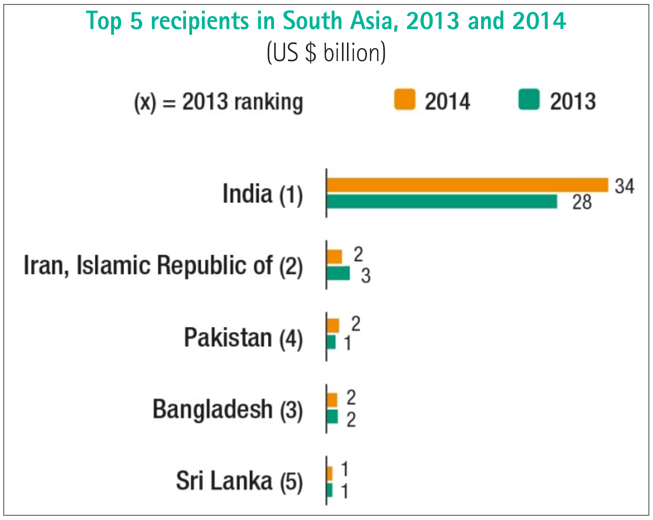
India leads in FDI inflows to South Asia

Foreign direct investment (FDI) inflows to South Asia rose to $41 billion in 2014, primarily owing to good performance by India, according to UNCTAD's World Investment Report 2015. FDI inflows to the country surged by 22% to about $34 billion.

FDI inflows to India are likely to maintain an upward trend in 2015 as economic recovery gains ground, the report adds. In terms of the sectoral composition of FDI inflows, manufacturing is likely to gain strength, as policy efforts to revitalize the industrial sector are sustained, including, for example, the "Make in India" initiative launched in mid-2014.



The report says that FDI inflows to Pakistan increased by 31% to $1.7 billion as a result of rising Chinese FDI flows in services. Furthermore, the country will benefit significantly from the China-Pakistan Industrial Corridor and associated Chinese investment in infrastructure and manufacturing in the overall context of implementing the "One Belt, One Road" strategy. According to agreements signed between the two governments in April 2015, Chinese companies will invest about $45.6 billion in Pakistan over the next few years – $33.8 billion in electricity and $11.8 billion in transport infrastructure.

In Sri Lanka, FDI flows from China also rose (China has become the largest source of FDI to the country in recent years). For example, a joint venture between two local companies and China Merchants Holdings (International) Company has invested $500 million in Colombo International Container Terminals, the largest foreign investment project in Sri Lanka. After two years of construction, the port started operation in August 2014. A China-Sri Lanka free trade agreement will be signed in June 2015. Moreover, if the implementation of the China-led 21st Century Maritime Silk Route Economic Belt gains ground, an increasing amount of Chinese investment will flow to Sri Lanka, particularly in large infrastructure projects.

In the manufacturing sector in South Asia, the report says that FDI success stories have emerged at country-, industry- and local-levels, with the automotive industry in India showing how large-scale FDI inflows can reshape the trajectory of industrial progress in low-income countries.

The automotive industry is a key part of the Indian economy and has been identified as one of the key industries in which India has the potential of becoming a world leader. According to data from the Indian government, accumulated FDI inflows to the automotive industry from April 2000 to November 2014 amounted to $11.4 billion. The country accounted for the majority of greenfield investment projects announced by global automakers and first-tier parts suppliers in South Asia during 2013–2014, including 12 projects above $100 million.

Inward FDI has led to the emergence of a number of industrial clusters in India, including those in the National Capital Region (Delhi-Gurgaon-Faridabad) in the north, Maharashtra State (Mumbai-Nasik-Aurangabad) in the west, and Tamil Nadu State (Chennai-Bangalore-Hosur) in the south. Though considerable differences exist in the patterns of the formation of these clusters, FDI can play an important catalytic role. For example, the early entry of Suzuki (Japan) has contributed to the development of an industrial cluster in the National Capital Region.

On a smaller but significant scale, Bangladesh, Nepal, Pakistan and Sri Lanka recorded cases of greenfield investment announced by foreign companies during 2013–2014. In 2013, for example, Mahindra & Mahindra (India) announced a more than $200 million investment in a plant producing light trucks and utility vehicles in Bangladesh. Investment from the growing automotive industry in India shows potentials of a positive "spill-over effect" to productive capacity building in South Asia as a whole.

Source: Press release, UNCTAD, www.unctad.org

'Make in India' initiative launched to boost manufacturing sector

On 25th September 2014, Indian Prime Minister, Narendra Modi, launched the 'Make in India' initiative with an aim of giving the Indian manufacturing sector a boost and give Indian economy global recognition.

In his speech, the Prime Minister said "FDI" should be understood as "First Develop India" along with "Foreign Direct Investment" and urged investors not to look at India merely as a market, but instead see it as an opportunity. The Prime Minister said it is important for the purchasing power of the common man to increase, as this would further boost demand, and hence spur development, in addition to benefiting investors. The faster people are pulled out of poverty and brought into the middle class, the more opportunity will there be for global business, the Prime Minister said. Therefore, investors from abroad need to create jobs. Cost effective manufacturing and a handsome buyer - one who has purchasing power - are both required, the Prime Minister said. More employment means more purchasing power, he added.

The Prime Minister emphasized on 3D advantage of India – demography, democracy and demand. India is the only country in the world which offers this unique combination, he said. He said the new Government was taking initiatives for skill development to ensure that skilled manpower was available for manufacturing. He also referred to the Digital India mission, saying this would ensure that Government processes remained in tune with corporate processes.

The Prime Minister said trust is essential for investors to feel secure. He gave the example of the new Government's initiative on self-certification of documents, and said this was illustrative of how the new Government trusted the citizens.

The Prime Minister also noted that India ranks low on the "ease of doing business" and added that he has sensitized Government officials in this regard. He also emphasized the need for "effective" governance. To the expression "Look East," the Prime Minister added "Link West", and said a global vision was essential. He said Mission Swachh Bharat and "waste to wealth" could lead to good revenue models for business as well. He referred to his vision of waste water management and solid waste management in 500 towns across India through public private partnership.

The Prime Minister also spoke of infrastructure of the future - including i-ways besides highways - and mentioned port led development, optical fibre networks, gas grids and water grids.

However, according to Deutsche Bank* in order to accomplish its goal of 10% manufacturing growth per year, the government will have to move quickly to address some long-entrenched issues. They are:

1) **Ease of doing business:** According to World Bank, India ranks 134 out of 189 countries in terms of the ease of doing business. China ranked 96. India performs especially poorly in categories that involve interface with the government (paying taxes, construction permits, etc.). PM Modi must enforce his "minimum government, maximum governance" mantra, so that India climbs up the ladder fairly quickly, Deutsche Bank says.

2) **Investments**: Foreign companies will set up factories only if India has world-class infrastructure. For this, huge investments are required. These can be funded through; i) Domestic savings have come down from a peak of 37% to 30% of GDP. This can go up if real interest rates go up. ii) foreign capital: Over the past decade, gross FDI inflows into India have averaged less than 2% of GDP. Deutsche Bank says the Modi regime recognizes the importance of foreign direct investment in capital formation and initial steps have been taken to attract foreign money including liberalizing the defense manufacturing and insurance sectors. In all, India's gross investment rate will have to go up from 31% of GDP in 2013-14 to 38-40% of GDP, the investment bank adds.

3) **Infrastructure**: Transportation infrastructure is inadequate to meet even current needs, leading to time delays and high transaction costs, making Indian manufacturing severely uncompetitive, Deutsche Bank says. The new government needs to build more roads and increase railways' capacity. A new goods and service tax (GST) is also urgently needed. "The combination of improved transport connectivity and simplified, one point collection of taxation will go a long way in implementing the Prime Minister's vision of 'Made in India'," Deutsche Bank says.

4) **Urbanization**: For large-scale manufacturing, millions of workers need to be absorbed into the urban landscape. However, two-thirds of India's population still lives in villages. In contrast, China is now an urban majority country. Deutsche Bank says Prime Minister Modi's vision is very enthusiastic about urban growth and the Finance Minister's budget speech reiterated the idea of building a hundred "smart cities".

5) **Labour law reform**: India has a plethora of outdated labour laws, some dating from the 1940s, that discourage hiring, Deutsche Bank says. Labour reforms are considered to be politically sensitive, but things may change now. Already in Rajasthan, a BJP-ruled state, the state government has amended some labour rules, which makes it easier to retrench workers. The idea appears to be that Rajasthan's example can then be used to change laws in other states as well as those at the central level, Deutsche Bank says.

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