains[8] high (25.4% - March 2019) with land acquisition hurdles being one of the reasons for the same.

3. Poor infrastructure for large scale projects

Large scale projects require enabling infrastructure for inward and outward movement of goods. Poor infrastructure raises transaction costs and reduces global competitiveness. In the global port efficiency scale except for JNPT, no port[9] from India features in the top 50. India lags in transshipment facilities. Ports in India lack the capacity to handle large volumes. They are deficient in dredging capabilities. Technical expertise and port maintenance are also major issues. Air cargo[10] dwell time in most of the airports in India ranges[11] between 3-4 days, while in Singapore, Incheon, Hong Kong it is in the range of 2-6 hours. Air cargo traffic in India is less[12] than that of individual airports like Hong Kong, Memphis, and Shanghai etc. Dedicated facilities for handling specialised cargo are missing at various airports. Poor hinterland connectivity exacerbates the situation further.

While road freight volume and the number of road vehicles have been growing[13] at a CAGR of 10.6% and 10.11% respectively, the growth rate[14] of length of roads lags behind at 3.9%.India has only 1.9%[15] of its total road network in the form of expressways and highways, whereas the corresponding figure for the US[16] is 5%[17], UK[18] – 13%, South Korea[19] – 16.6%. Table 2 depicts the efficiency in road transportation.

Efficiency indicators in road transportation	***India***	***Global***
Average truck speed (in km/h)	20–40	60–80 (developed countries)
Average truck distance covered in a year (kms)	60,000–1,00,000	4,00,000–6,00,000
Average truck distance per day (kms)	250–400	500 (BRICS) 700–800 (US & Europe)
Total length of expressways (kms)	~1000	74,000 (China)

Table 2 Data Source: EY and RAI[20]

B. The present pandemic has created a unique opportunity for India to attract large scale investments

The COVID-19 outbreak has altered traditional economic structures. These changes have created conducive conditions for attracting large investments. In this section, we explore a few of these.

1. With lockdowns across the globe, factories are operating at sub optimal capacity disrupting the global supply chains. It is imperative to diversify risks by developing capacity at home.

India's automobile, pharmaceutical, petrochemical, and power sectors are likely to be impacted because of India's dependence on imports. 27% of auto-components imported[21] to India are from China. 65-70% of the Active Pharmaceutical Ingredient (API) needed[22] for India's pharmaceutical sector is from China. The power sector, especially the solar power sector, is heavily reliant on Chinese machinery. India imports[23] 45-50% of its consumer durables. Forced business closures and restrictions on mobility in China have led to substantial production disruptions. There are also reports[24] of a possibility of a second wave of disease outbreaks in China. With no certainty of when the situation would improve it is imperative to develop capacities within India.

2. Foreign investors are exploring the option to diversify their supply chains and shift their bases out of China

China is the key producer of intermediate goods used for manufacturing computers, electronics, pharmaceuticals, and transport equipment. As China has a unique position in the global value chains, economies importing from China and exporting intermediate goods to China are expected to face supply chain disruptions. Companies and countries would prefer to diversify their risk.

Japan is incentivising[25] its companies in China to either shift to Japan or elsewhere. A mid-February survey[26] of senior executives of US companies found 76% of them willing to diversify their base away from China. As companies look for newer alternatives, it is an opportune moment to attract them to India.

3. A crisis of this scale can provide greater political space for deeper reforms

Though every crisis does not necessarily lead to deeper reforms, they do lead[27] to the acknowledgement of inherent problems (problem stream). Also, to get out of the crisis, a business as usual approach might not help. Newer ways might have to be thought through (solution stream). In this paper, we also attempt to provide some of these newer options.

If the problem and solution streams converge with the political stream (political will) deeper reforms can be brought forth.

C. India needs to assure investors, ease regulatory hurdles, and develop infrastructure and create enabling conditions for business

To address the hurdles to businesses and create enabling conditions, we propose the following policy recommendations.

Recommendation #1 - Transitioning from Regulating to Facilitating

To attract more investors, the government must facilitate starting new businesses and ensuring continuity of existing businesses. The investment promotion and facilitation agency should provide services throughout the entire investment lifecycle covering information, marketing, assistance, advocacy, and also post investment services. It should provide this for a service fee (e.g. a small % of the total investment). The institution should be target driven with their Key Performance Indicators (KPI) being - quantum of investments and number of jobs created. It should facilitate getting land for the project and the required statutory clearances. Post investment services like operational, administrative services will help in retaining investments, getting reinvestments. Operational services can include assistance in getting access to utilities like power, improving connectivity, collaborating with universities etc. Administrative services can include facilitating the process of getting import permits, work permits for spouses, food, drugs, and administration approvals etc.

Recommendation #2 - Creating Policy Certainty for investments

International Arbitration

The state governments should be ready for international arbitration to resolve disputes. This clause should be part of the tripartite agreement between the Union Government, state government and the private investor.

Competitive federalism

Another option can be to let states bid for RFPs from big ticket investors. The Ministry of Corporate Affairs should be enabled to coordinate with states and companies so that a change in dispensation doesn't lead to a change in commitment.

Recommendation #3 - Creating Global Sourcing Agency

Government should incentivise creation of global sourcing agencies to source raw materials for the manufacturing sector. Large scale sourcing will provide cost advantage and will ensure continuous availability of raw materials. Cheaper inputs will make exports lucrative.

Recommendation #4 - Creating supporting infrastructure

Five large cargo airports need to be constructed to provide access to 80 % of the industrial belts - (1) Mumbai-Pune, Ahmedabad-Baroda (2) Gurgaon-Delhi-Meerut (3) Chotanagpur and Hugli (4) Vishakhapatnam-Guntur (5) Kollam-Thiruvananthapuram, Bangalore-Chennai regions. Air cargo capacity needs to be improved to facilitate transportation and redistribution of high cost, low voluminous components e.g. semiconductors, medical devices, etc. Capacity at the large shipping docks needs to be expanded. Inland waterway capacity needs to be leveraged. The air and sea cargo terminals need to have seamless connectivity with highways, expressways, and rail networks. Warehousing infrastructure needs to be ramped up.

Recommendation #5 - Enabling MSMEs

MSMEs in India play a significant role because of their contribution to the GDP and the number of jobs they create. MSMEs can act as supply chains for the big-ticket investments. MSME clusters need to be integrated with industrial clusters. At present MSMEs face multiple challenges like liquidity crunch, poor technology adaptation etc. The MSMEs' capacity needs to be augmented through subsidised loans, tax waivers, grants for technology upgradation. Simplification of tax structures and processes will also help. MSMEs clusters should be provided with sector specific infrastructure support (e.g. cold chain storage for MSMEs in the food processing sector etc.)

Recommendation #6 - Improving quality of labour supply

Skills data helps the government understand the magnitude of skill deficits. Accordingly, incremental skills can be provided. An efficient Labour Management Information System (LMIS) would help the skill training sector, by projecting the present and future demand of skills. The present system is characterised by a large number of institutions at federal and state level. There are inefficiencies and unclear lines of responsibilities. A clear rationale should be identified for the data and information in LMIS. Many Sectoral Skills Council (industry led autonomous bodies in specific sectors) which create occupational standards, conduct skill gap studies and provide data to the LMIS are yet to reach Tier 2 and Tier 3 cities. Once the LMIS is fixed, the quality of labour needs to be improved.

Apprenticeship can be a mechanism to improve skills. It can be promoted by providing tax incentives to industry to hire apprentices. Apprenticeship based degrees/diplomas should be recognised and credit transfers facilitated. A "reimbursable industry contribution[28]" model could be used to impose levies on private players to create a common fund. The government should match the industry contributions. The fund will be managed by the industry though SSC. Industries providing in-house training can be reimbursed from this fund.

Recommendation #7 - Focussing on specific sectors

The Government should focus on certain attractive sectors in which India can be globally competitive - textiles & garments, electronics manufacturing, auto components, medical devices, building materials etc. The target should be to establish 2-3 marquee investments in each of these sectors. These investments will further attract investments.

Conclusion

India must leverage the present window of opportunity created by the pandemic to attract large scale private investments. For doing the above, we propose the following policy recommendations -

1. India's investment promotion and facilitation agency needs to focus on the entire investment cycle. Apart from information, investors should be assisted in structuring their financials, money movements, getting land, and other necessary statutory clearances. Different operational and administrative services must also be extended to investors.
2. To prevent policy uncertainty and boost investor confidence, state governments must agree for international arbitration. Policy uncertainty can also be reduced if competitive federalism is used to let states bid for RFP through the Ministry of Corporate Affairs.
3. To provide a cost advantage in terms of raw materials, the government should incentivise creation of global sourcing agencies. This cost advantage will also provide manufacturers in India an edge in exports.
4. To facilitate the inward and outward movement of goods, India needs to invest in increasing air and sea cargo facilities. Hinterland connectivity to these facilities needs to be ensured by constructing highways and railway networks. Warehousing infrastructure needs to be ramped up.
5. To ensure a healthy supply chain for large investments, MSMEs need to be provided with the necessary support. Subsidised loans, tax waivers, grants for technology up-gradation, sector-specific infrastructure support needs to be extended to MSMEs.
6. To improve the quality of labour supply, newer models of skill development must be used with the private sector playing the leading role.
7. Sectors where India has the potential to be globally competitive need to be identified and 2-3 marquee investments established in each of these. Textiles & garments, electronics manufacturing, auto components, medical devices, building materials etc. can be these potential sectors.

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This document is prepared for discussion and debate by the authors. It does not necessarily constitute Takshashila's policy recommendations. For any feedback, please email shankar@advisoryfeedback.com, sarthak@takshashila.org.in.

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