FDI Inflow Inertia, an Outcome of Policy Gaps and Operational Hang Ups

The Case of POSCO and VODAFONE

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Abstract

The Government of India is committed to deepen the economic reforms to attract Foreign Direct Investments inflows. FDI inflows have proliferated post 1991, and over the years the government has not only opened up several sectors wherein FDI was previously not allowed, but allowed greater foreign equity participation in existing ones. However, actual inflows continue to fall short of potential inflows. This phenomenon is studied through two cases of mega investments – POSCO and Vodafone. The study finds that systemic and operational hang ups play their part in slowing FDI inflows, and can counter act or even diminish the advantages of an otherwise open FDI regime in India.

Background

The Government of India is committed to deepen the economic reforms especially to attract Foreign Direct Investments inflows. Post reforms in 1991, FDI inflows have proliferated and the government, over the years have not only opened up several sectors wherein FDI was previously not allowed, but allowed greater foreign equity participation in existing ones.

However, a comparison of actual FDI inflows against approved FDI inflows shows the dismal numbers of approved FDI actually converting to real actual inflows (Bhagwati and Panagariya, 2012). This phenomenon highlights that non-policy hang ups play their part in slowing FDI inflows, and can counter act or even diminish the advantages of an otherwise open regime.

Objectives of the Study

The objectives of the study are the following:

1. To explore the issues associated with Land Acquisition Act for foreign companies through the analysis of the POSCO case.
2. To study the problems associated with uncertainty in Tax regime in FDI companies through the analysis of the Vodafone case.

Methodology

The paper utilizes the case study method to explore facets of the Foreign Direct Investment policy against the backdrop of the critical laws that govern land acquisition and tax regimes.

Case 1 – The Case of POSCO

Among the many policy and non-policy issues associated with big ticket FDI inertia, the most critical one to handle is land acquisition for foreign companies. Pandit (2014) argues that procedures for land acquisition of larger tracks of land cause tremendous delay especially at the project implementation stage. For all big ticket FDI approval has to be sought by the Central Government. After the proposal has been approved, the foreign company begins interaction with state governments. This is because all land acquisition related matters come under the jurisdiction of the respective state governments.

At this stage the process becomes complicated not only because land acquisition is rather a political and social decision, but also because even if the land is allotted acquiring environmental clearances and forest regulations can be tricky. Pandit (2014) stated that large projects especially linear ones require large tracks of land. Due to this prerequisite, rather large numbers of existing inhabitants have to be resettled and rehabilitated to new areas. This brings into play politics, violence and social hue and cry.

The case of POSCO explored in this section throws light on this issue. POSCO is a flagship South Korean steel firm. It is the world's fourth largest steel maker and was expected to bring in FDI of over Rs. 52,000 crore in Orissa in 2005. This was the largest FDI ticket size in India till date. This project has been held up due to land acquisition delays. POSCO maintains the plan to establish an integrated steel project. A Greenfield integrated steel project includes establishing steel mines with a steel plant and sea port in the same operating facility. The South Korean company continues to face delays. The delay is majorly due to unwillingness of land owners to resettle to a different place; who fear the loss of their lands and their livelihoods. This has resulted in social turmoil including agitation and violence.[i]

The POSCO case forms a classic one where despite the justifications provided by both governments and the firm on the benefits of the yet to be established project would accrue to the community it purports to establish itself in, the company remains involved in legal and logistic issues since 2005.

Research studies and think tanks reason out the plausible causes why despite what POSCO and the government alleges as benefits, the project continues to face land acquisition issues[ii]. But before we appreciate the issues at the ground, we realize the paucity of comprehensive cost-benefit studies conducted by the government and affiliated bodies. It appears that minimum research was conducted in a speedy manner to favor the POSCO project. This in itself forms the basis of a faulty start to the lengthy process of land acquisition for a mega project.

Think tanks argue that the cost benefit analysis by the government out rightly flouts the Forest Rights Act (FRA). It alleges that the information was withheld by the Ministry of Environment and Forests with a view to attract the foreign investment. It also alleges that the projected tax receipts were exaggerated to favor the project. It also argues that since the integrated plant was to be established in SEZ, tax collections would be far lesser than what was stated. Yet another important reason why the project faces resistance is with respect to the package for resettlement and rehabilitation. Studies allege that the same was unjustifiably low. For instance, every beetle nut cultivator was to be given a one-time compensation of Rs. 11000 per acre as against Rs. 40000 which he/she earns per acre per year. This would result in the loss of Rs. 4 lakh in ten years, even without including the loss of livelihoods to the adivasi families completely dependent on fisheries and forests, who were not getting covered under compensation.

Project costs, the government may appreciate involves not just financial cost but social and ecological costs too. The costs such as loss of livelihoods, resettlements costs, loss of homes, irreparable damage of forests, damage to canals, rivers and seas, needs to be comprehensively studied as part of any cost benefit analysis. In this case, we may find that despite the FDI policy being open, operational hang ups have stalled the inflow. It is suggested that the government before giving a green signal to any foreign firm in a mega green-field investment such as this, do so only after a thorough cost benefit analysis, which in the POSCO case, appears underdone. It appears that the FDI inertia may have resulted because the operational processes were not thought through in the beginning and in a bid to attract greater inflows, a thorough process has been compromised. As a result the POSCO and other mega projects face operational hang ups at the ground.

Case II – The Vodafone Case

The case of Vodafone is a typical case of clarity deficit with respect to policy and tax systems in India. Vodafone, the British telecom company is currently embroiled in a high profile tax liability case in India, which started in 2007 and is yet to get resolved. Vodafone had purchased a majority stake in the Indian based telecom company Hutchinson Essar from Hong Kong based Hutchison Whampoa. This sale of the stake and transfer transaction took place in Cayman Islands.

The Indian tax authorities imposed tax of Rs. 7,899.9 crore on the US$ 11.076 billion stake acquisition in 2007[iii]. It asserted that since Indian assets were transacted, Vodafone is liable to pay tax to the authorities. When Vodafone did not accept the tax liability, the government imposed fines for failing to pay the same. Later the case came up for hearing in the Supreme Court. The Supreme Court gave a verdict in favor of Vodafone as it believed that such transactions did not come under the jurisdiction of Indian tax authorities, therefore Vodafone couldn't be charged taxes.

As a response to Supreme Court's decision, the Government shockingly amended the Income Tax Laws retrospectively for all case similar in 2012. This meant that Vodafone and many others companies where Indian assets were transaction abroad would not be liable to pay tax in India. Such draconian amendments provoked criticisms by foreign investors who now were vary of investment in India. It also resulted in uncertainty in the market, where investors held back big ticket investments and maintained a wait and watch policy.

This disparagement prompted the Finance Ministry to become less stern over the next few months and it has currently decided to opt for an out-of-court settlement in such cases. In many such out of court settlement the government may decide to waive off the penalty or/and interest component. In 2013, Vodafone gave an official statement to show its readiness to commence settlement talks with Finance ministry. This loss of time along with the uncertainty in dealing with Indian systems, laws and policy have increased project costs for foreign firms such as Vodafone leading to FDI inertia.

We may appreciate that foreign firms make investment decisions based on policies and existing systems. Hence, policy ought to be clear, transparent and certain; and the language simple and unambiguous. Policy certainty shakes investor confidence resulting in lowering of FDI inflows.

Conclusion

The government has reiterated its commitment to make India one of the most open economies for garnering foreign investments. However, despite a rather progressive FDI policy, India is experiencing slowing of FDI inflows when compared to potential inflows. In this regard, the need to create an operational and systemic environment along with supporting institutional changes is indispensable to attract FDI inflows.

[i] Elliot, John, “Posco on a Learning Curve about India’s Social Process”, in http://www.ridingtheelephant.wordpress.com

[ii] Iron and Steel: The POSCO-India Story, Mining Zone People’s Solidarity Group October 20, 2010. http://miningzone.org

[iii] Union Cabinet to take call on Rs. 11,200 Cr. Vodafone tax dispute: Finance Minister P Chidambaram, ET Bureau, The Economic Times, February 21, 2013

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