Policy inaction weighs on FDI inflows

The government resorted to big-bang foreign direct investment (FDI) reforms on Friday, realising massive fall in FDI in the first quarter of this fiscal.

Official data showed that FDI in the first quarter of 2012-13 dropped 67 per cent, compared with the corresponding period last year, as government inaction on policy decisions weighed heavily on the sentiment of foreign investors,

FDI inflows, exclusive of re-investment, declined to $4.4 billion in the first three months of this financial year from $13.4 billion in the corresponding period of last year.

June attracted the lowest FDI since January of $1.24 billion , indicating waning foreign confidence affecting the balance of payments. Huge fdi is required to finance widening current account deficit, which touched an all-time high in 2011-12 at 4.2 per cent of gross domestic product (GDP). The declining inflows also impacted the exchange rate, leading to a depreciation of the rupee. The currency, after touching record low levels, is now around 55 per dollar, though foreign institutional investors play a larger part in determining the volatility exchange rate mechanism.

Though services attracted the maximum FDI at $1.07 billion till June, it was a 51 per cent decline from last year's $2.1 billion. Telecom, which got engulfed and scandals and finally cancellation of 122 licences by the Supreme Court in February this year, drew an investment of just $8 million till June, it is quite miniscule compared with last year's $1.2 billion. Telecom was the most attractive sector for foreign investment after services and pharma. The power sector saw a mere $145-million investment, compared with $859 million last year same period. The government took major reforms initiatives on Friday, reversing its earlier decision to defer fdi up to 51 per cent in multi-brand retail FDI, relaxing norms for single brand retail FDI up to 100 per cent, allowing 49 per cent foreign investment in power trade exchanges. In another positive move, the government on Tuesday cleared 21 FDI proposals worth Rs 2,410 crore, including eight from the pharmaceutical sector. This year's Budget decisions such as retrospective amendments in the Income Tax Act and General Anti-Avoidance Rule (GAAR) were major contributors to the FDI slowdown.

This saw flow from Mauritius (biggest contributor to Indian FDI) also declining to $1.46 billion up to June, compared with $4.5 billion last year in the first quarter, a 67 per cent drop. However, the panel headed by Parthasarathi Shome, former advisor to the finance minister has suggested deferring of GAAR by three years. The panel is also looking into retrospective amendments to the IT Act.

Also, the government decision to hike diesel prices and cap LPG cylinder will help it narrow down fiscal deficit, one of the parameters to judge fundamentals of the economy.

(Business Standard)