



SHASHI RUIA

Investment
abroad \$1.2bn
(2010-2011)

Investment in
India: \$200mn
(2010-2011)

MUKESH AMBANI

Investment
abroad \$5bn
(2011)

Investment
in India: \$2.7bn
(2010)

RATAN TATA

Investment
abroad \$4bn
(2009-2010)

Investment
in India: \$200mn
(2010-2011)

ANIL AMBANI

Investment
abroad \$3bn
(2010-2011)

Investment
in India: \$400mn
(2011)

SUNIL MITTAL

Investment
abroad \$16bn
(2010-2011)

Investment
in India: \$2bn
(2011)

HAS INDIA RUN OUT OF STEAM?

Twenty years after Manmohan Singh's reforms, the growth story is petering out. As the Government chokes the economy, India Inc seeks investments abroad.

By Dhiraj Nayyar and Shantanu Guha Ray

The cream of India Inc is making big ticket investments overseas rather than in India. Over the last 12 months, Mukesh Ambani's Reliance Industries has already invested \$5 billion in Africa and the US. Reliance Industries expects to double its investment abroad in four years. Anil Ambani's Reliance-ADAG has invested \$3 billion globally in 2011, including in mining projects in Indonesia in 2011. He expects to more than double that to \$7 billion in 2015. Ratan Tata, whose group already draws 65 per cent of its revenues overseas, has invested more than \$1 billion internationally this year. The Ruia-promoted Essar Group expects to invest \$6 billion overseas by 2015. Sunil Mittal's Bharti Airtel spent \$8.2 billion acquiring Middle East-based telecom firm Zain's Africa operations last year even as his competitors in India battled the fallout of the 2G scam.

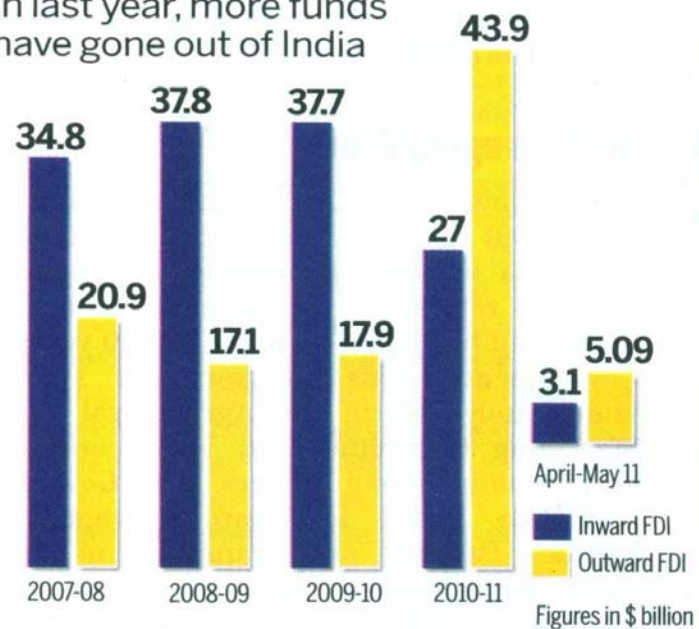
In the 12 months between April 2010 and March 2011, overseas investment by Indian firms was a massive \$44 billion, an unprecedented 150 per cent rise from \$18 billion in the previous 12 months. Inward direct investment from foreign firms between April 2010 and March 2011 was \$27 billion, 25 per cent lower than in the previous year. For a fast-growing emerging economy—India is still the second-fastest growing major economy in the world after China—it is most unusual to have significantly higher capital outflows than inflows. Is this what Ratan Tata meant when he said India had become a banana republic? Certainly, Tata is not investing in bananas. Rajiv Kumar, economist and secretary-general of apex industry body FICCI believes the global expansion is more than just a routine expansion of business. "I would say that the rate of return on investment in India is higher than abroad. So if investment is going abroad, then it must be for

reasons other than that," he says. Deepak Parekh, Chairman HDFC, is more pointed in identifying the reason behind this sudden rise in overseas investments by Indian firms. "Earlier, investing abroad seemed to be a risk diversification but the current impasse (in governance) makes it a necessity for companies to look elsewhere," Parekh says.

The diffidence of investors in the Indian story is corroborated by a cursory look at the numbers for fresh investment in the last 12 months. According to data compiled by Projects Today, a sum of Rs 1,97,000 crore of fresh investments was committed to the Indian economy in the period between April and June 2010. A year later, between April and June 2011, that number had fallen by 70 per cent to just Rs 57,000 crore. Says Saugata Bhattacharya, chief economist and sen-

Reverse Flow

In last year, more funds have gone out of India



Source: RBI

ior vice-president, Axis Bank, "There is no doubt that a slowdown in investment has taken place."

The UPA Government must bear the blame for failing to create an investor-friendly environment. Industry had high expectations from the Government after it was re-elected with an enhanced majority in the General Elections of 2009. The people of India had even unshackled the UPA from the clutches of the Left parties. Two years have passed since the elections and the UPA, much to the shock of its friends and surprise of its enemies, has failed to pass a single reformist, industry-friendly legislation. At least eight important economic legislations are drafted

and ready to be brought to Parliament. The opposition to most of these legislations is from within the UPA, not from opposition parties like the BJP. The UPA's managers have not reached out to the opposition. The Congress party, its heart still in old-fashioned socialism, has probably not wanted them to do so.

Instead, the Government is in a state of paralysis. It has been robbed of credibility by the revelations of successive scams. Its ham-handed attempts to nail the alleged perpetrators of the scams have led to perceptions of a witch-hunt. It has deterred ordinary bureaucrats and businessmen from making even routine decisions, all of which can be questioned by multiple Government

agencies—CBI, CVC, CAG, ED. The prospect of jail without bail is making corporates nervous. It isn't just scams. Crucial policy decisions are held to ransom by warring ministers unwilling to defer to prime ministerial authority. The prime minister seems unwilling to change this.

If a besieged Manmohan Singh is searching for inspiration, he need only rewind the clock to 20 years ago. At 5 p.m. on the evening of July 24, 1991, Finance Minister Manmohan Singh, just one month old in politics, stood in Parliament to deliver his maiden Budget speech. An hour later, he had laid out a radical new roadmap for reviving a crisis-ridden economy. At the end of his speech, alluding to India's in-

5 THINGS TO GET BACK STEAM

The Government can do a lot to arrest the slide without the need for new legislation

1

Allow foreign investment in multi-brand retail

The Government has failed to get a firm grip on the persistent problem of food inflation which has spilled over to the rest of the economy, prompting the Reserve Bank of India to raise interest rates sharply. That squeezes industry. The entry of big retailers will also cut out the many intermediaries that come between the farmer and the consumer in the supply chain. By eliminating the commissions charged by multiple intermediaries, big retail will lower prices for the consumer. It could be a means to get the farmer a better price. It will also serve as a positive signal to worried foreign investors.

3

Speed up roads, cut out red tape

The Government needs to quickly evolve a mechanism to speed up the construction of roads and highways. At the moment, they are at a standstill because of red tape. The power sector is struggling because of an acute shortage of coal. Allowing new mining is imperative. There has been little progress in developing big ports. Turnaround times at Indian ports are way above the best global practices.

4

Spend money, but be accountable

The UPA is committed to massive amounts of public expenditure, particularly on welfare programmes such as the NREGA and the Right to Food. That is unlikely to change. When growth slows, and Government revenue falls, there is an enormous pressure on the fiscal deficit. If it spins out of control, it will deter investors and threaten the growth story. The Government needs to introduce better accountability mechanisms.

5

Investigate, but don't lynch

Prospective investors are frightened by the sight of a number of businessmen incarcerated in jail without being granted bail. The fear of arbitrary action by the Government's investigative agencies is also deterring bureaucrats from taking even mundane decisions, stalling many projects. The Government has to immediately ensure that acting against the corrupt does not turn in to a witch-hunt of the honest.

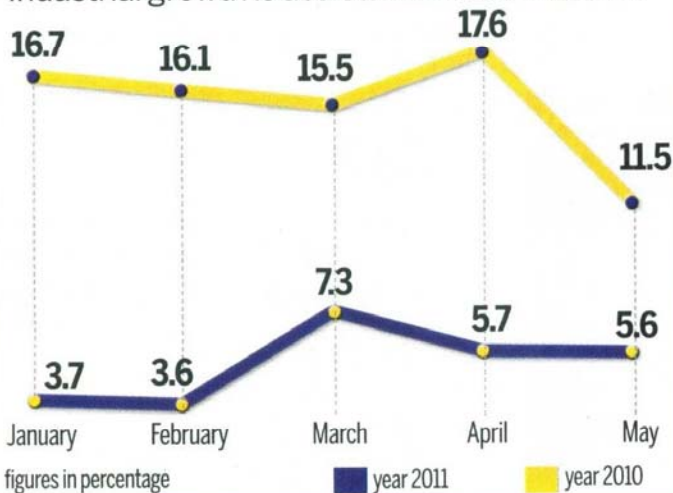
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Reform agriculture

While allowing foreign investment in the retail sector will help moderate price inflation to a degree, a wholesome solution to the problem requires reform of the agricultural economy, untouched by change over the last 20 years. The Government needs to persuade states to immediately reform the Agricultural Produce Marketing Committee Act, which encourages cartelisation among traders. The Government needs to invest in improving agricultural logistics (storage and transport) to prevent waste. Some limited amount of contract farming could be permitted.

In Stall Mode

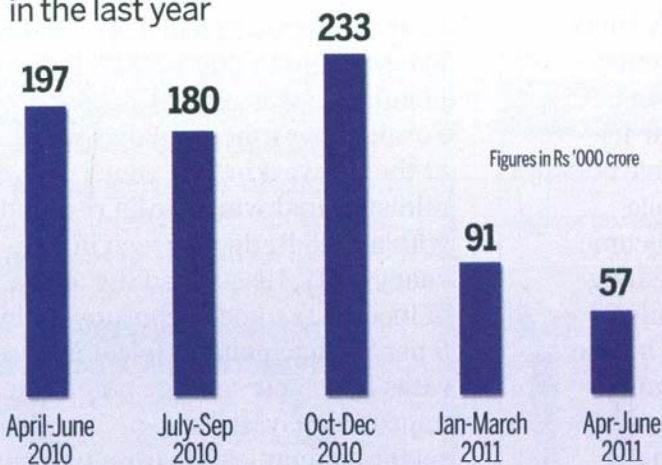
Industrial growth is at a standstill after March



Source: Ministry of Statistics

Losing Interest

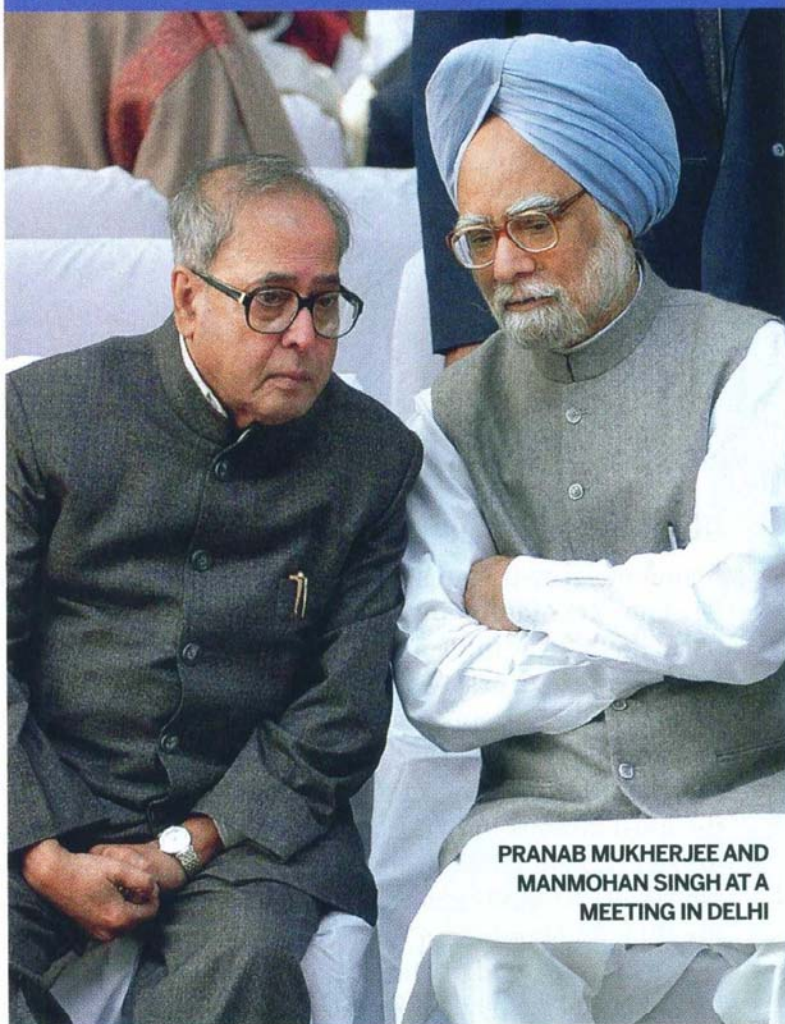
Fresh investment has fallen by 70 per cent in the last year



Source: Projects Today

"Some corporates have made investments outside India. There is nothing wrong in it as in a liberal economy there has to be outflow along with inflow."

PRANAB MUKHERJEE, Finance Minister
at a closed-door meeting with journalists on July 20



**PRANAB MUKHERJEE AND
MANMOHAN SINGH AT A
MEETING IN DELHI**

evitable rise as an economic powerhouse after liberalisation, he said, quoting Victor Hugo, "No one can stop an idea whose time has come." The self-effacing Singh had delivered a firm warning to the opponents of his reform programme. Most of them were in the Congress. He stuck to his course for the next five years. In 2011, Prime Minister Manmohan Singh, seven years in office, seems to have none of the passion from 1991. If ever there was a need for Manmohan to revisit those famous words of Victor Hugo and say them out loud, it is now. The promise of 1991 is threatening to implode in 2011.

A year ago, there was optimism of catching up with China's double-digit

growth rate. Now, there is despondency. The most visible symbol of a halt in the India story is the embattled telecom sector, which powered India's growth in the 2000s, much like IT and pharmaceuticals had done a decade earlier. The telecom sector was also the most powerful symbol of the UPA's favourite "inclusive growth" slogans. There are more than 700 million mobile phone subscribers today from just two million in 2000. More Indians have a mobile phone than a bank account. That story is turning sour. Three of India's biggest business groups, the Tatas, Reliance-ADAG and Essar have been directly hit by the mess created by the Government in telecom. Instead of

expanding their business in India—already under pressure from brutal local competition—they spend their time and resources dealing with investigations. The remaining players in a once-booming sector are lying low or, like Bharti-Airtel, focusing their energies overseas. When Bharti-Airtel bought Zain's Africa operations, Mittal appointed his right-hand man in India Manoj Kohli as head of Africa operations in a clear signal of where his priorities lie. This is a remarkable turnaround and is symptomatic of the spluttering of India's growth story.

Sunil Mittal isn't the only top businessman thinking about his overseas investments. In a week, the Essar

TEN YEAR ITCH

In 1991 and 2001, the Government responded boldly to a tough economic environment. In 2011,

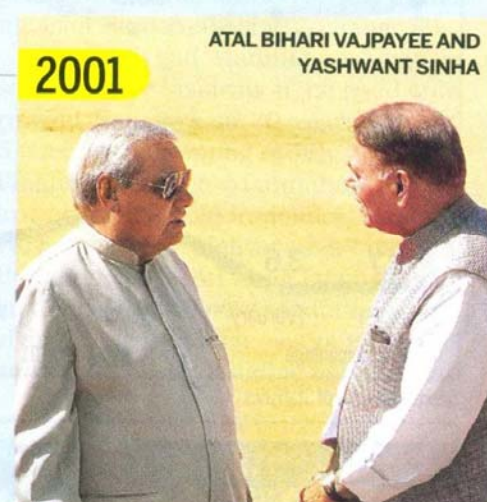


1991

P.V. NARASIMHA RAO AND
MANMOHAN SINGH

GOVERNMENT LIBERALISES FDI, GROWTH MOVES UP

Economic growth had slowed down to less than 6 per cent in 1990-91. The rate of inflation was over 12 per cent. The Government's fiscal deficit was huge and so were its external debt obligations, aftereffects of overspending through the 1980s. The Gulf War triggered a sharp rise in oil prices. India did not have the foreign exchange to pay for more than a fortnight of oil imports. Finance minister **Manmohan Singh** responded with what has now become the most famous Budget speech of Independent India, unleashing the energies of the private sector. In addition to a devaluation of the rupee to boost exports and earn foreign exchange, done before the Budget, Manmohan liberalised the foreign direct investment regime. He slashed tariffs on imports by almost half and urged Indian industry to become more competitive. The dismantling of the licence-permit Raj via ambitious institutional reform also began in this Budget. India's growth trajectory moved up from 5-6 per cent in the 1980s to 6-7 per cent in the 1990s. Unlike the 1980s, this growth was sustainable.



2001

ATAL BIHARI VAJPAYEE AND
YASHWANT SINHA

TAX, LABOUR LAW CHANGES

Economic growth had slowed down to 6 per cent in 2000-2001. Rate of inflation was high at 7.2 per cent. Foreign investment inflows were at their lowest in four years. Finance minister **Yashwant Sinha** responded with a bold Budget speech in February 2001. He slashed the top rate of income tax and corporate tax by 5 percentage points. He cut interest rates by 1.5 percentage points. He approved privatisation of 27 public sector companies. He even touched the holy cow of labour laws, saying they needed change. This Budget laid down the trajectory for 8 per cent plus growth for the next decade.

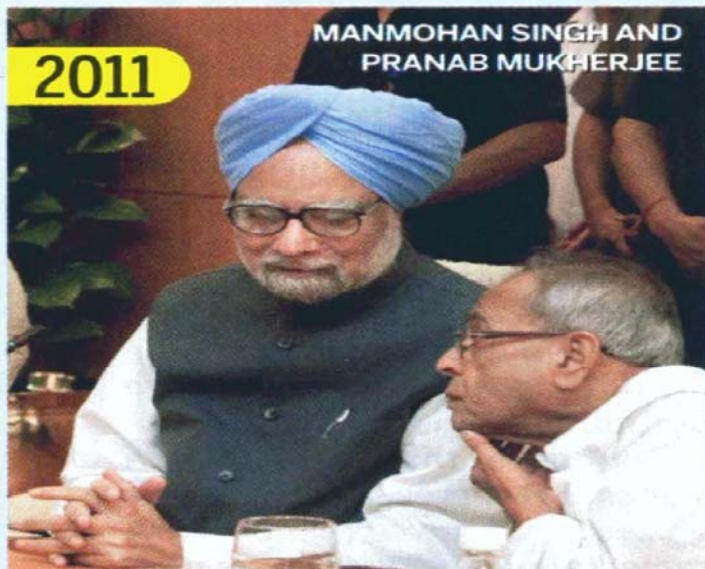
Group's Essar Energy Plc will complete its \$350 million acquisition of the UK-listed Stanlow oil refinery. The refinery's acquisition from Royal Dutch Shell PLC was initially announced in March. During an interaction with officials of JP Morgan Stanley and Deutsche Bank a fortnight ago, Essar's Ruia brothers compared the speedy processing of the deal by the UK government with the fate of their power plant that lies close to the Mahan coal block in Singrauli, Madhya Pradesh. Clearance has not come for

the coal block that has an estimated 150 million tonnes of thermal coal reserves to feed two power plants of Essar and Hindalco, the flagship subsidiary of the Aditya Birla group. "So what do we do?" asked brothers Shashi and Ravi Ruia. The bankers instantly showed them a report which said price per unit of power would skyrocket to Rs 150 from Rs 15 per unit if coal were to be imported from Australia. "We look abroad," said Shashi, reiterating the group's plans to diversify its asset base

beyond the Indian market. Besides the Shell refinery, the group had acquired an iron ore mine in Minnesota, US, a coal mine in West Virginia, US and a steel plant in Zimbabwe last year.

Ratan Tata's Tata Steel has already invested around \$ 1 billion in its wholly owned subsidiary in Singapore in 2011. Deepak Parekh can see why. "Groups like Tata have always evinced interest in setting up a new steel plant in India but that has not materialised for one reason or another. They are making

it is in a state of paralysis.



NO REFORMIST MEASURES

Economic growth in 2010-11 was down to 8 per cent. Growth in the last quarter of the 2010-11 financial year was 7.8 per cent, the lowest since the two quarters that followed the global financial crisis of 2008. Inflation is rising steadily, measuring 9.6 per cent in June. The international environment is adverse with the advanced economies registering slow rates of growth and oil prices hovering at over \$100 per barrel. Finance minister **Pranab Mukherjee's** Budget failed to unveil any radical reformist measure. The Government has failed to respond to problems in agriculture which are the root cause of the inflation.

their investments abroad," he says. Ratan Tata is still angry about the way things are playing out in India. In a recent meeting with a friend, Tata was reminded about the CBI's continued probe into the 2G scam, and how at least some of the group's complaints about the improper functioning of the Department of Telecom were being corroborated by the premier investigating agencies. Tata was silent for 10 seconds and then reportedly said, "Why is it that whatever good we do is

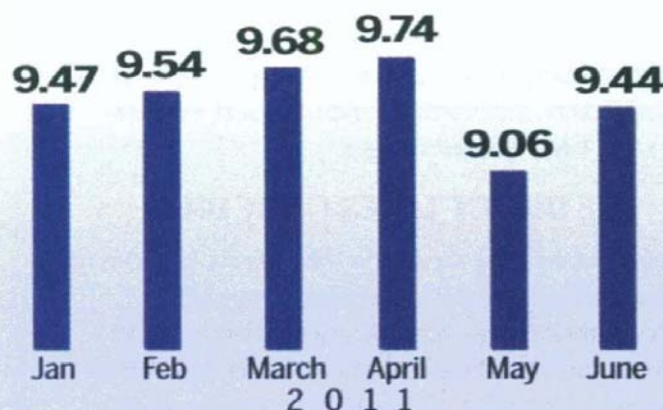
always turned into evil by someone? Will this be the fate of all honourable businesses in this country?" The conversation ended abruptly thereafter. Sitting at a close distance, a director on the board of Tata Sons reiterated what he had told a brand consultant a few months ago: "I am always happy to be engaged with the idea of India but, of late, I am getting anxious."

Engaging with India is not impossible. If the prime minister wants to focus on a single sector, it should be infrastructure. It is the one sector most likely to replace telecom as the leader of India's growth story in the 2010s. The Government is committed to spending \$1 trillion on infrastructure between 2012 and 2017. That should normally be enough to attract investors. But a combination of inefficient ministers presiding over key ministries, uncertainty about land acquisition and environment clearances and elaborate red tape are deterring potential investors.

The Cost of Living

Inflation shows no signs of abating

Figures in percentage



Source: Ministry of Statistics

Says Prashant Ruia, CEO Essar Group, "Clearances come much faster abroad." Mukesh Ambani, chairman of Reliance Industries, would no doubt agree. He recently called a friend in Delhi to inquire about the fate of his \$7 billion deal with British Petroleum announced in February. India's richest man was told that despite a deemed approval, the deal had been referred to the Cabinet Committee on Economic Affairs. The deal will go through. The question is when.

BOOSTER BILLS



Passing these Bills this year can give a significant impetus to economic activity and revive the confidence of investors

THE MINES (AMENDMENT) BILL

By inserting a provision which will make it compulsory for mining firms to share profits/royalties with affected tribals, the Bill can remove the most significant road-block to an expansion of mining activity. After lengthy debate, it has been cleared by a GoM and awaits Cabinet approval.

LAND ACQUISITION AND REHABILITATION AND RESETTLEMENT BILL

A much-needed successor to the archaic Land Acquisition Act of 1894, the Bill will require the private sector to directly acquire as much as 70 per cent of total targeted land directly from farmers. This will enable farmers to get a better price. The rehabilitation and resettlement provisions may address opposition from those who resist selling out.

THE BANKING LAWS (AMENDMENT) BILL

First introduced in Parliament in 2005, the Bill will open up India's relatively closed banking sector. Importantly, it will give shareholders in banks the right to vote in proportion with their shareholding. Currently, shareholders have a maximum of 1 per cent vote in a public sector bank and 10 per cent in a private sector bank irrespective of actual equity holding.

THE INSURANCE LAWS (AMENDMENT) BILL

Tabled in Parliament in 2008, the Bill will allow up to 49 per cent (up from 26 per cent) foreign

investment in domestic insurance companies.

PENSION FUND AND DEVELOPMENT REGULATORY AUTHORITY BILL

First introduced in Parliament in 2005, the Bill will allow up to 26 per cent FDI in pensions. It will also grant statutory status to the independent regulator.

THE COMPANIES BILL

A much needed update of the Companies Bill 1956, it will measures allow shareholders to file class action suits against fraudulent promoters. This change in company law is pending since the Satyam scandal broke out more than two years ago.

THE DIRECT TAXES CODE BILL

By lowering corporate and income tax rates while abolishing all exemptions, it will increase compliance and raise revenue for the Government. It will do away with the Government cashing in on its powers to grant exemption. The Government has failed to achieve consensus among stakeholders.

CONSTITUTION (115TH AMENDMENT) BILL (GST BILL)

It will overhaul India's indirect tax system which in its current form imposes multiple, cascading taxes on the same good or service. Like the direct taxes code, it will abolish exemptions and lower rates, increasing compliance and revenue for Government. The Government has failed to persuade all states that it is in their interest.

Moving the obstructionist Jairam Ramesh out of the environment ministry is a start to eliminating unnecessary red tape. However, other under-performing ministers in crucial infrastructure ministries like C.P. Joshi in roads and highways, G.K. Vasan in shipping and Sushil Shinde in power stay where they are. The prime minister says they will stay there until 2014. That cannot be good news. In environment, new minister Jayanthi Natarajan has her task cut out. The thermal power sector, pivotal to India's growth story, is facing a shortage of 100 million tonnes of coal, expected to double in the next five years. Ramesh's no-go policy for mining had ruled out the extraction of more than 600 million tonnes of coal reserves. Allowing new mining is crucial if investments are to be attracted and capacity targets met.

Says economist Bibek Debroy, summing up the dismal business environment, "India is entering a phase of decline. We are going back to a regime of controls. There is no sanctity of contracts; permissions granted can be overturned later. There is a climate of excessive government control."

Industry is also suffering from the regime of high interest rates. The RBI has hiked interest rates 10 times in the past year, raising the cost of loans by at least 3 percentage points to double digits. In contrast, capital overseas remains very cheap. It is the Government's mismanagement of the agricultural economy that originally created the problem of food inflation which later spilled over to the economy. There is now every chance that GDP growth in 2011-12 will be below 8 per cent. "Whether a growth rate of 7.5 per cent is disappointing or not depends on what your benchmark is. This government seems to have settled on 7.5-8 per cent rather than 9.5-10 per cent," says Debroy. If he's right, it would be a betrayal of the promise Manmohan made in 1991. Investors will always find other markets that bring them handsome returns but hundreds of millions of ordinary Indians who depend on a high growth rate and fresh investments for new jobs will be left behind.

Inputs from T. Surendar and Rajesh Sharma